March 15, 2006

Summary of Commentary on Current Economic Conditions by Federal Reserve District

Summary

Prepared at the Federal Reserve Bank of Chicago and based on information collected before March 6, 2006. This document summarizes comments received from business and other contacts outside the Federal Reserve and is not a commentary on the views of Federal Reserve officials.

Economic activity continued to expand in January and February, according to reports from the twelve Federal Reserve District Banks. Most Districts characterized the pace of expansion as moderate or steady. San Francisco said that the "solid expansion remained on track," and Dallas indicated that activity strengthened. In contrast, the pace of growth moderated in the Richmond District, and Philadelphia said activity expanded at a slow pace.

Nationwide, consumer spending continued to expand. Capital spending increased at a similar pace as in the previous reporting period, and expenditures for business services continued to rise. Employment continued to increase in most locations and in many sectors of the economy. Most Districts said that residential construction and real estate activity slowed from high levels, while commercial markets were generally more active than at the end of 2005. Reports indicated that manufacturing continued to expand during the first two months of the year. Household lending softened, while commercial and industrial lending expanded at a modest pace. Contacts noted ongoing input cost pressures, but prices at the retail level increased at only a moderate rate. Labor cost pressures were little changed. Natural resource activity was very solid overall. Agricultural conditions remained mixed, and a continued lack of moisture generated concern in several Districts.

Consumer Spending and Tourism

Consumer spending continued to expand. Many Districts reported that retail sales showed solid gains during January, which retailers frequently said were spurred in part by unseasonably warm weather and holiday gift card redemptions. Without the added boost from those factors, retail sales during February softened in the New York, Philadelphia, Richmond, Chicago, and Dallas regions. However, sales in the Atlanta, St. Louis, Kansas City, and San Francisco Districts apparently maintained much of their momentum. Retail inventories were generally at desired levels across the country. Light vehicle sales in many areas were described as "sluggish" or "unusually slow," although Philadelphia and Atlanta noted some improvement in sales between January and February. Vehicle inventories were generally above desired levels.

The majority of reports on tourism were positive. Sales were up over last year at winter-sports destinations in the Richmond, Minneapolis, and Kansas City regions; however, ski resorts in New England and New Mexico were suffering from a lack of snowfall. Warm-weather destinations in the Atlanta and San Francisco Districts reported a brisk pace of activity. Atlanta also noted that tourism in the Gulf Coast region was being re-established slowly, though several casinos experienced larger-than-expected increases in revenues.

Business Spending and Hiring

Most reports indicated that capital spending increased at a similar pace as in the previous reporting period. There were some exceptions. Manufacturers in Philadelphia reported a pickup in the pace of investment, and firms related to the heavy equipment industry said that they were budgeting large expansions in capital outlays. In contrast, manufacturers in Atlanta had modest near-term spending plans, and those in Kansas City indicated that they were slowing the rate of increase in their capital spending. In the San Francisco District, the implementation of productivity-enhancing technologies has allowed banks to maintain profit margins and helped producers in the agricultural and resource sectors maintain output levels in the face of input constraints.

Expenditures for most business services continued to rise. Several Districts noted strong revenue gains for insurance, accounting, telecommunications, and health care firms. Boston said that information technology services firms reported strong revenue growth and expectations for steady or faster growth in the next six months. Demand for trucking and rail shipping services remained robust in Cleveland, Atlanta, Chicago, and Dallas; two of those Districts observed tight capacity conditions. Air travel was strong in many parts of the country.

Employment continued to increase in most locations and in many sectors of the economy. Atlanta said labor markets were firm, and Minneapolis saw signs of tightening. Cleveland said job openings had increased but hiring remained sluggish. Kansas City indicated that layoff notices outnumbered hiring announcements. Retail employment was steady in recent weeks, according to Boston, Richmond, and Chicago. New York observed a pickup in manufacturing hiring, but factory employment was steady or showed more limited increases in other regions. Three Districts reported an expansion in service jobs. Demand for temporary workers was strong in most areas, although several staffing firms in the Boston region said that revenues have been lower than expected recently. Almost every District reported shortages of high-skilled workers.

Construction and Real Estate

Construction and real estate activity was mixed by market segment and location. Most Districts said that residential activity slowed from high levels. Homebuilders in many Districts indicated that new home sales were trending down, but contacts in the Cleveland, Kansas City, and Dallas regions said that demand for new homes had improved relative to the end of 2005. Half of the Districts reported that the number of homes for sale had increased. Home price appreciation slowed in many areas, and real estate agents in the Richmond region said that fewer homesellers were receiving multiple offers. Several developers in the Atlanta District reported putting condominium projects on hold because of soft pre-sales or rising construction costs.

In contrast, commercial construction and real estate markets were generally more active than at the end of 2005. Philadelphia reported that the completion of a number of office projects this year would boost the space on the market; Minneapolis noted a number of new development projects; and San Francisco said that building activity had picked up for commercial projects and public structures. Chicago and Richmond indicated that overall commercial vacancy rates were stable. Office vacancy rates fell in the Boston, Philadelphia, St. Louis, Minneapolis, Kansas City, and San Francisco regions, but were mixed in New York. Industrial vacancy rates fell in three Districts, and Philadelphia said that demand for factory space had increased.

Manufacturing

District reports indicated that manufacturing activity continued to expand during January and February. Atlanta and Dallas said that activity picked up, and New York noted continued improvement in conditions, while Kansas City and San Francisco suggested that the pace of expansion had slowed; the remaining Districts indicated that manufacturing conditions were similar to those at the end of 2005. Manufacturers in Boston and Philadelphia generally expected the expansion in activity to continue in the coming months, and factories in Cleveland anticipated a pickup.

In most Districts, the strength in demand for factory goods was widespread across industries. The sectors frequently mentioned as facing strong demand included construction materials, electrical equipment, defense products, tractor trailers, heavy trucks, and heavy machinery. Cleveland reported that steel shipments held steady or increased, and Chicago said that steel production remained strong. Conditions in other metals industries were mixed, as Philadelphia and Chicago reported strong growth in demand, Dallas noted little change, and San Francisco characterized demand as "tepid." Most regions had some weak performing industries, but few were consistently mentioned as underperforming. Several Districts commented on the ongoing struggles of the domestic nameplates in the auto industry. An automaker in the Chicago region reported that slowing sales and high inventories would likely restrain production in the coming months, and automakers in Cleveland noted large declines in output compared to year-ago levels. Atlanta mentioned that many suppliers to the domestic nameplates have seen slower demand, and Kansas City added that a number of partsmakers had ceased production. Dallas noted that a narrowing spread between refined fuel and crude prices led some refineries to briefly reduce production in February. Some refineries in the Gulf Coast region reportedly will have longer maintenance turnaround times this spring because repairs were postponed in the aftermath of the hurricanes last fall.

Banking and Finance

Household lending softened, while commercial and industrial lending expanded at a modest pace. Reports on mortgage demand ranged from slowing growth in Richmond, Atlanta, Dallas, and San Francisco to declining activity in New York, Philadelphia, Chicago, and Kansas City. Other types of consumer borrowing were typically characterized as "mixed" or "weak." Interest rates on household loans increased in most Districts.

Business lending increased at a slow pace in the Cleveland, Richmond, Chicago, and San Francisco regions, while it was unchanged in the New York and St. Louis Districts. Bankers in Philadelphia expected growth in commercial and industrial lending, although several indicated that they were limiting real estate development and construction loans. Interest rates on commercial loans increased, according to New York, Richmond, and Kansas City.

Comments about household and business credit quality were mostly favorable. Delinquencies were unchanged in New York and remained low in Atlanta, though a banker in the Chicago region said that there was a noticeable rise in delinquencies and foreclosures in parts of Michigan dominated by the auto industry. Deposit growth was generally steady, and several Districts indicated that interest rates on deposits had increased. Lending was very competitive, which squeezed margins for many banks. Nonetheless, no District reported a change in lending standards.

Prices and Employment Costs

Contacts generally reported ongoing input cost pressures, while prices at the retail level increased at only a moderate rate. Philadelphia observed a steady rate of increase in input costs, and Chicago said that cost pressures remained firm. Cleveland noted that cost pressures were less pronounced than in the previous reporting period, but Richmond said that the prices of most intermediate goods and services were increasing at a somewhat faster pace. San Francisco saw little or no change in modest inflation pressures. At the retail level, Kansas City said price increases edged up, but Atlanta saw only moderate price increases for non-energy consumer prices, and New York noted little broad-based acceleration in consumer prices.

Elevated energy costs were mentioned frequently. Fuel surcharges remained in place in many locations. Contacts in Atlanta felt that a high degree of uncertainty in the energy markets would cause many firms to leave surcharges in place for the indefinite future, but some large companies in the Chicago region obtained a few reductions. The costs of many non-petroleum materials--including asphalt, cement, gypsum, lumber, copper, and zinc--were on the rise, though steel prices stabilized in most places. Airfares and hotel room rates continued to increase.

Labor cost pressures were little changed. Most Districts reported that wages increased modestly on average. The only exception was Philadelphia, which reported that many of its contacts expected a faster rate of increase in average salaries and wages compared with 2005, as firms stepped up counteroffers to workers who were planning to change jobs. A shortage of qualified workers for skilled positions in finance, construction, and manufacturing industries resulted in more rapid increases in pay for those workers.

Energy and Natural Resources

Natural resource activity was very solid overall. Energy extraction improved in the Atlanta, Kansas City, Dallas, and San Francisco regions and remained at a high level in Minneapolis. Most of these Districts reported that output was constrained by shortages of labor, parts, and equipment. Oil and natural gas production in the Gulf of Mexico continued a slow recovery from last year's hurricanes. Mining activity increased in the Minneapolis District, where several mines were running at or near full capacity.

Agriculture

Agricultural conditions varied across the nation. Unseasonably mild weather boosted output in the San Francisco District and aided field preparations in Richmond and Chicago. Moisture conditions improved in much of the Minneapolis region, but a continued lack of moisture affected farmers and ranchers in the Chicago, St. Louis, Kansas City, and Dallas Districts. The drought concerns limited cattle herd expansion, and some banking contacts in the Dallas region said that they may not finance certain farming operations unless moisture conditions improved. Prices for agricultural products remained generally stable or increased, though poultry prices declined. Agricultural input costs were still high, which limited purchases of fertilizers, chemicals, and machinery.

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First District--Boston

First District economic reports are generally positive about early 2006, but include some soft spots. Retailers' results in January and February are mixed, and while staffing firms cite strong revenues at the close of 2005, some have seen a slowdown since then. Manufacturers and software and information technology firms are more solidly in the positive camp. Vacancies have come down somewhat in the Boston office market, but contacts remain uncertain about the fundamentals.

Retail and tourism

First District retailers report mixed sales results for the months of January and February, with year-over-year sales ranging from down 7 percent to up 12 percent. Products that sold particularly well this period include health and beauty items, sporting goods, women's apparel, and bedding. A pharmacy chain notes that photo processing sales are weak due to the increasing trend in digital photography, and an electronics and appliance retailer attributes slow sales partly to short supplies of plasma televisions and the failure of the New England Patriots to qualify for the Super Bowl.

Inventory levels are in line with expectations according to contacts. Vendor prices are varied, with some contacts noticing selected price decreases, and others still observing increases in petroleum-related items. Selling prices are also mixed, with some retailers able to pass increases along to consumers, and others holding prices steady or decreasing them slightly. Same-store employment is generally steady. Many retailers plan to increase capital spending, with most citing new store openings or the implementation of various new systems.

A travel and tourism contact reports that overall tourism in New England has been "a real challenge." The mild winter has hurt the region's ski resorts, but may have been a plus in the Boston metropolitan area, where tourism is doing well. The respondent notes a steady stream of international travel due to favorable exchange rates, particularly from the UK, Germany, and Ireland, with many tourists coming to New England for pre-planned ski vacations or shopping trips. Industry expectations in the near term largely depend on future snow accumulation in the northern states.

Overall, most retail and tourism respondents view the outlook as hopeful, with expected growth ranging from flat to high single-digit increases.

Manufacturing and Related Services

Most First District manufacturers and related services providers report that fourth quarter 2005 and first quarter 2006 sales and orders remain higher than a year ago. The percentage increases are mostly in the single digits. Gains are widespread across products, with non-automotive transportation equipment cited as being particularly strong.

About one-half of the respondents express concerns about materials and energy costs, fewer than in recent reports. Manufacturers indicate that they are paying more for copper, paper, chemicals, various derivatives of oil and gas, and product transport than a year earlier. Companies using natural gas report substantial rate increases. The remaining firms either cite examples of recent easing in materials and energy costs, or say that these costs are not exerting pressure on their company's margins. For example, one company indicates it is no longer facing supply constraints for steel, while another observes that additional capacity in Asia has caused resin prices to soften.

The majority of manufacturers contacted have raised their selling prices in recent months, with increases typically in the single digits. Some indicate that they have implemented greater increases for high-end or custom products than for more standardized items. By and large, customers are reportedly accepting price hikes, except for instances where they have ready access to multiple suppliers.

Most manufacturers are keeping their domestic headcounts unchanged or are paring back slightly. Those that are hiring indicate some delays or obstacles in adding technical personnel. Pay increases are in the range of 3 percent to 5 percent. A couple of large respondents express concerns about pension costs. Most companies expect to hold capital spending fairly steady in 2006, with an emphasis on information technology or productivity enhancement projects.

Most manufacturers expect their company to exhibit fairly normal growth in 2006, with defense- and security-oriented companies tending to be more optimistic than the norm. A couple of companies mention that a softening housing market may cause some erosion in demand for housing-related and other products this year.

Temporary Employment

Business conditions are generally good for staffing firms in the First District. All but one staffing contact reports year-over-year revenue growth for Q4 2005, with increases ranging from the low single digits to 37 percent. However, reports on demand over the first eight weeks of 2006 are mixed. While a few contacts say that 2006 is off to a good start and that revenues have continued to increase, others indicate that revenues in Q1 have been lower than expected. One Connecticut contact claims that an increase in the state's minimum wage caused Q1 revenues to fall to about one-third of their Q4 level.

Demand for workers is strong in office services, call centers, manufacturing, healthcare, and information technology services. Demand for permanent and temporary-to-permanent hiring continues to grow. Contacts report that they continue to have difficulty finding qualified people for skill-intensive positions, including high-end administrative positions, positions requiring special skills such as welding or carpentry, and positions in the information technology sector. This shortage of qualified labor has begun to put upward pressure on pay rates and to drive up recruiting costs.

Despite a slowdown for some staffing firms in the first two months of 2006, respondents are upbeat about the rest of the year. The consensus among contacts is that the staffing industry is performing well and that 2006 will be a year of improving business conditions and increasing revenues.

Software and Information Technology Services

Contacts in the software and IT services industries report year-over-year revenue increases ranging from near zero to 25 percent in their most recent quarters, with most in the double digits.

Over half of responding software and IT services firms are increasing their headcounts, via selective hiring of technology workers and marketing and sales personnel. Contacts report tightening in the labor market, especially for technical positions. One firm notes upward pressure on wages as employees see increasing opportunities elsewhere; respondents report annual wage increases between 4 percent and 10 percent. Most software and IT services contacts indicate they are holding capital spending fairly level; however, a few have increased outlays to expand facilities and upgrade equipment.

The outlook among software and IT services contacts is more optimistic than six months ago; all expect either steady or accelerated growth for their companies in the second quarter.

Commercial Real Estate

Although office vacancies have declined recently in the Boston market to around 12 percent, contacts say the fundamentals that underlie office space demand are still weak. Total employment remains below early 2000 levels and financial services, a major office employment sector in Boston, is reportedly soft. Contacts note that improving office vacancy numbers, combined with what they characterize as poor office job growth, suggest that existing workers are getting more space.

Despite the weak fundamentals, contacts report that there continues to be "a remarkable amount of capital" available for commercial real estate purchases. Property values have continued to rise without significant decreases in vacancies or increases in rents. Respondents say, however, that the purchases are not speculative, but rather reflect foreign investors' long term interest in Boston commercial real estate. The outlook for New England's commercial real estate sector is slightly pessimistic. Although some areas in the region are experiencing remarkable strength in commercial real estate markets--Providence RI has reportedly seen vacancy rates fall to around 6 percent--most contacts continue to worry about the long term job support for the region's commercial space.

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Second District--New York

The Second District's economy continued to expand at a good pace, on average, across sectors in the first two months of 2006, though housing and consumer lending have softened. Input price pressures persist and there are scattered signs of increased wage pressures, but there is little evidence of any broad-based acceleration in consumer prices. The labor market has shown further signs of strengthening, particularly in New York City's financial sector, and there are signs of a pickup in hiring in the manufacturing sector. Retailers report that sales were somewhat below plan, largely due to the mid-February snowstorm and unseasonably cold weather in the second half of the month. Housing markets have generally become softer, though Manhattan's apartment rental market has remained strong. The New York City area's office market has tightened further. Conditions in the financial sector remained strong in early 2006, and bonus payments are estimated to be up 17 percent from last year. Finally, bankers report widespread weakening in demand for consumer loans and residential mortgages but little change in credit standards or delinquency rates.

Consumer Spending

Retailers report that sales were slightly above plan in January, but slightly below plan in February. The more recent weakness was largely attributed to the February 12th snowstorm and, to a lesser extent, unseasonably cold weather in the second half of the month. Virtually all retail contacts note that higher-end merchandise has generally sold better than lower-priced categories. Inventories are reported to be at satisfactory levels, while selling prices for comparable items are said to be little changed on balance.

Tourism has remained strong since the last report, despite some slowing in late February. Manhattan hotels report that business was strong during January and the first half of February, with occupancy rates up from a year earlier and room rates up more than 10 percent, though there are scattered reports of softening in recent weeks. Similarly, Broadway theaters report strong conditions in January and February, with attendance up roughly 5 percent from a year earlier and revenues up 15 percent, though theaters also report some weakening in the last week of February.

Consumer confidence in the region was steady to stronger in February. Based on the Conference Board survey of Middle Atlantic residents, consumer confidence rose for the fourth time in five months, reaching its highest level since last July. At the same time, Siena College's survey of New York State residents shows confidence rising only marginally, following a decline in January.

Construction and Real Estate

The region's housing market was mixed but, on balance, softer in early 2006. New Jersey homebuilders report a growing inventory of homes at the higher end of the market. The number of transactions has been well below comparable 2005 levels, selling prices have been basically flat since last autumn, and builders are offering more concessions. However, an industry contact notes one exception: redevelopment in older urban areas, a growing segment of the market, has met with persistently strong demand. Albany area Realtors report that sales fell 13 percent from a year earlier in January and February, while selling prices were up 10 percent. Similarly, sales of Manhattan co-ops and condos are reported to be down 10 to 15 percent from a year earlier in January and February, despite strong demand for high-end apartments and townhouses reportedly driven by strong bonus payouts on Wall Street. Overall, real estate contacts report that the inventory of unsold apartments has grown and that prices have leveled off, though they remain more than 10 percent ahead of a year ago. In contrast, Manhattan's rental market has shown persistent strength, with rents rising steadily but moderately.

Commercial real estate markets across the New York City metropolitan area were generally stronger in early 2006. Manhattan's market continued to strengthen in February, according to a major brokerage firm, largely buoyed by strong leasing activity from financial, legal and media firms, with a large number of small leasing deals noted in Lower Manhattan. Suburban office markets were mixed, however, with vacancy rates edging down in northern New Jersey, but rising in Long Island, Westchester and southwestern Connecticut. Industrial markets were stronger across the metropolitan area, as vacancy rates were steady to lower and asking rents continued to climb. Long Island's market has been particularly tight, with an industrial vacancy rate below 5 percent.

Other Business Activity

A leading New York City employment agency reports a sustained pickup in the labor market, led by strong hiring from the financial and legal sectors. This contact reports a lack of available office workers and notes that a majority of hires are people switching jobs; average salary offers are up about 10 percent from a year ago for mid-level jobs and up 20 percent for high-paying openings. Scattered labor shortages are also reported from the manufacturing sector.

A contact in the securities industry characterizes January and February as strong months, largely driven by strong growth in derivatives trading and a more general shift in asset allocation away from money markets to equities and bonds. Annual bonuses, mainly paid out in January and February, were estimated to be up 17 percent, in aggregate, from last year.

Manufacturing contacts in New York and New Jersey report continued improvement in business conditions, a pickup in hiring activity, and ongoing widespread increases in input prices. Purchasing managers in the region report mixed to stronger results for February--those in the Buffalo and New York City areas indicate acceleration in activity, while those in the Rochester area note some slowing following an exceptionally strong January. Purchasers in all three areas report continued input price pressures.

Financial Developments

Small to medium-sized banks in the district report ongoing declines in demand for residential mortgages and a sharp decrease in demand for consumer loans; however, demand for commercial loans and mortgages was little changed. Over 45 percent of bankers report declines in demand for consumer loans, while just 7 percent indicate increases; responses on residential mortgages were similarly lopsided. Credit standards are reported to be virtually unchanged across all loan categories. Bankers report increased loan rates for all loan categories, most notably on commercial mortgages. There were also widespread increases in deposit rates. Delinquency rates remained unchanged across all loan categories.

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Third District--Philadelphia

Economic activity in the Third District grew at a slow pace in February. Manufacturers reported increases in shipments and new orders during the month. Retail sales of general merchandise rose, but the year-to-year gain was slight. Auto sales increased marginally from January to February, but fell on a year-over-year basis. Bank lending has been increasing, although demand for residential mortgages has declined. Commercial real estate markets continued to tighten, but residential real estate activity eased.

Third District business contacts generally expect business activity in the region to continue to expand at a modest rate. Manufacturers expect growth in business to accelerate somewhat from the current pace, and they are scheduling a slight increase in capital outlays. Retailers anticipate a small gain in sales in March and somewhat faster growth in April. Auto dealers anticipate slower sales this year than in 2005. Bank and other lenders expect to see business lending increase, but they forecast a decrease in residential mortgage lending. Contacts in commercial real estate generally expect further declines in vacancy rates and a firming in rents. Residential real estate agents and home builders anticipate slower sales for the balance of the year compared with the same period last year, and they expect the rate of home price appreciation to ease.

Manufacturing

Manufacturers in the Third District reported increased demand for their products in February. Slightly more than one-third of the companies contacted said that shipments and new orders rose from the previous month; about one-fifth reported a decline. On balance, area manufacturers saw an uptick in order backlogs. The improvement in conditions during February followed sluggish growth in January. Among the District's major manufacturing sectors, business improved in February for producers of industrial and construction materials, lumber, metals, and electrical equipment, but was about steady in other sectors.

Overall, manufacturers expect growth in business activity to pick up in the months ahead. Half of the firms contacted in February expect their shipments and orders to increase during the next six months; about one-tenth expect decreases. On balance, capital spending plans among District manufacturers call for slightly stepped up expenditures. The largest increases in capital spending are being planned by producers of metals, industrial materials, machinery, and electrical equipment.

Retail

Most of the retailers contacted for this report indicated that sales growth slipped in February from the pace in January. Overall, sales of general merchandise were up just slightly in February compared with the same month last year. Retailers said sales in January got a boost from the redemption of gift cards purchased for Christmas and from warm weather that encouraged shopping. A return to more normal winter temperatures in February helped sales of winter apparel but otherwise had a negative effect, according to area merchants. Despite the sluggish growth in sales, store executives said their inventory levels were not excessive. Third District merchants expect the rate of sales growth to remain slow through March, then pick up in April as a result of the late date on which Easter falls this year. However, some store officials said March sales could be exceed their current expectations if temperatures rise above seasonal norms.

Auto sales in the region rose slightly in February, although they were below the level of February 2005. Area dealers gave mixed reports, indicating that foreign models continued to have better year-to-year sales comparisons than domestic models. Dealers have kept inventories in check, limiting their orders to manufacturers. On balance, area dealers expect sales this year to be below those of last year, but they are uncertain of the amount of the decline.

Finance

The volume of loans outstanding at Third District banks edged up in February from January, according to commercial bank lending officers contacted for this report. Commercial and industrial lending increased for most banks. Reports on consumer lending were mixed; some banks posted growth for the month, but others had declines. Demand for residential mortgages at banks and other financial institutions softened. Banks and other lenders in the region indicated that competition for loans continues to be strong. On the funding side, some banks have experienced deposit outflows, and several banks said they have raised deposit interest rates to maintain deposit growth. Banks as well as nonbank lenders reported that their net interest margins have decreased, reducing their overall profit margins. Bankers in the District expect slow growth in lending in the months ahead. In general, bankers expect growth in commercial and industrial lending, although several banks indicated they were limiting growth in lending for real estate development and construction. Most bankers and other lenders contacted for this report expect a further decline in demand for residential mortgages.

Real Estate and Construction

Commercial real estate firms reported that vacancy rates in the region's office markets have continued to fall in the past few months. Rents have edged up generally in response to growing demand, although owners of older buildings have been upgrading and renovating them in order to compete with recently constructed buildings. Commercial real estate contacts expect further gradual tightening of the region's office markets this year. However, the supply of office space in the region will increase during 2006 as buildings under construction are completed and a large number of leases in existing buildings expire. Some commercial real estate agents believe the increased supply could limit the rise in rental rates unless demand picks up as well. Demand for industrial space in the region has been growing, with significant increases in leasing and purchasing, and rising rental rates.

Residential real estate agents and homebuilders generally reported a slowing in sales in February, compared with the pace set earlier this winter and with sales in February of last year. Some real estate contacts noted that the number of existing homes for sale has risen and the time they are on the market has increased. Homebuilders and real estate agents expect sales this year to be lower than in 2005, and they expect price appreciation to slow significantly.

Prices and Wages

Business firms in the Third District reported that they face continuing increases in costs of materials and intermediate goods, although the rate of increase does not appear to be accelerating. Manufacturers continued to face price increases for metals, petroleum-based products, and natural gas. Construction firms reported tighter supplies and higher costs for steel, cement, and products made of PVC, plastic, and gypsum. Prices have also increased for coal and asphalt. Firms in all industries continued to report increases in the cost of employee health benefits.

Employers in a range of industries reported that labor markets have tightened, noting that they have had more difficulty attracting and retaining qualified workers at all skill levels. Employee turnover has increased, and several firms surveyed for this report indicated that they have stepped up counteroffers in order to keep employees from leaving. Firms report that average salaries and wages will increase somewhat more this year than last year, but they are likely to boost salaries significantly for critical positions.

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Fourth District--Cleveland

Economic activity continued to increase at a steady pace throughout the District in the first two months of 2006. Moreover, gains were spread across a broad array of industries, including durable goods producers, most retailers, residential and non-residential builders, and trucking and shipping services providers. However, nondurable goods production was little changed, and auto sales and production weakened. While gains were widespread, cost pressures seemed somewhat less pronounced in recent weeks, especially among manufacturers. Hiring continued to appear somewhat sluggish across the District, though contacts from staffing services firms noted that District openings were on the rise. Moreover, many contacts mentioned that workers with adequate skills were becoming more difficult to find.

Manufacturing

Production at District durable goods producers continued to show steady increases in the first two months of 2006. Activity was also above year-ago levels. Among important District industries, steel producers reported that shipments held steady or improved. Strong steel demand was reported for many industries, including equipment, energy, aerospace, and appliance producers. However, steel shipments to the auto sector were mixed, and automakers in the District saw sizeable year-over-year declines in production. Most contacts, especially capital goods producers, expect to be busier as the year wears on; as a result, many are planning increases in capital spending for the first half of 2006. However, hiring plans remained relatively limited for most durable goods producers.

Among nondurable goods producers, production has been flat, both since the end of 2005 and relative to this time last year. Contacts' current order books suggest that production will remain flat through the next few months. Accordingly, capital expenditures are expected to remain flat or fall at most firms through the first half of this year. In general, nondurable goods producers are not making net additions to their payrolls; however, in replacing staff, some contacts report difficulty finding workers with more specialized skills. Among a majority of both nondurable and durable goods manufacturers, materials costs were characterized as flat overall through the end of February.

Retail

In general, sales at the District's retailers were above year-ago levels in the first two months of 2006. Discount retailers, in particular, reported solid year-over-year sales gains in January, with more moderate increases in February. Specialty stores, including apparel merchants, also generally reported year-over-year increases in sales, though some contacts noted that their growth rates had declined recently. Department-store sales were down, on a year-over-year basis, through the first two months of 2006, continuing a longer-term trend. Finally, District grocers continued to report solid sales gains. Products that sold well include those that were energy-conserving or -efficient, home repair and improvement items, personal care products, and some apparel. Most merchants reported that their product prices were generally stable.

At District auto dealerships, sales generally remained somewhat sluggish, even though unseasonably warm weather had increased traffic at some showrooms. Sales were especially weak for domestic nameplates. As a consequence, inventories continued to be above desired levels, generally by more than thirty days.

Construction

Residential builders reported a slight improvement in sales in the first two months of 2006, relative to the end of 2005. Builders attributed the improvement to several factors, among which were seasonality, particularly poor sales at the end of last year, warmer weather which may have encouraged shopping, and increased discounting. Discounting was more widely reported than usual, as inventories of unsold homes remained at relatively high levels--for some builders the highest they have ever seen. Despite the recent improvement in sales, they remained less than at this same time a year ago. Homebuilders generally reported continued increases in materials costs, at rates similar to those seen at the end of 2005. Specifically, contacts cited increases in costs for concrete, lumber, copper wire, various metals, and some petroleum-based products. Most contacts reported that subcontractors are readily available.

Commercial contractors continued to report increases in activity. In the first two months of 2006, activity was above that for the end of 2005 and a year ago. While commercial builders' backlogs were mixed, many contacts reported thinking that recent inquiries were more likely to turn into jobs than in the past. Regarding materials costs, commercial builders reported increases similar to those reported by residential builders, specifically citing increases in costs for concrete and some metals. However, unlike homebuilders, most commercial contractors have been able to raise their prices, keeping profit margins stable. Finally, most firms planned to add to their staffs in the months ahead.

Banking

Through the first two months of 2006, District banks, especially smaller institutions, reported a slight increase in loan demand from their commercial clients. Larger lending institutions also noted that lending for commercial real estate remained strong. By contrast, consumer borrowing continued to be "weak to moderate" for most banks in the District. Both automobile and mortgage lending were seen as slow, though for the latter, some of this weakness was attributed to normal seasonal patterns. Many contacts were concerned about the "flat" yield curve, and the pressure this put on their net-interest margins. Finally, credit quality continued to be at or near historical highs for many institutions.

Transportation

Demand for trucking and shipping services remained strong across a broad base of industries during the first two months of 2006. High fuel costs continued to concern contacts, even though trucking companies have been able to maintain their surcharges. Many contacts reported raising their base shipping rates at the beginning of the year, though none planned subsequent increases in the foreseeable future. Carriers continued to report difficulty attracting and retaining drivers; some carriers reported raising their wages in response. Capital spending in the industry is extremely strong, as firms attempt to purchase trucks that don't need to meet impending EPA guidelines.

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Fifth District--Richmond

Fifth District economic growth moderated in January and February as the pace of retail and housing activity slowed. District retailers reported sizeable sales gains in January, but said that colder weather and a decline in gift card redemptions slowed customer traffic and reduced sales in February. Housing markets continued to cool; real estate agents said that home sales slowed and that properties for sale were staying on the market longer. In the financial sector, bank lending expanded at a more moderate pace as growth in residential mortgage lending tapered off. Other services sector businesses generally continued to report solid growth in revenues and employment. Gains were particularly strong at healthcare organizations and professional and technical services firms. Manufacturing activity changed little since our last report; shipments and new orders edged lower in January and rose only modestly in February. Turning to prices, business contacts indicated that prices for most goods and services rose at a somewhat quicker pace. In agriculture, small grain crops were reported to be in good condition, and warmer-than-normal temperatures since the beginning of the year allowed farmers in southern areas of the District to get a head start on land preparation for spring planting.

Retail

After posting solid gains in December and January, retail sales pulled back in February. Contacts at apparel and department stores said that unseasonably warm weather, combined with the redemption of a large number of holiday gift cards, boosted sales in January. Shopper traffic and sales slumped in February, however, as the weather turned colder and gift card redemptions trailed off. A big-box retailer told us that more gift cards were being used for necessities this year than in the past--the change was attributed in part to higher energy costs pinching household budgets. Big-ticket sales were generally lower; automobile and light truck sales were especially sluggish according to dealers. A contact in Virginia's Tidewater area said that nearly all of their dealerships missed sales projections in February. In addition, furniture retailers in North Carolina and West Virginia noted that their sales were down. Retail hiring picked up in January but was flat in February. Retail prices continued to rise at a moderate pace in both months.

Services

Service-producing firms continued to report solid revenue growth in January and February. Most of the strength was in professional and technical businesses, such as insurance, accounting, and telecommunications firms. In addition, contacts at several hospitals in the District said that growth in demand for healthcare services picked up. Hiring at services firms was fairly strong and average wages grew more quickly in recent weeks. Prices in the sector also rose at a somewhat stronger pace.

Manufacturing

District manufacturing activity changed little in the weeks since our last report. Manufacturers said that shipments, new orders, and employment all edged down in January. But there were indications of a slight rebound in February; shipments and new orders, for example, moved up a bit during the month. Among industries, producers of rubber and plastics, electronics and electric equipment, and apparel reported increases in shipments and new orders. "We are very busy right now--new orders, shipments, and backlog are all up," noted a North Carolina plastics manufacturer. But the comments of a machinery manufacturer in North Carolina were more typical of other contacts' sentiments--"One week's up a little, another's down; it's sort of balancing out." Raw materials prices rose at a quicker pace since our last report, and a number of manufacturers told us that the prices they receive were not rising fast enough to recoup increases in materials costs.

Finance

District bankers reported that growth in lending activity moderated since the beginning of the year. Residential mortgage lenders said that cooling housing markets slowed growth in mortgage lending. A Richmond, Va., contact told us that he could attract new business only by promoting new and innovative products, such as interest-only loans. Bankers attributed slower commercial lending growth in part to higher interest rates. A banker in Charleston, W.V., said that lending to coal mining companies was fairly strong but that overall growth in commercial lending slowed because of the "higher interest rate environment." Standards for creditworthiness changed little in recent weeks.

Real Estate

Residential real estate agents generally reported slower home sales from January through early March. An agent in Washington, D.C., said, "It's definitely a buyers' market and they [the buyers] are holding off." He noted fewer multiple offers on homes for sale and said that properties were staying on the market as long as two to three months now. An agent in Richmond, Va., said that there had been a "general slowdown" in sales in that area as well, and that buyers were taking longer to purchase homes. He added that buyers felt less pressure to make hasty decisions now that multiple offers were less common. Markets in North Carolina also cooled: a residential real estate agent in Greensboro, for example, characterized the market as "slower, with buyers taking their time" [to purchase homes], while a counterpart in Asheville said sales were flat and upper-price-range homes were selling slowly. Pockets of strength remained, however; a Greenville, S.C., agent, for example, said that market activity had been "extremely positive" in recent weeks because of an increase in new businesses relocating to the area. Consistent with generally slowing sales activity across the District, home price appreciation slowed in many areas.

Commercial real estate agents across the District reported stronger leasing activity in recent weeks. Agents cited employment gains and improving local economies as driving forces behind the pickup. Office activity was particularly brisk. An agent in Raleigh, N.C., noted that office leasing had been "crazy," accelerating even further from the strong level of late last year. An agent in Northern Virginia reported considerable momentum in the commercial real estate sector, adding that he saw nothing that would "derail" activity in the real estate market in that area. Agents across all sectors reported an uptick in rents. A contact in Washington, D.C., said, "It seems like some of the high construction costs and high land costs are finally starting to be passed through." Vacancy rates remained stable since the beginning of the year and little new construction was reported.

Tourism

Tourist activity strengthened since our last report. A manager at a ski resort in Virginia told us that business during the Presidents' Day weekend was outstanding. A counterpart in West Virginia said that he believed the Winter Olympics had sparked interest in winter sports, which had boosted snowboarding and skiing at his resort. Tourism along the coast was also stronger. Hoteliers in Virginia Beach, Va., and on the Outer Banks of North Carolina reported that bookings were much higher in part because of the clement weather in that region.

Temporary Employment

Temporary employment firms in the District generally reported stronger demand for workers from January through early March. An agent in Morrisville, N.C., noted that employers were no longer "afraid to start hiring," while a contact in Hagerstown, Md., said that hiring in all sectors of the economy were experiencing growth and had a greater need for temporary employees. Executive-level assistants, skilled tradesmen, and data entry clerks were widely sought across the District. Several temporary employment firms noted some difficulty in finding qualified workers to fill positions.

Agriculture

Warmer-than-normal temperatures since the beginning of the year boosted agricultural conditions in much of the District. The mild weather allowed farmers in southern areas of the District to get an early start on land preparation. An agricultural analyst in Maryland noted that the mild winter was "positive for livestock" while a contact in Virginia said that the lack of substantial snowfall this winter allowed greater grazing and reduced the need for hay. Orchard owners in Virginia expressed some concern that the budding of fruit trees raised the possibility of frost damage later in the season. Contacts reported that small grain crops were in good condition throughout the District.

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Sixth District--Atlanta

Most reports from Sixth District business contacts continued to be upbeat in late January and February. Retailers posted strong results and auto sales improved. Reports from the tourism sector continued to be positive. Most industrial contacts reported an increase in activity, although weakness was cited for textiles and some auto producers. Real estate contacts noted further slowing in several housing markets, while new nonresidential development remained modest. Labor markets were described as firm in most areas, and shortages in several sectors were noted. Energy-related costs remained elevated, and construction industry contacts noted concern about rising labor and material costs. Non-energy consumer price increases remained moderate.

Consumer Spending

Merchants reported strong sales since the last report. Many contacts suggested that sales during late January and February benefited from the redemption of holiday gift cards. Rebuilding and replacement of lost and damaged items continued to boost sales near hurricane-ravaged areas. Several retailers in hard-hit zones have reopened, and smaller specialty shops in New Orleans reported better-than-expected sales. Going forward, District retailers anticipate modest sales growth over the next several months.

Auto sales improved slightly in late January and February. Strong demand for imports and U.S.-assembled foreign models continued to offset disappointing sales of domestic-branded vehicles. However, contacts noted that domestic vehicle sales received a boost from commercial fleet sales. Import dealers reported healthy activity in February, although demand for trucks and some SUV segments remained sluggish.

Real Estate

Residential real estate activity in the District continued to slow in late January and February, but remained at high levels. Reports from Realtors noted a deceleration in both new and existing home sales, while most homebuilders reported that new home construction was similar to year-ago levels. Condominium development showed signs of weakening as several developers put projects on hold because of soft pre-sales or escalating construction costs. Commercial development remained at modest levels, but most contacts reported improving conditions and steady absorption rates. Redevelopment in Hurricane Katrina-affected areas continued to be dominated by cleanup and debris removal.

Manufacturing and Transportation

Manufacturing activity picked up in late January and February for most sectors, although weakness remained for textiles and domestic-branded auto producers. Defense, building products, and transportation equipment producers reported stronger activity. Some aerospace and shipbuilding firms received new contracts, and several forest product producers and saw mills were said to be operating at capacity. A manufacturer of steel door and window frame units for commercial buildings reported backlogs of municipal/governmental type projects. A tractor-trailer manufacturer has increased the pace of hiring at a new plant to meet increased demand. On the downside, two large textile mills announced layoffs. Both companies indicated the decision to cut payrolls was a result of rising import competition and slow sales. Auto-related suppliers of U.S. branded vehicle assembly plants noted slower demand.

According to most manufacturing contacts, near-term capital investment plans were modest. Several noted that they had recently completed expansions or capital improvements. The owner of a rock and gravel company, however, reported preparations for a large capital expansion, and a steel manufacturer reported capital spending plans related to efforts to improve productivity.

Freight demand remained strong in late January and February. Contacts noted improved business conditions and tight capacity in rail and truck transportation. Despite last year's storm-related disruptions and higher fuel costs, one major regional rail company reported improved revenues.

Tourism and Business Travel

Reports from the tourism and hospitality industry remained positive in late January and February. South Florida contacts in the restaurant and hotel industries cited strong hiring during the winter vacation season. Florida's theme parks reported robust attendance, and the state's Gulf Coast was reportedly experiencing strong convention activity. New Orleans is

slowly re-establishing its tourism industry. The city held a scaled Mardi Gras and Harrah's Casino and part of the Ernest N. Morial Convention Center were reopened. Three reopened casinos in Biloxi have reported better-than-expected gaming revenues in their first full month of operations.

Banking and Finance
Financial conditions in the District remained stable and delinquencies remained near historical lows through February. Deposits were strong in the Katrina-impacted areas. However, some reports noted increased competition for deposits. There were additional reports of slowing in residential mortgage loan applications.

Employment and Prices
Most reports indicated continuing tight labor markets. Labor shortages in the construction industry were noted, especially in coastal areas. The dearth of housing and office space is expected to continue to limit available labor in the New Orleans market. In most areas of Florida there is strong labor demand for the construction, hospitality, and healthcare sectors. Many contacts expressed concern about the skill level of new hires. A shortage of truck drivers was also widely cited.

Most businesses continued to report that competitive pressures were limiting their ability to pass through input cost increases to customers. In Florida, contacts noted that commercial construction costs were going up so much some projects were put on hold. Louisiana and Mississippi officials are concerned about funding major rebuilding projects in light of rising labor and material costs. Concrete, glass, and sheetrock price increases were reportedly driving up building costs. Energy-related costs remained elevated and prices for products made with petroleum derivatives were expected to remain high. Contacts feel that uncertainty and volatility in energy markets mean that energy-related surcharges are likely to stay in place into the indefinite future.

Natural Resources and Agriculture
Recent weather conditions were favorable for most District crops in late January and February. Regional prices moved higher for cotton, oranges, and sugar, whereas poultry prices declined.

Shut-in oil and gas statistics improved marginally. For crude oil, 25 percent of federal offshore Gulf of Mexico production remains shut-in, while 15 percent of natural gas is shut-in. Lower demand, because of moderate winter temperatures, has offset production losses, keeping natural gas stocks significantly above their 5-year average.

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Seventh District--Chicago

Economic activity in the Seventh District continued to expand at a moderate pace during January and February. Spending by both consumers and businesses increased again. Labor market conditions improved modestly. Manufacturing activity remained strong. Residential construction and real estate activity softened, while commercial real estate activity increased at a slow pace. Mortgage demand was down, but the expansion in commercial lending gained some momentum. Cost and price pressures remained firm in January and February. Warmer weather allowed some field preparation for spring planting, but the lack of moisture in portions of the District kept farmers cautious.

Consumer spending
Consumer spending continued to increase modestly in January and February. Retailers said that sales in January were boosted by gift card usage; one retailer noted that customers often spent more than the card was worth. Sales in February were said to be "decent" and "at or above expectations." Apparel sold well. Retail inventories were at or slightly below desired levels. Some hardware stores were hurt by the lack of snowfall in the region. In contrast, some restaurants reported that the good weather helped their business; overall, area restaurants reported very strong growth in sales compared to a year earlier. Auto dealers said that sales of new vehicles were soft, but light truck sales were showing surprising resilience to high gas prices. Tourism strengthened in the District, with bookings in some areas running ahead of a year ago.

Business spending
Business spending and hiring expanded again. For the most part, District firms were holding to their existing plans to increase capital spending. The strongest reports came from toolmakers, which planned to expand capacity through purchases of both plant and equipment. In contrast, contacts in steel, trucking, and rail shipping maintained relatively cautious capital spending budgets. Trucking activity was brisk in January then slightly softer in February. Overall labor market conditions improved modestly. Employment increased for manufacturers of heavy equipment and fabricated metals, while retail employment was steady. A few firms noted that they were outsourcing some information technology work abroad. Staffing services firms reported that temporary hiring increased steadily again in most areas in the District, though Detroit continued to experience stagnant demand. No major layoffs were reported.

Construction and Real Estate
Construction and real estate activity was mixed by both location and market segment. Residential activity continued to slow from record levels. Builders in Michigan said that all segments were slow, while contacts in Wisconsin reported that sales of mid-priced homes were particularly sluggish. The supply of existing homes for sale was growing, as was the number of spec homes on the market. New home prices were holding steady, and builders were not passing along higher materials costs. Existing home prices were soft. Commercial construction and real estate continued to expand at a slow pace. One contact in the Chicago area suggested that development was being restrained by higher construction costs. Commercial vacancy rates were generally stable.

Manufacturing
Manufacturing activity remained strong during January and February. Demand for heavy equipment continued to be robust. Sales of mining equipment remained solid, and one contact expressed concern that the sector would run into production constraints in the coming months. Construction equipment orders increased again, albeit at a slower pace than last year. Still, order backlogs for construction equipment remained high. Based primarily on the strength in heavy equipment production, activity in fabricated metals industries remained solid, and order backlogs were growing. The steel sector continued to record strong production. Steel inventories were low; one contact said, "Service centers are showing impressive restraint and ordering just what they need." Heavy- and medium-duty truck orders were brisk, reflecting in part the pre-purchase of trucks before new EPA standards go into effect at the beginning of next year. One industry analyst expected 2006 order books to be full by May, at which time orders would fall off precipitously. Nationwide, light vehicle sales fell during February; however, one contact noted that an increase in fleet sales cushioned the decline. Vehicle inventories were said to be high, which, according to one contact, would likely hold back production in the coming months.

Banking and Finance
Lending activity moderated further. Bankers noted additional declines in applications for both home-purchase and refinancing mortgages. Use of existing home equity lines of credit remained stable, but one bank in Michigan said it had seen a decline in demand for new home equity loans; some customers were withdrawing their applications because appraisals showed that they did not have as much equity in their homes as they had expected. Mortgage spreads were down and pricing was said to be "aggressive," with a steady number of lenders chasing a smaller number of borrowers. Reports on mortgage credit quality were mostly favorable, though there was a noticeable rise in delinquencies and foreclosures in parts of Michigan dominated by the auto industry. Commercial lending continued to expand in January and February, and at a slightly faster pace than in the previous reporting period. Both loan volume and business use of existing credit lines picked up. A banker in Michigan said that demand was increasing for leveraged buyout financing. Commercial credit quality was in good shape, with low ratios of non-accruing loans and charge-offs.

Prices and Costs
Price and cost pressures remained firm in January and February. Prices for plastics and other petroleum-related products continued to increase, and copper, cement, gypsum wallboard, and paint prices all were up since the last report. Spot steel prices stabilized at high levels, though one contact said that contracted prices continued to move higher. Several contacts reported stable fuel costs. As a result, there were no reports of new fuel surcharges, and a few large firms said that they had begun to obtain reductions in surcharges. Price reports at the retail level were mixed. A regional retail chain said that customers were less resistant to price increases and that it had no problem passing along cost increases. In contrast, another retailer had not seen any upward pressure in prices of national brands. Wage increases generally held steady.

Agriculture
Sentiment in the agricultural sector was cautious, with many farmers making purchases only as needed. Unseasonably warm January weather aided field preparation in the District. However, the persistent lack of moisture this winter is leading farmers in Illinois and Iowa to plan for an extended drought. For example, some farmers switched their crop insurance coverage to protect more against yield losses than price declines. Relatively high input costs for corn did not induce many farmers to deviate from their normal corn and soybean rotations. Fertilizer costs appeared to peak and have started to come down in some areas. Corn and soybean prices were up from year-ago levels, leading farmers to forward contract more of the 2006 crop than they have done in past years. A contact reported that the prices for corn offered by ethanol producers were better than the prices offered by grain elevators.

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Eighth District--St. Louis

The Eighth District economy expanded modestly since our previous survey. Contacts reported improved conditions in manufacturing and continuing growth in the services sector. Retail sales increased in January and February compared with a year ago; car sales declined over the same period, however. Residential real estate market activity slowed in January compared with a year ago. Commercial real estate market conditions continued to be positive. Overall lending activity at a sample of District banks experienced little change in the fourth quarter of 2005.

Consumer Spending
Contacts reported that retail sales in January and February were up, on average, over year-earlier levels. Approximately 59 percent of the retailers surveyed saw increases in sales, while 32 percent saw decreases. About 71 percent of the contacts reported that sales levels met their expectations, 19 percent reported that sales were below expectations, and 10 percent reported that sales were above expectations. Winter seasonal items, home dï¿½cor, jewelry, and staple foods were all strong sellers, while women's clothing and winter clothing were moving more slowly. Approximately 73 percent of the contacts noted that inventories were at desired levels. About half of contacts expect that sales in March and April will increase over the same months of 2005, and about 23 percent of contacts are cautiously optimistic.

Car dealers in the District reported that, compared with last year, sales for January and February were down, on average. About 48 percent of the car dealers surveyed reported a decrease in sales, and 26 percent reported an increase. Nearly half of the car dealers noted that used car sales had increased relative to new car sales, while 9 percent reported the opposite. About 30 percent reported an increase in low-end vehicle sales relative to high-end vehicle sales, while 17 percent reported the opposite. About 87 percent of the contacts reported no change in the rejection or acceptance rates of finance applications. Nearly 57 percent of the car dealers surveyed reported that their inventories were too high, mostly with new or high-end vehicles, while 35 percent reported that their inventories were at desired levels. About 60 percent of the car dealers surveyed expect that sales will increase in March and April over year-ago levels.

Manufacturing and Other Business Activity
Reports from contacts in manufacturing were mostly positive. Several manufacturers reported plans to open plants and expand operations in the near future, while a smaller number of contacts reported plans to close plants and reduce workforce. Firms in the chemical, plastics, auto parts, nonmetallic mineral, medical equipment, and fabricated metal product industries reported plans to open new facilities in the District. Firms in the textile mill, primary metal, freight transportation, and auto parts industries reported plans to expand facilities or hire additional workers. On the other hand, there were some negative reports as contacts in the apparel, aerospace, paper, and electrical equipment industries reported plans to close plants or relocate operations and lay off workers.

The District's services sector continued to expand in most areas since our previous survey. Contacts in the wireless telecommunications, air transportation, and traveler accommodation industries reported increased business activity. One contact in the business support services industry reported plans to increase hiring of service representatives.

Real Estate and Construction
Residential real estate activity in the Eighth District showed signs, albeit mixed, of slowing. January home sales were up by 23 percent in Memphis and 19 percent in Louisville compared with a year ago. Home sales, however, were down 6.9 percent in Little Rock and 2.7 percent in St. Louis over the same period. Residential construction activity also slowed throughout the District in January. Compared with January 2005, January single-family housing permits rose 31 percent in Jackson, Tennessee, 22 percent in Evansville, Indiana, and 7 percent in Little Rock. Permits, however, were down 45 percent in Louisville, 23 percent in Memphis, and 6 percent in St. Louis over the same period.

Commercial real estate market conditions were mostly positive throughout the Eighth District. Industrial vacancy rates declined during the fourth quarter of 2005 in Memphis, St. Louis, and Little Rock. In contrast, Louisville's industrial vacancy rate increased over the same period. Memphis, St. Louis, Little Rock, and Louisville all saw a year-end decline in office vacancy rates compared with the third quarter of 2005. Contacts indicated that commercial construction is active in St. Louis, remains strong in south central Arkansas, but is down in Little Rock. Contacts in northeast Mississippi reported that commercial construction activity has returned to average levels after last year's sharp increase. Contacts in Memphis reported that industrial construction activity is slowing, while contacts in southwest Arkansas and southwest Indiana reported new industrial projects.

Banking and Finance
A survey of senior loan officers at a sample of District banks showed little change in overall lending activity in the fourth quarter of 2005. During this 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, residential mortgage, and consumer loans remained basically unchanged during the same period. Meanwhile, the demand for commercial real estate loans ranged from moderately weaker to moderately stronger, and the demand for residential mortgage and consumer loans remained basically unchanged.

Agriculture and Natural Resources
Mississippi has received above-normal levels of precipitation since the beginning of 2006. In contrast, southwestern Missouri and western Arkansas remain under extreme drought conditions. The winter wheat crop is in mostly fair or good condition and has begun to come out of dormancy in a few areas. In Mississippi, the number of catfish operations and acres used for production declined in January compared with January 2005.

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Ninth District--Minneapolis

The Ninth District economy grew at a moderate pace since the last report. Increases in activity were noted in consumer spending, manufacturing, tourism, mining, construction and commercial real estate. Meanwhile, agriculture and residential real estate softened. Labor markets showed signs of tightening in several parts of the district, and overall wage increases were moderate. Significant price increases were noted in heating, sugar and some building materials.

Consumer Spending and Tourism
Consumer spending expanded since the last report. A major Minneapolis-based retailer reported same-store sales up 3.6 percent in February compared with a year ago. Sales and traffic were higher at a Minneapolis area mall during January and February compared with a year ago. A mall manager in North Dakota reported strong sales in January relative to a year earlier, while sales during the first part of February were flat.

A representative of an auto dealers association in South Dakota reported increased sales in January compared with a year ago, but sales slowed during February. Sales were up slightly in January, but down in February, according to a Minnesota dealer; domestic vehicle sales were in a slump, while several imported brands sold well.

Winter tourism activity was above year-ago levels. A representative of a ski resort in northern Minnesota reported strong gains in lift ticket sales and area lodging reservations compared with a year ago; area cross country ski trails were in good condition. Tourism activity in northwestern Wisconsin during January and February was above year-ago levels. A strong start to the season at a ski resort in southwestern Montana was slowed somewhat by a frigid Presidents' Day weekend, but lift tickets and lodging were still above levels from a year ago.

Construction and Real Estate
Construction was strong. A warm January led to higher construction activity throughout the Ninth District. Contractors in Minneapolis-St. Paul described the number of recent building projects up for bid as steady to up from last year, when activity was at record levels. Construction in Minnesota and the Dakotas is projected to grow in 2006 by 7.4 percent in nonresidential building and 2.7 percent in residential. Developers announced plans for a $70-80 million athletic center on an industrial site in Bloomington, Minn., and a $60-70 million office tower in Golden Valley, Minn. Redevelopment plans for a block in downtown Minneapolis at an estimated $180 million were also announced. The construction boom in southwestern Montana continued.

Real estate was mixed. In Minneapolis-St. Paul, the supply of single-family homes for sale in recent weeks has been up as much as 34 percent over last year, but pending sales were down. However, an oil field boom in eastern Montana and western North Dakota has led to strong housing demand in those areas, a bank director reported. The Minneapolis-St. Paul office market is at its lowest vacancy rate in five years, with industrial absorption at its highest since 1999. Recent weeks have seen two of the largest office buildings in Minnesota put up for sale, with a combined 2.6 million square feet of office space and an estimated value of half a billion dollars. Analysts expect 3 million square feet of retail space to hit the market in the coming year.

Manufacturing
Manufacturing activity expanded. A February survey of purchasing managers by Creighton University (Omaha, Neb.) indicated growing manufacturing activity in the Dakotas and Minnesota. In Montana, a producer of large equipment transport trailers plans to double capital purchases this year to meet rising demand. A paper producer plans to double its production at a mill in Minnesota. Due to strong demand for respirators, a manufacturing plant in South Dakota is investing in new equipment. However, in the face of strong foreign competition, an electronic components producer closed a South Dakota facility.

Energy and Mining
Activity in the energy sector was stable at a high level and increased in the mining sector. Oil and gas exploration and production were about level from early January through late February. A Montana talc mine is investing in new equipment, and a cement producer is doubling its capital expenditures from last year. Nearly all open mines in the western portion of the district were producing at near full capacity. Taconite mines in northern Minnesota and the Upper Peninsula of Michigan continue to operate at full capacity and are expected to operate at near capacity throughout 2006.

Agriculture
The agriculture sector was down. Responses to the Minneapolis Fed's fourth quarter (January) agricultural credit conditions survey indicated that after a strong finish to 2005, overall agricultural income and capital spending would be down in the first quarter of 2006 due to higher costs of fertilizer, fuel and machinery. Hog prices are expected to decrease throughout 2006. Meanwhile, projected wheat prices increased modestly, while corn, soybean and cattle prices were stable. Soil moisture conditions improved across much of the district.

Employment, Wages and Prices
Labor markets showed signs of tightening in several parts of the district. A director commented that in eastern Montana, "If you are 18 years old and are willing and able to do manual labor, you are hired." In western North Dakota, oil rig operators noted a shortage of workers with a standing list of 150 job openings posted on a job Web site. A chamber of commerce representative in central Minnesota said finding skilled workers will be the biggest challenge for area businesses during the upcoming year. According to a state survey, the number of job openings in Minnesota increased 22 percent during fourth quarter 2005 compared with a year earlier, but remained 56 percent below fourth quarter 2000. Initial claims for unemployment insurance in Minnesota were down slightly during the first few weeks of February compared with a year earlier. A manufacturer of racks and cabinets for technology networks plans to hire 75 workers over the next two years in South Dakota, and a medical claims processing company recently announced plans to add 140 jobs in North Dakota.

In contrast, a mortgage call center in Minnesota will close this spring, resulting in 200 job losses, and a small Minnesota beef packer suspended operations, affecting 125 workers. A manufacturer of data record products is expected to lay off 80 workers in North Dakota.

Overall wage increases were moderate. While increases in salaries for professional positions were moderate, bank directors noted pressure on wages for manual labor jobs in several parts of the district.

Significant price increases were noted in heating, sugar and some building materials. The February price of natural gas for heating homes in Minnesota was up 22 percent from a year ago, but down 11 percent from January. Sugar prices increased since the last report and were 20 percent higher than a year ago. Prices for building products such as asphalt, concrete, gypsum and plastic products increased recently and are notably higher than prices a year ago. Steel prices were stable at relatively high levels. Gasoline prices per gallon in Minnesota during the last week of February were slightly below prices in early January, but were 31 cents above a year ago. Recent diesel prices have stabilized at lower levels, but were 35 cents per gallon higher than a year ago.

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Tenth District--Kansas City

The Tenth District economy continued to expand at a moderate pace in late January and February. Consumer spending grew moderately, residential construction edged up, and commercial real estate activity improved further. On the negative side, growth in manufacturing activity eased, labor markets softened somewhat, and dry weather raised concerns in the agricultural sector. Wage pressures remained low, while wholesale price pressures eased slightly and retail price pressures edged up.

Consumer Spending
Consumer spending continued to grow moderately in late January and February. Most retailers, mall managers, and restaurants reported that sales were above plan and higher than a year ago. Several contacts also noted that traffic was higher than normal for the period due to unseasonably warm weather. Store managers were generally satisfied with inventory levels, and nearly all of them expect sales to increase in the months ahead. Auto dealers reported that sales during the period from late January through February were generally flat and below year-ago levels. Several contacts noted that sales of SUVs had begun to pick up after stalling during the past several months. Dealers generally expect a modest increase in sales heading into spring. Inventory levels were said to be satisfactory at most dealerships. Travel and tourism contacts reported moderate growth in activity. Traffic was slightly higher than a year ago at most airports across the district, and hotel occupancy rates were above year-ago levels in most areas. Visits to ski resorts in Colorado remained strong, while visits to New Mexico resorts continued to be depressed by inadequate snowfall. Contacts expect that tourism activity will improve slightly in most parts of the district in the months ahead.

Manufacturing
Manufacturing activity in the district continued to expand in late January and February, although at a somewhat slower rate than in recent surveys. Many plant managers reported increases in production and new orders, but the increases were not as widespread as in the previous survey period. Growth in capital spending also slowed somewhat from the strong pace in the second half of 2005. On the other hand, a higher fraction of respondents than in the previous survey expect production and new orders to increase in the months ahead. Contacts also reported that most materials remained fairly easy to obtain, although several noted that there might be slight delays in acquiring steel in coming months.

Real Estate and Construction
Residential construction edged up from already high levels in late January and February, and commercial real estate activity showed further signs of improvement. Most home builders reported that starts increased modestly since the previous survey. However, some contacts attributed this rise partly to favorable weather, and builders in several metro areas said that they expect construction to decline somewhat in the months ahead. While construction materials were generally reported to be available, several contacts noted some difficulties acquiring cement. Overall, most contacts do not foresee significant problems obtaining materials in the coming months. Residential real estate agents said home sales were mostly unchanged from the previous survey, and they expect sales to generally remain flat in coming months. Many contacts noted that sales of high-end housing were soft. In addition, inventories of unsold homes were well above year-ago levels in several markets. Home price appreciation remained subdued in most markets, and real estate agents expect moderate growth in home prices in coming months. Mortgage lenders reported a slight increase in home purchase loans since the previous survey but said that demand was still lower than a year earlier. Demand for refinancings declined and was considerably lower than in the same period last year. Commercial real estate activity in the district continued to improve in late January and February. Vacancy rates for office, industrial, and retail space all held steady or edged down since the previous survey, and rents were higher than a year ago in most areas. Contacts expect commercial real estate markets to improve further heading forward.

Banking
Bankers reported that both loans and deposits held steady since the last survey, leaving loan-deposit ratios unchanged. Demand rose slightly for agricultural loans and fell somewhat for home equity loans and home mortgages. Demand for other major loan categories was generally unchanged. On the deposit side, small increases in transactions accounts were offset by a slight decline in large CDs. Many respondents increased their prime lending rates since the last survey, and a few also raised their consumer lending rates. Lending standards were unchanged.

Energy
District energy activity expanded solidly during late January and February. The count of active oil and gas drilling rigs in the region increased and remained well above year-ago levels. Many contacts continued to report that shortages of equipment and workers were constraining drilling activity. In addition, a temporary reduction in local refining capacity was reported to have depressed the price of crude oil produced in Wyoming. Firms throughout the district expect further increases in drilling in the months ahead.

Agriculture
Agricultural conditions remained mostly unchanged in late January and February, as drought conditions persisted across much of the district. The lack of moisture has been of particular concern to cattle producers, especially in Oklahoma. Contacts report that if the dry weather continues through the summer months, many producers will be forced to sell off herds and fall back on cash reserves. Nevertheless, conditions could improve dramatically if moisture arrives in the next several weeks. The high cost of fertilizer remains a concern for crop producers. Due to the high price of wheat, however, wheat producers are not expected to adopt less fertilizer-intensive practices during spring fieldwork.

Labor Markets and Wages
Labor markets softened somewhat relative to recent surveys, and wage pressures remained modest. Hiring announcements fell short of layoff announcements in late January and February, after outpacing layoff announcements by a considerable margin in the previous survey period. Several large meatpacking plants announced that they were closing or cutting shifts, and a number of auto parts manufacturers also ceased production. On the other hand, a number of pharmaceutical manufacturers announced plans to add workers. A slightly smaller percentage of contacts reported labor shortages than in the previous survey. Among the workers reported to be in short supply were truck drivers, auto technicians, and geologists. The fraction of firms reporting above-normal wage increases remained low by historical standards and was nearly unchanged from the previous survey.

Prices
Wholesale price pressures eased somewhat in late January and February, but retail price pressures edged up. The percentage of manufacturers reporting increases in materials prices declined modestly from the previous survey, returning to levels seen last summer. The share of plant managers expecting material prices to increase in coming months also declined, although the share remained high by historical standards. The fraction of manufacturers raising selling prices was roughly unchanged from the previous survey, while the fraction expecting to raise selling prices in the near future declined somewhat. Builders indicated that the cost of cement continued to rise modestly, but they did not expect any large increase in materials prices in the months ahead. The share of retailers reporting higher prices than a year ago increased slightly from the previous survey. In addition, a larger percentage of retail stores than in the previous survey plan price increases in the future.

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Eleventh District--Dallas

Overall Eleventh District economic activity strengthened in January and February. Energy activity remains extremely strong. Reports from the manufacturing, construction and service sectors also strengthened. Consumer spending was mixed. Retailers said sales growth was up in January but declined in February, and auto sales were down. The financial services industry reported some softening in consumer lending.Agricultural conditions remain extremely dry.

Contacts in both the construction and manufacturing sector are keeping their eyes on the housing market with optimistic trepidation. At this point there is little evidence that slowing in other housing markets has spread to this region.

Prices
High energy costs remain a concern for many industries. Crude oil prices fluctuated between $58 and $68 per barrel over the past two months. Crude demand has remained relatively weak, with refinery capacity utilization low and imports of refined products at record levels.

Wholesale gasoline prices are down, falling from $1.85 in early January to $1.50 in early March. Retail gasoline prices have fallen by about 10 cents during the same period. Gasoline demand has been strong, but inventories were built up dramatically through record imports and the return of most the hurricane damaged refining capacity. Contacts expect upward pressure on gasoline prices for several reasons. The refinery maintenance season is just beginning, price incentives to ship gasoline from Europe to the U.S. have disappeared, and new environmental restrictions on additives and sulfur will eliminate many imports over the summer. Heating oil prices have fallen from $1.75 to $1.65. Diesel and heating oil inventories have built up thanks to a very warm winter.

Natural gas prices have fallen from near $9 per thousand cubic feet in early January to below $7. Natural gas inventories are currently 48 percent above the five-year average level and are expected to be at record high levels for the season going into the spring and summer.

Manufacturers report that high energy and other input costs are putting upward pressure on selling prices, but competition is limiting some price increases. Prices are up for primary metals, stone, clay, brick and glass. Paper producers announced a spring price increase, but many in the industry do not expect it to stick. Steel prices have been declining, according to contacts, who say that imports of less expensive steel are squeezing profits. Selling prices have declined for petrochemicals, such as ethylene, polyethylene, polypropylene, PVC and chlorine, but prices remain well above pre-hurricane levels. The service sector reports that utility costs are pushing up rents and transportation costs.

Texas home prices have increased at a faster pace in recent months, according to contacts, who say the increase is driven by economic fundamentals rather than speculation. The construction industry expressed growing concern about rising costs for energy, lumber and other inputs. Cement prices have eased some, because a reduction in tariffs has increased imports from Mexico.

Labor Market
The labor market continues to firm. Hiring was reported at both manufacturing and service companies. While there are little or no wage pressures in some industries, others report growing pressure. Salaries continue to increase at accounting firms, and temporary service firms said wages are rising for lower paid workers. Many contacts expressed serious concern about the high and rapidly rising cost of health insurance, even in industries without wage pressures.

Shortages of some types of skilled employees remain a concern, and worker shortages are constraining activity in the construction and energy industries, according to contacts. A shortage of skilled oilfield workers is expected to push up labor costs in that industry by 10 percent or more this year.

Manufacturing
Manufacturing activity picked up. Demand remained strong for energy and construction-related products. The high-tech sector continued to strengthen. Demand for apparel and food products was up, but sales of paper were seasonally slower.

Demand remained strong for stone, clay, brick and glass, boosted by sales for construction and oil and gas drilling. Lower tariffs on cement imports from Mexico are helping ease but not eliminate shortages, according to contacts. Good weather spurred demand for lumber and reduced inventories, but firms say they will see if good weather persists before rebuilding inventory. Metals producers reported little change in demand. Some expressed concern that there had been some sales weakness as a result of construction slowing in other parts of the country, but most contacts see no substantive evidence of slowing and do not expect it.

Manufacturers of high-tech equipment said that production and orders growth continued at a healthy pace since the last survey. Demand continued strong for flash memory for hand-held music devices and multi-function communication devices. Inventories are lean.

A narrowing spread between product and crude prices led some refineries to briefly reduce production in February. Operating rates on the Gulf Coast and at the national level are declining, as the industry begins the spring turnaround season. Maintenance turnarounds are expected to be longer than normal because work had to be postponed because of the hurricanes last fall. Petrochemical production along the Gulf has returned to normal levels. Contacts expect a pick up in domestic demand in the weeks ahead as seasonal weakness passes and spring construction picks up.

Services
Temporary staffing agencies say activity picked up and was markedly higher than expected. Orders were primarily to supply workers for call centers, distribution centers and light industrial manufacturing. Accounting firms reported strong activity and increased hiring mostly due to Sarbanes-Oxley and seasonal tax needs. Demand for legal services remained strong, especially for litigation, transactions, real estate and corporate activity. Some contacts noted that out-of-state investors were helping drive real estate transactions.

Demand for transportation services remained strong. Trucking firms say demand is still solid, and a shortage of qualified drivers is limiting their capacity to take on more business. Cargo volume increased at a slower pace over the past six weeks--mostly due to post-holiday inventory liquidations. Increase in volume came from growth in shipments of durable goods. Contacts say continuing high demand for trade services has pushed up shipping rates at a faster pace than cost increases.

Rail activity remained strong, with increases in shipments of crushed stone, metals, grain and coal. Shipments of construction-related materials, wood, metallic ores and motor vehicles declined. Contacts say the industry is operating at or near capacity, and expansion plans are underway. Demand for air travel has also been strong, and carriers say load factors are high. While fuel costs remain a concern, reduced capacity and increased prices have helped improve the outlook.

Retail Sales
Gift card redemptions and clearance sales helped spur strong sales growth in January. February sales growth was softer. Retailers are uncertain about the strength of consumer spending and say Easter's shift from March in 2005 to April in 2006 will make it difficult to evaluate for a few months. Still, contacts are cautiously optimistic about the outlook. Auto sales have been unusually slow, according to dealers. Contacts speculate that the market has become saturated by a long stream of rebate offers. Inventory levels are high. Some dealers have reduced salaries.

Construction and Real Estate
Demand for new and existing homes continued to be strong since early January. Existing homes sales are still rising in Austin and Houston, but there was some weakening in the Dallas/Fort Worth area. Builders report that new home demand in Texas did not follow the trend in other states, where they experienced slower sales and higher contract defaults. They expressed growing caution about the outlook, however, voicing concerns about talk of a "nationwide" downturn in the housing market, labor shortages due to hurricane rebuilding, and escalating materials costs.

Apartment demand has been strong. Unusually warm weather may have helped boost leasing activity, according to contacts, who say this is normally a slow time of year. Multifamily construction starts increased recently, with many of the projects expected to continue into 2007. Respondents say the construction is mostly justified, because vacancy rates are tight for newer "top-tier" properties but expressed some caution that rents would increase enough to justify future projects.

Office leasing continued to increase at a steady pace, and rents are up in some areas. Demand and selling prices were up for industrial properties, boosted by sales to out-of-state investors.

Financial Services
Consumer lending softened. Contacts report slowing in automobile loans and residential mortgages, especially for hybrid adjustable rate mortgages. Contacts say yields are higher on auto loans, fixed rate mortgages and home equity lines of credit. Loan quality remains good, however, and deposit growth unchanged. There were reports of fierce pricing competition for commercial loans.

Energy
The U.S. rig count has reached a 20-year high, rising by roughly 75 rigs since early January. The increase in activity is primarily the addition of newly-constructed rigs but is also due to the arrival of some foreign rigs and some hurricane-damaged rigs returning to service. An additional 250 rigs are under construction, although shortages of component parts, such as mud pumps and engines, are causing some delays. Manufacturers of energy equipment report long and growing backlogs of orders.

Oil service activity remains strong and driven mostly by land-based drilling directed toward natural gas. Service costs are still rising, pushed up by increasing labor costs, rig rental rates and the cost of pressure pumping for fracturing formations. International activity also continues to rise, with recent gains stemming from Latin America, the United Kingdom, and Saudi Arabia.

Agriculture
Low water supplies, poor pasture conditions and high feed prices are encouraging cow-calf producers to limit herd expansion. Most farmers continue to await rainfall for sufficient moisture to prepare land for planting. Contacts in the banking industry say they may not be able to finance some farm operations, especially those without irrigation, unless sufficient rain restores soil moisture. Producers are extremely concerned about high energy, fertilizer and chemical costs. The high cost has limited purchase and forward bookings of inputs and has tempered income gains in the agribusiness industry. Contacts are hopeful that 2006 farm program payments may provide some relief to producers and expressed concern that the structure of the farm program could be shifted from subsidy payments for specific commodities to investment in rural development.

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Twelfth District--San Francisco

The Twelfth District's solid economic expansion remained on track during the survey period of mid-January through the beginning of March. Contacts reported modest price and wage inflation on net, despite elevated prices for energy-intensive products and faster wage growth for scattered groups of workers with specialized skills. Retail sales grew compared with year-earlier levels, and service providers saw robust demand. District manufacturers reported generally solid demand. Orders and sales grew for providers of agricultural and resource-related products. Activity in residential real estate markets generally remained at high levels but slowed further in some areas, while demand for commercial real estate continued to improve. District banks reported net growth in loan demand and very good credit quality.

Wages and Prices
Contacts reported little or no change from the modest inflationary pressures reported in the previous survey period. Continued productivity gains reportedly held down increases in final prices in most sectors, and nearly all contacts expect the existing trend pace of productivity growth to be maintained or to pick up in 2006. The prices of energy-intensive production inputs remained quite high and rose further in some cases, but the availability of selected construction materials improved and their prices stabilized or fell slightly in some areas.

The pace of wage growth was moderate on net, with increases generally in the range of 3 to 5 percent or less on an annual basis. However, wage gains were rapid for scattered groups of workers with specialized skills in the financial, construction, health-care services, and information technology sectors; some of these worker groups have seen double-digit wage growth over the past year.

Retail Trade and Services
Contacts reported solid retail sales, with gains evident relative to year-earlier levels. Sales grew in most market segments, although performance varied substantially across individual retailers within segments. Automobile sales were very strong in January. However, preliminary information suggests spotty sales of new vehicles in February, and throughout the survey period demand remained stronger for imports than for domestic makes.

Service providers saw robust demand in general. Orders and sales grew further in the food and beverage, health-care, and transportation sectors. Intense competition held down sales for individual service providers in some sectors, such as media services and telecommunications, but past and ongoing investments in technologies that enhance efficiency helped these businesses maintain profit margins. District travel and tourism activity was vigorous, notably in Hawaii, where visitor counts and spending remained on the record-setting pace established in 2005. Tourist activity also was strong in California; hotel occupancy rates reportedly showed signs of stabilizing at high levels in the San Francisco Bay Area, but room rates rose further.

Manufacturing
District manufacturers reported generally solid demand for their products during mid-January through the beginning of March, with slight slowing evident in some sectors compared with the previous survey period. Orders and sales of semiconductors were strong, and capacity utilization remained at high levels; inventories reportedly were in balance based on recent and expected demand growth. By contrast, a maker of metal products described conditions as "tepid" compared with the robust demand experienced in late 2005. District food processors reported a slight slowing in sales relative to the rapid pace established in 2005, although they expect this slowdown to be temporary.

Agriculture and Resource-related Industries
Providers of agricultural and resource-related products reported further demand growth and generally good supply conditions. Mild weather resulted in an unusually abundant supply of fruits, vegetables, and flowers for this time of year, and material costs were largely stable. However, contacts in California expressed concern that increasingly tight supplies of agricultural labor may interrupt harvests in coming months. In the resource sector, producers of oil and natural gas saw robust demand; they continued to operate at close to full capacity but faced difficulties and delays in hiring skilled workers and obtaining raw materials. Producers facing input constraints in both the agricultural and resource sectors reportedly maintained output in part through the implementation of productivity-enhancing equipment and technologies.

Real Estate and Construction
Activity in residential real estate markets continued at high levels but showed further evidence of softening in some areas. The pace of home construction and sales was rapid in general, and sales prices held steady or increased in most areas. However, a decline in the pace of home sales and slowdowns in other indicators reflect significant cooling in some previously hot markets, notably in Hawaii, Arizona, and parts of California. On the non-residential side, office vacancy rates continued to fall and rental rates rose further in most major markets, and building activity has picked up for commercial projects and public structures. Construction costs also rose further in some areas, due to elevated prices on selected materials and higher wages for skilled workers.

Financial Institutions
District banking contacts reported growing loan demand and very good credit quality overall. Mortgage lending slowed slightly, but demand for commercial and industrial loans continued to advance, as did loan demand for commercial real estate and construction projects. Contacts also noted increases in venture capital activity in parts of the District. In an environment of intense competition, narrow interest rate spreads, and rising compensation costs, many banks reportedly have been relying on technology investments and organizational efficiencies to maintain profit margins.

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