The Federal Reserve Board

The BEIGE BOOK

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Summary of Commentary on Current Economic Conditions by Federal Reserve District

Summary

Prepared at the Federal Reserve Bank of Minneapolis and based on information collected before August 29, 2005 and, thus, before Hurricane Katrina made landfall on the Gulf Coast. This document summarizes comments received from business and other contacts outside the Federal Reserve System and is not a commentary on the views of Federal Reserve officials.

Economic activity increased across the nation from mid-July through August, except in the Boston District, where activity was mixed. The growth was widespread as retail sales, services, finance, construction, manufacturing, mining, energy, and tourism all expanded. A few Districts reported softening in residential real estate markets, albeit from still brisk levels of activity, while commercial real estate markets strengthened in most Districts. Lending activity increased, and credit quality was stable. Conditions in the agricultural sector improved slightly, with late summer rains somewhat alleviating the effects of drought. Meanwhile, labor markets showed signs of tightening with modest wage increases. Except for energy, overall consumer price increases were modest. Most Districts reported significant price increases in certain commodities and energy products, especially gasoline.

Consumer Spending

Most Districts saw an increase in retail sales. Minneapolis described sales as improving and strengthening, while sales were above year-ago levels in the Atlanta, Boston, and St. Louis Districts. Kansas City, Richmond, and San Francisco variously described consumer spending as expanded, brisk, or solid. Meanwhile, retail sales were about level with a year ago in New York and Philadelphia, and consumer spending was mixed in Dallas and weak in Cleveland. Back-to-school sales were strong in Kansas City, but slow in Philadelphia. Several Districts reported that retailers expect sales to be negatively affected by higher fuel prices.

Vehicle sales were up in all Districts. Cleveland, Kansas City, Philadelphia, and San Francisco reported strong sales, and Atlanta and St. Louis described recent vehicle sales as rising or improved. Most Districts cited the effect of manufacturer discounts; however, Chicago and Dallas reported slower sales in August as "buyer fatigue" set in. Several Districts mentioned dealers' concerns that current high sales would come at the cost of lower sales in the near future. Atlanta, Minneapolis, and Richmond mentioned a shift in demand toward more fuel-efficient vehicles. A number of auto dealers indicated that inventories for new cars were low while stocks of used vehicles surged.

Tourism and Services
Tourism activity grew in most Districts. Atlanta, New York, Richmond, and San Francisco described tourism activity as strong, robust, or at high levels, while Kansas City and Minneapolis noted that activity increased from last year. Richmond noted that tourism in Washington, D.C., has recovered from September 11, 2001, and was on pace for a record year. The Chicago District reported that tourism in Michigan increased faster than expected, while Minneapolis observed that tourism in Michigan's Upper Peninsula was flat from last year. Several Districts noted that bookings were up and that activity was expected to increase for the remainder of the season.

Contacts in other service businesses also noted growth in activity. Dallas and New York noted increased demand for temporary staffing services. Trucking and shipping businesses in the Cleveland and Dallas Districts reported an increase in activity; however, freight volumes slowed in the Chicago District. Meanwhile, railroad traffic in the Dallas District was generally up, with decreases in chemical, car, and appliance volumes. Sales for software and information technology services in Boston were generally up.

Manufacturing
Manufacturing activity increased in all Districts except Boston and St. Louis, where activity was mixed. New orders and production were up over a year ago. Nearly all Districts noted increased activity across a broad range of industry sectors. Atlanta, Chicago, and Dallas reported strong production in construction-related products. San Francisco indicated strong demand for semiconductors and that orders increased at commercial aircraft and defense product firms. However, Atlanta and St. Louis reported that auto parts and motor vehicle industries experienced net declines in activity, and Boston reported declines in the textile industry. Rising material and energy costs were a common theme across most of the nation.

Real Estate and Construction
Residential real estate was strong, with signs of softening in some markets. Dallas, St. Louis, and San Francisco reported increased activity, with Kansas City, New York, Philadelphia, and Richmond all observing strong sales, but signs of cooling were evident. Atlanta reported sales above last year's levels in Florida, but demand was beginning to soften. Chicago, Cleveland, Kansas City, Minneapolis, and New York reported residential construction was still strong but down from last year, while St. Louis described it as lagging.

Overall commercial markets grew. Most Districts described conditions as improving from weaker levels. Commercial real estate markets were strong in the New York and San Francisco Districts. Commercial construction activity increased in Cleveland, Dallas, Minneapolis, and St. Louis and was mostly flat in Boston, Philadelphia, and Chicago.

Agriculture
Overall, agricultural conditions improved somewhat across most of the nation. Minneapolis reported generally strong conditions. Atlanta, Chicago, Dallas, and Kansas City reported that August rains lessened the impacts of drought. Highly variable crop yields were expected because of the drought damage that had already occurred. Meanwhile, Chicago, Dallas, Richmond, and San Francisco reported that agricultural producers were facing higher energy and other input costs. Prices for most agricultural commodities were solid; however, Kansas City reported some softening of cattle prices.

Natural Resources Industries

The energy and mining sectors remained generally strong. San Francisco reported energy operations were running at near full capacity. Dallas, Kansas City, and Minneapolis reported strong production, exploration, and capital investment in energy, with reports of service firms having difficulty keeping up with demand and rapidly growing backlogs. Meanwhile, Atlanta reported that the approach of Hurricane Katrina had temporarily halted oil and gas production in the Gulf of Mexico. Mining activity was robust, as Minneapolis reported full production at mines and active interest in starting new operations.

Labor Markets

Several Districts reported signs of tightening in labor markets and some difficulty in finding workers for certain occupations. Atlanta, Dallas, Kansas City, Minneapolis, and San Francisco noted that labor markets tightened or improved, while demand for temporary employment was higher in Boston and Richmond. New York reported a step-up in hiring for the fall season. In St. Louis, hiring in manufacturing was mixed, while service sector hiring was up. Hiring in the manufacturing sector was limited in the Cleveland District. Atlanta, Boston, Dallas, Kansas City, and Richmond reported that some firms had difficulty finding qualified workers. Occupations mentioned include healthcare, accounting, information technology, trucking, energy, and construction-related trades.

Wages and Prices

Wage increases were generally modest, but a number of Districts noted pressure on benefit costs, such as health insurance. In the Kansas City, Minneapolis, and San Francisco Districts, wage pressure was described as up slightly, moderately, and modestly. Meanwhile, Dallas noted that pressure on salaries was growing, particularly for skilled workers, but that firms were resisting overall wage increases. Temporary firms in the Boston District noted concern about rising costs for unemployment and health insurance, while manufacturing and related services firms noted moderate wage and salary increases. In Kansas City, the percent of firms reporting wage pressures increased slightly from recent surveys. A contact in the Richmond District noted that companies were turning to temporary agencies to reduce costs of benefits and payroll administration.

Except for energy, overall consumer price increases were modest. Most Districts reported significant price increases in certain commodities and energy products, especially gasoline. Higher energy costs were reported by almost all Districts, and energy-intensive industries were able to pass some of these costs on to consumers in the Atlanta, Boston, Cleveland, Chicago, Kansas City, Minneapolis, Philadelphia, and San Francisco Districts. Dallas and Richmond noted that most industries had difficulty passing increased energy costs on to consumers. In addition, several Districts reported significant increases in certain manufacturing and construction input prices, including steel, chemicals, plastics, and cement. Decreased lumber prices were noted in Dallas, Kansas City, and Minneapolis. Retailers and hotels increased prices in the Kansas City District.

Banking and Finance

Most Federal Reserve Districts reported increased lending activity. Districts reported strong demand for commercial and industrial loans and mixed activity for residential loans. Atlanta, Chicago, Kansas City, and San Francisco reported higher residential loan demand, while New York, Philadelphia, and Richmond saw decreased demand for residential loans, and St. Louis indicated mixed demand. Meanwhile, deposits were up in New York and steady in Kansas City.

Credit conditions remained at high levels in Atlanta, Chicago, Cleveland, Richmond, and San Francisco and were unchanged in Dallas, Kansas City, New York, and St. Louis.

Return to top

First District--Boston

Contacts in the First District report that recent changes in business activity are mixed. Most retailers say overall sales in the summer months were higher than a year earlier, but month-to-month changes were erratic. Manufacturers' results vary by sector, with companies supplying consumer goods seeing weaker sales and orders than makers of aircraft components, computer hardware, and biopharmaceuticals. Staffing firms say labor demand continues to grow. Respondents across the board express concern about high energy prices. With the exception of commercial real estate, the outlook is generally positive, with contacts expecting continued growth in the remainder of 2005.

Retail and Tourism
Retail respondents in the First District generally report sales ahead of year-earlier levels for the summer months. Same-store sales in the quarter ending in July range from flat to up 9 percent year-over-year, although sales results for individual months were mixed. Products that sold particularly well during the summer include wireless networking devices, digital imaging and related products, high-definition and flat-screen televisions, back-to-school products, and summer apparel. Sales of air conditioners, carry-out food, and fall apparel were disappointing.

Inventory levels are generally satisfactory. The majority of retail contacts report cost increases for petroleum-based products. Changes in selling prices are mixed; several respondents are uneasy about passing along cost increases to price-sensitive consumers. For the most part, employment is steady.

Travel and tourism contacts report that results improved in June and July after inclement weather discouraged travel in April and May. Revenue per available room in the first half of 2005 was up 7 percent year-over-year in the Boston and Cambridge areas, with single-digit increases in occupancy and little or no rise in room rates. Increasing gas prices are cited as a major industry-wide concern, but contacts primarily attribute weaker-than-expected results to more frugal travelers and overly optimistic forecasts following a very strong 2004. Some large resorts note continued employee shortages because many foreign workers were denied seasonal employment visas, and student employees are now returning to school. Tourism contacts are optimistic about the fall, citing an increase in the number of last minute bookings, a full convention schedule, and the usual seasonal boost from both fall foliage and the return of Boston students. International travel has started to increase but remains below expectation.

Overall, retail and tourism respondents are upbeat about the remainder of 2005, with expected growth ranging from flat to double-digit increases.

Manufacturing and Related Services
First District contacts in manufacturing and related services report mixed sales and order patterns in the second and third quarters. Makers of aircraft components, computer hardware, and bio-pharmaceuticals cite continuing double-digit revenue gains from a year ago. By

contrast, manufacturers of a wide variety of consumer goods and components describe challenges. For example, a food processor is disappointed by sales to supermarkets and fast food markets; a fabric maker notes cutbacks in large retailers' orders in response to declining disposable incomes; and a semiconductor firm is concerned that its consumer electronics customers may not be building much inventory for the holiday season.

Most respondents complain of higher costs for oil and gas, petrochemicals, and metals. Although some contacts have managed to increase their selling prices as much as 8 percent to 10 percent this year, many are concerned about their inability to raise selling prices enough to offset margin pressures fully. Technology-oriented companies tend to be exceptions to the general pattern: Most are not materials-intensive and have not felt the need to increase selling prices.

Companies generally are making only minimal adjustments to domestic headcounts, except those in high-growth industries or making significant acquisitions. Typical wage and salary increases are in the range of 2.5 percent to 4 percent, although several firms report higher raises.

Capital spending is reported to be mostly flat, or up slightly because of specific needs. A couple of companies indicate that they are being cautious in their capital spending because escalating materials costs tie up cash or create uncertainty about profitability. Another expresses concern that appreciation of the yuan could lower the returns to their recent investments in China.

Manufacturers are varied in their outlook. On the optimistic side, some feel confident that their markets will continue to grow. About the same number of respondents on the pessimistic side believe energy and materials price increases will continue to exert a drag or diminish their margins. A third camp is either "cautiously optimistic" or awaiting clarification of future trends.

Temporary Employment
Business appears to be growing steadily at temporary employment firms in New England, with revenues in the most recent quarter up 6 percent to 39 percent over last year. Labor demand continues to increase, particularly in the healthcare and information technology industries. Other sectors with growing demand include R&D, manufacturing, construction, financial and food services. The volume of permanent hiring, as well as temporary-to-permanent hiring, continues to improve at most firms. Meanwhile, staffing firms are finding it increasingly difficult to attract qualified people, particularly in medical and technical fields; hence, they are expanding their efforts to reach potential employees through internet recruiting.

Bill rates are holding steady for the most part, while pay rates are steady or rising. Contacts express concern about rising costs for unemployment insurance, health insurance, commercial insurance, and workers' compensation. Rising fuel costs are also worrisome, particularly for staffing firms that provide transportation or compensate workers for travel costs. Despite these concerns, respondents are confident that the coming quarter will bring continued growth for their own firms and for the staffing industry.

Software and Information Technology Services
First District contacts selling software and information technology services report business results ranging from flat to "going well." Revenues in the most recent quarter (generally

ending in June or July) were near zero percent to 17 percent higher than a year earlier, with the majority of respondents close to the high end of the range. Headcounts are increasing, generally modestly, with selective hiring of technology workers. Almost all contacted firms have raised pay, usually between 2 percent and 3 percent, but sometimes more. Increasing health insurance costs continue to concern most companies. Respondents indicate that they are holding capital and technology spending fairly stable.

Contacted software and IT services firms are cautiously optimistic looking forward. With strong orders in the pipeline, they expect more of the same over the next quarter--revenues and profits are generally projected to continue growing at current rates.

Commercial Real Estate
Commercial real estate markets in the Boston area are reported to be stagnant. Rents are said to be in the low $30's per square foot in downtown Boston and low teens in the suburbs as they have been for most of the last four quarters. Similarly, vacancy rates remain just above 12 percent downtown and near 20 percent in the suburbs. Outside Boston, contacts say office markets in the rest of New England remain stagnant as well. Respondents say that gradual increases in commercial mortgage rates over the past few months have pushed borrowing costs above income yields in the current context of high office vacancies and low rents. Furthermore, they express concern that some lenders might be reluctant to refinance soon-to-expire commercial mortgage loans that were made at a time when occupancy and rents were more favorable.

Observers' expectations for commercial real estate remain flat for the time being. A small up-tick in rents may occur as seasons change and utility costs increase; net rents received by landlords, however, are not expected to increase. Office construction is not on the horizon, as rents in most New England markets are said to remain well below the estimated construction construct threshold.

▲ Return to top

Second District--New York

The Second District's economy has strengthened since the last report. Tourism has been exceptionally strong. Commercial real estate markets showed signs of tightening in July and August. Conditions in New York City's financial industry continued to strengthen since the last report, and Wall Street employment and compensation continue to expand. More broadly, there are indications that New York City area firms are stepping up hiring activity for the Fall season. Surveys of both manufacturers and purchasing managers indicate continued expansion in business activity in August. In contrast, retailers generally report that sales were below plan in August, hampered by unseasonably hot weather and rising energy prices. There are scattered signs of softening in the housing market, though the overall level of demand has remained fairly strong. Finally, bankers report a pickup in demand from the commercial sector but a dip in demand for home mortgage loans; delinquency rates also improved among commercial borrowers but were little changed in the household segment.

Consumer Spending
Most retailers report that sales were below plan in August, with contacts attributing the bulk of the weakness to unseasonably hot weather and rising energy prices. Overall, comparable-store sales were virtually unchanged from a year ago, with individual reports

ranging from a 3 percent decline to a 3 percent increase. Still, retail inventories were generally said to be in good shape. Selling prices were little changed.

Tourism has continued to show exceptional strength since the last report. Manhattan hotels report that the overall occupancy rate rose more than 4 percentage points from a year earlier in July, to 86.2--the strongest July level on record--while average room rates were up nearly 15 percent. August is reportedly shaping up to be comparably strong. Broadway theaters indicate that attendance and total revenues slowed somewhat in the first three weeks of August; still revenues were running more than 5 percent ahead of a year ago, and industry conditions continue to be described as strong.

Construction and Real Estate

The region's housing market has shown signs of softening since the last report, though it is still characterized as strong. New Jersey builders report that housing demand remains fairly brisk, but that buyers are increasingly hesitant and that lenders have grown more skeptical about appraised home values. An industry authority reports that the rate of price appreciation has slowed and that there has been price discounting along the Jersey Shore, for the first time in three years.

The market for existing homes is also reported to have softened somewhat. In New York State, July home sales were off more than 7 percent from a year earlier, though prices continued to run 10-20 percent ahead. There has been some noticeable weakening in some upstate New York regions; in contrast, both sales and prices in New York City continued to run well ahead of a year ago. A leading appraisal firm reports that Manhattan's co-op and condo market has shown no significant signs of slowing since mid-year--listing times have not changed noticeably, the inventory of unsold homes remains steady at a low level, and prices have continued to increase, though at a somewhat slower pace. Finally, a contact specializing in Manhattan's rental market indicates that while rents have not risen significantly, there is a dwindling inventory of available apartments.

Commercial real estate markets across the New York City area showed further strength in July and August. Since mid-year, office availability rates have fallen to a four-year low in Midtown Manhattan and declined moderately in Lower Manhattan and northern New Jersey. Availability rates were generally stable in the rest of the metropolitan area. Rates were little changed in the Lower Hudson Valley and southwestern Connecticut; on Long Island, rates ticked up but were still about ½ point lower than a year ago. Office rents continued to climb in Midtown Manhattan and Long Island but were little changed across the rest of the metro area. Industrial markets in and around New York City saw little net change in vacancy rates since the last report, but there has been notable escalation in rents.

Other Business Activity

A major NYC employment agency, specializing in office jobs, reports that hiring activity for the upcoming Fall season appears to be strong, and that they are getting placement requests from clients they have not heard from for a few years. Conditions in the securities industry have continued to improve since the last report, as both profits and revenues have grown briskly; industry employment and compensation reportedly remain on a fairly strong growth path.

Surveys of both manufacturers and purchasing managers indicate continued expansion in business activity in August. However, a number of contacts indicate growing concern about rising energy prices adversely affecting their business in the months ahead.

Financial Developments
Bankers at small to medium-sized banks in the district report reduced demand for residential mortgages but increased demand for both commercial and industrial loans and commercial mortgages. Banks continue to report declining refinancing activity. Bankers reported unchanged credit standards across all loan categories. Higher loan rates were reported across all loan categories--particularly residential and commercial mortgages. Increased average deposit rates were reported by over 80 percent of bankers with no bankers reporting decreased rates. Finally, bankers report little change in delinquency rates on consumer loans and residential mortgages, but lower delinquency rates from the commercial sector.

Return to top

Third District--Philadelphia

Economic activity in the Third District expanded modestly in August. Manufacturers reported increases in orders and shipments. Retail sales of general merchandise rose from July to August, but only matched or slightly exceeded year-ago levels for many stores. Auto sales rose in July and continued to be strong in August. Banks and other lenders reported that business and consumer lending continued on an upward trend in August, but mortgage lending eased during the month after rising in July. Commercial real estate conditions have shown little change in recent months. Sales of both new and existing homes slowed somewhat in August after an increase in July.

Third District business contacts generally expect business activity in the region to continue to expand at a modest pace. Manufacturers expect increases in shipments and orders during the next six months. Retailers anticipate growth but with only slight year-over-year gains. Auto dealers are uncertain about the outlook and many expect the sales rate to decline as new models are introduced and price discounting is curtailed. Bankers expect continued growth in business and consumer lending, but they anticipate a decline in mortgage activity. Contacts in commercial real estate forecast a moderate increase in demand for office and industrial space. Homebuilders and residential real estate agents expect sales to pick up seasonally in the fall as long as mortgage interest rates do not rise substantially from current levels.

Manufacturing
Manufacturing activity in the Third District increased in August, according to manufacturing firms contacted during the month. Just over one-third of the companies contacted posted increases in new orders and shipments for the month, and around one-fifth had decreases. Order backlogs edged up in August, although delivery times were unchanged. Among the District's major manufacturing sectors, business improved more for producers of furniture, paper products, and electrical machinery. Most other sectors experienced slight gains, although producers of primary metals and transportation equipment reported some slowing in business.

On balance, manufacturers expect continued growth in business activity. About four out of ten of the firms contacted in August expect their shipments and orders to increase during the next six months, and one out of ten expect decreases. Roughly the same number of firms gave positive forecasts in August as in July, but there has been a decline in the number of firms giving negative forecasts. Capital spending plans among District manufacturers call for stepped up expenditures, on balance, but the number of firms scheduling increased outlays remains somewhat lower than in the first half of the year.

Reports of price increases from Third District manufacturers outnumbered reports of decreases in August, although a majority of manufacturing firms reported steady prices for the month. One in three of the manufacturing firms contacted for this report noted increases in input prices in August, and one in eight raised output prices. Fewer than one in ten reported declines in either input or output prices. The number of firms noting increases in input prices has not changed for the past several months, although the number reporting increases in output prices has declined. During the next six months, about half of the manufacturers surveyed expect increases in input prices, and about one-third plan to increase the prices of their own goods; only a very small percentage expect declines in either input or output prices. Expectations of further increases in energy prices are widespread among Third District manufacturers, and many also expect increases in the prices of raw materials and intermediate inputs.

Retail

Retailers generally reported a slow start to back-to-school shopping in August. Although sales increased from July, several merchants indicated that their August sales were just even with or only slightly higher than sales in August of last year. Store executives said the exceptionally warm weather during the month reduced store traffic and reduced sales of fall apparel. Stores specializing in mid-price and low-price merchandise continued to report slower sales growth than stores specializing in higher-price goods.

Retailers in the region expect sales growth to pick up in the weeks ahead, but not strongly. Merchants generally believe consumers are limiting spending as they cope with rising gasoline prices. Looking ahead to the fourth quarter, several of the retail executives interviewed for this report said the outlook is becoming more uncertain; they cite declines in store traffic and uneven sales growth as signs that consumer confidence is slipping.

Auto dealers in the region reported a continued high rate of sales in August as manufacturers extended price discounts. Inventories of 2005 model year vehicles were low, except for large sport utility vehicles. Dealers reported a sharp decline in demand for these vehicles. Dealers expressed some concern that sales of 2006 models will be slow, following the high rate of sales in the past few months and the scheduled end of the current discount programs.

Finance

The volume of loans outstanding at Third District banks rose from July to August, according to banks surveyed for this report. Commercial and industrial loans have been increasing at a roughly steady pace. Consumer loans and credit card lending have also been moving up. Lending for residential mortgages eased in August, following an increase in July. However, mortgage lenders indicated that the decrease was slight, and that the volume of new mortgage loans remained high for home purchases as well as refinancing. Bankers and other lenders in the District expect business and consumer lending to continue to move up at around the current pace, but they expect mortgage lending to decline.

Real Estate and Construction

Commercial real estate firms reported that vacancy rates in the region's office markets have been roughly steady in the past few months. Rental rates have also been about steady, although in some local markets landlords have reduced concessions. Leasing activity has been fairly strong, and there has been a slight increase in build-to-suit construction in some areas. Commercial real estate agents expect a tightening in the region's office markets during the second half of the year, although the scheduled completion of a large building in Philadelphia's central business district at the end of the year is expected to prevent a substantial decrease in the city's vacancy rate. Industrial building vacancy rates have been nearly flat in recent months, and rents have shown little change. Commercial real estate contacts believe demand for industrial space will grow about in line with overall economic expansion during the rest of the year.

Residential real estate agents and homebuilders generally reported a seasonal slowing in sales in August. Nevertheless, they indicated that the pace of sales continued to be strong. Some real estate contacts noted that existing homes for sale seem to be on the market longer now than earlier in the year. They believe this might be due to sellers setting unrealistically high asking prices. In general, real estate agents said the inventory of homes for sale remains low. Homebuilders and real estate agents expect the sales rate to pick up somewhat in the months ahead; however, several of those contacted for this report believe any increase in mortgage interest rates could reduce home sales significantly.

Return to top

Fourth District--Cleveland

In general, District business conditions continued to show steady improvement in the eight weeks ending August, despite modest declines in some sectors. Most manufacturers continued to see increases in production through this period. District retailers typically reported sales above year-ago levels with strong sales continuing for automobile dealerships. However, outside of autos, there was some softening more recently in retailers' sales. Commercial builders continued to report increases in activity, and while District homebuilders have seen demand weaken, sales remained strong by historical standards. After slowing slightly in late July, demand for trucking and shipping services returned to its previously brisk pace. And at the District's banks, loan demand from commercial and consumer clients generally remained steady to slightly increasing.

While most materials costs remained relatively stable in July and August, increases in the prices for petroleum-based products were widely cited by contacts. As in recent reports, hiring remained modest in most industries. However, staffing-services companies continued to report steady increases in the number of job openings available throughout the District. Some staffing-services contacts also indicated that their job seekers have been finding employment more quickly.

Manufacturing
Business conditions continued to be largely positive at the District's durable goods facilities. Through the eight weeks ending August, production at most District durable goods plants remained steady, and above the levels of this time a year ago. Nevertheless, a significant share of firms reported having higher levels of inventories than desired. Inventories in the steel supply chain, though, are reported to have fallen through the last several weeks, prompting increases in production at District steel mills as of August. Activity is expected to increase through the remainder of the year, at a time when market demand would usually diminish due to seasonality. Steel spot prices are also expected to rise after having fallen for about a year. Automakers are also reducing inventories through their aggressive employee-

discount pricing promotions; although, production at automobile assembly plants in the District remained notably below last year's levels in July.

Nondurable goods producers also reported production below last years' level, though there were some signs of improvement in recent weeks. For the two-month period through the end of August, production improved relative to the late spring, with contacts sounding a somewhat more optimistic tone.

Most manufacturers reported slight increases in their total input costs in recent weeks, driven primarily by increases in the prices of petroleum-based products. There were also slight increases in some metals prices. Several contacts indicated that they could partially pass through these increases in costs to their consumers. Hiring continued to be limited throughout the manufacturing sector. Planned increased in capital spending were also limited, though several manufacturers that anticipated adding to their capital stock cited expectations of stronger demand through the remainder of 2005.

Retail
After reporting an improvement in the economic environment in June and through the first half of July, District retailers reported somewhat weaker business condition through the end of August. Discount retailers generally reported that their sales in July were at anticipated levels and up from the levels of a year ago; however, sales seemed to weaken in August. Contacts cited increases in gasoline prices and unseasonably warm weather (which was thought to discourage sales of items for fall) as among the reasons for the declines. Discount retailers also reported that their higher-priced items seemed to sell better in recent weeks. In other segments, sales at specialty retailers were generally flat or above year-ago levels, while sales at District department stores were typically down from a year ago and continued to be below expectations. Finally, several contacts expressed disappointment with the back-to-school selling season.

Automobile sales continued to be strong throughout the District in July and August, spurred by several automakers' employee-discount pricing promotions. Some dealerships, however, worried that these promotions have simply shifted activity from future months to the present. Dealers' inventories were typically characterized as at or below target levels.

Construction
Business conditions continued to weaken slightly for homebuilders, although activity remained relatively high by historical standards in July and August. Nevertheless, relative to this time a year ago, most residential builders reported that their sales had fallen. Most contacts also characterized their backlogs as average while some said that they were light. In general, homebuilders do not anticipate any significant improvement in the economic environment through the remainder of 2005. Cost pressures also appeared to intensify somewhat in the third quarter. In particular, contacts indicated that inputs related to oil, such as shingles and siding, were commanding higher prices. And several contacts noted that concrete costs had risen. By contrast, labor costs were characterized as stable, with subcontractors seen as readily available. Finally, new home prices have, in general, remained relatively stable throughout the District.

Unlike their counterparts in residential building, nonresidential contractors continued to characterize business conditions as improving. Nonresidential builders reported increases in activity relative to a year ago, and indicated that their backlogs were rising. One contact noted that his firm's backlog was big enough to keep it occupied through the end of 2006. Still, most contacts considered profit margins to be tight, due to both reasonably intense competition and increases in materials costs. Prices for petroleum-based products, and especially for fuel, have been particularly difficult to estimate and include in bids. Hiring among general contractors continued to be fairly limited, though demand for work from subcontractors increased in July and August, with several contacts citing rising subcontractor rates. Regarding demand from specific sectors, contacts indicated that the number of institutional and educational projects available rose in recent weeks, while inquiries from manufacturing firms were also higher.

Trucking and Shipping
After slowing slightly toward the end of July, demand for trucking and shipping services in the District rebounded in August, with activity remaining at relatively high levels. This followed a period of weaker demand that ended in early spring. While rising fuel costs continued to be largely offset through surcharges, cost changes affected firms' margins through truck operations that could not be billed to clients. Outside of increases in fuel surcharges, it was reported that shipping rates remained stable. Despite the increases in energy prices, most contacts continued to foresee favorable business conditions.

Banking
The economic environment for commercial banks in the District remained relatively strong through the eight weeks ending August. For larger institutions, loan demand from commercial clients was steady throughout this period, while smaller banks saw increases in demand. And while demand from commercial clients was broad-based, there appeared to be notable increases in demand from manufacturing firms. Loan demand from consumer clients also rose in recent weeks, with contacts citing a significant increase in automobile loans. This was attributed to automobile dealerships' move away from incentive financing toward price-discount promotions. Most District institutions saw an increase in core deposits, and credit quality continued to be notably strong.

Return to top

Fifth District--Richmond

The Fifth District economy continued to expand at a solid pace in late July and August. District services businesses reported steady revenue gains and moderately higher employment during the period. Retail sales growth was brisk, boosted again by exceptionally strong automobile and light truck sales. Manufacturing output grew modestly and factory employment increased for the first time since last February. District real estate agents said that though commercial and residential real estate markets remained generally strong, home sales decelerated in a few localities. In the financial sector, bank lending rose at a more moderate pace as growth in residential mortgage lending eased. On the price front, higher oil and natural gas prices drove materials costs up for homebuilders and manufacturers, but prices for most goods and services continued to rise at only a moderate pace. In agriculture, crops and livestock were reported to be in good condition, despite very hot and dry weather in August.

Retail
Retail sales grew at a brisk pace in the weeks since our last report, but retailers expected high energy prices would trim consumer demand over the next six months. Automobile and light

truck dealers chalked up record sales in July and August as "employee pricing" and other incentive programs drew customers to showrooms. In addition, a big-box retailer with stores across the District said summer sales figures were the best in several years. But not all signs were positive. Several contacts said that sharply higher energy prices were beginning to constrain consumer behavior, and they expected that continued high prices would weaken demand in coming months. A District automobile dealer, for example, told us he had sold SUVs recently to customers who exchanged them within a few days for smaller, more fuel efficient vehicles. Despite higher gasoline prices, overall price growth in the retail sector remained modest.

Services
Contacts at District services firms reported continued solid growth in revenues in recent weeks. Professional, scientific, and technical firms reported that their revenues had either remained on pace or accelerated, and that they expected stronger demand during the next few months. Many contacts said higher energy prices were having little effect on their businesses, though a North Carolina trucking executive noted that his firm would increase shipping rates if gasoline prices rose further, which he said could slow demand. Employment and wages rose at a somewhat quicker pace, and prices in the sector increased only modestly in August.

Manufacturing
District manufacturing activity moved modestly higher in August after edging lower in June and July. Manufacturers told us that shipments rose at a faster pace in August and that factory employment expanded for the first time in six months. Producers in the electrical equipment, industrial machinery, and printing industries recorded the strongest gains in output during the month, but a variety of manufacturers reported that their shipments strengthened. A plastics producer in South Carolina noted, "We have had an excellent month [August] and look forward to the rest of this year." A North Carolina boat manufacturer told us, "Business in general is good and more expensive boats are selling." Raw materials costs increased in August--prices of petroleum-based products and steel, in particular, rose sharply--and an increasing number of manufacturers voiced concern that their profit margins were being squeezed because they could no longer pass along price increases to customers.

Finance
District loan officers said that lending activity rose at a more moderate pace in late July and August as residential mortgage lending grew less rapidly. Rising mortgage interest rates and rapidly escalating home prices weighed on home sales and mortgage lending activity in some areas. A mortgage lender in Charleston, S.C., said that while lending remained strong there, rising interest rates were beginning to pare growth. In Charlotte, N.C., a contact reported that demand had slowed both because interest rates rose and because more people were being "priced out of the market." District bankers generally reported little change in commercial lending during August. A Charlottesville, Va., lender told us that demand for commercial loans had flattened, noting that new lending was just "replenishing the runoff [of business] to competitors." Several contacts said they expected commercial loan volumes to pick up in the fall, as there was business "in the pipeline." Credit quality remained good.

Real Estate
Residential real estate agents reported that while housing activity remained generally strong across the District in July and August, demand cooled in some localities and for upscale homes. An agent in Odenton, Md., said multiple offers on homes for sale were still common, but that houses selling in excess of one million dollars were staying on the market somewhat

longer. A contact in Greenville, S.C., reported that the area's housing market remained very strong, with sales of mid-priced homes strong, though sales of larger homes were starting to languish. In Virginia Beach, Va., an agent said that while houses in all price ranges were selling well, a recent rise in mortgage rates was slowing sales "a little bit." Home prices continued to rise in most areas, as did construction costs. Builders in Charlotte, and Winston Salem, N.C., told us that materials costs increased substantially in August--particularly petroleum-based products such as roofing material.

Commercial real estate agents reported a pickup in activity since our last report. Demand for office and retail space remained strong, particularly in the Washington, D.C., metropolitan area. A contact in the District of Columbia said there continued to be a great deal of interest in office and retail space near the site of the new ballpark for the Washington Nationals baseball team. Real estate agents in Northern Virginia described office activity as "very strong"--contacts in McLean, Va., and Prince William County said that higher interest rates "had not slowed things at all." Contacts in the Carolinas also reported generally strong commercial activity. An agent in Columbia, S.C., said that it had been a "very positive market" all summer, and noted continued solid leasing of office and warehouse space. Rents in the commercial sector were little changed since our last report.

Tourism
Tourism remained strong in late July and August. Contacts in Myrtle Beach, S.C., and on the Outer Banks of North Carolina reported brisk restaurant and retail sales for the month, which they attributed to sunny weather and later starting dates for North Carolina schools. A hotelier in Virginia Beach, Va., said that holiday bookings for the Labor Day weekend were strong. Analysts reported that tourism in Washington, D.C., had recovered from the severe downturn following the terrorist attacks of September 11th 2001, and was expected to surpass the record year of 1998 when the area attracted more than 19 million visitors.

Temporary Employment
Contacts at temporary employment agencies in the District reported moderately higher demand for workers in recent weeks and, in a few cases, more difficulty finding qualified workers. The warehousing, manufacturing, construction, and hospitality industries were actively seeking temporary employees. A contact in Richmond, Va., said that her clients were turning to temporary agencies in order to reduce costs of benefits and payroll administration. Agents in South Carolina reported that their clients were optimistic about their business prospects and were increasingly hiring more temporary workers to permanent positions.

Agriculture
Despite excessively hot and dry weather in much of the District in August, crops and livestock were said to be in generally good condition. Soybeans and cotton progressed well in South Carolina and yields on corn harvested early have been excellent. Although a third of the farmland in North Carolina was rated as short of moisture, corn and soybean crops have developed ahead of schedule. Tobacco harvesting was underway in Virginia, but agricultural analysts warned that high energy costs would likely boost the costs to cure tobacco. In Maryland, harvesting of cucumbers, lima beans, and snap beans was ahead of schedule. Cattle and sheep were reported to be in good condition in West Virginia.

Return to top

Sixth District--Atlanta

Reports from Sixth District business contacts suggested that the pace of economic activity in late July and August was quite strong, but had moderated relative to earlier in the summer. District retail sales activity remained positive overall. But several contacts suggested that the higher gasoline prices were a drag on sales growth. Home construction and sales remained brisk, although the pace had slowed modestly in a few areas in Florida. Nonresidential real estate markets continued to improve. Reports from manufacturing and transportation contacts were mostly upbeat and reports from tourism and business travel contacts remained positive. Employment levels continued to improve. Temporary employment agencies and construction firms noted shortages of skilled workers. Prices moderated for some non-energy commodities, and more contacts reported that they were able to pass on a portion of increases in raw material and freight costs to their customers. Hurricane Katrina halted production in most industries along the central Gulf Coast and caused as-yet-unquantified damage.

Consumer Spending
Reports from District retailers remained mostly positive, although several contacts suggested that higher gasoline prices were moderating sales growth. Retail sales during late July and August were up from last year, with the strongest results reported by contacts in Florida and Georgia. Most District merchants said that back-to-school sales had met their expectations. Overall, vehicle sales rebounded sharply to levels not seen since late 2001. Domestic industry contacts were pleased with the high traffic and sales, but some noted concern that the price discounts that helped boost recent sales may have a negative effect on future sales. A large accumulation of used vehicles from trade-ins was also noted. Dealers offering hybrid-fueled vehicles reported particularly strong sales.

Real Estate
Overall, District construction and home sales during late July and August rose compared with last year. The strongest reports continued to come from Florida, with both Realtors and builders continuing to note shortages of homes for sale. However, about half of the Florida homebuilders contacted also reported that demand had softened relative to earlier in the year.

District commercial real estate markets improved based on continued absorption of space and low levels of new construction. Vacancy rates declined in most markets and rent concessions were less generous. Some new office projects were announced for several District cities.

Manufacturing and Transportation
Reports from the factory sector were mostly upbeat in late July and August. Manufacturing production related to construction remained robust. A producer of hurricane resistant windows and doors is doubling capacity to meet demand, and a producer of manufactured housing is running at near capacity. Activity in defense-related industries continued at a healthy pace as a result of new government contracts. Less positively, some District shipyards are planning layoffs by the end of the year because of declining new orders. GM announced a scaling back in production at the plant in Doraville, Georgia, because of slower sales of the models produced there.

Despite high fuel prices, strong demand for freight services continued in late July and August. Regional transportation services also continued to be boosted by growing international container traffic from District ports.

Tourism and Business Travel
Reports on tourism and business travel remained positive. Most contacts indicated that

high-fuel prices did not have a significant impact on travel. Reservation clerks in Orlando indicated that occupancy levels remained at high levels and international passenger traffic was up by double-digits over last year at Orlando International Airport. Tourism activity in South Florida was strong with high occupancy numbers at hotels and resorts. Mississippi casino gaming revenues increased in July. Some reports did note that vacationers were spending less once they reached their destinations, and tourist industry contacts were also concerned that the earlier start to the school year in many areas will adversely affect end-of-summer tourist activity.

Banking and Finance
Most areas reported that bank loan demand was strong, especially for real estate loans. The high volume of lending for condominium construction remained a concern for bankers in Florida. Reports indicated that credit quality remained at high levels.

Employment and Prices
Reports generally indicated that labor markets conditions improved in August. Contacts noted that shortages continued in construction-related trades in Florida. A contact at a temporary staffing company said that business was very strong and that the company was starting to see shortages of both skilled and unskilled labor in several markets.

Higher energy prices continued to be noted by all contacts, whereas prices moderated somewhat for non-energy commodities such as building materials. Several contacts also reported that they have been able to pass on some of the increases in raw material and freight costs to their customers. For instance, trucking companies that had contracts with built-in fuel surcharges reported that they were able to pass along higher fuel costs.

Agriculture and Natural Resources
Most crop conditions were relatively good, with favorable weather providing adequate moisture levels to most areas of the District. Florida's citrus industry contacts noted that anti-dumping duties imposed on several Brazilian orange juice exporters would benefit the local citrus industry this year.

Hurricane Katrina
After causing several deaths and considerable damage to areas of South Florida, Hurricane Katrina struck the central Gulf Coast on August 29. At the time of this writing, initial damage assessments were being made. The most immediate economic impact was substantial damage to a large segment of the Gulf Coast. Oil and gas production in the Gulf of Mexico has been halted and energy prices have spiked as a consequence. Unemployment claims are expected to rise significantly in Louisiana and Mississippi.

Return to top

Seventh District--Chicago

Economic activity in the Seventh District continued to expand at a moderate pace during July and August. Consumer spending continued to increase gradually. Business spending and hiring expanded at a modest pace. Residential construction moderated some from high levels, while activity in commercial real estate markets held steady or firmed. Manufacturing activity continued at a solid pace. Lending continued to increase at a moderate pace. Cost and price pressures remained modest outside of energy-related increases. August rains eased drought conditions, leading to higher expectations for soybean yields.

Consumer spending
Consumer spending continued to increase gradually during July and August. Retail activity in the District lagged activity in other parts of the country, but retail sales in the Chicago area apparently held up well. One analyst noted that heightened uncertainty in the auto industry had made Michigan consumers particularly cautious. Non-auto retail inventories were little changed in July. Auto dealers in the District said that sales moderated in August due to both a lack of vehicle availability and "buyer fatigue," but sales remained brisk on balance. Dealers were surprised at the strength of light truck sales given recent increases in fuel prices. Inventories of new vehicles were quite lean. However, the strength in new vehicle sales reduced demand for used vehicles and increased the number of trade-ins, leading to a surge in used vehicle inventories. A large restaurant chain noted that demand seemed to be softening, but sales of premium products had improved. Tourism activity in Michigan increased faster than expected, and one contact noted that early bookings for the fall suggest the gains should persist.

Business spending
Business spending and hiring expanded at a modest pace. In general, contacts reported continued gains in capital spending. A pharmaceutical manufacturer said that its spending on structures was strong, but the firm had increased the rate of return required for new investment projects to get approval. A large transportation firm reported that higher-than-expected fuel costs had led it to invest less than planned and rethink its capital spending plans for 2006. A trucking firm noted that growth in freight volumes was slowing, with an unusual amount of weakness in shipments of consumer goods. Labor market conditions continued to improve gradually. Job gains were reported by firms in the banking, food processing, and pharmaceutical industries. In contrast, a Chicago auto dealer said that it was likely to hold off hiring until next spring. Staffing services firms reported steady growth in hours.

Construction/real estate
Construction and real estate activity was mixed by location and market segment. Residential construction moderated from high levels, but continued to be brisk on balance. Homebuilders in Milwaukee reported that much of the recent moderation occurred in the mid-price segment, while lower- and higher-priced homes had seen only slight declines in sales. Contacts generally felt that the number of homes on the market was near appropriate levels, though some builders added extra incentives, such as free hot tubs, to keep up interest. Rental unit vacancy rates declined. Activity in commercial real estate markets held steady or firmed somewhat. Demand for small blocks of office space was said to be stronger than demand for large blocks. Office vacancy rates remained elevated, though they improved slightly. A contact in Indiana expected commercial construction to pick up further in the wake of "a few big deals" that were announced recently.

Manufacturing
Manufacturing activity continued at a solid pace in the District during July and August. Reports from the heavy equipment industry remained especially favorable, with double-digit growth in construction equipment demand from a year ago and a "hot" sales pace of mining equipment. Equipment inventories were in line with preferred levels. The steel industry recovered from a soft patch experienced earlier in the summer, and one steel firm reported that its order books looked stronger in August. Steel inventories fell but stayed at higher-than-desired levels. Gypsum wallboard orders remained "very strong," as demand for home

repair and remodeling reportedly increased. Domestic automakers reported some moderation in nationwide light vehicle sales during August, though sales remained above the year-to-date average; contacts expected steeper declines later in the fall. Demand for heavy-duty trucks softened from strong year-ago levels. One industry analyst said that a smaller portion of customers were ordering trucks for delivery within six months, which could lead to reduced production in the fourth quarter but higher output in 2006. Area tool and die firms reported somewhat slower growth in production, but orders and backlogs remained at good levels.

Banking/finance

Lending activity continued to expand at a moderate pace during July and August. Demand for home-purchase mortgages remained strong on balance, though Michigan lenders noted some weaker demand. Refinancing activity continued to slow in general, though one Chicago bank said that its refinance applications were relatively stable because many applicants wanted to move from adjustable-rate to fixed-rate mortgages. A Michigan bank reported it was "looking harder" at the loan-to-value ratios of the mortgages it issues. A mid-sized Wisconsin bank noted "soft" demand for home equity loans and lines of credit. Consumer credit quality in the District was good, with average or low levels of delinquencies. Business loan demand continued to increase, with gains fairly balanced across segments. Business credit quality was good and even improved in some areas. Business customers were said to have strong cash positions, and more than one bank said that business usage of lines of credit was unusually low. Continuing competitive pressures led to reports of easing standards, terms, and/or margins on business loans.

Prices/costs

Overall cost and price pressures remained moderate. Material costs rose for energy and some construction materials. Shortages of alloys led to increases in the cost of some specialty steel products, while scrap steel prices bottomed out. Truckers were said to be recovering much of their higher fuel costs, and there were some reports of new fuel surcharges. A local airline said it has not been able to increase the dollar value of its fares enough to fully offset higher fuel costs, but the airline had tightened requirements on discount fares. Higher gas prices required bigger discounts on the largest sport utility vehicles, according to one large automaker. A restaurant chain felt it had a greater ability to increase its prices, while a mid-size retailer was under more competitive pressure to lower prices. Labor cost increases remained modest overall, though one contact noted that recruiters were increasing their fees for the first time in more than four years.

Agriculture

August rains lessened drought conditions in the District and boosted expectations for soybean yields. However, the rains came too late to aid affected corn crops, particularly those in Illinois and northern Indiana. Crop conditions in Iowa and Michigan remained better than conditions in the rest of the District. Crop yields were expected to be highly variable, even within local areas. Corn and soybean prices were restrained because of the carryover from the record harvest in 2004. Farmers continued to face higher operating costs. Fuel surcharges and higher railroad freight rates pushed up transportation costs, and extra pesticide spraying was needed to maintain yields in some areas hurt by the drought.

Return to top

Eighth District--St. Louis

The Eighth District's economy has expanded since our previous survey. The services sector continued to grow. Retail and auto sales increased in July and August over year-earlier levels. Home sales continued to increase and commercial real estate markets gained strength. Reports in manufacturing, however, were mixed. Several contacts reported plans to expand operations and hire new workers, while some other contacts reported plans to close plants and lay off employees. Commercial lending activity at a sample of District banks increased slightly in the past three months.

Consumer Spending

Contacts reported that, on average, retail sales in July and August were up over year-earlier levels. While 35 percent of the retailers surveyed noted that sales levels met their expectations, 43 percent reported that sales were below what they had anticipated, and 22 percent reported sales above expectations. Summer seasonal items, back-to-school items, children's clothing, and shoes were all strong sellers, while women's apparel moved more slowly. Approximately 69 percent of the contacts noted that inventories were at desired levels, while 27 percent reported that inventories were too high. Retailers appear generally optimistic about sales over the next two months.

Car dealers reported that, on average, sales in July and August were up over year-earlier levels. About 74 percent of the car dealers surveyed reported increases in sales, while another 17 percent reported no change. Many contacts attributed increased sales to the price discounts on new cars; about 68 percent of the respondents reported declines in sales prices, while 26 percent reported no change. About 45 percent of the car dealers noted that new car sales had increased relative to used car sales. About 18 percent reported an increase in low-end vehicle sales relative to high-end vehicle sales; 14 percent reported the opposite; and about 68 percent reported no change. Approximately 90 percent of the respondents reported no change in the acceptance rates of finance applications. Just over one-half of the car dealers surveyed reported that their inventories were at desired levels, while 43 percent reported that their inventories were too low. Nearly 48 percent of the car dealers surveyed expect increased sales over 2004 for the next two months.

Manufacturing and Other Business Activity

Reports from contacts in the manufacturing sector in the period since our previous survey were mixed. Several manufacturers reported plans to hire additional workers, expand operations, increase capital spending, and add new space, while a similar number of firms reported plans to reduce workforces and close production facilities. Contacts in the electronic product, primary metal, nonmetallic mineral, and medical supplies industries announced plans to expand operations, increase capital spending, and add new space in the District. Other firms in the rubber product and miscellaneous manufacturing industries reported plans to hire additional workers. Despite this growth, several other contacts in the pharmaceutical, food, and wood product industries reported plans to close plants or lay off workers. Several contacts in the Eighth District's auto parts and motor vehicle industries experienced net declines in economic activity since our previous report. Several manufacturers expressed concern over margin pressures because of the rising cost of fuel.

The District's service sector continued to expand in most areas since our previous report. Firms in the printing, health care, telecommunications, health benefits, and entertainment industries reported plans to open new facilities, expand operations, and hire new workers. Several of these contacts cited proximity to the distribution infrastructure within the District as a major reason for their investment. Some firms in the freight industry have added fuel surcharges to their delivery cost. A large District retailer indicated that it has no plans to raise prices to pass on rising costs to consumers.

Real Estate and Construction
Home sales continue to increase throughout the Eighth District. July year-to-date sales increased by 7 percent in Louisville and over 6 percent in Memphis compared with the same period in 2004. In St. Louis, July year-to-date home sales remained virtually unchanged. Residential construction has been lagging in the majority of the District's metro areas. July year-to-date single-family residential permits declined in Jackson, Tennessee, in Evansville, Indiana, and in Owensboro, Kentucky. In contrast, permits were up in Fayetteville and Little Rock, Arkansas, as well as in Louisville and Memphis.

Commercial real estate markets in the District continue to gain strength. The second-quarter industrial vacancy rate declined in Louisville, Memphis, and St. Louis. Office vacancy rates in these cities decreased as well. Contacts report that commercial construction is up in Paducah, Kentucky, while contacts in Evansville, Indiana, report only moderate commercial construction activity. In southern Indiana, contacts report that government construction remains high. Contacts indicate that industrial development is on the rise in both Memphis and northern Mississippi.

Banking and Finance
A recent survey of senior loan officers at a sample of District banks indicates a slight increase in commercial lending activity over the past three months. During this period, credit standards for commercial and industrial loans remained basically unchanged, while demand was moderately stronger. Credit standards for commercial real estate loans, residential mortgage loans, and consumer loans were basically unchanged. Demand for commercial real estate loans was moderately stronger. Demand for consumer loans was generally unchanged, while demand for residential mortgage loans varied from moderately stronger to moderately weaker.

Agriculture and Natural Resources
Despite recent rains throughout the District, overall crop and pasture conditions have continued to deteriorate. Farmers have reported irreversible damage to the corn crop. In Illinois and Missouri, farmers anticipate corn yields at least 30 percent below last year's. Over half of the pastures in Arkansas, Illinois, Kentucky, and Missouri remain in poor condition.

Return to top

Ninth District--Minneapolis

The Ninth District economy displayed broad-based growth since the last report. Numerous sectors experienced expansion, including consumer spending, manufacturing, real estate, construction, tourism, agriculture, energy, and mining. Reports of employment increases outweighed reports of employment declines. Meanwhile, wages grew moderately. Significant price increases were noted in fuel and certain construction materials.

Consumer Spending and Tourism
Consumer spending grew since the last report. A major Minneapolis-based retailer reported same-store sales up 6 percent in July and expects a 6 percent gain in August compared with

the same period last year. A North Dakota mall manager noted that traffic was heavier in July and August than a year ago; apparel sales were particularly solid. A Minneapolis area mall manager noted that sales were up in the single digits during July compared with a year earlier. Another Minneapolis area mall manager noted that while traffic was slower in July and August from last year, sales were up about 1 percent. A western South Dakota mall manager reported slower traffic in July and August, but sales are expected to increase 2 percent to 3 percent from a year ago.

A representative of an auto dealers association in South Dakota reported that sales were strong in July, spurred by special price discounts. Dealerships in western Wisconsin report that customers are trading in used sport utility vehicles and pickup trucks and purchasing fuel-efficient cars.

Tourism activity was higher than a year ago in several areas of the district. In July and early August the number of visitors at a tourism office was above last year's levels in northwestern Wisconsin. The number of visitors was up 2 percent and sales were up 6 percent during July compared with last year in the Black Hills area of South Dakota, according to a local official. The South Dakota state fair had record attendance in 2005. A chamber of commerce representative in northwestern Montana said that lodging and retail sales were ahead of last year. In contrast, a tourism official in the Upper Peninsula of Michigan noted that the region was struggling to keep tourism activity at last year's relatively soft pace.

Construction and Real Estate
Construction activity grew. Housing units authorized in Minneapolis-St. Paul in July were up 6 percent from last year. A representative of a homebuilders association in Fargo, N.D., said the building season has been very strong, but is not quite on track to match 2004's record-breaking year. Retail construction in the Minneapolis-St. Paul area was strong, especially in the suburbs. A Minneapolis commercial real estate firm forecast construction of 2.9 million square feet by the end of the year, which would be a new record. A major railroad in the Dakotas and Montana began construction on $54 million in upgrades to rail lines in those states.

Real estate activity was strong. The Minneapolis-St. Paul office market continued to rebound, with a commercial real estate firm projecting a vacancy rate below 16 percent by the end of the year, down significantly from the 18 percent rate at the beginning of this year. In addition, industrial and retail markets remained robust. Residential real estate was brisk in most markets, with signs of cooling in the Minneapolis-St. Paul area. The housing market in Sioux Falls, S.D., was strong, with home prices up 9 percent in July from a year earlier. Realtors in Fargo, N.D., and Billings, Mont., described high activity in their areas as well. However, closings in July for the Minneapolis-St. Paul metro area were down 4 percent from a year earlier, with some real estate salespeople describing the market as much slower than it has been in recent years.

Manufacturing
Manufacturing activity expanded. A July survey of purchasing managers by Creighton University (Omaha, Neb.) indicated strong manufacturing activity in Minnesota and the Dakotas. In addition, recent Minnesota manufactured exports to China increased significantly from a year ago. In Minnesota, a recreational vehicle manufacturer is building a new engine plant and an aircraft maker is expanding production capability. In South Dakota, a meat processor plans a major expansion. In western Wisconsin, a disk drive component company

will invest $25 million in a facility expansion.

Energy and Mining
Activity in the energy and mining sectors increased. Oil and gas exploration and production increased from early July through mid August. Mines across the district are producing at near full capacity. Exploration and permitting activity is strong. For example, a proposed copper mine in northern Minnesota is testing samples of ore, which could result in a $235 million project. In Montana, a coal-to-liquid-fuel plant is under consideration.

Agriculture
Economic activity in the agricultural sector increased due to strong yields and prices. Good growing conditions aided crop development across the district as progress for almost all district crops was ahead of last year and of the five-year average. In Montana, 73 percent of the spring wheat crop is rated good to excellent. Meanwhile, 86 percent of the cattle in South Dakota are rated good to excellent. The U.S. Department of Agriculture projects corn prices in 2005/06 to average $2.85 to $3.35 per bushel, up $0.25 on each end from last month's projection. The USDA also increased its price projections for soybeans and corn and expects cattle and dairy prices to remain at strong levels. Lenders responding to the Minneapolis Fed's second quarter (July) agricultural credit conditions survey expected that overall agricultural income and capital spending would be stable in the third quarter of 2005.

Employment, Wages, and Prices
Employment levels increased since the last report. A Minnesota-based healthcare provider recently reported plans to hire 600 employees companywide in preparation for a federal prescription drug program for seniors. Also in Minnesota, an electronic components distributor expects a net annual gain of 150 jobs by year's end and a disk drive maker opened a new office and hired 20 engineers. The number of agricultural workers in Michigan, Minnesota, and Wisconsin increased by 9 percent in July from a year ago.

In contrast, a lumber company recently announced plans to lay off 120 workers in Montana. Job vacancies in Minnesota during the second quarter were down 10 percent compared with a year earlier.

Wage increases were moderate. Wages paid to manufacturing workers in district states increased 2.8 percent for the three-month period ended in July compared with a year earlier. The average wage rate for agricultural workers in Michigan, Minnesota, and Wisconsin increased 3.5 percent in July from a year ago.

Overall price increases were moderate; however, significant price increases were noted in fuel and fuel-dependent services and some building materials. Diesel fuel was up about 60 percent compared with a year earlier. Minnesota gasoline prices in mid-August were 38 percent higher than a year earlier. A number of delivery service operators in Montana have increased rates. Natural gas prices increased about 10 percent to 15 percent since the last report. Cement and concrete prices posted gains since the last report; they are about 10 percent to 15 percent higher than a year ago. In contrast, lumber prices were lower than a year ago.

Return to top

Tenth District--Kansas City

The Tenth District economy continued to expand in late July and August, although at a slightly slower pace than in the previous survey. Consumer spending increased solidly, and activity also improved in the commercial real estate, energy, and agricultural sectors. Expansion in manufacturing activity and labor markets was slower than earlier in the summer, and residential construction edged down. Wholesale price pressures increased considerably, and retail price pressures and wage pressures edged higher.

Consumer Spending

Consumer spending in the district expanded further in late July and August. Most retailers, mall managers, and restaurants continued to report solid year-over-year increases in sales. Contacts were generally pleased with back-to-school sales, and sales of appliances were also noted as particularly strong by several store managers. Most retailers were satisfied with current stock levels and plan few changes to inventories in coming months. Nearly all store managers remain optimistic about future sales, although a few expressed concerns about the impact of rising gasoline prices. Auto dealers reported continued strong growth in vehicle sales, driven largely by the continuation of manufacturers' employee price discounts. Virtually all dealers said sales were higher than a year ago. Sales of new vehicles, especially trucks and SUVs, were reported to be especially strong, while sales of large cars and used vehicles were said to be weak at some dealerships. Many dealers believe discount programs have drawn from future sales and thus expect a sizable sales dropoff once the discounts end. Travel and tourism activity in the district continued to rise in late July and August. Hotels generally reported increased occupancy rates from both the previous survey and a year ago, and several contacts expressed surprise at the apparent lack of impact from high gasoline prices. Most tourism contacts expect further increases in activity in coming months.

Manufacturing

District manufacturing activity expanded modestly in late July and August. Factory activity remained stronger than a year ago, but fewer plant managers reported recent increases in production, shipments, and orders than in the previous survey. Firms generally expect production to increase in the months ahead, although some producers of petroleum-based products and trucking equipment were worried about the impact of high oil and gasoline prices on future sales. Capital spending at district manufacturing plants continued to increase solidly, and many firms plan further expansions in plant and equipment in the months ahead. Consistent with this, expectations for future sales among producers of capital equipment were very high. Some plant managers reported difficulties obtaining materials, due in part to rail transportation delays, but most materials remained generally available.

Real Estate and Construction

Housing activity showed some signs of easing in late July and August, while commercial real estate activity improved further. Builders generally reported that housing starts edged down from the previous survey. Despite the recent decline, construction remained close to year-ago levels overall, with starts down slightly in several cities but up considerably in others. Starts are expected to ease further in coming months in most areas. Several builders reported difficulties obtaining cement, but other building materials were generally available. Real estate agents reported that home sales were up slightly from both the previous survey and a year ago. However, inventories of unsold homes were up considerably from a year ago in some markets. Year-over-year home price growth remained moderate in most cities, and Realtors expect little growth in home prices in the months ahead. Mortgage lenders reported a drop in refinancings. Overall demand for new home mortgages was steady, although demand for investment property mortgages continued to rise. Several lenders noted a slight increase in requests for non-traditional mortgages. Mortgage lenders expect overall loan demand to remain steady in the months ahead. Commercial real estate activity in the district continued to improve in late July and August. Vacancy rates were flat or down slightly across the district, and prices for office and other commercial space were up modestly in most cities. Commercial real estate agents generally expect further improvements in office markets in the months ahead.

Banking

Bankers report that loans edged up and deposits held steady since the last survey, boosting loan-deposit ratios somewhat. Demand rose slightly for consumer loans, home equity loans, and residential construction loans. Demand for home mortgage loans, commercial and industrial loans, and commercial real estate loans was little changed. On the deposit side, all types of accounts held steady. Almost all respondents increased their prime lending rates since the last survey, and half of respondents also raised their consumer lending rates. Lending standards were unchanged.

Energy

District energy activity expanded solidly in late July and August. Although several contacts continued to cite shortages of rigs and workers, the count of active oil and gas drilling rigs in the region increased for the first time in several surveys. Most energy firms plan further increases in drilling in the months ahead, as they expect natural gas prices to increase slightly and oil prices to remain high. To help transport increased natural gas output from the Rocky Mountains, several new pipelines are either under construction or being planned.

Agriculture

Agricultural conditions in the district improved slightly in late July and August. Rural bankers reported that cooler temperatures and recent rains helped improve the condition of the soybean crop, which had been under considerable stress. However, the recent rainfall is expected to provide little, if any, boost to corn yields this late in the growing season. In the livestock market, cattle prices fell due to rising U.S. cattle supplies, renewed live cattle imports from Canada, and limited demand growth. Nevertheless, cattle producers were generally optimistic about future activity.

Labor Markets and Wages

Labor markets continued to firm, though at a somewhat slower pace, while wage pressures edged higher. Hiring announcements continued to exceed layoff announcements, but by a smaller margin than in the previous survey. Also, the percentage of contacts experiencing labor shortages was unchanged after rising in previous surveys. Still, two large MBA programs in the district said demand for their graduates was much higher than a year ago, and many firms noted difficulties finding specific types of workers, such as mechanics, machinists, welders, rig workers, hotel workers, and retail salespeople. The percentage of firms reporting wage pressures ticked up slightly from recent surveys, although the share remained much lower than before the last recession. A higher percentage of contacts than in recent surveys expect wage pressures to increase slightly in the months ahead.

Prices

Wholesale price pressures increased considerably in late July and August, and retail price pressures edged up. The share of manufacturers reporting materials price increases rose sharply after easing in recent surveys. Price increases were reported for a wide variety of inputs, but especially for petroleum-based materials. The share of manufacturers raising output prices also increased, and a higher percentage of plant managers than in previous surveys expect materials prices and output prices to rise in the months ahead. Most builders also reported increased materials costs, especially for cement, although prices for lumber generally eased somewhat. Somewhat more retail stores than in the previous survey reported raising selling prices, and a number of stores plan further increases in prices. Hotels generally reported higher daily room rates than in the previous survey, and additional increases are expected in coming months.

Return to top

Eleventh District--Dallas

Eleventh District economic activity continued to expand at a moderate pace from mid-July to late August. High energy prices have led contacts to be cautious about the economic outlook although most did not see evidence of slowing. Energy activity remained very strong. Construction-related activity also was still brisk. Manufacturing activity expanded moderately, with output constraints in some sectors. Activity in the service sector was also expanding moderately. Retail sales reports were mixed. Financial Service contacts expressed concern that there might be too much credit chasing too few deals. Agricultural conditions declined slightly.

Prices
Energy prices remained high and rising since the last Beige Book, pushing up transportation, shipping and utility costs. Most industries reported difficulty passing these costs on to customers, although some prices of goods and services were higher.

Crude oil prices have risen from under $60 per barrel of West Texas Intermediate crude oil in early July to over $67 per barrel in late August (before Hurricane Katrina). Demand for crude oil has been high, but domestic inventories remain at five-year high levels. Strong demand for natural gas has pushed prices up from $7 dollars per thousand cubic feet in early July to near $10 (pre Katrina). Natural gas inventories were 18 percent above the five-year average in May, but growing consumption has squeezed them down to only 6 percent above the five-year average level. Demand for gasoline remained very strong, and prices at the pump rose 32 cents per gallon since early July (and before Katrina). A series of refinery outages prior to Hurricane Katrina pushed down inventories more than is normal for this time of year.

Chemical prices were mixed. Demand and prices for ethylene and propylene rebounded after falling earlier this summer. A series of plant outages helped erase an overhang of ethylene inventory. Prices fell for bottle resins and PVC. Polystyrene prices fell along with falling component prices of styrene and benzene. The recent surge in oil and natural gas prices has raised concerns in the chemical industry because the companies are concerned they can not raise prices sufficiently to maintain profit margins.

Lumber prices were lower, and contacts say they are unable to pass higher energy costs to their customers. Apparel producers say high oil prices have increased the cost of producing polyester fabrics, but selling prices remain unchanged. Contacts report "rumblings of steel price increases" and expressed concern that steel prices would increase this fall like they did last year. For example, prices for reinforcing steel will increase 10 percent in September.

Airfares have increased "pretty significantly" in some markets but not as fast as fuel costs.

One airline noted that for the first time the company's fuel costs are exceeding wage costs.

Labor Market
The labor market continues to tighten, with more reports of hiring, difficulty finding workers and wage pressures. The accounting, trucking and energy industries are still reporting problems finding workers, but scattered hiring problems are sprouting up in manufacturing, where a few contacts say they are having difficulty finding both skilled and, in a few instances, unskilled workers.

Firms are resisting wage increases, but report continued pressure on benefits. Still, pressure on salaries is growing, particularly for skilled workers. Accounting firms say their own wages are rising faster than fees. One manufacturer gave lump sum bonuses to employees rather than increase hourly wages. Wages have declined for some positions. Temporary service firms report intense downward pressure on fees despite increased demand.

Manufacturing
Strong home building continued to spur demand for construction-related manufactured products, such as brick, concrete, cement and metals. Producers of brick, concrete and cement report selling product as fast as it is produced and say order backlogs are long. Demand was up for apparel manufacturers.

Chemical producers said Asian demand returned after weakness in June and July, but sales of PVC and bottle resins were lower. Demand for lumber has been gradually slowing, which contacts attribute to higher energy costs and construction disruptions. Sales of paper products have been sluggish and lower than a year ago, largely because of import competition.

High-tech manufacturers reported steady growth in sales and orders. Consumers continued to purchase electronic products and services at a good pace, especially high-end products such as digital cable and advanced cell phones. Demand for industrial and medical equipment was strong. Demand for food products has held steady after slowing in the second quarter, but demand remains stronger than a year ago. Contacts suggest that demand for food to supply restaurants has softened because high fuel costs are eating into consumers' pocketbooks.

Refiners experienced a series of outages that sharply reduced capacity utilization on the Gulf Coast to under 90 percent, but capacity had recovered to near 100 percent prior to Hurricane Katrina.

Services
Demand for temporary staffing services strengthened, with particularly robust activity to provide workers to light industrial manufacturers and the oil and gas sector. Demand picked up to provide high-skilled workers in the defense, high-tech and insurance sectors. Contacts at accounting firms reported continued strong demand. Activity was still driven by compliance with Sarbanes-Oxley regulations, CPA work, taxation, mergers and acquisition. Legal firms said activity continued to be driven by real estate transactions, corporate work and some mergers and acquisitions. Legal contacts say slowing demand for activities such as bankruptcy and litigation is a positive indicator of economic growth.

Transportation firms reported strong demand, although many anticipate growth to slow over the next year. Railroad and trucking firms report large volume increases in construction-related materials. High oil prices have forced trucking firms to add fuel surcharges, which have led some customers to switch to rail shipping. Railroads report higher traffic volumes for almost all commodities, including gas alternatives like petroleum coke. Among sectors with observed decreases in traffic volumes are chemicals, cars and appliances. Airlines said passenger demand was up, possibly because some customers are finding it less expensive to fly than to drive.

Retail Sales
Retailers say overall sales have been largely unaffected by high energy prices. While there has been a noticeable slowing of sales to lower income consumers, sales have improved to high end customers, such as those purchasing digital TVs. Demand for cars picked up significantly in June and July, driven by numerous manufacturer price discounts. Demand fell in August, which contacts attribute to low inventories and "payback" for heavy sales in July.

Construction and Real Estate
Demand for new homes stayed strong over the past six weeks. Sales of higher priced homes continued to rise. The homebuilding market remains very competitive, however, and builders say they cannot raise prices, especially in Dallas and Houston. Existing home sales are rising steadily in Austin and Houston, but are flat in Dallas, although contacts there consider the market "healthy."

Some contacts expressed concern about the large amount of condominium and town-home construction near downtown Dallas, questioning whether all the "contracted" units would actually close. Many of the purchases are being made by investors, they say, and are actually just "reservations" on properties currently under construction.

Office markets continued to improve steadily, with rising occupancy and firming to rising rents. Investment activity in the office sector remains at high levels. Demand for apartments is still rising slowly and rents continued to stabilize. The San Antonio market is a notable exception, where rents are edging down, construction of new units remains robust and occupancies are flat.

Financial Services
Respondents reported fairly strong loan demand and business conditions. Contacts expressed optimism about the regional economy and prospects for future loan growth. Credit quality standards remain unchanged, but pricing is "very, very competitive" and loan spreads have declined. As one contact said, "there is too much money chasing too few deals."

Energy
Energy activity continues to expand, with an increasing rig count in the U.S. and Texas. Shortages of equipment and labor still constrain activity; manufacturing and service firms report difficulty keeping up with demand and rapidly growing backlogs. Service firms say pricing is "very good." Scheduling and equipment availability are major issues for customers, and many are seeking to sign up for multiple jobs to guarantee availability of rigs and services.

Service companies reported that numerous capital expansion programs are underway. Rig construction is the most widely noted capital spending, mostly land rigs but also construction of large semi-submersibles that won't be delivered until 2007 or 2008. These large rigs are pointed to as growing faith in a long cycle for high oil and natural gas prices. Other areas cited for capital expansion were oil tools for internal and rental purposes and pressure pumping.

Agriculture
Rain replenished moisture levels in the northern parts of the District, but the southern region is still dry, reducing hay production, stressing crops and causing cotton crop losses. Reduced hay production increased supplemental feeding and pushed up fodder costs. High fuel prices are a major concern for farmers and ranchers, increasing the cost of irrigation, fertilizer and chemicals.

Return to top

Twelfth District--San Francisco

The Twelfth District economy expanded at a solid pace in late July and August. Inflation was reportedly well contained, except for frequently noted price jumps in energy-intensive products and services. Labor markets tightened a bit further, particularly for several high-skill occupational categories. District retailers and service providers reported solid demand in recent weeks, and manufacturing activity continued to expand throughout the District. Demand for District agricultural and resource-related products was strong. Activity in residential real estate markets remained robust, and commercial real estate markets improved further. District banks reported strong loan demand and high overall credit quality.

Wages and Prices
Contacts reported that increases in inflationary pressures were limited to products and services for which energy costs are a significant component. For instance, prices were reported to have increased notably for transportation services, fertilizers, and some construction materials. More generally, though, prices for most other goods and services remained stable, with contacts citing strong competitive pressures and continued gains in production efficiencies as the primary reasons for pricing restraint.

District labor markets tightened a bit further during the survey period, especially for high-skill occupations within the financial, construction, information technology, and health-care services sectors. As a result, increases in compensation for these positions were prevalent. By contrast, wage pressures outside of these sectors and for less skill-intensive occupations reportedly remained modest. However, contacts continued to report that for most sectors and occupations, non-wage costs, such as benefits, grew faster than base salaries.

Retail Trade and Services
District retailers and service providers reported solid sales and improved inventory positions in the most recent survey period. Sales of both new and used motor vehicles, particularly light trucks, were strong; sales of domestic brands soared, spurred by generous discounts by manufacturers. Retail sales outside of motor vehicles also reportedly did well, especially for apparel. Demand for District services remained strong overall. District travel and tourist activity was robust in many areas, as observed by further increases in hotel occupancy rates and average daily room rates in Hawaii and California. The tourism sector in Hawaii benefited from higher numbers of both domestic and international visitors.

Manufacturing
Contacts reported solid demand for District manufactured products in late July and August. Respondents at semiconductor firms reported strong orders and sales and generally balanced inventories, while contacts at other IT producers noted that demand softened somewhat. Orders increased at commercial aircraft and defense product firms. Some food processors

reported a pickup in foreign demand. Finally, many manufacturers noted higher costs for energy and energy intensive inputs; not all of the manufacturers were able to pass these cost increases on to final sales prices.

Agriculture and Resource-related Industries
Demand remained solid among District agricultural and resource-related producers. Prices were stable for a variety of agricultural products, including cotton, fruits and vegetables, and beef. Of note, contacts reported that overall production costs have been boosted by higher energy and transportation costs. In the energy sector, producers of oil and natural gas operated at or near full capacity and inventories remained close to last year's levels.

Real Estate and Construction
Residential real estate markets in the District continued to be robust, while commercial real estate markets improved further in recent weeks. The pace of home sales, price appreciation, and construction, including home improvements was rapid in most areas. However, several contacts indicated that the housing market may be leveling off, as witnessed by increased time on the market for single family homes and a flattening of price increases. On the commercial side, demand strengthened further; office vacancy rates fell and rental rates increased in many District markets, notably in Southern California. Construction activity was strong overall throughout the District, reflecting a full pipeline of residential, commercial, and large public projects.

Financial Institutions
District banking contacts indicated generally solid loan demand and good credit quality in late July and August. Demand for business lending continued to improve in many markets. The volume of commercial real estate, construction, and home loans remained at high levels in most areas and grew further in some.

Return to top
