July 27, 2005

Summary of Commentary on Current Economic Conditions by Federal Reserve District

Summary

Prepared at the Federal Reserve Bank of Kansas City and based on information collected on or before July 18, 2005. This document summarizes comments received from businesses and other contacts outside the Federal Reserve and is not a commentary on the views of Federal Reserve officials.

Reports from all twelve Federal Reserve Districts indicate that economic activity continued to expand in June and early July. Richmond and Dallas reported that the rate of economic growth increased, and Cleveland said economic growth was stronger and more balanced than in the spring. New York was the only District to report a slowing in the rate of economic growth. Among the other Districts, Atlanta, Minneapolis, Kansas City, and San Francisco characterized the pace of expansion as solid, while Chicago described the rate of economic growth as moderate. Boston, Philadelphia, and St. Louis did not characterize the overall pace of expansion, although Boston noted that locally-based retailers were not sharing in the expansion.

Most Districts reported increases in retail sales, and vehicle sales in nearly all Districts were boosted by a new round of price discounting. Demand for most services, including tourism, continued to increase across the country, and most Districts noted moderate to solid expansions in manufacturing activity. Commercial real estate activity improved in most Districts. Residential real estate activity remained strong overall but showed a few signs of cooling in some Districts. Bankers reported solid or increasing loan demand.

Labor markets generally continued to improve, although hiring in several Districts was mixed. Skilled worker shortages were reported in several Districts, but nearly all Districts said wage pressures remained moderate. Overall price pressures eased slightly or remained unchanged in most Districts, despite substantial increases in energy costs.

Consumer Spending
Most Districts reported increases in retail sales, and reports on retailers' expectations were generally positive. Dallas said sales growth had been stronger than expected given high gasoline prices, and Atlanta noted that higher gasoline prices did not appear to have cut into spending on other items; Cleveland and Chicago said warmer weather may have boosted sales in their Districts. Minneapolis and Kansas City reported solid year-over-year retail sales gains, and sales also increased in the Philadelphia, Richmond, and San Francisco Districts. The weakest report on retail sales came from the Boston District, where sales were flat or

down from a year ago and retailers were less optimistic than in previous surveys. New York also reported a softening in sales in early July following solid growth in June, while St. Louis said reports on retail sales were mixed in June.

Nearly all Districts that reported on vehicle sales noted improvements, which were generally attributed to a new round of price discounting by some automakers. Cleveland reported dramatic gains, saying all types of dealerships benefited from increased buyer traffic. San Francisco also said vehicle sales rose substantially in response to the price cuts. Only St. Louis cited mixed reports on auto sales. Sales of most types of vehicles were characterized as strong, although Philadelphia and Kansas City reported some weakness in sales of large SUVs. Auto dealers in the Philadelphia and Dallas Districts were somewhat concerned about future auto sales, but Kansas City said dealers expect strong sales to continue.

Services and Tourism

Demand for services continued to increase in June and early July. Boston reported healthy growth in demand for advertising and management consulting, and Philadelphia contacts noted increased activity in information services and business support services. Richmond also reported increased demand for business-to-business services. Demand for health care was reported to be flat in the Richmond District but robust in the San Francisco District. Dallas and San Francisco noted an increase in demand at transportation firms, while Cleveland and Chicago said that demand for trucking was steady and that overall conditions for the industry remained favorable. On the other hand, Atlanta reported some transportation firms have seen activity fall slightly from the high levels experienced earlier in the year.

Tourism continued to show strength throughout much of the country. New York reported that hotel occupancy rates in Manhattan were near record levels and that room rates were up substantially from a year earlier. In addition, Atlanta said hotel occupancy rates in the Miami area were at record levels, and theme park attendance was ahead of last year's pace. Chicago and Kansas City also noted an increase in demand for hotel rooms since the previous survey. Tourism activity over the Fourth of July was characterized as being particularly strong in parts of the Richmond and Minneapolis Districts. San Francisco reported continued strong growth in visits to key tourist destination states.

Manufacturing

Most Districts reported moderate to solid expansions in manufacturing activity, and expectations for future factory activity were generally upbeat. New York saw a rebound in manufacturing production in July, adding that manufacturers' expectations had also risen. Chicago reported continued solid growth, and Atlanta said that reports from District manufacturers were positive. Boston said sales and orders remain on an upward trend. Philadelphia, Minneapolis, and Dallas noted increases in activity as well. St. Louis and Kansas City reported moderate expansions in factory activity, and San Francisco said demand for manufactured goods rose slightly after slowing in the previous survey period. Cleveland said durable goods production had been flat since the previous survey but nondurable goods production was steady or rising. Richmond reported a softening in factory activity in June but a solid increase in shipments and new orders in July. Despite the overall expansion in manufacturing activity, as well as generally positive reports on capital spending, factory hiring remained sluggish in most Districts that reported on employment.

Activity in a wide variety of manufacturing industries was characterized as strong. Boston and San Francisco reported strength in aircraft and high-tech manufacturing, and Atlanta and

Dallas said refineries were doing quite well. Several Districts also noted strong activity for producers of construction materials--especially cement--as well as for producers of industrial equipment and materials. While most factory sectors were strong, some weakness was noted among producers of metals and textiles.

Construction and Real Estate

Residential real estate activity remained robust overall but showed a few signs of cooling in some Districts. Boston reported that residential real estate markets were still strong. However, housing activity and home price appreciation in Massachusetts moved from "hot" to "normal," and housing inventories in the District as a whole became somewhat less tight. Housing activity was described as robust in the New York District, but housing inflation slowed in New Jersey and the condo market in Manhattan was less frenzied than in the spring. In the Richmond, Atlanta, and San Francisco Districts, housing activity remained strong but eased in a few markets that had been especially hot--Washington, D.C., several Florida markets, and parts of southern California. Dallas also described housing demand as strong but noted that the supply of new homes was sufficient to keep housing inflation from exceeding overall inflation. Housing activity was brisk in the Chicago District and solid in the Kansas City and Minneapolis Districts, although homebuilding edged down in the Kansas City District. The weakest report came from the Cleveland District, where homebuilders have faced slightly softer conditions since early spring and new home prices have been flat.

Commercial real estate activity improved in most Districts. Cleveland said commercial builders were experiencing steady improvement and higher backlogs of orders. In the Atlanta District, new construction projects moved forward, and office vacancy rates trended downward but were still high. Contacts in the Chicago District described commercial activity as busier than normal, although activity was slower in Michigan. Commercial real estate activity was described as strong in the Richmond District and as improving in the Minneapolis, Kansas City, and San Francisco Districts. Dallas reported that speculative office construction increased, apartment construction remained high, and hotel markets were hot. Some of the increased real estate demand in the Dallas District was attributed to outside investors attracted by the area's lower real estate prices.

Banking and Finance

In Districts reporting on banking conditions, loan demand increased or remained solid. Overall lending increased in most Districts, with growth ranging from slight in the Cleveland and Kansas City Districts to solid in the Dallas District. Atlanta and San Francisco both characterized loan demand as strong. In most Districts, loan growth was attributed to increases in home mortgages, home equity loans, or business loans. Credit quality was generally strong, although there were some concerns about loans to auto suppliers and farmers in the Chicago District and loans for Florida condominium developments in the Atlanta District. Dallas indicated that competition for large commercial loans had intensified, and Chicago said that competitive pressures had led to some easing of commercial credit standards. Outside of the banking sector, cash inflows to investment companies increased in the Philadelphia District, and venture capital rose for the first time in five years in the Chicago District. New York and Richmond also reported increased activity in the financial services sector as a whole.

Agriculture and Natural Resources

Although conditions remained favorable in most agricultural Districts, dry weather was a problem in some areas. Richmond reported that substantial rainfall brought on by two tropical storms generally improved soil conditions in the District. Atlanta reported only limited damage to crops from the storms and favorable crop conditions overall, although citrus canker continues to be of some concern in Florida. Kansas City and Minneapolis also said that crop conditions were mostly favorable, and winter wheat yields were above year-ago levels in both Districts. Some Kansas City contacts reported concern about higher energy prices boosting irrigation costs. Drought conditions were reported in the Chicago, St. Louis, and Dallas Districts, and Chicago noted these conditions had led to an increase in corn and soybean prices. The lack of rain caused pasture conditions to deteriorate substantially in the St. Louis and Dallas Districts. San Francisco reported little or no impact on cattle prices from renewed fears about mad cow disease, while Kansas City reported that the resumption of live cattle imports from Canada was contributing to downward pressure on cattle prices.

Activity in the energy industry remained strong. Oil and gas activity increased in the Dallas and San Francisco Districts and remained steady in the Minneapolis and Kansas City Districts. Kansas City reported that drilling was constrained due to a shortage of available rigs and regulatory factors, and some oil service firms in the Dallas District were turning down available work due to limited capacity. Dallas contacts also noted difficulty finding qualified engineers and training crews. Atlanta reported a temporary shut-in of some oil and natural gas supplies in the Gulf of Mexico due to Hurricane Dennis. Minneapolis respondents said that mines are operating at full capacity, with exploration activity in full swing across the District.

Labor Markets, Wages, and Prices

The demand for labor continued to increase in most Districts, although hiring in several Districts was mixed. Atlanta, Chicago, Minneapolis, Kansas City, Dallas, and San Francisco all noted an overall firming in labor markets. Boston reported moderate increases in services employment and mostly steady employment in retail and manufacturing. In the Richmond District, jobs increased moderately at services firms but declined slightly at manufacturing firms. New York said labor markets were a bit softer overall despite a pickup in hiring in financial services. Several Districts reported increased demand for temporary workers, while no Districts reported weaker demand for temps. Skilled workers were said to be in shorter supply in several Districts, and truck drivers were reported as scarce in the Cleveland, Richmond, and Atlanta Districts.

Despite generally tighter labor markets, nearly all Districts said overall wage pressures remained moderate. The only wage pressures cited by the Dallas District were in the accounting and energy industries, and Chicago said the only sizable wage gains were in some skilled professions experiencing labor shortages. San Francisco also reported only modest overall wage growth but noted an increasing use of incentive compensation by some employers to attract workers. Rising health-care costs continued to be a concern for contacts in the Atlanta and San Francisco Districts, but Chicago reported that one large health insurance firm plans to implement the smallest premium increase in a decade.

Overall price pressures either eased slightly or remained unchanged in most Districts, despite substantial increases in the costs of energy and some building materials. Manufacturers in the New York District reported a marked deceleration in input prices and expect substantially less upward price pressure in coming months. Some moderation in input price increases was also noted in the Richmond, Kansas City, and Cleveland Districts. Overall cost and price pressures were described as mild in the Richmond District, moderate in the Chicago District, and largely unchanged from the second quarter in the Philadelphia District. Kansas City and

Minneapolis noted some softening in the costs of steel. However, many Districts reported substantial increases in the costs of energy, petroleum-based products, and building materials such as concrete and plywood. Chicago, Cleveland, and Dallas said that transportation firms were able to pass on much of their increased fuel costs to customers. However, in a number of Districts, firms outside the transportation sector were reported as having only limited success passing on cost increases. Retail prices were reported as either flat or up moderately from the previous survey.

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First District--Boston

The First District economy continues to expand, with the exception of New England-based retailers. Contacted retailers say sales are flat or down compared with a year ago. By contrast, most responding manufacturers are enjoying year-over-year revenue growth, as are advertising and consulting firms in the region. Both retailers and manufacturers report cost increases that they are unable to pass along fully to their customers. New England's residential real estate markets are still going strong, although the pace of activity and rate of increase in home prices in Massachusetts are moving toward normal from "hot," and region-wide inventories of homes for sale are rising somewhat toward more normal levels.

Retail
First District retailers cite flat or poor sales results in the second quarter. According to one contact, furniture sales are sluggish compared to this period last year, and slowed in June and early July compared to May, possibly because of good vacation weather and soaring gas prices. Another respondent reports a slowdown in casual dining compared to previous months and year-ago levels but remains unsure of the cause. A contact selling discount apparel and home fashions relayed that business has been "okay," but still slightly below year-earlier levels and below plan. Another contact selling apparel notes that year-over-year sales are down, but believes that the decrease is due to poor merchandising decisions and not a lack of consumer demand.

Inventory levels remain flat or have decreased according to most respondents. One exception is the apparel retailer who has increased inventories in order to shift to more-salable merchandise. Several retail contacts note cost increases for utilities, steel-based items, and paper; they remain hesitant to pass these increases on to customers. Employment levels are mostly steady, with increases occurring only in connection with the opening of new stores. Respondents also report increased capital spending associated with these new store openings, as well as for improvements in distribution and technology.

Most contacted retailers are less optimistic than in previous months, and remain cautious in their outlook. Many hope that sales will at least remain flat compared with a year ago. Respondents also express uncertainty and caution about consumer demand, rising healthcare costs, and geopolitical instability.

Manufacturing and Related Services
First District contacts in manufacturing and related services mostly report that sales and orders remain on an upward trajectory, with levels in the second quarter of 2005 higher than a year earlier. Makers of aircraft, medical equipment, pharmaceuticals, chemicals, and IT and information-related products used by the financial services industry are doing particularly

well. However, a fabric manufacturer indicates that business is falling off, while a fabricated metals firm reports a temporary downturn in sales to the automotive industry.

Prices for some materials and services continue to increase. Respondents cite cost pressures from freight and transport, energy, and petrochemicals and other synthetic products in particular. In general, manufacturers cannot fully pass along these higher costs to their customers. Some have managed to offset margin pressures by introducing greater efficiencies in purchasing and production.

Companies are mostly keeping their domestic headcounts steady. A few are laying-off employees or shortening the factory workweek. Hiring generally is restricted to sales and marketing and high-end technical positions. Labor markets typically are tight for these types of positions, but contacts do not complain of hiring delays except for positions requiring government security clearance. Wage and salary increases are mostly in the range of 3 to 3.5 percent. Most companies are increasing their capital spending, but they describe their added investments as modest or careful.

Respondents tend to characterize the revenue outlook in terms such as "satisfactory," "decent," or "on plan." Companies in information-related businesses stress that they expect to grow more slowly than in the 1990s. Manufacturers say they intend to remain focused on cost containment, especially given their limited ability to pass on high oil prices and competition from producers in low-cost locations such as China.

Selected Business Services

New England advertising and management consulting companies experienced healthy demand growth in the second quarter of 2005. Most companies believe clients are now more liberal with their discretionary spending than they were in 2004. Although still generally cautious, these clients seem to be shifting toward strategies of growth and expansion, rather than focusing on efficiency. Responding companies have earned moderate price increases over year-ago levels, but costs are also increasing, most notably for labor. Headcounts are growing in response to demand, but at a slightly slower rate than revenues. Looking forward, most respondents call themselves optimistic and expect revenue growth in the second half of 2005 to continue at the first-half pace or to go higher. Nonetheless, contacts see the possibility of a general economic slowdown, higher oil prices, or terrorism as sources of risk to their positive outlook.

Residential Real Estate

Residential real estate markets in New England remain strong and active. Contacts report that brokers are busy throughout the region, even though markets typically slow down this time of year. In Massachusetts, the number of sales of single-family homes declined in April and May compared with year-earlier levels, but the number of condominiums sold reached new record highs for both months. However, inventory of both types increased and sale prices rose by only single digits compared to last year--a more moderate rate of appreciation than in the last few reports. Contacts in other states have not observed much slowdown in price appreciation. Average sale prices have increased in Connecticut, Maine, New Hampshire and Vermont. Nevertheless, some contacts report that there is "finally" a little more inventory for buyers to choose from. Most contacts expect prices to continue rising for the rest of the year.

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Second District--New York

The Second District's economy has expanded at a somewhat more moderate pace since the last report than in earlier periods. Reports on the labor market have been mixed but, on balance, a bit softer. Retailers generally report that sales were strong in June, though a number indicate some softening in early July. Tourism activity was robust in June. While housing markets continue to be characterized as sturdy, there has been some deceleration in selling prices and a modest dip in activity since the last report. Office markets strengthened moderately in the second quarter, but the market for industrial space was mixed. New York City's financial industry has shown signs of improvement in early July, after a sluggish second quarter; moreover, hiring activity is said to have picked up and compensation has accelerated. Manufacturers and purchasing managers report a considerable diminution of input price pressures in June and early July. Finally, bankers report a pickup in demand for commercial mortgages but little change in other loan categories; they also report some tightening in credit standards and further declines in delinquency rates.

Consumer Spending

Retailers report that sales were generally on or above plan in June, but have softened and appear to be a bit below plan in early July. After a relatively cool spring, unseasonably hot weather in June boosted sales of summer merchandise--particularly apparel. More generally, sales of premium lines of clothing were characterized as strong, as were sales of jewelry and accessories. However, sales of home-related goods were weak across the board. In general, retail inventories were said to be at desired levels at the end of June, though a number of wholesale trade contacts indicate that inventories were on the high side. Selling prices were little changed.

Tourism continued to show strength in June. Manhattan's hotel occupancy rate climbed above 90 percent in June--close to a record high and up more than 3 percentage points from a year earlier; moreover, with average room rates up nearly 18 percent from a year earlier, total revenues are up more than 20 percent over the past 12 months. Similarly, Broadway theaters indicate that attendance remained robust in June, with revenues running roughly 10 percent ahead of a year earlier, though attendance has tapered off moderately in the first half of July.

Consumer confidence improved in June, based on two separate surveys. The Conference Board's survey of Middle Atlantic residents shows consumer confidence rebounding strongly in June, after slipping to a 6-month low in May. Siena College's survey of New York State residents shows confidence climbing for the second month in a row--whereas May's gain was concentrated in the New York City metropolitan area, all of the June gain was in upstate New York.

Construction and Real Estate

The housing market generally continued to be robust in June and early July, though there were some signs of slowing in activity and deceleration in prices. New Jersey homebuilders report that conditions remain strong, though the rate of price increase has slowed; residential construction activity has been stronger in 2005 than it has been since the late 1980s, but there is still a fairly long queue of homebuyers. Two contacts maintain that Manhattan's co-op and condo market remains robust across the board, though not as frenzied as during the spring. Apartment prices were estimated to be running 10 percent to 15 percent higher than a year earlier in June--a bit less than in April and May--while unit sales were down moderately.

Office markets in and around New York City have continued to show signs of strengthening. At the end of June, office vacancy rates declined to 4-year lows in both Midtown and Lower Manhattan, and this improving trend has continued during the first half of July. Similarly, Westchester County's vacancy rate fell to a 5-year low at mid-year, while Fairfield County's rate was down slightly for the quarter. In Long Island, however, vacancy rates rose by nearly a full point in the second quarter, though they are still 1/2 point lower than a year earlier. Industrial markets in and around New York City were mixed in the second quarter. Industrial vacancy rates edged down to near a 3-1/2 year low in Fairfield County and were steady at record lows in Westchester County; rents in both areas were up slightly from a year earlier. In New York City, Long Island, and northern New Jersey, industrial vacancy rates were little changed, though asking rents were up roughly 10 percent from a year earlier.

Other Business Activity
A contact at a major New York City employment agency describes the job market as lukewarm, noting that hiring activity has been a bit slower in June and early July than anticipated. In contrast, a contact in the financial industry notes that employment and compensation have accelerated in recent months; more generally, business activity is said to have picked up in early July, after a sluggish second quarter.

According to our latest survey, New York State manufacturers report a further rebound in activity in early July and have become increasingly optimistic about the near-term outlook. Still, hiring activity is reported to have slowed, and a number of contacts indicate that inventories are higher than desired. They also note a marked deceleration in input prices, and anticipate substantially less upward pressure on prices in the months ahead. Regional surveys of purchasing managers also point to considerable moderation in input price pressures.

Financial Developments
Small and medium sized banks in the district report little change in demand for consumer loans, residential mortgages, and commercial and industrial loans since the last report, but an increase in demand for commercial mortgages. Refinancing activity continued to weaken. Bankers reported tightened standards on residential mortgages, consumer loans and commercial mortgages. Higher rates were reported across all loan categories, particularly in the consumer loan category. Increased average deposit rates were reported by 67 percent of bankers versus only 6 percent reporting lower rates. Finally, banks report lower delinquency rates on consumer loans, commercial mortgages, and commercial and industrial loans.

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Third District--Philadelphia

Economic activity in the Third District was expanding in early July. Manufacturers reported increases in orders and shipments compared with June. Retail sales of general merchandise increased compared to the prior month and year. Auto sales remained on the rise following a strong upturn from May to June. Banks reported that lending continued on an upward trend, with gains in business lending and home equity credit. Firms in the District's major service industries reported growth in activity in the past few months about in line with the growth rates they posted earlier in the year.

Third District business contacts generally expect business activity in the region to continue to expand at around the current pace. Manufacturers expect increases in shipments and orders during the next six months, although the balance of positive forecasts is not as great as it was during the first half of the year. Retailers anticipate steady sales growth, with moderate year-over-year gains. However, auto dealers are uncertain about the outlook, and some expect the sales rate to decline in the months ahead. Bankers expect continued loan growth near the recent pace. Service sector firms expect moderate, steady increases in business.

Manufacturing

Manufacturing activity in the Third District was on the rise in early July according to manufacturing firms contacted during the month. Nearly one-third of the companies contacted posted increases in new orders and shipments compared with June, and around one-fifth had decreases. However, order backlogs were on the decline, and delivery times were unchanged from the prior month, on balance. For early July compared with June, the improvement in business was relatively stronger among firms producing wood products, packaging, and industrial materials. Manufacturers of metals and metal products generally had declines. Makers of other products gave mixed reports.

On balance, the region's manufacturers expect continued growth in business activity, although positive expectations are not as widespread as they were in the first half of the year. About half of the firms contacted in July expect their shipments and orders to increase during the next six months, and about one-fourth expect decreases. On balance, capital spending plans remain positive among District manufacturers, but the number of firms scheduling increased outlays is somewhat lower than it was during the first half of the year.

Reports of price increases from Third District manufacturers outnumbered reports of decreases in early July, although a majority of manufacturing firms reported steady prices for the month. One-third of the manufacturing firms contacted for this report noted increases in input prices from June to early July, and one-fifth raised output prices. Less than one-tenth reported declines in either input or output prices. The number of firms noting increases for the month was about the same as during the second quarter, and lower than in the first quarter. During the next six months about half of the manufacturers contacted for this report expect increases in input prices, and almost one-third plan to increase the prices of their own goods; only a very small percentage expect declines in either input or output prices.

Retail

Retailers generally reported higher sales in early July compared with June and with July of last year. There were gains among most lines of goods, with somewhat better performance for seasonal items, apparel, and home furnishings relative to other merchandise categories. Some merchants noted that shoppers were visiting stores less frequently, consolidating shopping trips in order to economize on gasoline expense. Some store officials also noted an apparent decline in impulse buying by shoppers. Retailers expect sales growth to continue at about the current pace, but they are being cautious in their expansion plans. Several retail executives indicated that rising operating costs were leading them to focus on measures to increase sales at existing stores rather than on opening new stores.

Auto dealers in the region generally reported a pickup in sales in June and early July stemming from new price discounts by manufacturers. As a result, inventories have been reduced to more desirable levels. However, dealers indicated that sales of large sport utility vehicles have been declining, and they attribute the sales falloff to high gasoline prices. Dealers expressed some concern that the pace of sales will ease later this year as the impact of recent price cuts wanes.

Finance
The volume of loans outstanding at Third District banks rose in the first weeks of July compared with June, according to banks surveyed for this report. Commercial and industrial loans have been increasing. Some bankers indicated that there has been strong growth in lending to construction firms and to manufacturers and other companies with housing-related business. Lending for residential mortgages, home equity loans, and home equity credit lines has been growing, as has credit card lending. Bankers in the District expect continued expansion in business activity in the region, and they expect overall lending to remain on the rise.

Investment companies reported gains in cash inflows in recent weeks, with about equal growth in purchases of money market, bond, and equity funds. Investment company officials said investor confidence appears to be improving, although both individual and institutional investors continue to believe there remains some risk that financial conditions could deteriorate and economic growth could falter.

Services
Most of the Third District service firms contacted in early July reported growth in activity. Information services firms have had some increases in demand, and they have been upgrading their own systems. Among other business services, there has been an increase in activity among basic business support services firms and at temporary employment agencies. Demand for temporary workers has picked up for health care, administrative, and some skilled manufacturing occupations. Some temporary employment agencies also noted more demand for workers this year compared with last year from firms with summer peak activity. Most of the service sector firms contacted for this report expect business to continue to advance at around its current growth rate during the balance of the year.

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Fourth District--Cleveland

District business conditions generally improved across a broad base of industries in the six-week period through the middle of July, after a period of uneven growth throughout the spring. Outside of a few categories, most manufacturers reported that production remained steady or rose in recent weeks. And reports from retailers suggested notable improvements in the sector, paced by strong gains at automobile dealerships. As in recent reports, commercial builders continued to see steady improvements in business conditions, while residential builders reported a more mixed economic environment. At the District's banks, loan demand was steady to slightly increasing. And demand for trucking and shipping services continued to be strong, after slowing slightly through the early spring.

Growth in most materials prices moderated through the middle of July, though prices of petroleum-based products and concrete increased more sharply since May. Despite steady improvements in the economic environment in recent months, hiring continued to be modest in most industries. Nevertheless, staffing-services companies reported an increase in the number of job openings, especially for workers with specific skills, such as accountancy and information technology. Contacts at staffing-services firms also noted that these workers were in shorter supply than in the recent past.

Manufacturing

Through the six-week period ending in mid-July, production at most District durable goods facilities remained steady, and above the levels of this time a year ago. While inventories were generally reported to be at acceptable levels, more firms cited excessive inventories than was true at this time last year. Nevertheless, most contacts reported that their new orders had risen in recent weeks, and accordingly, they expected production levels to rise throughout the remainder of 2005.

Activity at the District's steel facilities, however, has not been as strong. Contacts cited weaker demand from firms in commercial construction and in automobile and appliance production as part of the explanation for recent declines. These developments have led to larger-than-desired inventories and, along with an increase in imported steel, have pushed prices down for some steel products on the order of 40% from fourth-quarter 2004 levels. Regarding another important District industry, production at automobile assembly plants continued to be above year-ago levels in June, despite some domestic auto producers' recent production cuts.

Among nondurable good producers, production was generally characterized as steady or rising, both relative to earlier in the year and to this time last year. According to most contacts, the current pace of new orders suggests steady gains in production through the rest of 2005. While most manufacturers reported that their input costs were flat or falling for the six weeks through the middle of July, costs generally continued to be above year-ago levels, and firms with petroleum-based products as important inputs reported that their input costs rose in recent weeks. Several contacts from durable goods firms reported that their companies were able to successfully increase prices in June and early July. Hiring continued to be limited among most manufacturers, and while durable goods producers generally did not anticipate any significant changes to their capital spending through the end of 2005, several nondurable goods contacts noted that they planned to upgrade equipment, in some cases to improve the energy efficiency of their capital stock.

Retail

After a lull in the spring, which coincided with an increase in gasoline prices, sales for District retailers improved in June and through the first half of July. Typically, retailers reported that their sales were consistent with expectations, though warmer weather may have helped to improve traffic. By segment, several specialty apparel stores, particularly those catering to teens, saw strong year-over-year sales gains. Department stores also saw solid year-over-year increases in sales, despite reporting declines throughout much of 2005. In general, attitudes among retailers were characterized as cautiously optimistic, especially regarding the upcoming back-to-school selling season. Few firms reported using an abnormal amount of discounts or other incentives to attract shoppers.

Automobile sales were strong across the District in June and through the early part of July. Contacts reported that the recent employee-discount pricing policy introduced by General Motors (GM) led to dramatic year-over-year sales gains. Interestingly, respondents reported that the promotion not only benefited GM, but also other automakers by drawing would-be buyers to dealerships. Other automakers have since moved to mimic GM's employee-discount pricing policy, which has been extended through the end of July.

Construction

The slightly weaker business conditions that homebuilders have reported since early spring continued to prevail throughout the District. In the six-week period through the middle of

July, most homebuilders reported that their sales were slightly weaker than anticipated, although activity levels varied from market to market. Most homebuilders do not expect conditions to change markedly through the remainder of 2005. Regarding costs, outside of isolated increases in specific materials, such as cement and concrete, materials costs remained relatively flat. Labor costs have also stayed steady, though some subcontractors in specific trades have been less available because of increases in nonresidential construction. New home prices have tended to be flat for the most part across the District.

Nonresidential builders continued to report more growth than their counterparts in residential construction, with contractors typically seeing increases in year-over-year sales. As with residential builders, materials costs were generally seen as stable, though isolated increases were reported for concrete and petroleum products. Builders noted that these cost increases were difficult to pass through to prices, which have remained relatively stable. With respect to specific sectors, contacts reported an increase in demand from firms in the manufacturing sector. Finally, builders generally noted that their orders backlogs had increased, which was typically taken as a positive sign for the future.

Trucking and Shipping
Demand for trucking and shipping services in the District remained steady at a high level in June and July, after a period of weaker demand that ended in early spring. While rising fuel costs continued to be offset through surcharges, contacts noted that these increases were still affecting their margins as a result of truck operations that cannot be billed to clients. Prices, nevertheless, remained relatively stable in recent weeks, as did wages, despite continuing complaints of a driver shortage.

Banking
Conditions at commercial banks in the District were little changed for the six-week period ending in mid-July. Loan demand was steady to slightly increasing at institutions in the District among both commercial and consumer clients. In addition, demand from commercial clients was broad-based, with no specific industry identified as driving demand. For consumer clients, though mortgage demand was down slightly, the demand for home-equity loans remained robust. Most contacts reported an increase in core deposits, and credit quality continued to be strong, with some contacts indicating that their charge-offs and delinquency rates were at unusually low levels.

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Fifth District--Richmond

The Fifth District economy expanded at a quicker pace in the weeks since our last report as growth in the services sector edged up. District services businesses reported moderately higher revenue growth in June and early July. Retail sales gained momentum throughout the period, boosted by brisk automobile and light truck sales in recent weeks. District manufacturing activity edged lower in June but strengthened substantially in the first half of July. District real estate agents continued to report robustness in housing markets and relatively strong demand for office and retail space in the commercial sector. In the financial sector, bank lending moved moderately higher as demand for residential mortgages strengthened. When asked about prices, most of our business contacts responded that price pressures remained generally mild. In agriculture, remnants of two tropical storms brought substantial rainfall to the District in July, helping to alleviate dry soil conditions and boost crop and pasture conditions.

Retail
Retail sales rose at a moderate pace in the weeks since our last report. Automobile and light truck sales, which languished in the spring, picked up in June and the first half of July. Furniture sales also strengthened in recent weeks--a manager at a department store in North Carolina noted that customer response to an expansion of the store's furniture product line had been "very positive." In addition, other retailers generally reported higher shopper traffic and big-ticket sales in early July. District bookstores noted particularly brisk customer traffic in mid July in advance of the latest release in the Harry Potter series of children's books. Retailers reported that their hiring picked up in June but eased in the first two weeks of July. Retail price growth was moderate in both months.

Services
District services firms reported stronger revenue growth since our last report. Contacts at business-to-business firms in central West Virginia and at financial services firms in Richmond, Va., and eastern North Carolina told us that customer demand rose at a quicker pace in recent weeks. In contrast, most contacts at healthcare facilities in the District said demand, while strong, had shown little additional growth. Services sector firms reported moderate increases in hiring and noted that information technology workers, truck drivers, and registered nurses were more widely sought. Prices in the services sector rose at a moderate pace in June and July.

Manufacturing
District manufacturing activity softened in June but picked up the pace in early July. Manufacturers told us that shipments, new orders, and capacity utilization expanded at a solid clip in July. Manufacturers in the electronics, food, and plastic products industries reported particularly strong growth in output during the month. A plastics manufacturer in North Carolina, for example, reported being "very busy right now...We have some good new orders in-house and pending, so I'm optimistic about the next few months." Despite higher output, manufacturing employment continued to drift lower. Textiles firms, in particular, said they continued to trim payrolls. District manufacturers told us that raw material price increases eased in June and July and that prices for final goods manufactured rose only modestly.

Finance
District bankers said lending activity rose at a moderate pace in June and early July as demand for residential mortgages picked up. A mortgage lender in Greenville, S.C., told us that residential mortgage applications and closings in his office in June were the best this year, and that while the year started off slowly, they were now "turning the corner." Several lenders said that the pickup in mortgage lending was due in part to uncertainty regarding future mortgage interest rates--borrowers were committing to mortgages now in anticipation of higher interest rates ahead. Commercial lending activity was little changed. A commercial banker in Richmond, Va., reported "a lot of renegotiation of existing loans, but little new business" in recent weeks. A lender in Charlottesville, Va., told us there were new loans in the pipeline, but noted that many of his commercial clients appeared reluctant to draw down their lines of credit until business strengthened further.

Real Estate
While a few residential real estate agents reported somewhat slower growth in home sales,

most told us that both home sales and prices strengthened since our last report. Housing markets in Virginia were particularly robust; a Richmond agent reported "great" home sales in July, while a contact in Virginia Beach said he had never seen a stronger market. Residential real estate markets in the Washington, D.C., metropolitan area showed continued strength as well, although the pace of activity was not as frenzied as in the spring. An agent in Washington, D.C., said that multiple offers on homes for sale were still common, and that condominiums selling for prices in excess of $500,000 were moving particularly well. A contact in Fredericksburg, Va., however, noted that while the market there remained busy, it was taking "maybe a bit longer to sell properties." Real estate agents in several towns in the Carolinas said that housing markets were generally stable; a Greenville, S.C., agent said there were lots of homes on the market and they were being sold relatively quickly. House prices continued to move higher in most areas of the District.

Commercial real estate agents reported little change in Fifth District leasing activity in June and early July. Demand for office and retail space remained strong in most areas but the onset of summer vacations made closing deals a little more difficult. "There is still a lot of business going on out here; it just takes a little longer to get stuff done when summer rolls around," noted a contact in Columbia, S.C. Despite robust demand for lease space and investment properties, agents said that price increases for both had begun to moderate during the last six weeks, and most contacts said they expected only modest increases in rents in the near future.

Tourism
Tourist activity was somewhat stronger in recent weeks. Hoteliers along the coast reported solid bookings for July. A contact at Myrtle Beach, S.C., noted that hotel bookings were particularly strong around the July 4th holiday. In addition, July 4th holiday celebrations attracted lots of visitors to the nation's capital--the city's Metro subway ridership on the holiday was about 25 percent higher than a year ago. Tourism officials noted that the return of professional baseball to Washington, D.C., had also boosted tourism in the city.

Temporary Employment
Temporary employment agencies in the District reported continued strong demand for workers since our last report. Warehouse, production, sales, administrative, and software skills in particular were widely sought. A Raleigh, N.C., contact told us that renewed confidence in business growth strengthened demand for his agency's services. An agent in Baltimore, Md., said that he expected demand for services to rise further in coming weeks, and noted that he was seeing better qualified applicants for temporary positions.

Agriculture
Remnants of tropical storms Cindy and Dennis brought much-needed rainfall to crops and pastures in the Fifth District in early July. While some eastern parts of the District remained generally dry, substantial rainfall greatly improved soil conditions and yield prospects for corn and soybeans, and "greened-up" pastureland in most of the District. Heavy rains in South Carolina, however, caused some flooding and damaged crops in low-lying areas. On a brighter note, small grain harvesting neared completion in the Carolinas, and peach crops in Maryland and South Carolina remained in good-to-excellent condition.

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Sixth District--Atlanta

Most Sixth District business contacts reported that the pace of economic activity remained solid during June and early July. Disruptions from recent tropical storms along the Gulf Coast are expected to have only a limited impact on overall economic activity. Retail sales were up modestly from last year, and vehicle sales benefited from new price discounts. Housing markets remained at robust levels, although some slowing in activity was noted in several Florida markets. Improvements continued in commercial real estate markets. Reports from manufacturers were generally upbeat and most reports on tourism and business travel were quite positive. Loan demand remained strong, especially in the housing segment, although some lenders noted concern about the pace of condominium development in South Florida. Contacts reported that labor markets improved, and shortages continued in construction-related trades in several parts of the District. Price increases were reported for industrial commodities, building products, energy-related goods, and healthcare.

Consumer Spending

Reports on retail sales during June and early July were generally positive. Most contacts indicated that sales were up modestly from a year ago and were in line with expectations. Inventories were described as balanced. Higher gasoline prices did not appear to be having a significant impact on non-gasoline retail sales overall, although some discount retailers noted reduced spending per customer. Building supply and home improvement stores in Florida benefited from a two-week tax holiday in early June on hurricane-related supplies. Most contacts said they expect sales to rise slightly in the third quarter compared with last year.

District vehicle sales improved in June. Several contacts cited a new round of price discounts by domestic suppliers as boosting traffic and sales. Demand for foreign brands remained strong.

Real Estate

Home construction and sales in the District remained at high levels during June and early July, although some deceleration was noted in a few Florida markets. Realtors reported that sales in June rose slightly compared with last year, while reports from builders were more mixed. Shortages of homes for sale continued to be a problem in Florida, and some builders noted a shortage of available land for development. Several Florida builders indicated that labor shortages were an additional restraining factor. Overall, builders expect new home construction to increase in Florida and remain steady throughout the rest of the District in the second half of the year. Early reports on Hurricane Dennis suggest that structural damage was not as widespread as last year, but repairs may add to backlogs for many contractors.

Solid improvements continued to be noted in commercial real estate markets across the District as expansion plans and new projects moved forward. Contacts noted that office vacancy rates remain elevated on several markets but are generally trending lower.

Manufacturing and Transportation

Reports from the factory sector were positive. Production of building products, lumber and gypsum board, and cement remained at high levels because of strong residential construction. Manufacturing activity in defense-related industries continued to be strong. A large refinery in Mississippi announced plans for an expansion to increase production by about 25 percent. Contacts in manufactured housing, machine tool, heavy truck, and electrical equipment sectors also cited healthy levels of activity. Paper and packaging production was mixed; "away from home" paper products were selling well, while shipments of packaging material were off from levels seen earlier in the year. Hurricane Dennis reportedly resulted in the temporary shut-in of some oil and natural gas supplies in the Gulf.

Most District transportation contacts reported good freight demand through mid-year, although some noted a slower pace than earlier in the year. A shortage of qualified drivers continues to be a concern for many trucking companies.

Tourism and Business Travel
Despite the early start to the tropical storm season, most reports on tourism and business travel were positive. In addition, most contacts indicated that high fuel prices were not having a significant impact on travel overall. Tourist activity in South Florida was very strong, and the prospects for the remainder of the summer season were positive. Miami hotels reported high demand with record occupancy and increased room rates. Theme park contacts stated that they were enjoying a strong summer, with attendance ahead of last year's pace, and Orlando area hotels noted high occupancy levels. Reports from Tennessee destinations and the Mississippi Gulf Coast were also upbeat. Convention business in Atlanta, New Orleans, and Orlando improved.

Banking and Finance
Financial conditions in the Sixth District remained stable. Loan demand remained strong in most areas, but concerns about the possibility of excessive condominium construction in parts of Florida were noted by several contacts. Asset quality remained high.

Employment and Prices
Reports suggest that labor markets tightened in some sectors and temp hiring increased in June and early July. For instance, a contact at a large temporary staffing company said that their business was extremely strong and that the company was starting to see shortages of both skilled and unskilled labor in several sectors.

Prices for lumber and other building products as well as several industrial commodities continued to drift higher, and most businesses have reportedly been able to pass on some of these increases to their customers. Rising energy prices and healthcare costs continued to be noted by most contacts.

Agriculture
Tropical storm Cindy and Hurricane Dennis caused only limited damage to regional crops. Crop conditions for cotton and peanuts were favorable, according to recent USDA reports. Florida contacts noted that citrus canker continued to be found throughout the Indian River Citrus District.

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Seventh District--Chicago

Economic activity in the Seventh District continued to expand at a moderate pace during June and early July, though activity in Michigan lagged. Consumer spending increased modestly during June, as did business spending and hiring. Construction and real estate activity was quite brisk in much of the District. The manufacturing sector continued to expand at a solid pace. Mortgage lending kept pace with home sales, while commercial loan demand increased modestly. Overall cost and price pressures remained moderate. The drought expanded and has now affected all of the District' states, contributing to a rise in corn and soybean prices.

Consumer spending
Consumer spending increased gradually during June. One area retailer attributed most of the pick-up to better weather during the month, adding that consumers seemed more focused on buying "needs-based" goods rather than discretionary items. Apparel sales were said to be strong. Retail inventories were slightly higher. Auto sales in the District increased in line with national trends, though one contact thought the new employee discount marketing programs did not benefit sales in the Detroit area as much as in other areas. One auto dealer in northern Indiana said sales in early July slowed to a more average pace. Tourism spending continued to increase steadily, with reports of increased demand for hotel rooms in Chicago and Michigan.

Business spending
Business spending continued to expand at a modest pace. Several contacts noted that they had increased capital spending as planned, and others reported that the investment climate remained positive. Trucking volumes held steady through the end of the second quarter. One trucking contact said that an inventory correction among their retail customers had restrained activity, but overall conditions in the shipping industry remained good. A Wisconsin utility reported a rise in power demand during the first six months of the year. Labor market conditions improved slightly overall, but conditions varied by location and industry. Job markets in Wisconsin and Indiana were better than those in Michigan. Hiring in the banking, trucking, and distribution industries reportedly increased. By contrast, layoffs were reported by pharmaceutical and auto-supply firms.

Construction/real estate
Construction and real estate activity was quite brisk in many of the District' markets during June and early July. Residential real estate markets remained active, with reports of more homes going on the market in Milwaukee and a solid pace of condo conversions in Chicago. Homebuilders in Wisconsin added incentives to help boost interest in some new properties. One homebuilder noted a decline in sales in metro Detroit but stronger activity in Indiana and Illinois. The news on commercial real estate was more positive than that of the previous reporting period. Contacts described commercial activity as "busier than normal" and "fast paced." However, activity in Michigan was slower than elsewhere in the District, and there were reports of weakness in office markets in a number of locations. Commercial occupancy rates and rents were stable on balance, though one contact was adding incentives to attract new clients to some properties.

Manufacturing
Manufacturing activity continued to expand at a solid pace in the District during June and early July. Automakers reported a slight pick-up in sales in the first two weeks of July and expected sales for the month to be higher than June. Light truck sales were stronger than car sales, and one contact felt that the new incentives were offsetting consumers' concerns about higher gas prices. Industry contacts revised up their sales forecasts for the year, but left production plans unchanged. Toolmakers reported a solid sales pace in June, and one added that early indications suggest that sales in July will be strong as well. Office furniture producers reported solid growth in domestic sales. Activity in the heavy equipment market continued to be brisk, with production increasing and backlogs remaining high. One contact in the industry noted that sales of construction equipment remained very healthy, though retail sales of small tractors had declined slightly in the U.S. and Europe, perhaps because of

drought conditions. Tire shortages were still limiting production of heavy equipment and heavy-duty trucks, though one contact said that a major tire maker was increasing capacity for large tires, potentially easing that constraint.

Banking/finance

Lending activity generally continued to increase during June and early July. Demand for home-purchase mortgages was solid. Refinancing was mixed by location, with a Chicago bank reporting a modest pick-up and a Michigan bank reporting little change. The mix between adjustable-rate and fixed-rate mortgages was stable. Business loan demand continued to increase modestly, led by strength in commercial real estate loans. Nonetheless, several bankers said that competitive pressures were lowering margins on commercial lending and resulting in easing standards and terms for such loans. Business credit quality remained in good shape with many firms flush with cash. One exception was the auto-supply industry, where many banks expressed concern about the financial health of their customers. One analyst reported that venture capital in the Chicago area increased for the first time since 2000, adding that there was "renewed excitement and enthusiasm" for investing in local technology start-ups.

Prices/costs

Overall cost and price pressures remained moderate. Higher material costs were noted for energy, resins, and some construction materials. Firms most directly affected by higher energy costs, such as those in trucking and air travel, said that they were able to offset most of the higher costs through surcharges and fare increases. However, one trucker noted that shippers who tried to raise rates too aggressively had lost customers. Manufacturers of heavy equipment, wallboard, and tools reported a new round of price hikes, though a heavy equipment maker reported some resistance to its increases. Reports of retail price increases outnumbered the reports of decreases. New car prices fell, not only for retail customers but also for corporate fleets. Wage gains remained modest overall, except in some skilled professions with shortages. With regard to costs for benefits, a large health insurance firm in Michigan announced plans to implement the smallest premium increase in a decade.

Agriculture

Crop conditions deteriorated in most of the District, contributing to a rise in corn and soybean prices. The drought expanded and deepened, despite some rainfall in early July. Illinois continued to be hit hardest, though at least part of each state in the District experienced drought conditions. In Iowa, crop development has been quite good, but some areas are at risk if they do not receive timely rains. District bankers were apprehensive about some farmers' poor risk management, especially with respect to inadequate crop insurance. Dairy farms generally did well in the reporting period, as milk prices increased. Livestock producers remained profitable overall, though cattle feeders were pressured by lower prices for cattle.

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Eighth District--St. Louis

Business activity in the Eighth District has continued to expand since our previous survey. Manufacturing activity increased in many industries, although several District manufacturers announced plant closings and workforce reductions. Contacts in the services sector continued to report increased economic activity. District retailers and auto dealers had mixed reports for

May and June compared with the same months in 2004. Home sales continued to increase in most of the District. Although commercial real estate markets remained soft, some areas showed signs of improvement. Lending activity at a sample of small and mid-sized District banks increased from mid-March to early June.

Manufacturing and Other Business Activity

Manufacturing activity in the Eighth District continued to expand moderately since our previous survey. Several manufacturers reported plant openings and expansions. Firms in the electrical equipment, machinery, furniture, and chemical industries announced plans to expand production capacity or open new facilities in the District. In spite of these reports, contacts in the fabricated metal product, leather product, food, and electronics industries announced plans to close plants or lay off workers. Several of these firms cited plans to move operations abroad because of increased foreign competition.

Activity in the District's services sector has continued to increase in most areas since our previous report. Firms in the freight transportation, utilities, leisure, and insurance industries reported plans to open new facilities and hire new workers. Contacts in the air transportation, tourism, administrative support, wireless, and Internet service industries experienced solid customer growth and high sales volume. Despite overall positive reports, contacts in the business software, real estate, and water transportation industries announced plans to lay off workers. District retailers generally reported increased sales in May and mixed sales in June compared with the same months last year. Discount and large retailer sales remained steady over the same period. Reports from District auto dealers were generally mixed. In some cases, price discounts led to increased sales growth. Inventories generally remained high. Used car sales were strong in May but slowed in June relative to May.

Real Estate and Construction

Home sales in the Eighth District have continued to increase. May year-to-date home sales were up 7.2 percent in Louisville, 5.8 percent in Memphis, 2.8 percent in Little Rock, and 1.0 percent in St. Louis compared with the same period in 2004. Residential construction conditions were mixed throughout the District. May year-to-date single-family residential permits were down 2.6 percent in St. Louis; down 8 percent in Owensboro, Kentucky; and down about 16 percent in Evansville, Indiana, and Jonesboro, Arkansas. In contrast, permits were up 7 percent in Louisville, 11 percent in Little Rock, and 1 percent in Memphis. Pine Bluff, Arkansas, continued its residential construction climb with May year-to-date permits increasing over 114 percent compared with the same period in 2004.

Commercial real estate markets have remained soft throughout much the District. The first-quarter industrial vacancy rate in Little Rock held steady at nearly 14 percent. Contacts indicated that the industrial and office sectors in Memphis have recently shown signs of improvement. In contrast, the first-quarter office vacancy rate in Louisville increased to 20.4 percent from 18.7 percent at the end of 2004. Contacts in northeast Arkansas reported little new activity in commercial construction, while contacts in northeast Mississippi reported that commercial growth has remained strong. Contacts have indicated that Louisville has several large construction projects on the horizon, and industrial development in DeSoto County, Mississippi, is on the rise.

Banking and Finance

Total loans outstanding at a sample of small and mid-sized District banks increased 2.2 percent from mid-March to early June. Real estate lending and commercial and industrial loans (with increases of 1.3 percent and 5.7 percent, respectively) contributed roughly 1 percentage point each to the rise in total loans. Loans to individuals fell 4.1 percent. All other loans, accounting for roughly 5.4 percent of total loans, increased 9.5 percent. Over this period, total deposits at these banks increased 0.6 percent.

Agriculture and Natural Resources
Since early June, most parts of the District have endured unusually dry conditions. As of mid-July, about 62 percent of the District's corn crop and about 72 percent of the soybean crop are rated in fair or better condition, while over 90 percent of the District's rice and cotton crops have reached that category. Nevertheless, corn and soybean crop development remain ahead of their five-year averages, while cotton and sorghum are on par with their five-year averages. Since June, pasture conditions have deteriorated throughout the District, and at least half of the pastures in Arkansas, Illinois, Kentucky, and Missouri are rated as poor or very poor. Every District state except Indiana has completed more than 95 percent of its winter wheat harvest.

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Ninth District--Minneapolis

The Ninth District economy displayed solid growth since the last report. Growth was evident in consumer spending, manufacturing, real estate, construction, tourism, agriculture, energy, and mining. Employment growth was evident since the last report, and contacts report difficulty finding skilled workers. Meanwhile, wages grew moderately. Significant price increases were noted in fuel and certain construction materials.

Consumer Spending and Tourism
Consumer spending showed solid growth. A major Minneapolis-based retailer reported same-store sales up 9 percent in June compared with a year ago. Sales were up between 5 percent and 10 percent from a year ago at a mall in North Dakota, and the first week in July was "huge," according to the mall manager. Recent apparel sales were described as outstanding at a mall in Montana. A Minneapolis-St. Paul area mall manager reported sales and traffic were up in the single digits for June compared with a year ago.

During the past couple of months, import car sales were about even with a year ago in Minnesota, while domestic brand sales were down. However, during the past few weeks, price discounts have helped boost domestic brand sales, according to a Minnesota auto dealer. New incentives also aided sales in North Dakota, according to a representative of an auto dealers association.

Summer tourism picked up by early July. In South Dakota, tourism activity started slowly in early June, but showed strength by early July, including strong attendance at Mt. Rushmore on the Fourth of July, according to a tourism official. Some resort owners and retailers in northwestern Wisconsin said they had the best Fourth of July weekend yet. A Montana tourism official said the summer tourism season so far has been good and is expected to continue. In Minnesota, tourism in June was steady or showing slow growth compared with last year, according to an official. Business travel is growing after several years of decreases, a particular boost to Minneapolis-St. Paul area hospitality businesses.

Construction and Real Estate
Overall, construction grew since the last report. In June, housing units authorized were up 5

percent for the Minneapolis-St. Paul area from a year earlier, which indicated a recent spike after a slow start to the year's building season. The value of newly permitted residential and commercial construction projects in Rochester, Minn., was up significantly in June from last year; however, the number of permits issued was down 12 percent from last year. Bank directors from North Dakota and Montana described residential and commercial construction as busy.

Real estate showed signs of increased activity. Commercial markets were picking up. Office and industrial sales for 2005 in the Minneapolis-St. Paul area are forecast to reach $1.4 billion, compared to $1.2 billion for last year. Office vacancy declined throughout Minneapolis-St. Paul, with industrial absorption at its highest levels since 2000. Developers in Marquette, Mich., reported that commercial and retail vacancy rates were down dramatically. Residential real estate markets were solid. There is practically no inventory in the parts of Montana and North Dakota experiencing an oil boom. Bank directors from North Dakota and Montana reported home prices up by 8 percent to 10 percent, with increases as high as 20 percent in oil-rich areas. June home sales in Minneapolis-St. Paul were down 4.4 percent from last year, but remained at a high level with prices up 5 percent and pending home sales up 3.2 percent.

Manufacturing
Manufacturing activity expanded. A June survey of purchasing managers by Creighton University (Omaha, Neb.) indicated increased manufacturing activity in Minnesota and the Dakotas. In northern Minnesota, a paper mill and a metal processing plant are planning to expand. In western Wisconsin, a furnace company plans to build a new production facility. However, a foundry in North Dakota recently shut down and a maker of semiconductor testing machines in Minnesota plans to reduce production.

Energy and Mining
Activity in the energy sector was up slightly, and increased in the mining sector. A refinery in Montana plans to invest $325 million to upgrade its facilities. Several wind energy farms and three ethanol plants are under construction in district states. Oil and gas exploration and production were about level from early June through early July. Mines across the district are producing at near full capacity, and maintenance activity is occurring without the usual complete shutdowns. Expansions at several mines are in the permitting stage, and exploration activity is in full swing across the district.

Agriculture
Economic activity in the agricultural sector increased. Warm, dry weather aided crop development in the district. Yields and production for the South Dakota winter wheat crop are up from a year ago. In Montana, 84 percent of the winter wheat crop is rated good to excellent, significantly above the five-year average of 36 percent. Row crop progress increased rapidly during the first half of July. The U.S. Department of Agriculture projects corn prices in 2005/06 to average $1.70 to $2.10, up 15 cents on each end from last month's projection. The USDA also increased its price projections for soybeans and expects cattle and dairy prices to remain at strong levels. However, the Montana sweet cherry crop is forecast to decrease 45 percent from last year.

Employment, Wages, and Prices
Employment growth was evident since the last report, and contacts noted difficulty finding workers for some jobs. In Montana, a recently reopened copper-and-silver mine has hired

150 employees, while another mine has hired 50 more workers. In South Dakota, construction recently began on a cooling system and heat exchanger plant that will eventually create 150 jobs, and a new filter production line recently created 26 jobs. A health insurance group recently reported it will hire 100 more workers in Minnesota. A temporary employment agency in the Minneapolis-St. Paul area noted that demand was up from three months ago, particularly for specialized jobs such as accounting and human resources. A bank director in northeastern Montana reported that available contractors and carpenters are hard to find. Some bankers in the Minneapolis-St. Paul area recently noted a short supply of quality commercial banking professionals. A temporary staffing agency survey of Minneapolis-St. Paul businesses found that 24 percent of respondents expect to increase employment during the third quarter of 2005, while 9 percent expect to make reductions.

Employment reductions included a boat producer in Minnesota that laid off about 145 workers due to slow demand. Restructuring at a Minnesota-based travel company will affect about 200 jobs in the state.

Wage increases were moderate. A county board in northern Wisconsin recently passed pay raises of 3 percent per year over three years for highway, forestry, and sheriff's department employees. According to a recent survey of businesses by the *St. Cloud Area Quarterly Business Report*, 44 percent of respondents expect to increase employee compensation by November 2005; 53 percent expect no change in compensation levels.

While overall price increases were moderate, significant price increases were noted in fuel and certain construction materials. Mid-July gasoline prices in Minnesota were 42 cents higher than a year ago, while recent jet fuel prices were 56 percent higher and diesel fuel was 64 percent higher than last year. Recent price increases were noted for some construction materials, including asphalt, concrete, and roofing materials. However, steel prices have softened since the last report.

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Tenth District--Kansas City

The Tenth District economy expanded solidly in June and early July. Non-automotive retail sales posted further gains, auto sales improved sharply, and labor markets continued to firm. Manufacturing activity also grew moderately, and commercial real estate activity improved. In addition, energy activity remained strong, and agricultural conditions were positive. Residential construction edged down, but housing activity remained solid overall. Price pressures eased slightly at both the wholesale and retail levels, while wage pressures remained moderate.

Consumer Spending
Consumer spending in the district continued to increase in June and early July. Most retailers, mall managers, and restaurants reported solid year-over-year increases in activity, with sales generally at or above plan. Sales of electronics, appliances, and outdoor furniture were characterized as strong, while sales of home improvement items, hardware, and indoor furnishings were said to be weak at some stores. Many stores reduced inventories since the last survey, and most managers were satisfied with current stock levels. Nearly all store managers were optimistic about future sales. Auto dealers reported strong vehicle sales since the last survey, driven largely by new price discounts from manufacturers. The increased

activity pushed sales above year-ago levels at many dealerships. The strongest sales were reported for new trucks and fuel efficient cars, while sales of used vehicles and large SUVs were characterized as weak by some dealers. Most dealers expect sales to remain strong in the months ahead. Travel and tourism activity in the district increased strongly in June and early July. Most hotels reported occupancy rates were up from both the previous survey and a year ago, and nearly all tourism contacts expect further increases in activity in coming months.

Manufacturing

District manufacturing activity expanded moderately in June and early July. Many plant managers reported increases in production, shipments, and orders since the previous survey, and some firms added workers and hours. Growth in capital spending remained strong at most plants. Plant managers said materials were generally available, although petroleum-based materials were reported to be scarce in some areas. Expectations for future factory activity remained solid, and many plants plan further additions to their workforces.

Real Estate and Construction

Housing activity remained solid in June and early July despite some easing in construction, and commercial real estate activity improved further. Most builders reported that housing starts edged down and were slightly below year-ago levels. However, new home construction was still generally characterized as strong. Builders reported few difficulties obtaining materials and most do not expect problems heading forward. Home starts are expected to remain steady in the months ahead. Real estate agents reported home sales increased slightly from both the previous survey and a year ago. Home prices were up moderately from a year ago in most cities. Real estate agents expect home sales to continue to rise in coming months, while home prices are expected to level off in some cities. In a few cities, purchases of homes for investment purposes were reported to be putting downward pressure on home rental rates. Mortgage lenders reported an increase in demand for both new home purchase loans and refinancings since the previous survey, and they expect demand for new home mortgages to rise further. Commercial real estate activity in the district improved further in June and early July. Vacancy rates edged down in several markets, and prices for office space were up moderately in some cities. Some commercial real estate agents expect activity to continue to increase in the months ahead.

Banking

Bankers report that loans and deposits both increased slightly since the last survey, leaving loan-deposit ratios unchanged. Demand rose moderately for commercial and industrial loans and edged up for home mortgages, residential construction loans, and commercial real estate loans. Demand for consumer loans was unchanged. On the deposit side, all types of accounts increased slightly. All respondents increased their prime lending rates since the last survey, and almost all respondents raised their consumer lending rates. Lending standards were generally unchanged.

Energy

District energy activity remained strong in June and early July. The count of active oil and gas drilling rigs in the region was basically unchanged from both the previous survey and a year ago. Several contacts continued to cite constraints on drilling due to rig shortages and regulatory factors. In order to increase drilling heading forward, some rig operators in the district placed orders for new rigs to be delivered later this year, including some that are being shipped from China. One large rig operator also plans to begin producing some of its own rigs. In addition, a few energy firms are proposing to test new drilling techniques in Wyoming next winter designed to reduce impacts on the environment.

Agriculture
Agricultural conditions remained generally positive in June and early July. With the winter wheat harvest nearly complete, overall yields were slightly better than a year ago. Corn and soybean crops were also reported to be in good to excellent condition across the district. On the negative side, some contacts said higher energy prices were boosting irrigation costs. In the livestock market, a seasonal rise in U.S. cattle supplies and the announced resumption of live cattle imports from Canada have placed some downward pressure on cattle prices.

Labor Markets and Wages
Labor markets in the district firmed further in June and early July, but wage increases remained moderate. Hiring announcements exceeded layoff announcements by a considerable margin, and several military bases in the district learned they will be adding considerably more personnel than originally announced in May. The percentage of contacts experiencing labor shortages increased somewhat from the previous survey, with most of the shortages reported for either low-skilled or high-skilled workers. In addition, several contacts noted an increase in help-wanted advertisements in their areas. However, the share of firms reporting wage pressures remained moderate, lower than before the last recession but higher than a year ago. Some contacts expect wage pressures to increase slightly in the months ahead.

Prices
Price pressures eased somewhat at both the wholesale and retail levels in June and early July. The share of manufacturers reporting materials price increases continued to fall, and most users of steel reported price declines. On the other hand, prices for many petroleum-based products rose. The share of manufacturers raising output prices also fell slightly, and fewer plant managers than in previous surveys expect materials prices and output prices to rise in the months ahead. However, the share of firms planning to raise prices remains relatively high by historical standards. Most builders reported increased costs for materials, especially for plywood, and expect further increases heading forward. Retailers generally reported flat selling prices in June and early July after reporting slight price increases in the previous two surveys. However, a number of stores plan to raise prices on some products in the months ahead.

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Eleventh District--Dallas

Eleventh District economic activity strengthened from late May to early July, driven by strong construction- and energy-related activity. Many contacts expressed increased optimism about the economic outlook, noting surprise that activity had strengthened more than they had expected. Manufacturing and service sector activity was up. Retail sales increased. Contacts say real estate investment is very strong. There has been a pickup in all types of construction and real estate activity, leading to a very hot housing market and construction of speculative office space in the Dallas area. The financial sector continued to report solid loan growth and good credit quality. Hot, dry weather hurt agricultural conditions.

Prices
Energy prices were higher than during the last survey period. Strong demand pushed up crude oil prices. Pump prices for gasoline and diesel fuel were also higher. Exceptionally strong demand for diesel raised concern about the refinery system's ability to build inventories for next winter. Natural gas prices have risen along with crude prices, helped by warmer-than-normal temperatures in the South. Despite high temperatures, natural gas inventories remained 12 percent above normal for this time of year. Refinery margins on the Gulf Coast remained very strong throughout June, about the same as May and better than $3.50 per barrel higher than last June. Prices for energy services were sharply higher.

Most contacts expressed concerns about rising freight, fuel and utility costs. Transportation firms said they are passing these costs on to customers as much as possible, and even airlines have been able to raise fares. The ability of manufacturers and retailers to push through price increases remained mixed, however.

Strong demand pushed up prices for cement and most other construction-related materials. Selling prices were lower for scrap steel, nickel, and aluminum. Excess inventory led to price declines for a variety of basic chemical and plastics products, but increased orders and unplanned outages were helping inventories adjust and prices stabilize.

Labor Market
The labor market continued to strengthen, with more reports of hiring, employees being bid away and scattered problems hiring skilled workers. Only a few industries noted any significant wage pressures, notably accounting firms and the energy industry.

Manufacturing
Manufacturing activity increased, with very strong demand for most construction-related and energy-related manufactured products. Very strong demand for cement has led to shortages in Texas, and inventories are rapidly depleting--despite manufacturing plants working at capacity. Some producers said they imported cement from abroad to keep up with demand. Producers of clay, brick and glass continued to report robust demand. Demand for fabricated metals has been good and steadily improving, spurred by particularly strong sales for highway and commercial construction. Demand for lumber was above last year's pace.

Respondents in high-tech manufacturing said sales and orders continued to grow at healthy rates since the last survey. Industrial demand for semiconductors has picked up in the past six weeks. Apparel producers say demand has been decreasing due to import competition, which has resulted in another plant closure. Sales of primary metals have cooled from very strong growth earlier this year, and producers continued to report increased import competition. Inventories are higher than desired for some metals but are being pared down.

Chemical producers continued to struggle through a patch of weak demand. Sales to Asia have slowed. There was some improvement in orders in late June, which contacts said was an early indication that demand was stabilizing. Refinery capacity utilization averaged rates near 98 percent in the District, higher than the U.S. average.

Services
Activity in the service sector picked up slightly. Temporary staffing firms said demand edged up over the past six weeks. Transportation firms also reported an increase in demand. Legal firms reported no change in demand. Demand continues to be strong in the accounting sector,

keeping pace with last year's strong growth.

Retail Sales

Retailers report that sales growth has been stronger than expected, and early signals suggest a healthy back-to-school season. Contacts thought high oil and gasoline prices would restrain growth, but reported that consumers have kept spending, and there has been no deterioration in bad debt portfolios. Auto dealers also reported a pick up in sales growth. Contacts noted some uncertainty because they said sales were being stimulated by manufacturer price reductions, and the underlying market is not strong.

Construction and Real Estate

Contacts say real estate investment is extremely high in part because the District's competitively-priced markets are attracting investment capital from more expensive coastal markets. Construction of new homes picked up over the past six weeks. Demand is strong, and sales are ahead of this time last year. With few regulatory or land development constraints, the supply of new homes has been sufficient to meet demand, and prices are not increasing faster than inflation. Existing home sales in major metropolitan areas remained above last year's record levels, but sales growth was less robust than earlier this year and some contacts expressed concerns about rising inventories.

Demand for apartments rose over the past six weeks. Contacts noted an upturn in market conditions with occupancies tightening in Dallas and Austin, and rents rising modestly. Apartment construction continued to be at high levels in Dallas, Houston and San Antonio, and developers remained optimistic that conditions will continue to improve. Several high-end condo and town-home projects are slated to break ground in Dallas, and contacts noted that most are at least 60 to 70 percent pre-leased.

Office markets also continued to improve. Occupancy rates increased, although they are still low in comparison with other parts of the country. Contacts say rents are "firm" to "rising." There is limited office construction activity in Houston and Austin, but speculative space is being developed in the Dallas area. Industrial activity is also picking up, especially near the Port of Houston. Hotel markets are "hot."

Financial Services

Loan growth remained solid, according to contacts, who said that there has been a pickup in consumer auto loans as a result of an increase in purchase incentives. Credit quality was still good. The banking environment is very competitive, they said, particularly for large, commercial loans.

Energy

Drilling activity continued to expand. The rig count increased, and contacts say the outlook for future drilling activity has picked up. Oil service companies reported extremely strong demand, limited capacity, and strong pricing power. Service firms say they are turning down work and have expressed more willingness to expand capacity, given current pricing and the potential durability of this drilling cycle. Expanding manufacturing capacity for oil field equipment poses few barriers, but finding qualified engineers and training crews is difficult and time consuming. Technical skills will increasingly have to be found abroad, they say.

Agriculture

Dry weather has reduced yields and increased the cost of production. Irrigated land crops remained in fair condition but the outlook for dry land crop yields worsened. Range and pasture conditions also deteriorated substantially since the last report, and hay production has been very limited. Corn producers expressed concern about aflatoxin.

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Twelfth District--San Francisco

The Twelfth District's solid economic expansion remained on track during the survey period of early June through mid-July. Price inflation for final goods and services moderated somewhat. Labor markets tightened further and an increasing number of employers relied on incentive compensation to meet recruiting challenges. District retailers and service providers reported sales gains, and growth in manufacturing activity picked up following a slight lull during the previous survey period. Demand rose further for District agricultural and resource-related products. The pace of home sales and price appreciation remained rapid but slowed slightly in some markets, while demand for commercial real estate continued to improve. District banks reported strong loan demand and good credit quality.

Wages and Prices
Contacts reported modest inflationary pressure on net in recent weeks. Energy costs rose significantly, increasing prices of production inputs for which energy costs are a significant component, such as transportation services, fertilizers, and some construction materials. However, contacts in most sectors noted that pricing power for final goods and services remained muted more generally, citing vigorous competition from domestic and foreign producers and continued gains in production efficiency as restraining factors.

Demand for labor increased, and District labor markets tightened further. The most significant recruiting and retention challenges were reported for skilled occupations in the financial, construction, information technology, and health-care services sectors. Contacts in the agricultural, retail, services, and financial sectors reported substantial reliance on temporary workers to meet demand. Although wage growth generally remained in the modest range of 2 to 4 percent, contacts in several areas reported rising use of incentive compensation, including signing bonuses to attract qualified workers. Employer costs for health insurance benefits remained on a relatively steep upward trajectory, causing total compensation to rise more rapidly than wages and salaries. Looking ahead, about one-third of respondents plan to increase their pace of hiring for permanent staff during the second half of 2005 compared with the first half, and virtually none plan to reduce their pace of hiring.

Retail Trade and Services
District retail sales expanded during the survey period. Automobile sales climbed substantially, as demand remained strong for imported makes and purchases of domestic makes surged in response to price discounts by manufacturers. Sales of apparel and other small retail items also rose, and prices for these items generally were flat or fell because of extensive discounting.

District service providers reported a substantial increase in demand on net. Sales were robust for providers of food, transportation, and health-care services. Contacts reported continued strong growth in tourist visits to key destination states such as Hawaii, California, and Arizona, with further increases in hotel occupancy rates and average daily room rates noted.

Manufacturing
Demand for District manufactured products picked up a bit, following a mild slowdown

during the previous survey period. Orders and sales of semiconductors and other technology products generally remained at high levels. Makers of machine tools and industrial equipment reported that demand expanded and was particularly strong for small and medium-sized capital equipment items. Demand for commercial aircraft and defense products grew further, and makers of these items reported ample capacity to accommodate a rising number of new orders. Manufacturers of certain construction materials, notably wallboard and roofing products, have expanded capacity to meet booming demand, and sales of these products have increased commensurately.

Agriculture and Resource-related Industries
Orders and sales of District agricultural and resource-related products grew further during the survey period of early June through mid-July. Demand was strong and prices generally were stable for dairy products and most fruits and vegetables, particularly for items filling market niches, such as organic foods. Cattle sales and prices remained high, with little or no adverse impact from recently renewed fears about the BSE ("mad cow") virus. In the energy sector, producers of oil and natural gas continued to operate at or near full capacity, and extensive new drilling is underway to help meet steadily growing demand.

Real Estate and Construction
Demand and sales of residential real estate remained vigorous in most parts of the District, and demand for commercial real estate continued to improve. The pace of home sales, price appreciation, and construction was rapid in most areas, fueled in part by rising purchases of second homes and investment properties. The market reportedly heated up further in some areas, such as Seattle, but a few respondents reported evidence of slight cooling in parts of Southern California, where houses remained on the market longer and price appreciation slowed. Demand for commercial real estate strengthened further; office vacancy rates fell and rental rates increased in many District markets, with especially strong demand reported in Southern California. Growth in demand for residential and commercial properties kept overall construction activity at high levels throughout the District.

Financial Institutions
Contacts reported that loan demand was strong overall and credit quality remained good across all loan categories. The number of commercial and industrial loans rose, and demand for construction, commercial real estate, and home loans remained at high levels in most areas and grew further in some.

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