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 Philadelphia based on information collected before October 11, 2005. This document summarizes comments received from businesses and other contacts outside the Federal Reserve and is not a representation of the views of Federal Reserve officials.

Economic activity continued to expand in September, according to information received by Federal Reserve District Banks. Most Districts described the pace of activity as moderate or gradual. Richmond reported some quickening in the pace of growth while New York reported a slowdown. Atlanta reported mixed economic conditions, with significant negative effects on the District economy from hurricane damage. Dallas reported expansion overall but also experienced noticeable disruptions to the District economy as a result of Hurricanes Katrina and Rita.

Retail sales of general merchandise increased in most Districts, but a number of Banks reported that retail sales were either below plan or weak. Auto sales fell throughout the Districts. Tourism activity was mixed. Service sector activity continued to expand. Manufacturing advanced in all Districts except St. Louis and Atlanta. Commercial real estate markets continued to firm up. Residential real estate activity remained generally strong, but reports that demand for homes has eased have become somewhat more common. Agricultural conditions were viewed as mostly good. Mining and energy production increased except in the Gulf of Mexico, where damage to onshore and offshore oil and gas facilities is still being repaired. Bank loans and deposits rose.

Employment has been rising, and Federal Reserve Districts reported some tightening in labor markets. Wage increases have been moderate, although a number of Districts noted increased upward pressure on wages and salaries in the service sectors and for some skilled occupations in several industries. All Districts reported cost increases for energy, petroleum-based products, building materials, and shipping. Several Districts indicated that input cost increases are being passed through to retail prices.

Consumer Spending

Retail sales of general merchandise rose moderately in most of the Federal Reserve Districts in September, but other Districts reported some softness in the retail sector. Sales increased in Boston, Philadelphia, Cleveland, Richmond, Chicago, Minneapolis, Kansas City, and Dallas. Atlanta District retailers also had increased sales except in areas where hurricane damage forced stores to close. Retailers in New York and St. Louis reported that sales in September had not met their plans, and retail sales in San Francisco were said to have weakened somewhat. Retailers in many Districts noted that consumer confidence has ebbed as gasoline prices have risen.

Auto sales fell in the Districts that received reports from auto dealers. The drop came as manufacturers ended their discount programs. Sales of light trucks and large sport utility vehicles were reported to have declined sharply. However, within the generally slower sales environment, Atlanta and Dallas reported that sales of smaller, more fuel-efficient cars and hybrid vehicles were strong.

Reports on tourism and leisure travel were mixed. New York, Chicago, and San Francisco reported ongoing gains in tourism business and high rates of hotel occupancy. Richmond and Minneapolis reported slower tourism activity, although Minneapolis indicated an increase in business travel was boosting hotel occupancy. Tourism in Kansas City was said to be largely unchanged after a period of strong expansion. Tourism activity declined in Richmond, and fell in Atlanta as a result of hurricane damage in New Orleans and along the Mississippi Gulf Coast.

Services
Service activity expanded in almost all the Districts that reported on this sector. Health-care services expanded in Boston, St. Louis, and San Francisco. Professional and technical service business increased in Boston, Richmond, St. Louis, and Dallas. Philadelphia reported gains in business services and information technology services. Transportation activity was strong, according to New York, Philadelphia, Cleveland, St. Louis, Dallas, and San Francisco. Atlanta gave a mixed report on transportation: demand for shipping was said to be strong, but damage to port facilities and railroads was severely limiting capacity.

Manufacturing
Manufacturing activity rose in all Federal Reserve Districts except St. Louis, where manufacturers gave mixed reports, and Atlanta, where manufacturers along the Gulf Coast are still recovering from hurricane damage. There were noticeable increases in demand for food products in Philadelphia, Dallas, and San Francisco, but St. Louis reported decreased demand at food processors there. Increased demand for industrial equipment was noted by Chicago, St. Louis, and San Francisco. Boston and St. Louis reported increased demand for pharmaceuticals. Richmond's producers saw increased demand for chemicals and a variety of durable goods. Cleveland and Kansas City also reported increased demand for durable goods generally. Dallas and San Francisco cited increased demand for building materials, and Atlanta noted increased demand for manufactured housing as part of the rebuilding effort in hurricane-affected areas. Producers of metals and metal products reported rising demand in Cleveland, Richmond, and Chicago, but they reported slower demand in Philadelphia and St. Louis.

Real Estate and Construction
All the Districts reporting on commercial real estate conditions noted rising demand for office, retail, or industrial space. Increased demand for commercial space was reported by New York, Richmond, St. Louis, Minneapolis, Kansas City, Dallas, and San Francisco. Cleveland and Richmond cited growing construction of commercial buildings. Atlanta reported a surge in demand for commercial space in areas where firms relocated after the hurricanes struck the Gulf Coast. Chicago indicated that demand for commercial space was

rising in many parts of the District, although not in downtown Chicago. Office vacancy rates were declining in New York, St. Louis, Kansas City, and Dallas. San Francisco reported rising commercial rental rates. Chicago indicated that rents rose in areas other than downtown Chicago. Dallas reported that rents were holding firm but landlords were reducing incentives.

District banks gave mixed reports on residential real estate markets. Although levels of activity appeared to remain generally high, a number of Districts indicated that demand for housing was slowing in some regions. Residential real estate activity continued to expand in Chicago, St. Louis, and Dallas, and remained strong in San Francisco. Richmond reported continued strength in housing construction, but indicated that demand was easing in some parts of the District. Minneapolis reported that home sales had slowed in some areas but were strong in others. Boston reported that homes were taking longer to sell, as did New York. Cleveland reported little growth in residential construction. Kansas City reported some easing in home sales and a growing inventory of houses for sale. Chicago also reported higher inventories of unsold homes on the market. Atlanta reported a strong increase in demand for housing in areas where evacuees from the coast were relocating, but indicated that demand for homes was moderating elsewhere in the District.

Agriculture

Agricultural conditions have been mostly good, but not uniformly so around the country. Atlanta received mostly positive crop and livestock reports, although the storms damaged at least half of the Louisiana sugarcane crop. Chicago reported that corn and soybean yields have been greater than expected. Crop yields in Minneapolis were up for most crops. Kansas City reported favorable harvest conditions and good progress in winter wheat planting. Less positive reports came from St. Louis, where the rain brought by the hurricanes damaged corn, rice, and cotton crops. Dallas reported that hot, dry weather in parts of the District has stressed crops, although cotton yields were high. Richmond reported that hot, dry conditions were hindering fall planting of winter wheat, rye, oats, and barley. Kansas City said that the transportation difficulties associated with the hurricanes hampered crop exports. Chicago also reported that transportation of grains was disrupted, and farmers were unable to obtain adequate storage space; As a result, crops were left in the fields or sold at lowered prices.

Natural Resources Industries

Districts reporting on the energy sector noted strong demand in the midst of supply constraints. The limits on supply are a result of hurricane damage to oil and gas production and refining facilities along the Gulf Coast and to shortages of drilling equipment and oilfield workers elsewhere. Atlanta reported that production in the Gulf remained severely disrupted, and that safety inspections and repair work continued. Kansas City saw an increase in the rig count, but indicated activity could have expanded further if more equipment and workers were available. Dallas also reported increased activity, but noted that the loss of rigs in the Gulf had cut oil and gas production, and that damage to staging areas on the coast was retarding the repair effort. San Francisco reported that producers of natural gas in that District were operating at or near full capacity. Minneapolis reported that mining and energy activity was steady at a high level.

Financial Services and Credit

Lending rose in most Federal Reserve Districts in September. Commercial and industrial lending advanced in Philadelphia, Richmond, Chicago, Kansas City, and San Francisco. Commercial and industrial loan demand was reported to be steady in New York and St.

Louis, but business borrowing slowed in Cleveland. New York noted decreased demand for consumer loans and residential mortgages. Chicago and Kansas City reported an easing in demand for residential mortgages, but St. Louis reported gains. Dallas and San Francisco noted growth in lending in general. St. Louis, Kansas City, and Dallas reported growth in deposits. In the Atlanta District, small banks in areas devastated by the hurricanes are concerned that they will not retain their customer base if their market areas do not regain their resident populations. Competition for loans was reported to be very intense in most regions.

Employment and Wages

Federal Reserve Districts reporting on employment noted tightening in labor market conditions. Increased hiring was noted in a variety of industries. Boston reported increased demand for professional and technical service workers. New York cited stepped up hiring of office workers, especially in the financial industry. Increased hiring in the financial sector was also reported by Chicago, Minneapolis, Dallas, and San Francisco. Philadelphia and Cleveland noted that trucking firms in their Districts were having difficulty attracting and retaining drivers. Dallas also indicated strong demand for truck drivers. Chicago reported increases in hiring at firms in the software and telecommunications industry and among chemical companies, but noted layoffs among manufacturers of motor vehicles, paper products, and communications equipment. St. Louis reported increased hiring in the lodging industry and the health care sector. Minneapolis and San Francisco reported hiring in the mining industry, and Kansas City and Dallas reported increased hiring in the energy industry. Richmond and Chicago noted an upturn in hiring at temporary staffing companies.

Atlanta reported significant problems resulting from dislocation of workers caused by the hurricanes. Temporary help agencies have been active in recruiting workers for disaster relief and cleanup operations. In locations outside the areas damaged by the hurricanes, employment centers have been established, and job fairs have been held to assist displaced workers find jobs. However, employers in the Dallas District have looked to evacuees to bring needed skills to the District labor pool.

Most of the Districts reporting on wages said recent increases have been moderate, and Kansas City indicated that wage pressures have edged down. However, Richmond noted that wages in the service sector have been increasing briskly, and San Francisco reported that wage pressures have risen noticeably for skilled workers in finance, construction, information technology, resource extraction, and health care. Employers in the Philadelphia District said their benefit costs have been rising steeply. San Francisco reported that employers there said their benefit costs have been rising faster than wages, but not as rapidly as in previous survey periods.

Prices

All Federal Reserve Districts reported a pickup in cost pressures from recent increases in the prices of energy, petroleum-based products, and shipping. Reports of price increases for building materials, such as cement, sheetrock, and lumber, were also widespread. These price increases have come largely in the wake of the recent hurricanes, as the supply of oil and natural gas has been disrupted and repair and rebuilding have increased the demand for construction materials. Nevertheless, many business firms indicated to the District Banks that they expect high prices for energy and construction materials to persist. In addition, New York and Kansas City reported a general escalation of costs for manufacturing inputs.

While a number of Districts noted increases in prices of final goods, others continued to report that those prices remain relatively stable. Chicago cited price increases for pharmaceuticals and air travel. In Richmond and Atlanta, retailers and other business firms reported passing their cost increases through into their selling prices, and in Philadelphia and Dallas, large numbers of business firms said they have raised, or plan to raise their prices. However, San Francisco reported that prices of final goods have remained stable, and Boston and Chicago said that the ability of businesses in their Districts to raise prices downstream was limited.

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First District--Boston

Most business contacts in the First District report year-over-year growth in sales or revenues in the third quarter, with some sectors enjoying a pick-up in the pace compared with earlier quarters and others seeing slower growth. Some retailers cite recent reductions in consumer spending resulting from high gasoline prices, which they predicted earlier, but had not yet observed six or 12 weeks ago. Manufacturers are facing cost increases, but vary considerably in their ability to raise their own prices. Residential real estate markets in New England are becoming "more reasonable" as they cool slightly from record highs.

Retail
Retail respondents in the First District report mixed results for the quarter ending in September. While the quarter's sales were mostly ahead of year-earlier levels, several contacts note a marked slowdown in the closing weeks.

According to one contact in the apparel industry, same-store sales were up more than 4 percent in the third quarter partly due to better merchandising decisions, but year-to-date sales are virtually unchanged from last year. Another apparel contact noted that same-store sales were either up marginally or flat compared with a year ago in the months of August and September, with overall year-to-date sales still up just slightly from last year. Both respondents emphasized the negative impact skyrocketing fuel prices are having and threaten to continue to have on consumer spending. A contact in the surplus merchandise market echoed this sentiment and remarked that sales were okay until gasoline hit the $2.00 mark, with "the bottom falling out" once prices surpassed $2.50. An automobile dealers' group indicates that sales were strong in the summer months due to a successful employee-pricing incentive, but have now slowed dramatically compared to year-ago levels. Sales in the lumber business were strong according to one contact, but he also expected 2005 sales to end up flat compared to last year.

Inventory levels are mixed, but generally in line with plans. Vendor prices and selling prices are mostly stable, although several respondents report price increases for petroleum-based products. Capital spending is focused on new store openings. Some respondents note increased staff turnover; they are hesitant to hire other than for replacement or to staff new stores until business is better.

Almost all contacted retailers are less optimistic than in previous months; they remain cautious in their outlook, with many revising previous forecasts. Concerns include rising oil prices, the war in Iraq, and interest rates.

Manufacturing and Related Services
For the most part, First District manufacturing sales are continuing in line with first and second quarter trends. Slightly more than one-half of First District contacts in manufacturing and related services report that sales are currently running near-zero to 5 percent higher than a year ago. The others report greater growth, mostly as a result of strong demand for defense and aircraft products and biopharmaceuticals. Contacts characterize any negative revenue impacts of Hurricanes Katrina and Rita as relatively minor--in all cases less than 2 percent in the third quarter--and some capital goods makers foresee added business associated with the reconstruction of damaged areas.

Many respondents describe metals costs as high but no longer rising, and some mention that paper prices have not subsided after increasing earlier in the year. Distribution and transportation costs are said to have risen in the last several months. Reports on selling prices vary considerably. At the high end, a paper products company reports that its prices are up 7 to 25 percent from levels in the second quarter. On the other hand, some other firms indicate that competition or long-term contracts have left them with no ability to pass cost increases on to their customers for the time being. Most contacted manufacturers are between these extremes. For example, a housewares company has managed to improve margins by increasing selling prices since mid-year, and a couple of publishing companies describe their customers as being willing to pay a little more for value.

Companies generally report domestic headcounts are flat or up a little in response to growing needs for professional and technical workers. Wage and salary increases are in the range of 3 percent to 4 percent, with many manufacturers citing bonuses as a means of accommodating temporary situations.

Capital spending is reported to be increasing somewhat, with a couple of contacts indicating that they plan to ramp up IT spending in 2006. On the whole, however, manufacturers' attitudes are cautious in light of a perceived need to contain costs or to react to business uncertainties.

Manufacturers generally see "more of the same" for the remainder of 2005 and in 2006. Several mention downside risks associated with federal government budget or regulatory policy, and some express concern that higher energy prices could constrain their customers' spending.

Selected Business Services
Almost all First District advertising and management consulting contacts report third quarter revenues above year-earlier levels. While the majority of companies say clients continue to increase their discretionary spending, a handful of contacts note a recent pullback. Demand from clients in technology-related industries appears robust, while reports on healthcare demand are mixed, and government-related demand is said to be weak.

Nearly all responding companies have kept prices flat relative to a year ago. Labor-related costs have increased modestly, and marketing firms note a rise in fuel expenses. Companies are making only minimal adjustments to headcounts to accommodate demand, with typical wage and salary increases in the range of 3 percent to 5 percent.

Residential Real Estate
Housing prices across New England continue to rise, with contacts reporting year-over-year

price appreciation on the order of 5 percent to 9 percent. Most respondents call these price increases more reasonable than in quarters past. Sales volume continues to increase, although several contacts mentioned that year-over-year price and volume increases may mask a flattening during the most recent quarter.

In the Greater Boston market, condominium inventory is up 50 percent while single family inventory is up about 25 percent. Similarly, inventory is increasing or stable in other New England markets due to construction and trade-up selling. Affordable inventory attractive to first-time buyers is low, particularly single-family houses.

Although many markets are still seller-oriented, with lower than normal selling times, the balance may be shifting somewhat towards buyers. Contacts say buyers are making fewer full price offers and negotiating harder. Times on the market are creeping up as sellers struggle to maintain high initial prices.

Moving into the winter months, respondents expect the region to see a seasonal slowing as cold weather and holidays dampen activity.

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Second District--New York

Economic growth in the Second District has moderated since the last report. Consumer confidence in the region declined moderately in September, and consumer spending has been weaker, in part due to unseasonably warm weather. The housing market has shown signs of softening, especially at the high end, though the rental market has continued to strengthen. On a more positive note, labor markets and commercial real estate markets have continued to firm, and tourism has continued to show exceptional strength. Freight traffic at the Port of New York and New Jersey has been robust and reportedly little affected by the recent Gulf hurricanes. Generally, manufacturers indicate little or no disruption from the storm and report ongoing improvement in business conditions. Finally, bankers report weaker loan demand from the household sector but little change in delinquency rates or credit standards.

Consumer Spending
Retailers report that sales were below plan in September, with weakness again attributed to unseasonably warm weather and high energy prices. Overall, comparable-store sales were little changed from a year earlier, though a number of major Manhattan stores report brisk gains, attributed to strong tourism. Despite the sluggish sales, retail inventories were said to be at or near desired levels. There was little change in retail selling prices, aside from gasoline. Consumer confidence fell moderately in September, based on both Siena College's survey of New York State residents and the Conference Board's survey covering the Middle Atlantic region.

Tourism remained exceptionally strong in September. Preliminary reports from Manhattan hotels point to a record month for overall revenues: occupancy rates continued to hover near 90 percent while room rates soared nearly 20 percent above a year earlier, pushing revenues above the peak levels of 1999 and 2000. Moreover, an industry contact indicates increased plans for new hotel development. Broadway theaters report that business strengthened sharply in September, following somewhat of a lull in July and August. Both revenues and attendance were up more than 10 percent from the same time last year.

Construction and Real Estate
The region's housing market has shown further signs of softening since the last report. New Jersey homebuilders indicate that they have not lowered prices thus far, but they are no longer raising prices, despite sharp increases in the costs of lumber and other building materials, which are expected to rise further once post-hurricane rebuilding gets underway. One industry contact in New Jersey notes that existing homes are taking longer to sell and that the inventory of homes on the market has increased noticeably. This contact also expresses concern about increased use of bridge loans, which are typically taken out by home buyers that have not yet sold their old home.

Manhattan's co-op and condo market was mixed in the third quarter. While selling prices continued to increase, the number of transactions declined and the inventory of apartments has increased--particularly at the high end of the market. However, a contact at one of Manhattan's leading real estate firms reports continued gradual strengthening in the rental market: while the supply of available apartments has been boosted by more individuals renting out investment property, new inventory is being absorbed without concessions. In contrast with the sales market, the high end of the rental market is said to be doing particularly well.

Commercial real estate markets across the New York City metropolitan area generally strengthened during the third quarter. Office vacancy rates fell to a four-year low throughout Manhattan, as well as in Brooklyn, while rates were virtually unchanged in Long Island and Northern New Jersey. However vacancy rates edged up in Westchester and Fairfield Counties. Industrial markets were also steady to stronger: vacancy rates were steady at a relatively low 5 percent in New York City and Long Island, and at just below 8 percent in northern New Jersey. In Westchester and Fairfield Counties, industrial vacancy rates were down modestly but still fairly high at 13 percent.

Other Business Activity
A major NYC employment agency, specializing in office jobs, reports that the pickup in hiring activity noted in August has gained further momentum in recent weeks, led by the financial sector. September was characterized as a very busy month and much stronger than a year earlier, and this contact reports that there are substantially fewer people looking for work than a year ago.

A contact at the Port of New York and New Jersey reports robust shipping activity in recent months, following a second-quarter lull, and indicates little effect from the Gulf Coast hurricanes. A number of manufacturing contacts in New York State report that the hurricanes caused some disruptions in business during September, but most of these disruptions were characterized as minor. More generally, manufacturers report ongoing improvement in general business conditions but have become slightly less optimistic about future conditions, noting widespread escalation in input prices, which is expected to continue. Separately, purchasing managers in the region report mixed results for September: those in the New York City area indicate continued favorable conditions, but those in the Buffalo and Rochester areas note some slowing in activity.

Financial Developments
Small to medium-sized banks in the district report decreased demand for consumer credit and residential mortgages but steady demand for commercial loans and mortgages. One in four

bankers indicate weakening demand for consumer loans, while fewer than 10 percent report increased demand. Refinancing activity remained weak: 42 percent of bankers report decreases, while only 6 percent report increases. Credit standards were mostly unchanged since the last report, except on commercial mortgages, where some tightening in standards was noted. Higher loan rates were reported for all loan categories--particularly for commercial borrowers. As in the prior survey, almost all of the banks surveyed report increases in average deposit rates. Delinquency rates remain unchanged across all loan categories except commercial and industrial, where there was a modest decrease.

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Third District--Philadelphia

Economic activity in the Third District advanced slowly in September. Manufacturers reported a slight increase in shipments during the month but a steady rate of new orders. Retail sales of general merchandise rose from August to September, but year-to-year gains were modest for most stores. Auto sales fell in late September and remained slow in early October. Banks and other lenders reported that lending continued to move up in September, but many said loan growth had slowed. Service firms generally indicated that their business activity has been expanding at a steady, moderate rate. Business contacts in all industries expressed concern about rising energy costs and price increases in general. The number of firms reporting pressure on profit margins, primarily from rising energy and material costs, has increased. Many firms are looking for ways to reduce energy expenses but most have not yet made firm plans to implement any energy-saving measures.

Third District business contacts generally expect business activity in the region to continue to expand, but several expect growth in the fourth quarter to be slower than in the third quarter. Manufacturers expect business to pick up from the September pace, but not strongly. Retailers anticipate slow growth and difficulty meeting fourth-quarter sales targets. Auto dealers expect slow sales in the months ahead. Bankers anticipate continued growth in lending, but many expect the pace of loan growth to ease. Service firms expect activity to advance at about its current rate through the rest of the year.

Manufacturing
Manufacturers in the Third District reported generally steady demand for their products in September. About half of the companies contacted said that new orders received during the month were level with orders received in the prior month, and the number of firms reporting decreases was offset by an equal number reporting increases. On balance, shipments increased among area manufacturers, but order backlogs fell. Among the District's major manufacturing sectors, business improved in September for producers of food products, apparel, and industrial materials but weakened for makers of furniture and chemicals. Producers of primary metals and transportation equipment reported continuing declines in orders for their products.

Overall, manufacturers expect growth in business activity to pick up in the months ahead. About one-third of the firms contacted in September expect their shipments and orders to increase during the next six months, and one-fourth expect decreases. Capital spending plans among District manufacturers call for stepped-up expenditures, on balance, but in September the number of firms scheduling increased outlays remained somewhat lower than in the first half of the year.

Retail
Retailers in the Third District, on balance, reported increases in sales from August to September; for most year-over-year gains were modest. Also, the majority of retailers reported a decline in store traffic month-to-month and compared to a year ago. Store executives said the exceptionally warm weather during the month reduced sales of fall apparel. They also said consumers appeared to be limiting discretionary spending in the face of rising energy costs. Stores selling teen-oriented merchandise or luxury goods posted greater annual sales increases than other types of stores. Discount stores had moderate gains. Stores specializing in mid-price merchandise had mixed results; some had slight year-over-year increases, and others had slight decreases.

Slow sales of fall apparel have left some stores with large inventories, and they have stepped up price reductions and added sales events to their calendars for October. Looking ahead, most retailers in the region expect sales growth to be slow through the rest of the year. Some said they expect their fourth-quarter results to fall short of plan unless consumer confidence improves.

Auto dealers in the region reported a sharp drop in sales as manufacturers' discount programs ended in September. Inventories of 2005 model year vehicles were nearly depleted, except for large sport utility vehicles. Dealers reported a sharp decline in demand for these vehicles. Dealers said sales of new model year vehicles have been slow, and they expect sales for the fourth quarter to remain well below the pace achieved in the first three quarters of the year.

Finance
The volume of loans outstanding at Third District banks rose in September compared with August and with September of last year. However, banks gave mixed reports on the magnitude of the gains; many indicated that loan growth has been sluggish, although a few said it has been robust. Among major credit categories, growth has been relatively faster for commercial and industrial loans and credit card lending, and less rapid for other types of consumer loans and residential mortgages. All the financial companies contacted for this report indicated that competition for loans, as well as deposits, has been strong among banks and other financial institutions. Bankers and other lenders in the District expect lending to continue to move up at around the current pace for the rest of the year, but several said they expect growth to be slower in 2006 than in 2005.

Investment companies reported steady overall cash inflows in recent weeks. They indicated that inflows to money market funds have increased substantially and inflows to bond funds have risen somewhat, but inflows to equity funds have eased. Investment company officials said investor confidence appears to be stable, although both individual and institutional investors have been reluctant to increase the portion of their investments allocated to stocks or long-term bonds.

Services
Most of the Third District service firms contacted in early October reported continuing moderate growth in activity and at about the same pace as during the summer months. Firms providing information services have picked up some business from new clients. Activity at business services firms has been growing as their existing clients make more use of their services. Trucking firms reported continuing high rates of activity, resulting in difficulty finding sufficient numbers of drivers. Most of the service sector firms contacted for this

report expect business to continue to advance at around its current growth rate during the balance of the year. However, firms providing business services noted that their customers are looking for ways to reduce operating expenses in order to cope with rising energy costs, and they expect the amount and price of outsourced services will be reviewed as part of this process.

Wages and Prices
Business firms in the Third District generally indicated that wages have not been rising at a rapid pace, but nearly all of those surveyed said they face continuing steep increases in benefits costs. Many firms said they were reviewing ways to reduce these costs as they prepare their 2006 budgets.

Third District firms in all industries contacted for this report said the costs of their inputs have been rising, and many said the rate of increase has accelerated recently. Firms reported rising prices for a range of basic materials, petroleum-based products, and energy. Firms that purchase large quantities of motor fuels and other energy products have begun to make more use of hedging, and some have instituted other measures to control current and future energy costs, including negotiating long-term and bulk purchase contracts. Trucking firms said fuel costs have reached record highs and they have raised fuel surcharges to their customers. Expectations of further price increases are widespread, and the number of area firms that have raised, or plan to raise, prices for their own goods and services has increased. Executives at many Third District firms say the costs of the goods and services they purchase are rising more rapidly than official price measures. One contact said his firm is developing a cost index to replace the consumer price index for automatic price escalation in long-term contracts.

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Fourth District--Cleveland

The District's business conditions continued to show gradual improvement, despite declines in some areas, for the six-week period through the end of September. Manufacturing activity was stronger through the last several weeks for the District's durable goods producers. And District retailers saw sales rebound somewhat in September. In nonresidential construction, contractors again reported increases in activity, though sales seem to have peaked for many of the District's homebuilders. Demand for trucking and shipping services remained strong in September. And, on a year-over-year basis, loan demand at District banks was generally steady or slightly increasing.

Increases in firms' input costs intensified somewhat in September, especially for petroleum-based products, and partially as a consequence of the storms that struck the Gulf Coast. However, outside of the construction sector, contacts saw storm-induced increases in costs as likely to be short-lived. Hiring remained modest across most industries, with staffing services companies noting that employment conditions continued to improve throughout the District, but much more slowly than in the rest of the country.

Manufacturing
Business conditions continued to show steady improvement for the District's durable goods manufacturers through the six weeks ending September. However, on a year-over-year basis, contacts generally reported that their production levels were flat. Conforming to this pattern,

steel producers, which had seen shipment levels fall throughout the earlier part of this year, reported rising shipments in recent weeks. Contacts attributed the improvement in conditions to strengthening demand in some sectors and lower inventory levels throughout the steel distribution channel. Hurricane Katrina had yet to have a noticeable impact on steel shipments, but as reconstruction efforts expand, contacts expected this to change. The automobile sector was among those that registered an increase in demand for steel. Relative to a year ago, District automobile plants posted increases in production in August and September. Outside of durable goods manufacturing, nondurable goods producers generally reported that production levels were flat for the last several weeks, as well as relative to this time a year ago, with the pace of new orders remaining relatively unchanged for most firms.

Both durable and nondurable goods manufacturers mentioned increases in energy prices in recent weeks, only some of which were thought to be related to the hurricanes. Thus far, the primary impact of the storms that struck the Gulf Coast on the District's manufacturers has largely been confined to changes in input costs. In some cases, the temporary unavailability of certain inputs caused disruptions to firms' production facilities. Nevertheless, most firms expect the impact of the recent hurricanes on their operations to be short-lived, and accordingly, few have changed their capital spending or hiring plans, which were already generally cautious.

Retail

Business conditions in the retail sector seemed to strengthen in September, after District retailers had reported a disappointing August. Activity at the District's discount retailers was reported to be above year-ago levels, and typically conformed to firms' sales projections. Additionally, some discount retailers reported successfully shifting their product mixes toward higher quality items. In general, the District's specialty retailers also reported somewhat stronger sales than at this time a year ago. One contact observed that brands for buyers who are younger have tended to sell relatively better recently. However, in keeping with recent reports, the District's department stores generally reported that their sales were down dramatically from the levels of a year ago.

Contacts were cautious in their assessments of the outlook, since most expected energy prices to remain high and to continue to undermine consumer confidence. Accordingly, hiring plans among retailers remained modest. Still, contacts generally thought that the storms in the Gulf had not yet noticeably affected their sales or operations. With respect to prices, the District's department stores reported increases in mark-down activity, while other retailers reported that they were able to pass higher-priced merchandise along to consumers.

After strong sales in August, the District's automobile sales appeared to fall sharply in September when compared with a year ago, despite the continuation of several manufacturers' employee-discount pricing promotions. Some dealerships speculated that consumers who had planned to purchase cars this year rushed to make their purchases earlier in the summer.

Construction

The economic environment for the District's homebuilders generated little growth in recent weeks, with roughly as many builders seeing sales increase as decrease. Relative to a year ago, a majority of residential builders reported that their sales had fallen somewhat. Given the current business climate, most builders have not tried to increase prices, which are generally only slightly higher than at this time last year. Regarding changes in input costs, several contacts noted that many materials prices--notably prices for petroleum-based products, concrete, and drywall--appeared to rise as a direct consequence of the recent hurricanes that affected the Gulf Coast. Some contacts thought that input costs would increase further in the months ahead, although lumber prices--which have not risen as much after the current set of storms as was true after the several that struck the U.S. a year ago--were not expected to see sharp increases.

Commercial contractors in the District, unlike their counterparts involved in residential building, continued to see steady increases in activity in the six-week period through the end of September. In addition, most firms indicated that their backlogs would keep them occupied through at least the end of 2005. Commercial contractors also reported increases in input costs, citing many of the same increases in materials prices to which residential builders referred. Regarding specific building segments, contacts cited industrial and institutional building as faring particularly well. Despite recent improvements in business conditions, hiring among commercial builders continued to be limited.

Trucking and Shipping
Demand for trucking and shipping services in the District remained robust in September, despite increases in transportation costs from higher fuel surcharges. Even with the support of surcharges, increases in fuel prices still adversely affected shipping firms' profits through truck operations that could not be billed to clients. With fuel surcharges nearing historical highs, contacts reported that their customers were increasingly putting pressure on them to find ways to cut costs. Attracting and retaining drivers continued to be difficult for many firms in the industry. In fact, some contacts noted that they cannot accommodate all of the existing demand due to their inability to attract and retain drivers.

Banking
Trends in the banking sector remained relatively favorable. While some seasonal slowing was reported, on a year-over-year basis, commercial borrowing continued to be firm. District banks also reported that the healthcare sector saw especially strong loan demand. However, demand for consumer credit was more mixed across institutions. With respect to specific consumer borrowing categories, institutions reported that the demand for auto loans fell to more typical levels, as auto sales generally slowed in September. Additionally, there was a slight increase in demand for home equity loans. Credit quality was still seen as strong at most District banks, though some banks reported a minor increase in delinquencies.

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Fifth District--Richmond

Fifth District economic activity expanded at a somewhat quicker pace since our last report as services and manufacturing activity gained some momentum. District service-producing firms reported stronger growth in revenues and steady gains in employment in September and early October. Retail revenues rose as well, despite sluggish sales of automobiles and a pullback in hiring in September. Manufacturing output gathered some steam; shipments, new orders, and capacity utilization picked up the pace in September and early October. District housing sales remained generally solid and demand for office and retail space strengthened. In the financial sector, bank lending expanded at a moderate pace. On the price front, substantially higher energy and building materials prices rippled through the economy in the wakes of Hurricanes Katrina and Rita, leading District businesses to raise their prices. In agriculture, unusually hot and dry weather during much of September depleted soil moisture and slowed fall planting, but early October has seen steady rainfall and improved soil conditions.

Retail

District retailers reported moderate growth in shopper traffic and sales in September and early October. A manager at a large department store in North Carolina said that sales were "on track" heading into the holiday season, and furniture retailers throughout the District generally reported stronger sales growth in recent weeks. But several of our contacts said that higher gasoline prices were hampering sales growth. An automobile dealer in the Washington, D.C., metropolitan area said "when there's news of gas price spikes, business stops." Retailers generally passed along some of the higher costs of energy and commodities to their customers, leading to a quickened pace of retail prices in the past six weeks. A Richmond, Va., hardware store owner reported that he tacked on freight surcharges, while a South Carolina lumber retailer raised prices to recover higher wholesale lumber costs. Retail hiring contracted modestly since our last report.

Services

Services firms reported stronger revenue growth in September and early October. Professional, scientific, and technical firms generally reported faster revenue growth. A contact at a North Carolina trucking firm indicated that business was still good, despite raising prices to recover higher diesel fuel costs. Hiring in the services sector rose moderately and wages increased briskly. An executive at a healthcare system in North Carolina told us that wages in some medical professions, particularly nursing, had risen substantially. Despite some transportation-related price increases, most services sector contacts said that price increases remained modest.

Manufacturing

District manufacturing activity rose at a quicker pace in September, driven by faster growth in factory shipments and new orders. Product demand strengthened appreciably in the chemicals, fabricated metals, furniture, rubber and plastics, and transportation equipment industries. A North Carolina plastics manufacturer told us, "We are busy now; the outlook is good, and we will probably be adding people and equipment." In contrast, some textile manufacturers continued to indicate that their shipments and new orders were declining. A textile manufacturer in Greensboro, N.C., said his firm was closing a denim plant in part because of stiff competition from Far Eastern manufacturers. Raw material prices continued to escalate and a number of respondents expressed concerns about declining profit margins. A fabricated metals manufacturer, for example, reported that raw materials prices were "skyrocketing" and he planned to partially offset higher costs by raising prices. He anticipated losing some sales as a result, however.

Finance

District bankers said that lending activity continued to expand at a moderate pace in September. Commercial lending was somewhat higher, boosted by increased merger and acquisition activity. Several bankers, however, noted that some business clients were reluctant to borrow because they were concerned about their future business prospects, while other clients had little need to borrow because they were "sitting on" large cash reserves. Residential mortgage lending rose at a modest pace, bolstered by continued gains in home sales and mortgage interest rates below 6 percent. Credit standards were generally unchanged and credit quality remained good.

Real Estate
Residential real estate agents reported mostly strong housing activity in September, although demand continued to cool in some areas. Agents in Fairfax County and Virginia Beach, Va., said their local housing markets "were doing very well." A contact in Greenville, S.C., said "sales were outstanding," while a contact in Greensboro, N.C., reported "lots of activity." But signs of moderating activity were a little more widespread in recent weeks. An agent in Fredericksburg, Va., noted "the market's not as crazy as it once was," while a contact in Odenton, Md., said she was not seeing as many multiple offers on properties for sale. Although home prices in many areas continued to rise, there were a number of reports of prices leveling off. Residential homebuilders reported relatively strong housing starts and building permits in September and higher costs of construction materials, particularly lumber.

Commercial real estate agents reported generally steady growth in leasing activity in September. Demand for office and retail space strengthened, with activity in Washington, D.C., continuing to lead the way. An agent in the District of Columbia noted that office and retail leasing was advancing at a healthy clip and that he had "never seen such strong markets." Agents in Greenville and Columbia, S.C., reported steady gains in office and retail leasing and a pickup in industrial leasing activity. Commercial construction activity was modestly higher; a contact in Raleigh, N.C., said there were "lots of dump trucks on the road," signaling strong construction activity in the area. But construction costs were rising. An agent in Northern Virginia said that costs had risen by 30 percent over the past 18 months, and several contacts speculated that construction costs would rise further in coming months.

Tourism
Tourist activity slowed in September and early October. Contacts in coastal areas said bookings for the Columbus Day weekend were soft, which they attributed to higher gasoline prices. A hotelier in Virginia Beach, Va., said that group bookings had declined in recent weeks and that the industry was anticipating lower occupancy in the weeks ahead. On a brighter note, a manager at a Virginia mountain resort told us that their business had picked up and noted that timeshare sales were particularly strong.

Temporary Employment
Contacts at temporary employment agencies in the District generally reported stronger demand for workers since our last report. Although some firms remained concerned that rising energy prices might slow economic growth and with it demand for temporary employment services, most agents looked for firmer demand over the next six months. Distribution and warehouse workers, customer service representatives, and administrative assistants were widely sought.

Agriculture
Hot and dry weather in September depleted soil moisture and hindered fall planting in many areas of the District, though widespread rainfall in early October improved soil conditions. As of October 3rd, 77 percent of farmland in North Carolina and over 80 percent of farmland in other District states was short of moisture. Analysts said that planting of winter wheat, rye, oats, and barley proceeded slowly because of dry soil in September but substantial rainfall in October improved planting conditions. The rain came too late, though, to improve yields for many crops reaching maturity and being harvested.

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Sixth District--Atlanta

Reports from Sixth District business contacts suggested that the pace of economic activity was mixed in September and early October. Hurricanes Katrina and Rita had a significant impact on activity throughout the District. Loss of life and property damage was tragic, and individual and firm dislocations were widespread. Business contacts reported that economic activity remained severely disrupted in coastal Louisiana and Mississippi. Reports from other areas noted spillover effects, including shipping delays, higher fuel and building material costs, and increased demand for commercial and residential real estate in some locations.

Consumer Spending
Retail sales varied widely across the District, according to merchants. Building supply and grocery stores experienced a surge in demand prior to the storms. Most retailers directly in the storms' paths remained closed because of damage, whereas many others were unable to open for some time because of the lack of power, shortages of workers, and transportation delays. Merchants in several areas, such as Baton Rouge, experienced strong year-over-year sales gains in September and early October because of the influx of evacuees. Outside of the storm-affected areas, a few contacts reported that their sales had been hurt by higher energy prices, and some clothing retailers noted that unseasonably warm temperatures had slowed sales.

September vehicle sales fell across the District. Most regional contacts blamed high gasoline prices for their disappointing performance. Several domestic dealers that had enjoyed good sales volumes in previous months reported a decline in activity and a large increase in the inventory of trucks and SUVs. In contrast, an import distributor noted that economy cars and Hybrid models sold extremely well across the region.

Real Estate
Reports from building contacts across the region noted delays and higher prices for shipments of building materials in September and early October, including concrete, lumber, and sheetrock. Many contacts expected that shortages and higher prices will persist as reconstruction in hurricane-damaged areas gets fully underway. Housing demand in neighboring areas surged as evacuees sought new living arrangements, and commercial real estate markets tightened as businesses set up temporary operations. Damage to schools, hospitals, roads, bridges and other public infrastructure was extensive in southern Mississippi and Louisiana, and reconstruction activity is expected to provide a significant boost to the regions' commercial construction industry over coming months. Housing markets in some other parts of the District showed signs of moderating in September, although reports from many homebuilders and Realtors suggested that activity in Florida remained strong.

Manufacturing and Transportation
By early October, manufacturing activity had partially recovered in the storm-affected areas, although some contacts reported labor and material shortages and ongoing transportation difficulties. Several petrochemical plants along the Gulf Coast have come back on line as damage repairs were completed. Several shipyards in the area were also returning to an operational status, and in some cases were supplying temporary onsite housing for workers. Contacts noted that some lumber producers planned to restart idled plants to meet an

expected rise in demand. Producers of manufactured housing reported that they have received contracts from FEMA to build houses for hurricane victims.

Most transportation contacts reported mixed business conditions in early October. Demand for freight was said to be quite strong, although uncertainties about fuel costs remained a concern for smaller trucking firms. A major District rail company suffered substantial infrastructure damage because of Hurricane Katrina and the normalization of services to the Gulf area could take several months. Repairs at the port of New Orleans could also take several months, and the port has been operating far below capacity. By early October, Mississippi river ports that handle grain shipments had largely returned to normal operations.

Tourism and Business Travel
The hurricanes severely affected several tourist and business destinations. For instance, most casinos along the Mississippi Gulf Coast suffered extensive damage and will need to be rebuilt. In New Orleans, events at the damaged Morial Convention Center have been cancelled through March of 2006, and many conventions have chosen to relocate to places such as Atlanta and Orlando. Officials in other areas, such as Florida, expressed concern that high gasoline prices could put a damper on travel plans.

Banking and Finance
Financial operations in most of the District were stable following the hurricanes. Loan losses were reported to be low and deposits remained strong overall. Potential short-term liquidity problems in the wake of the hurricanes appeared to have been avoided, and most institutions were operating. Some smaller banks with business concentrations in evacuated areas reported concerns about the loss of their customer base.

Employment and Prices
Contacts reported that employee dislocation presented significant problems for businesses that were reestablishing operations in the affected areas. Temporary employment agencies reported strong business activity placing workers in cleanup or disaster relief positions. In neighboring areas, career centers and job fairs had helped displaced workers find employment.

Higher energy prices continued to be noted as a concern by most contacts. For instance, operators in the petrochemical and paper industries noted that high natural gas prices would reduce international competitiveness, while higher fuel costs were said to be adversely affecting farmers. Builders across the region reported higher prices for building materials, especially for repair-related items. Fuel cost increases were being passed on in a number of industries. Plastics and fertilizer companies were increasing prices on a variety of products because of higher feedstock prices, for example.

Natural Resources and Agriculture
Energy production in the Gulf of Mexico remained severely disrupted because of damage to offshore facilities and the need to complete safety inspections. Through the first week of October nearly 90 percent of normal pre-storm oil production and more than 70 percent of natural gas production remained off-line. Refining capacity also remained lower because of storm damage, and contacts anticipated that it may be several months before all the processing plants are operational.

Reports on District crop and livestock conditions were positive overall, although it was noted that the hurricanes damaged at least half of the Louisiana sugarcane crop

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Seventh District--Chicago

Economic activity in the Seventh District continued to expand at a moderate pace during August and September. Consumer spending continued to increase modestly, and business spending and hiring expanded at a gradual pace. Both residential and commercial construction and real estate activity strengthened. The manufacturing sector expanded again, though some firms in the District experienced minor supply chain disruptions related to Hurricane Katrina. Mortgage demand was flat to down, while commercial lending activity grew at a slower pace than earlier in the year. Cost and price pressures firmed on balance in August and September. Corn and soybean prices fell because yields were higher than expected and Hurricane Katrina disrupted the transportation of grain for export.

Consumer spending
Consumer spending continued to increase modestly in August and September, though retailers reported that the pace of sales in the Midwest generally lagged that of the nation. Contacts believed the effects of higher fuel prices have been limited thus far. However, several expressed concerns that energy costs would weigh more on spending during the winter, particularly by low-income and rural consumers who spend a greater portion of their income on energy. Michigan retailers' plans for holiday-season ordering were on par or down slightly when compared with last year. Most District auto dealers reported further declines in sales. A national restaurant chain reported that demand in the Midwest was softening. Tourism spending continued to increase.

Business spending
Business spending and hiring continued to expand at a gradual pace. Firms in a wide range of industries--including telecommunications, food services, health care, and pharmaceuticals--planned to increase capital spending. There were limited reports of firms boosting investment to improve their energy efficiency. One transportation firm scaled back its planned increase in capital spending due to higher fuel costs. Business air travel continued to expand steadily on both domestic and international routes. Increased hiring was reported by firms in the chemical, software, telecommunications, furniture, food services, and banking sectors; in contrast, layoffs were reported in the paper, automotive, and communication equipment industries. Staffing services firms said that demand picked up steadily in all District states except Michigan. They also noted a general tightening in labor market conditions, with one citing fewer visits to their online job postings by individuals looking for work and another saying it had seen an increase in temporary worker turnover.

Construction/real estate
Construction and real estate activity expanded. Homebuilders reported a small increase in sales, though one contact felt the increase would be short lived. Sales of mid-priced homes continued to lag those of high-end homes in most areas. Several contacts expressed concern about the growing number of homes for sale. Commercial activity expanded further in many locations, and retail development was continuing apace. Demand for office space in downtown Chicago was flat, with one developer in the area expressing concern about overbuilding. In contrast, a contact reported declines in office vacancy rates and the amount of sublease space available in Indianapolis. Rents for office space increased in parts of Indiana and suburban Chicago, but decreased slightly in downtown Chicago.

Manufacturing

Manufacturing activity continued to expand in August and September. Light vehicle manufacturers reported a steady pickup in production as they replenished lean inventories. Nationwide, vehicle sales were down in September, though they were better than many industry analysts had expected in light of the drop in consumer sentiment and the increase in gasoline prices. Industry contacts forecast that sales in the fourth quarter would run near the average pace recorded in the first half of the year. Heavy truck demand held steady. In contrast, demand for medium duty trucks was soft, in part because accelerated depreciation tax credits had pulled sales forward. One industry analyst reported high demand from the Gulf Coast for towable recreational vehicles. Shipments of heavy equipment were still strong, although growth was down from the extremely robust rates of earlier in the year. Demand for mining equipment remained very strong. Conditions in the steel industry continued to improve, with order books filling up, capacity usage increasing, and inventories running slightly lean. Cement shipments continued to increase year-to-date, though demand was expected to soften in the fourth quarter. Machine tool producers reported steady, solid growth in sales. The damage from Hurricane Katrina led to some disruptions in District firms' supply chains. While most disruptions were short lived, hydrogen (used to galvanize steel) and many resins remained in short supply.

Banking/finance

Lending activity moderated. Contacts reported little change or declines in home-purchase and refinancing mortgage demand. Mortgage credit quality was in good shape, and delinquencies remained low. In contrast, one banker said home equity loan delinquencies had ticked up, and an industry analyst reported that consumer credit scores were down from last year. Commercial lending continued to expand, though at a slower pace than earlier in the year. Contacts noted that competitive pressures continued to lead to easier standards and terms, and one banker expressed concerns about profitability. In addition, a Chicago-area banker said that excess capacity in mortgage lending was squeezing margins in that line of business.

Prices/costs

Price and cost pressures firmed on balance in August and September. Contacts reported increases in the costs of a number of materials, including oil and gas, steel, concrete, and resins. A number of contacts said that their suppliers had put on new or additional fuel surcharges. A contact in the air travel industry noted that the spread between jet fuel and crude oil prices was running three to four times larger than historical norms because of refinery disruptions. Downstream, prices for air travel rose again, and new price increases were reported for pharmaceuticals and hotel rooms. In contrast, appliance manufacturers said that they were unable to raise prices to cover higher freight costs, an automaker planned new incentives, and retailers in Michigan reported an easing in price increases in August. Wage gains held relatively steady in most industries. However, a staffing firm noted that their recruiting expenses have increased noticeably.

Agriculture

Corn and soybean yields in much of the District were higher than had been expected before the harvest began. Current expectations were that this year's corn harvest will be the second largest ever and the soybean harvest will be in the top five. One reason is that genetic advances in seeds seemed to reduce losses in areas affected by the drought. Still, contacts were concerned that many farmers did not have adequate crop insurance. Grain storage has become a major issue for the District because of the transportation network backup after the hurricanes and large stocks left over from 2004. Furthermore, higher energy prices have pushed up the costs of drying grain, leading farmers to let corn dry longer in the fields. Contacts were worried about the impact of increased operating costs. Dairy and livestock producers benefited from lower feed costs, as well as generally higher prices for sales. In farmland auctions, some winning bids were lower than market participants had expected.

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Eighth District--St. Louis

Economic activity in the Eighth District expanded moderately since our previous survey. The services sector continued to grow. Reports in manufacturing, however, were mixed. Home sales continue to increase throughout the District, while business conditions in commercial real estate markets continue to improve. Lending activity at a sample of small and mid-sized District banks increased from early June to mid-September.

Manufacturing and Other Business Activity
Reports from manufacturing contacts in the Eighth District were mixed. Several manufacturers reported plans to open plants and expand operations and a similar number of contacts reported plant closings and layoffs. Firms in the rubber product, machinery, chemical, pharmaceutical, software, and plastics industries announced plans to open new facilities in the District. Firms in the motor vehicle parts, machinery, paper, and insurance industries reported plans to expand facilities and hire additional workers. In contrast, contacts in the fabricated metal product, electronics, furniture, transportation equipment, food, and apparel industries reported plant closings and layoffs. Several of these firms also cited slowing demand or plans to move production abroad.

The District's services sector continued to expand in most areas since our previous report. Firms in the health care, traveler accommodation, and management and consulting services industries reported plans to open new facilities and hire additional workers. Contacts in the wireless telecommunications industry experienced solid customer growth and high sales volume. Despite overall positive growth, several contacts in the freight transportation industry expressed concern over rising fuel costs and softening in demand. District retailers generally reported increased sales in August compared with the same month last year. Most retailers, however, reported that sales failed to meet expectations during September. District auto dealers also reported increased sales in August compared with last year, but they indicated a decline in September sales, when compared with August.

Real Estate and Construction
Residential sales continued to increase throughout the District. Compared with the same period in 2004, August year-to-date home sales were up 9.8 percent in Louisville, 7.7 percent in Memphis, 2.2 percent in Little Rock, and 1.2 percent in St. Louis. Contacts indicated that housing demand in Memphis and Little Rock increased in September. August year-to-date single-family housing permits increased in most of the District's metropolitan areas compared with the same period last year. Permits were up 3 percent in St. Louis, 5 percent in Louisville, and over 8 percent in Memphis and Little Rock. September residential construction was reportedly high in Memphis and Little Rock, while contacts in northern Mississippi reported that early September residential construction fell sharply.

Business conditions in many of the Eight District's office and industrial real estate markets have improved. In Little Rock, third-quarter office and industrial vacancy rates declined compared with the second quarter. In Memphis, contacts reported that office and industrial real estate markets were strong, and contacts in St. Louis reported a strong industrial market as well. Commercial construction activity was mixed throughout the District. Contacts in northeast Arkansas reported that commercial construction was strong. In contrast, contacts in northeast Mississippi reported that new commercial development was down during July and August compared with the same months last year, but they indicated that a large industrial construction project in that area is slated to begin later in the year. Contacts in western Tennessee indicated that a large industrial construction project is on the horizon as well.

Banking and Finance
Total loans outstanding at a sample of small and mid-sized District banks increased 2.4 percent from early June to mid-September. This increase stemmed primarily from real estate lending, which rose 3 percent and accounts for 71.3 percent of total loans. Commercial and industrial loans, which represent about 17.5 percent of total loans, decreased 0.1 percent. Loans to individuals, which account for nearly 5.4 percent of total loans, rose 2.7 percent. All other loans, roughly 5.8 percent of total loans, increased 3 percent. Over this period, total deposits at these banks increased 1.2 percent.

Agriculture and Natural Resources
Heavy winds and rain from Hurricane Katrina caused some corn lodging (i.e., falling to the ground) throughout the District, but the rain improved the dry conditions of crops and pastures. The rain also caused significant rice lodging and cotton stress in Arkansas and Mississippi. Crop harvest is in full swing across the District. The corn harvest is nearly complete in Arkansas and Mississippi, but it is less than halfway finished in Illinois and Indiana. At least 20 percent of the soybean harvest is complete in all states except Missouri. The sorghum harvest is nearly complete in Arkansas and Mississippi. In contrast, the cotton and the rice harvest are behind average pace in the District.

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Ninth District--Minneapolis

The Ninth District economy grew moderately during September and early October. Increases in activity were noted in consumer spending, manufacturing, real estate, and construction. Meanwhile, agriculture was mixed, energy and mining were stable at a high level, and tourism was slow. Some signs of tightening in labor markets were noted since the last report. Meanwhile, wages grew at a moderate pace. Significant price increases in energy, fuel, and some construction-related plastics were the most visible effects of Hurricanes Katrina and Rita on the district.

Consumer Spending and Tourism
Overall consumer spending increased since the last report. A major Minneapolis-based retailer reported same-store sales up almost 6 percent in September compared with a year ago. A mall manager in North Dakota reported that sales were soft in the early part of September compared with last year, but grew at near double-digit levels during the later part of September. August and September traffic at a mall in Montana was up over a year ago; retailers reported strong back-to-school sales.

According to a Minnesota auto dealer, sales were brisk in August and early September, but slowed by late September. In western Montana, sales of domestic vehicles were slow during September compared with the summer due in part to a lack of supply. In addition, customers were shopping with more sensitivity to higher gas prices as sales of cars have picked up relative to trucks and SUVs.

Early fall tourism activity was slower than a year ago. A tourism official in the Upper Peninsula of Michigan noted that tourism activity during late summer and early fall was slow compared with last year. In South Dakota, a tourism official reported that September activity was likely affected by higher gas prices; sales and traffic were off about 10 percent from a year ago. However, recent hotel occupancy and room rates were above year-ago levels in Minneapolis due in large part to stronger business travel.

Construction and Real Estate
Construction continued at a strong pace. In Minneapolis, developers announced plans to renovate a downtown skyscraper for mixed use, and a major hotel project was announced for Bloomington, Minn. Developers in Sioux Falls, S.D., announced plans for a $15 million waterfront redevelopment and a $32 million recreation center. August building permits in Grand Forks, N.D., were well above a year earlier. September residential permits for Minneapolis-St. Paul were above August levels, but below year-earlier levels.

Real estate was mixed. A contact in Sioux Falls, S.D., who has been in business for 30 years said he has never seen a boom in commercial office and retail as strong as the city is currently experiencing. A Minneapolis Realtor said home sales are continuing to slow, in part due to seasonal trends; the pace of housing price appreciation is expected to slow, but still increase 7 percent over the next year. Realtors in Fargo, N.D., said the housing market boom continued there.

Manufacturing
Manufacturing activity expanded. A September survey of purchasing managers by Creighton University (Omaha, Neb.) indicated strong manufacturing activity in Minnesota and the Dakotas. In Minnesota, a glassmaker plans to expand capacity through additional capital investment. In North Dakota, a soybean-crushing facility is under construction. In South Dakota, a tool and die maker plans to double the size of its manufacturing facility. In the Upper Peninsula, a sewing business reported that "business is flourishing." However, in Minnesota, an automobile assembly plant temporarily shut down.

Energy and Mining
Activity in the energy and mining sectors was stable at a high level. Oil and gas exploration and production were about level from mid August through late September. Meanwhile, several new wind farms and ethanol plants were recently proposed or under construction. Mines in the western portion of the district were producing at near full capacity. However, taconite mines in northern Minnesota and the Upper Peninsula stabilized production in the face of softening demand.

Agriculture
Economic activity in the agricultural sector was mixed since the last report. Yields and production were large for most district crops. However, crop prices softened, and costs for many inputs grew. Some producers are delaying harvest to let the grain dry naturally in fields due to higher energy costs. In addition, barge transportation costs increased as Mississippi barge traffic was disrupted due to hurricane-damaged Gulf ports. Meanwhile, the first cases

in 34 years of tuberculosis-infected animals were reported in three Minnesota cattle herds.

Employment, Wages, and Prices
Some signs of tightening in labor markets were noted since the last report. A local job service representative in Montana noted that there were more job openings than qualified people available. Bank directors reported that openings for mining and finance-related positions in Minnesota, call center positions in South Dakota, and construction trades in Montana were difficult to fill.

Employment surveys indicate moderate hiring activity. According to a survey by a temporary staffing agency, 26 percent of businesses in Minneapolis-St. Paul expect to hire employees during the third quarter while 13 percent plan to reduce staffing levels. A year ago, 32 percent planned increases and 4 percent expected reductions. According to the recently released *St. Cloud (Minn.) Area Business Outlook Survey*, 32 percent of respondents plan to increase staffing levels during the next six months; 11 percent anticipate decreases. A recent survey of about 100 business leaders in the Upper Peninsula showed that employment was expected to grow, but at a relatively sluggish pace.

In contrast, the number of initial claims filed for unemployment benefits in Minnesota increased 15 percent in September compared with a year ago. A Minnesota-based airline recently announced plans to lay off 400 pilots and 1,400 flight attendants companywide. A hair care product plant closed in St. Paul that affected over 100 jobs.

Overall wage increases were moderate. For example, a South Dakota county recently announced plans to give county employees 3 percent raises next year. Results from the *St. Cloud Area Business Outlook Survey* show that just more than half of respondents expect to increase employee compensation over the next six months. However, a bank director noted that a fast food restaurant in southwestern Montana was recently offering starting wages of $10 per hour.

Significant price increases in energy, fuel, and some construction-related plastics were the most visible effects of Hurricanes Katrina and Rita on the district. Home and commercial heating bills recently increased 27 percent in Montana; similar increases are expected in other district states. During the first week of October, average gasoline prices in Minnesota were 92 cents higher than a year ago, but down 8 cents from their peak in early September. Surcharges were common at various stages of production for several goods, ranging between 3 percent and 12 percent. Prices for construction-related plastics, including PVC pipe, have increased significantly.

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Tenth District--Kansas City

The Tenth District economy continued to expand moderately in September and early October. Expansion in the manufacturing sector was strong, and labor markets showed solid improvement. In addition, activity in the commercial real estate and energy sectors improved, and agricultural activity remained solid. On the other hand, consumer spending increased less than in previous surveys, and residential real estate activity eased slightly. Wage pressures edged down, but wholesale price pressures rose further and retail price pressures increased moderately.

Consumer Spending
Growth in consumer spending was somewhat weaker in September and early October than in previous surveys. Retailers, mall managers, and restaurants reported modest year-over-year increases in sales in September and early October, following stronger growth during most of the summer. Sales of apparel were generally reported to be strong, but several contacts noted that sales of "big-ticket" items such as electronics and jewelry were weak. Some retailers reported that stock levels were somewhat too high, although they plan few changes to inventories in coming months. Store managers were less optimistic about future sales than in previous surveys due to concerns about the impact of high energy prices on holiday spending. They generally expect sales to be flat to slightly higher in the months ahead. Most auto dealers reported a decline in vehicle sales as manufacturers' employee price discounts came to an end. Sales were down both from the previous period and from a year ago. Smaller, fuel-efficient cars were reported to be selling relatively well, while sales of trucks and SUVs were said to be weak at most dealerships. Most dealers believe that sales will remain sluggish in the months ahead due not only to the termination of employee price discounts but also to high gasoline prices. Travel and tourism activity in the district was largely unchanged in September and early October after expanding strongly in recent surveys. Most hotels reported that occupancy rates remain above year-ago levels. Tourism contacts generally expect activity to remain high in coming months.

Manufacturing
District manufacturing activity expanded strongly in September and early October. Many plant managers reported increases in production, shipments and orders from the previous survey, and factory activity was up considerably from a year ago. The strongest growth was reported by producers of durable goods, although producers of nondurable goods also noted continued solid gains. A number of firms reported that raw materials had become more difficult to obtain, due in part to transportation delays caused by Hurricanes Katrina and Rita. Manufacturers generally expect production to increase in the months ahead, although those firms that are heavy users of petroleum-based inputs tend to be less optimistic.

Real Estate and Construction
Housing activity eased slightly in September and early October, while commercial real estate continued to show modest improvement. Builders reported that housing starts generally declined somewhat from the previous survey, with starts below year-ago levels in some areas. In the months ahead, starts are expected to continue to ease in most areas. Although most builders said that they have had no significant problems obtaining materials, many expect that availability will become a problem in coming months. Real estate agents reported that home sales were generally flat since the previous survey and unchanged from a year ago. Several contacts noted an excess inventory of unsold homes in their markets. Year-over-year home price growth remained moderate in most areas, and realtors expect similar growth in home prices through the end of the year. Mortgage lenders reported that demand for new home mortgages and refinancings declined modestly since the previous survey. Commercial real estate activity in the district continued to improve modestly in September and early October. In several cities, vacancy rates edged down, while absorption rates and sales edged higher. Prices and rents for office and other commercial space were largely unchanged. Commercial real estate agents generally expect further slight improvements in office markets in the months ahead.

Banking

Bankers report that loans and deposits both edged up since the last survey, keeping loan-deposit ratios unchanged. Demand rose slightly for commercial and industrial loans, home equity loans and residential construction loans, while home mortgage demand fell slightly. On the deposit side, demand deposits and money market deposit accounts increased slightly, while other types of accounts held steady. All respondents increased their prime lending rates since the last survey, and almost all respondents also raised their consumer lending rates. Lending standards were unchanged.

Energy

District energy activity expanded solidly in late September and early October. The count of active oil and gas drilling rigs in the region continued to increase, although several contacts noted that they were still constrained by a lack of workers and equipment. Drilling is generally expected to increase further in the months ahead. Most contacts believe natural gas prices will continue to rise due to shut-in production in the Gulf of Mexico, and oil prices are also expected to remain elevated. Several contacts said oil and gas production in some parts of Wyoming will be boosted during the winter months by the lifting of seasonal drilling restrictions.

Agriculture

Agricultural conditions in the district remained solid in September and early October. Bankers report that warm, dry weather allowed for favorable harvest conditions. Many producers were able to take advantage of the weather to dry crops in the field rather than incur drying costs at elevators. However, following Hurricanes Katrina and Rita, producers faced lower prices for their crops due to transportation disruptions that significantly hampered grain exports. Winter wheat planting was progressing well due to the dry conditions, and cattle producers were benefiting from lower grain prices. However, high energy and fuel prices remain a key concern heading forward.

Labor Markets and Wages

Labor markets continued to firm in September and early October, but wage pressures edged down. Hiring announcements exceeded layoff announcements by a sizeable margin, and the percentage of contacts experiencing labor shortages rose slightly from the previous survey. Specific types of workers reported to be especially difficult to find included rig workers, retail salespeople, and resort staff. Nonetheless, the percentage of firms reporting wage pressures was lower than in recent surveys, as was the percentage of contacts expecting wage pressures to increase in the months ahead.

Prices

Wholesale price pressures continued to rise in September and early October, and retail price pressures also increased moderately. The share of manufacturers reporting materials price increases was the highest on record. Price increases were reported for a wide variety of inputs, including steel and petroleum-based materials. Transportation costs were also reported to have increased sharply. The share of manufacturers raising output prices also rose, and plant managers expect materials prices and output prices to rise still further in the months ahead. Most builders reported increased costs for a wide range of materials, and they expect that prices will continue to rise in the months ahead. More retail stores than in the previous survey reported raising selling prices, and many stores plan further increases in prices going forward. Hotels generally reported higher daily room rates than in the previous survey, and additional increases are expected in coming months.

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Eleventh District--Dallas

Eleventh District economic activity continued to expand in September and early October. Two major hurricanes caused loss of life and significant economic disruptions in some areas, destroying property and dislocating families and businesses. Many areas of the District received an influx of evacuees that accelerated activity and made assessment of the underlying business cycle more difficult. Some firms anticipate increases in demand, at least temporarily, to supply goods and services to evacuees and to support rebuilding efforts. Still, in the near term, many contacts say the higher cost of fuel, energy and other inputs has dampened the economic outlook.

Demand for energy and manufactured products remained strong, but hurricane damage slowed the rate of growth of activity. Retail sales and service sector activity increased and, for some firms, was boosted by the storms. Construction and real estate activity continued to strengthen, and some markets were strongly stimulated by demand from hurricane evacuees. There was little change in activity in the financial services sector, where contacts say the supply of credit continues to outstrip demand. Agricultural producers reported that dry conditions are hurting some production, but hot weather is encouraging a large cotton crop.

Prices
There were numerous reports of price increases--some sizeable--since the last Beige Book, most notably for energy, petrochemicals, plastics, transportation and some construction-related products, such as sheet rock and cement. Lumber prices increased considerably after Katrina, partly because of increased demand but also because of uncertainty about shortages and about the extent of the damage. Lumber contacts say prices are not expected to rise further but may remain high for some time. Fuel surcharges and rising energy costs have become a serious concern for most manufacturers. Some manufacturers have been able to pass a portion of the cost increase to selling prices, but others say stiff competition is forcing them to absorb rising costs by looking for additional productivity increases. Retailers report upward price pressure from vendors, but stiff competition is limiting the ability to pass cost increases forward to selling prices. Some manufacturers and retailers say they are making plans for price increases in the first quarter of 2006.

Heavy demand and hurricane disruptions pushed crude oil prices to near $70 per barrel, but prices fell to $62 per barrel in early October, the lowest price of the last two months. Crude inventories remain near 5-year high levels. Distillate inventories (diesel and heating oil) are near a 5-year high, but contacts say inventories should be building more rapidly. A series of mechanical problems, fires in the refinery system and a strategy of building distillate inventories had reduced gasoline inventories prior to the storms. Gasoline inventories have bounced back strongly as increased imports bolstered supply and consumers reduced gasoline consumption in response to high retail prices. Natural gas prices increased from $9 per million Btu to $14. With the approaching heating season, contacts are concerned about the loss of natural gas production in the Gulf of Mexico. Natural gas inventories were heavy last spring but were reduced close to normal levels by a very hot summer. Injections into inventory have been near normal in recent weeks despite the loss of Gulf production, partly because so many large gas-using petrochemical plants are down.

The strength and uncertain path of Hurricane Rita led to an unprecedented shutdown of 90 percent of petrochemical capacity on the Gulf Coast. Coming on the heels of Katrina, the result has been widespread shortages of many chemicals and plastics. A number of large producers declared force majeure, allowing them to break contracts. Basic chemicals and plastics are now on allocation, with sizable price increases for ethylene, propylene, polyethylene, PET bottle plastic, polystyrene, polyvinyl chloride and polypropylene. Chemical prices have not risen in the rest of the world, but contacts say it takes roughly six weeks for imports to reach U.S. markets.

Labor Market

The labor market appears to be tightening. There are more reports of rising wages, such as for workers to support the energy industry, professionals with financial experience, accountants, auditors, auto mechanics, truck drivers, engineers and software programmers. Anecdotal reports suggest accountants are receiving sizable raises and bonuses. The high cost of gasoline is discouraging some workers from taking low-paying jobs with long commutes. Temporary service firms expect wages to gradually increase to keep pace with higher energy costs.

Contacts expressed optimism that evacuees would bring much needed skills to the labor pool, and some businesses report hiring skilled workers who intend to stay in the District. Hiring has picked up to provide goods and services to evacuees.

Manufacturing

Manufacturing activity expanded but hurricane disruptions slowed the rate of growth, particularly for energy-related products. Demand for construction-related materials remained strong and in some instances increased. Food manufacturers also reported higher demand.

Demand for metals was mixed. Some producers experienced a strong surge in orders to supply product to the Gulf Coast, but others reported a dip in orders, largely because of a loss of the New Orleans market. Prices are up for some metals, such as for copper and scrap steel. Demand for lumber was stronger than usual because competitors in the Gulf Coast and New Orleans were unable to fill their orders. Demand for paper products was unchanged over the past month.

Respondents in high-tech manufacturing said sales and orders continued to grow at a solid pace. The semiconductor industry reported no noticeable impact from the hurricanes, although some electronics producers had increases in orders for emergency related items, such as two-way radios. Demand from Asia continued to pickup.

Refinery utilization rates have fallen sharply, with about 15 percent of U.S. capacity still out of service. The decline in utilization has been similar to the drop that occurs with the usual fall maintenance schedule, but maintenance has not been done. Contacts expect more mechanical problems because some plants are being run hard. Respondents say refinery margins have increased from an "excellent" $10 per barrel to $22 in September. Refined product imports have soared.

A lack of basic inputs is keeping a number of chemical plants on partial or complete shutdown. Contacts say the actual damage to these plants is not serious. The system is unbalanced for a number of products, pushing up costs and prices. For example, chlorine and caustic soda are joint products. Much of the demand for chlorine was put out of service by

Katrina, but the demand for caustic soda remains strong. Chlorine is hard and expensive to store, so caustic soda users (particularly pulp manufacturers in the southeast) are facing allocations and large price increases.

Services

Demand for temporary staffing services picked up in most parts of the District, with some of the increase resulting from the disruptions caused by Hurricane Katrina. Orders to supply workers to lumber and mobile home manufacturers climbed sharply, while demand for skilled workers in high-tech manufacturing in Dallas and Austin remained strong. Legal firms reported good demand for their services. Accounting firms report very strong demand, especially for audit services, mergers and acquisitions and Sarbanes-Oxley related services.

Demand is up for railroad, trucking and cargo firms. The rail and trucking industries say they are operating at or near full capacity. Trucking firms say Katrina and Rita have recently stimulated demand for shipping, but their ability to increase fees is not keeping pace with rising fuel prices and, in some instances, customers are choosing to forgo shipments because prices are too high. The rail industry has been unable to meet demand because of a lack of capacity. Grain volumes have almost tripled because grain that used to be shipped down the Mississippi by barge to the New Orleans port and is now being shipped by rail to other international ports. Shipments decreased significantly for chemicals, petroleum products, coke, pulp, paper, lumber, wood and raw logs. Contacts were surprised by a significant and unexpected slowing in rail shipments of metals, metallic ores (used in cars, appliances and construction), cars and other construction-related materials. This was unrelated to the hurricanes, they say, and suggest that this may indicate an upcoming slowdown in consumption of intermediate goods and home building.

A sharp increase in jet fuel costs has added to the airline industry's difficulties. Contacts say demand remains strong despite fare increases. But higher ticket prices have not been sufficient to cover fuel costs for most airlines, leading some carriers to reduce flights. This, along with the bankruptcy of two more major carriers, has reduced capacity in the domestic market--but not enough for most carriers to be profitable. The labor market for airline employees has become even looser as some workers attempt to flee newly bankrupt carriers. High fuel costs along with proposed pension reform are expected to force further structural change in the industry.

Retail Sales

Retail sales continued to increase, with strong sales of bottled water, generators and gasoline. The District became home--at least temporarily--to upwards of a quarter of a million evacuees. Contacts say these additional shoppers will make it difficult to interpret sales figures. Retailers serving higher income customers reported better sales growth than those serving lower income customers, who are spending a larger share of their income on gasoline. A large retailer noted that customers had increased use of credit cards instead of debit cards and questioned if they are conserving cash or are cash constrained. Contacts were less optimistic about the outlook for sales for the rest of the year, and at least one national retailer had canceled orders in anticipation of slower national sales. Auto sales were mixed. Demand for fuel efficient vehicles increased slightly, but sales of trucks and SUVs fell 20 percent.

Construction and Real Estate

The large influx of evacuees generated a surge in real estate activity. The long-term impact of the hurricanes is a wild card for real estate markets because it is unclear where displaced businesses and residents will choose to put down roots. Apartment demand was strengthening prior to Katrina and exploded as evacuees fled New Orleans. Sharply increased demand affected apartment markets in most metropolitan areas, but the effect was most dramatic in Houston, where the market tightened up virtually overnight after being one of the most overbuilt markets in the country. Big blocks of class A apartments were snapped up by employers to use as corporate housing. Demand from evacuees in the Dallas area was mostly for older properties, helping reduce the chronic overhang of class C and D properties, at least temporarily. Contacts expect occupancies to tighten over the next year because there is little construction planned for 2006.

Demand for new and existing homes remained strong. While demand was slightly boosted by sales to hurricane evacuees, the larger influence continued to be from relocations and investment purchases. In Austin, sales strengthened for higher-priced homes. Builders in Dallas say competition is stiff, holding down price increases despite strong demand. Rising construction costs have led builders to be more uncertain about the outlook.

Office markets continued to improve at a steady pace. Leasing continued to increase in Dallas, and landlords are reducing incentives while rents are holding firm. Houston's office sector also continued to improve, with rising occupancies and rents, but contacts say Katrina's impact has not been huge. Some temporary space has been absorbed by legal and energy firms with operations in both Houston and New Orleans, and some of the energy firms may choose to remain in Houston, which reflects an on-going trend.

Financial Services
Deposit and loan growth remained solid, according to contacts, who report that the supply of credit continued to outstrip demand. Respondents report continued pressure on net interest margins and a lot of competition on the pricing of loans, but credit quality is still good. Hurricane-related disruptions to financial services appear to have been only short-term.

Energy
Although the hurricanes weakened activity in this sector, contacts report strong underlying demand and emphasized their inability to fill orders or provide services without long lead times. International activity also remained strong. Service firms continued to push through price increases and build margins.

The hurricanes caused some significant loss of rigs in the Gulf of Mexico, and repairs have been hampered by a lack of infrastructure. Katrina's damage to Louisiana's staging areas for the Gulf forced the industry to move its logistical base to Cameron, Texas, which was wiped out by Rita. Loss of docks, boats, warehouses and equipment has hampered repairs in the Gulf. The repair effort will create jobs for diving companies, supply boats and helicopter transportation for months or years to come.

Agriculture
Hot and dry weather conditions prevailed across most of the district, stressing crops and pastures, reducing hay production and compelling ranchers in the driest areas to liquidate cow herds. The cotton crop has benefited from the hot weather conditions, and producers are expecting yields to be just under last year's record harvest. Cattle prices are high. Contacts are uncertain about the full economic impact of the hurricanes. There were pockets of considerable disruptions, particularly to poultry producers in East Texas and to the rice crop

that was ready to be harvested. Producers are extremely concerned about the recent surge in fuel prices which has pushed up fertilizer, chemical, irrigation and other production costs.

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Twelfth District--San Francisco

The Twelfth District economy expanded further during the survey period of September through early October. Increases in energy prices added to inflationary pressures in some industries, although overall price inflation remained modest. District labor markets tightened further, with significant wage increases reported for selected high-skill occupational categories. District retail sales weakened somewhat, but service providers saw continued strong demand. Most manufacturers and producers of agricultural and resource-related products saw further growth in output and sales. Activity in residential real estate markets remained robust but slowed slightly in some areas, and commercial real estate markets improved further. District banks reported strong loan demand and good credit quality.

Wages and Prices
Price increases generally were limited to products and services for which energy costs are a significant share of total costs. Prices rose significantly for transportation services and energy-intensive goods such as plastics, petrochemicals, fertilizers, and selected building materials, and contacts noted fuel and freight surcharges of up to 30 percent for some items. Final prices for most goods and services were largely stable, however, with contacts citing strong competitive pressures and continued gains in production efficiency as factors that limited the impact of rising input costs on final prices.

Respondents reported further tightening in District labor markets in recent weeks, especially for workers with specialized skills in the financial, construction, information technology, resource extraction, and health-care services sectors. Wage pressures for these occupations were up noticeably, and one producer of natural gas in Idaho reported recent salary increases near 14 percent for selected occupations. By contrast, salary increases remained much more modest outside of these sectors and occupations, in the range of 3 to 4 percent on an annual basis. Employers' costs for employee benefits continued to rise more rapidly than wages, though less rapidly than in previous survey periods.

Retail Trade and Services
District retail sales weakened somewhat. Retail contacts in several areas noted slower sales, reportedly due in part to a decline in consumer confidence and reduced spending power arising from higher gasoline prices. Automobile sales fell relative to the previous survey period but reportedly remained at high levels. Sales of imported vehicles were strong, but sales of domestic brands slowed, due in part to a shift away from SUVs and trucks to more fuel-efficient automobiles.

Activity in the services sector expanded significantly on net. Demand grew further for providers of health-care, media, real estate, and transportation services, but contacts noted uneven demand for high-tech services. District travel and tourist activity remained vigorous, notably in Hawaii, where domestic and international visits have been at record levels. Hotel occupancies and room rates rose further in several markets, with demand stimulated in part by relocation of business conferences away from cities affected by the recent hurricanes.

Manufacturing

District manufacturers in general reported solid demand and sales for their products in September and early October. Semiconductor contacts reported a modest increase in orders and sales and a steady rise in capacity utilization, with improved profitability noted as well. Makers of machine tools and industrial equipment saw strong demand. A strike by Boeing machinists put a temporary halt on commercial aircraft production in the Pacific Northwest, but the strike was resolved within a month and production returned to its earlier high level. Increased demand arising from the recent hurricanes added to underlying demand strength for several product groups, including processed foods and beverages, shelter and storage products, and selected building materials. Contacts also reported scattered materials shortages due to interrupted production in areas affected by the hurricanes, notably for plastic pipes. Apparel manufacturers reported little change in output and sales.

Agriculture and Resource-related Industries
Providers of agricultural and resource-related products reported strong demand. Orders and sales for a variety of crops, beef cattle, and dairy products expanded further, and contacts noted good profitability despite rising input costs. In the energy sector, District producers of natural gas operated at or near full capacity, and inventories reportedly were adequate.

Real Estate and Construction
Demand for residential real estate remained strong, while the market for commercial real estate tightened further in most areas. Home sales, price appreciation, and construction activity continued at rapid rates, although contacts in some areas noted a gradual slowing in the pace of price increases and sales. On the commercial side, demand for office space strengthened further, and rental rates rose in most major markets. In the midst of high levels of construction activity, scattered shortages of building materials emerged, reportedly leading to project delays and potential cancellations in a few rapid-growth areas.

Financial Institutions
District banking contacts reported further growth in loan demand and solid asset quality during the survey period. Demand for commercial and industrial loans grew further in most areas, while demand for construction, commercial real estate, and home loans remained at high levels or grew as well. A Southern California respondent noted slight slowing in the pace of loan growth in that region. Asset quality reportedly was high, with declining delinquencies noted in some areas.

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