The Federal Reserve Board

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Summary of Commentary on Current Economic Conditions by Federal Reserve District

Summary

Prepared at the Federal Reserve Bank of San Francisco based on information collected on or before July 17, 2006. This document summarizes comments received from businesses and other contacts outside the Federal Reserve System and is not a representation of the views of Federal Reserve officials.

Reports from all twelve Federal Reserve Districts generally indicated continued economic growth during June through mid-July, with numerous individual reports pointing to evidence that the pace of growth has slowed. Several Districts characterized the overall pace of economic growth as "moderate" or "modest," although San Francisco reported that its economic expansion remained "solid" and Atlanta and St. Louis described overall conditions as "mixed." The Philadelphia, Cleveland, Richmond, Chicago, Dallas, and San Francisco reports each highlighted a decline in the overall rate of economic growth in their Districts.

Most reports on retail sales indicated slightly weaker conditions, on balance, than earlier in the year. But tourist spending remained robust, albeit with evidence of slower growth in some areas, and activity expanded for providers of nonfinancial services to businesses and consumers. Reports from the manufacturing sector were strong, with significant gains in output and sales, especially for durable goods. Producers in the agricultural and natural-resource sectors also saw strong demand, although some weather-related difficulties and other supply constraints were noted. Activity in residential real estate markets cooled in most parts of the country, but various Districts reported an ongoing pickup in demand for commercial space. Among financial institutions, lending activity mirrored developments in the economy more generally: commercial and industrial lending expanded further, while most Districts reported a decline in residential mortgage lending and some noted reduced demand for consumer loans.

Increases in wages and in prices of final goods and services remained modest on net. Upward pressure from the elevated prices of energy and other inputs persisted; while this pressure increased further in some cases, a few Districts noted a moderation in prices for some items. Scattered reports from various Districts indicated an increase in manufacturers' and retailers' ability to pass such cost increases on to final prices. More generally, however, Districts reported that vigorous competition held price increases down, and some contacts noted reliance on productivity increases to maintain profit margins in the face of rising input costs. Labor markets tightened a bit further in most areas. Increases in base wages and salaries generally remained moderate, but they were relatively rapid for workers with specialized skills in a wide range of sectors.

Consumer Spending and Tourism

Many reports indicated that consumer spending on retail goods weakened slightly during the survey period. Although most Districts reported gains in retail sales compared with a year earlier, they generally characterized the pace of growth as modest or disappointing. Retail sales were "mixed" or "varied" in Boston, New York, and Atlanta, "flat" in Richmond, "cooling" in Dallas, and "below expectations" in Chicago and San Francisco.

Most Districts reported that sales gains for department stores and smaller retail establishments were limited or below retailers' expectations. Sales were healthy for luxury retailers but relatively weak among "big box" retailers and other low-price outlets. Cleveland and Chicago reported that general retail spending was held down in part by high gas prices, which have squeezed households' budgets and reduced the frequency of shopping trips.

In general, sales of automobiles and light trucks were flat to down. Sales remained healthier for imported vehicles than for domestic makes despite the revival of sales incentives for the latter, as high gas prices continued to nudge buyers towards fuel-efficient models. Inventories reportedly were undesirably high for SUVs and light trucks in some areas.

Activity in the travel and tourism sector generally remained at high levels or increased further, although a few reports indicated that the pace of growth has slowed. New York noted that occupancy rates in Manhattan recently edged down from very high levels. Performance was mixed in Richmond's tourism sector, and Kansas City and Minneapolis reported that summer tourism activity has been at or only slightly above year-earlier levels. Atlanta reported "cautious optimism" in the tourist trade and increased tourist traffic to Florida destinations, while San Francisco reported that tourist activity increased further from very high levels in Hawaii and other destinations throughout the West.

Nonfinancial Services

Activity in the nonfinancial services sectors generally expanded further, although the pace of growth reportedly slowed in the Philadelphia and Richmond Districts. Providers of business and professional services, such as advertising, accounting, management consulting, and technology services, saw solid demand in general and increased activity in the Boston, Richmond, and San Francisco Districts. Providers of permanent and temporary employee placement services were quite active, with modest or better increases in hiring reported in the New York, Philadelphia, Cleveland, Richmond, and Dallas Districts. Reports on the health-care sector were mixed, with "brisk" activity reported by San Francisco but Richmond noting that activity was "flat to lower."

Reports on the transportation sector suggested further increases in activity on net. Philadelphia, Richmond, St. Louis, and Dallas pointed to recent expansion in rail freight and trucking activity, and San Francisco reported strong demand for transportation services. By contrast, Cleveland and Chicago noted slight declines in trucking tonnage and rail tonnage, respectively, with the latter attributed to reduced shipments of construction materials.

Manufacturing

Reports on manufacturing activity indicated significant gains across most Districts during June and July. The only slightly weak reports came from New York, where manufacturers reported decelerating activity in July in the wake of a strong June, and St. Louis, where manufacturing conditions were mixed.

Among products, demand was especially vigorous for various durable goods. Substantial sales gains were reported for makers of electrical equipment and information technology products such as semiconductors, along with further increases in orders and activity for makers of commercial aircraft and products used for national defense. The reports also pointed to a further rise in demand for makers of heavy equipment, machine tools, and steel, offset in part by reduced demand for smaller equipment that is oriented towards residential construction activity. Demand for building materials was mixed but generally positive. Atlanta reported a drop in demand for concrete, but Chicago reported strong demand for wallboard, and Richmond and Minneapolis noted further increases in the production of fabricated metals. Among nondurable products, the reports indicated strong demand and further growth for chemicals, plastics, textiles, and processed food.

The Cleveland, Chicago, and San Francisco Districts noted that capacity utilization was high in various manufacturing sectors and increased a bit further in general. Looking ahead, manufacturers in the Boston, Philadelphia, and Cleveland Districts reported plans to increase their capital spending over the balance of the year, but in the Kansas City District expectations for future capital spending remained low.

Real Estate and Construction

With only scattered exceptions, Districts reported slower activity in residential real estate markets. For new and existing homes, available reports indicated that the pace of sales declined and that the inventory of available homes and time on the market rose in most major metropolitan areas nationwide. Slower sales activity has translated into more limited price gains, and residential construction activity has fallen in most Districts as well.

The St. Louis and Dallas Districts were exceptions to the general slowdown in residential market activity. In the St. Louis District, the pace of home sales was largely unchanged or up slightly compared with a year earlier, although residential construction slowed there. Housing markets have remained resilient in the Dallas District, where despite signs of cooling, "home demand remains strong" and residential building activity has been "robust."

As home demand has slipped more generally, scattered reports indicated a strengthening in demand for rental units. New York reported that the market for apartment rentals has been tightening in Manhattan, and according to Atlanta slower condominium sales in Florida have prompted owners to convert some units to rental property.

Slower activity on the residential side was offset in part by firmer activity on the commercial side. Demand for commercial space was strong in general, and the market tightened further in most Districts. Commercial construction activity was at high levels and increased further in the Dallas, Atlanta, and Richmond Districts. By contrast, Chicago reported a modest slowdown in commercial construction activity, and Kansas City noted that "commercial real estate activity was mostly flat."

Builders in some areas faced moderate constraints on construction activity. High construction costs reportedly were a restraining factor that delayed or caused the cancellation of some building projects in the Cleveland, Chicago, and San Francisco Districts. Moreover, Atlanta reported that some commercial building projects along the Gulf Coast have been put on hold until late fall, after the current hurricane season is over.

Banking and Finance
Overall lending activity remained strong on net but growth slowed in most Districts, as continued strength in business loans was offset by further weakening in loans to households. On the business side, commercial and industrial lending generally was at high levels and rose further in many Districts. The main exceptions were Richmond, where rising interest rates reportedly contributed to a decline in commercial lending, and Atlanta, where commercial lending "remained slow overall."

Loans to households weakened somewhat in most Districts, as ongoing declines in mortgage lending were reinforced by slightly slower consumer lending in some areas. Most Districts reported a reduction in the pace of mortgage lending, although St. Louis saw a slight increase. While consumer lending was reported to be stable in a few Districts, it slowed somewhat in the St. Louis, Kansas City, Dallas, and San Francisco Districts. New York noted overall weakening in loan demand, with especially pronounced declines for consumer loans and mortgages for commercial real estate. In most Districts, credit quality remained high across all loan categories.

Agriculture and Natural Resources
Reports indicated further expansion of demand for most agricultural and natural-resource products, but growing conditions for crops in some regions were hampered by dry weather. Demand was strong for most crops and livestock products, and prices generally remained firm even for products in ample supply. Dry conditions constrained growing in the Chicago, Minneapolis, Dallas, and Atlanta Districts, holding yields on corn, cotton, and other crops below normal levels. Dry conditions also caused pasture deterioration in the St. Louis, Kansas City, and Dallas Districts, increasing operating costs for livestock producers and prompting some to reduce or liquidate herds. By contrast, dry weather contributed to healthy crop conditions for corn, cotton, and other items in the St. Louis District. High input prices reportedly squeezed agricultural profit margins in some areas, with Chicago noting an increase in farmers' reliance on operating loans and Kansas City reporting an expected drop in farm incomes this year.

Activity was robust in the natural-resources sector. Dallas, Atlanta, Kansas City, and Minneapolis reported further increases in extraction activities for oil and natural gas. Demand for labor and equipment was strong, and some producers reported labor shortages and difficulties obtaining needed materials and equipment. Producers of natural gas continued to operate at high levels, although Dallas and San Francisco reported that inventories have risen substantially, causing prices to decline.

Prices and Wages
Increases in prices of final goods and services generally remained modest, despite the pressures from high prices for selected inputs and further increases for some. Manufacturers' and retailers' ability to pass cost increases on to final prices varied. Providers of transportation services have been able to apply fuel surcharges, significantly increasing the price of their services in some areas over the past year. In addition, Atlanta noted rising prices charged by various service providers, and Kansas City reported an increase in the percentage of manufacturers reporting higher prices on finished goods. Other reports indicated more limited pricing power and smaller increases in final prices. Richmond reported that retail prices rose at a slower pace in recent weeks, and Kansas City reported that recent and planned increases in retail prices were unchanged from the previous survey

period. Dallas noted that weaker demand of late reduced firms' ability to raise prices in some industries.

District reports indicated that labor markets were tight in general and tightened a bit further in most areas. Increases in base wages and salaries generally remained moderate overall, with scattered indications of faster growth for some workers. San Francisco noted that numerical reports on wage increases generally were in the range of 3 to 4 percent. In the Kansas City District, the fraction of firms reporting "above-normal" wage increases edged up, and Dallas reported significant pay increases for workers employed through temporary services firms. Wage increases remained relatively rapid for skilled workers in many areas, including managerial and professional employees and those with specialized occupational skills in a variety of industries. Moreover, New York reported that the market for recent college graduates has tightened, with starting salaries up 7 percent over the past year in that city.

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First District--Boston

Many segments of the First District economy continue to grow. Rising numbers of manufacturers and business services providers are increasing their selling prices, and some now report that competition for high-end workers is exerting upward pay pressures. Retailers indicate that their ability to raise prices remains spotty. Residential real estate sales volumes are slowing, and selling prices are flat to slightly down from a year earlier. With the exception of real estate and some consumer-oriented contacts, companies have a mostly positive revenue outlook for the remainder of 2006. However, many retailers and manufacturers mention downside risks related to rising business costs or eroding consumer purchasing power.

Retail
First District retailers cite mixed results in the second quarter. An automobile dealers association reports that sales have decreased an estimated 20 percent from year-ago levels. A lumber retailer notes that sales have been slow and below plan for the quarter, possibly due to a weaker housing market and higher interest rates. However, a hardware chain reports that same-store sales are up over 6 percent compared to last year, largely due to favorable weather conditions and some internal restructuring. A discount furniture retailer notes that sales are geographically mixed from flat to positive, while a provider of surplus merchandise is seeing "very, very good" sales, up 7 percent over year-ago levels. A contact in the apparel industry reported same-store sales up 4 percent for both May and June, and expects sales growth to remain positive.

The majority of contacts observe higher-than-expected inventories, although one retailer reports keeping inventory levels very lean to maximize purchasing flexibility. A number of contacts report vendor price increases for petroleum-based products, but only a few have been able to pass on these increases to the consumer. Employment levels are mostly steady, with increases occurring only with the openings of new stores. Capital spending reports are mixed.

While many First District retailers are optimistic about the next few months, almost all express concern over rising energy costs and the effects of inflation and higher interest rates on consumer budgets.

Manufacturing and Related Services

First District manufacturers and related services providers generally report that second quarter and early third quarter revenues, orders, and production levels were higher than a year ago. Among the strong performers are firms producing pharmaceuticals, semiconductors, and aircraft, mining, and power equipment. Various manufacturers report robust sales to overseas customers, particularly in Asia and the Middle East. Several companies indicate that they are straining to keep up with increases in demand.

Almost all of the respondents mention that inputs cost substantially more than a year ago, and some are expecting continued upward movements. Contacts point to copper and other metals, oil derivatives, packaging, inputs from China, energy, and fuel surcharges as sources of cost pressure, but several mention that natural gas prices have come in below expectations.

Almost all of the manufacturers contacted have raised their selling prices this year or plan to do so in the current quarter. The remaining contacts report that their selling prices have firmed after being under downward pressure. Many contacts indicate that their customers are accepting price hikes. For example, a couple of companies say they are factoring in the full amount of input cost increases when entering new contracts. One manufacturer reports that it is having greater success passing along energy price increases than earlier in the year, and another firm says its pricing capability is stronger than it has been for a couple of years. The companies reporting customer resistance to price hikes are mostly in chemicals and selected consumer goods industries.

Most manufacturers report that their U.S. headcounts are stable or edging downward. Base pay increases for 2006 mostly remain in the range of 3 percent to 4 percent, but some companies indicate growing pressures for higher raises, especially for professionals. Employers continue to report that openings in finance, accounting, supply chain management, and certain technical jobs are hard to fill. Most manufacturing respondents expect their domestic capital spending to be flat or increasing this year. The higher spending is chiefly for product development and reconfiguration of operations.

Most manufacturers have a positive revenue forecast for the remainder of 2006. Their concerns center around the impacts of high energy costs and rising interest rates either on their own costs or on the economy at large.

Selected Business Services

The majority of First District advertising and management consulting contacts note that business has been steady, and they report modest revenue gains in the second quarter of 2006 compared to a year ago. Respondents note that demand for IT consulting services is robust, and the financial services, telecom, and aviation and aerospace industries have increased their demand for consulting services. Advertisers say that the New England banking industry has been a strong purchaser of their services.

Contacts note that travel expenses continue to climb and the prices for market data have increased. The ability of business services firms to raise prices has been mixed; some firms say that their selling prices are increasing a little with limited or no push-back, while those that are keeping pricing stable report that they face less downward price pressure than previously.

A majority of New England consulting contacts plan to increase their headcounts in 2006.

The labor market for experienced consultants continues to tighten, and a few contacted companies note that they are beginning to experience difficulties filling vacancies in fields such as finance and sales. Advertising and marketing firms report no plans to change headcounts. Wage increases at business services companies range from 2 percent to 10 percent, with consulting firms reporting raises on the higher end of the range. One consulting contact reports that people are seeing low- to mid-single digit increases on average, but their "stars," who have an increasing number of outside offers, are asking for--and getting--low-double digit raises.

Most respondents expect revenue growth to remain the same or accelerate slightly over the remainder of 2006, although a few contacts caution that they have limited visibility beyond the third quarter.

Residential Real Estate
Across the First District, the pace of residential sales continues to slow and market times continue to increase. These slower sales, combined with increased listings, have led to inventory increases. At the end of May, Massachusetts had 30 percent more units listed than a year ago, pushing the supply to around 11 months overall. Contacts indicate that inventory has decreased more recently, though data are not yet available.

Contacts attribute slower regional sales to increasing mortgage interest rates, a lack of both buyer and seller urgency, and unwillingness on the part of sellers to reduce asking prices. Certain areas of New England have seen downward movement in sales prices. In Massachusetts, median single-family home prices declined 0.3 percent and 1.2 percent in April and May, respectively, compared to the year before. Median condominium prices declined 2.5 percent year-on-year in April but increased 2.5 percent in May.

Contacts project modest price decreases for the year in single family homes in Massachusetts and no price appreciation for condominiums. They also believe the sales pace will continue to slow. Despite softening sales and cooling prices, contacts remark that sales volume in 2006 is still slated to be one of the highest on record.

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Second District--New York

The Second District's economy has continued to grow at a moderate pace since the last report, though there are further signs of softening in housing. Businesses report that increases in input prices continue to be widespread but have not intensified, and there are no signs of any broad-based acceleration in consumer prices. Contacts indicate further tightening in the labor market since the last report. On balance, retailers report that sales were mixed but close to plan in June and early July; tourism activity has receded slightly since the last report but remains strong. Manufacturers report some deceleration in activity in recent weeks but are increasingly optimistic in their outlook for the second half of the year. The home purchase market showed continued signs of softening in June, but Manhattan's apartment rental market reportedly strengthened further. Office markets across the New York City metro area were mixed but, on balance, stronger in the second quarter. Finally, bankers report further widespread weakening in loan demand, some tightening in credit standards, and little change in delinquency rates.

Consumer Spending

Retailers report mixed results for June and early July, with same-store sales ranging from flat to up 3 percent from a year ago. Retail contacts continue to note relative weakness in demand for lower-end merchandise lines. While furniture sales continue to lag, one large chain notes a pickup in housewares and home textiles. There are also reports of some weakening in restaurant business. Overall, retailers report that inventories are at favorable levels and that selling prices continue to be steady.

Tourism activity, though still quite strong, has shown signs of slowing slightly since the last report. Manhattan hotels report strong business for May and June: occupancy rates edged down from their near-record levels of a year earlier, as well as April, though they were still close to 90 percent; room rates were up nearly 14 percent from a year earlier. Hotel occupancy rates in the Buffalo-Niagara Falls area were reported to be up strongly from a year earlier in May, but advance bookings are reported to have weakened. A contact in upstate New York reports that attendance at State parks has been buoyed by people vacationing closer to home.

Consumer confidence in the region showed signs of improving in June. The Conference Board survey of Middle Atlantic residents showed consumer confidence rebounding, after slipping in April and May; moreover, perceptions of current conditions were more positive than in almost five years. Similarly, Siena College's survey of New York State residents shows confidence rising in June, particularly upstate.

Construction and Real Estate

Further slackening is noted in the region's housing market since the last report, though Manhattan's rental market has continued to firm. New Jersey homebuilders report that the inventory of new and existing homes on the market increased further in the second quarter, but a bit less rapidly than in the first. A disproportionate part of the inventory accumulation is at the middle to high end of the market ($500,000 and over). Builders are also seeing that homes they have recently sold to investors looking to "flip" the properties are remaining on the market longer, exerting increased competitive pressure. Builders have recently begun to reduce selling prices on some units.

A major appraisal firm reports that sales of Manhattan co-ops and condos were down more than 10 percent from a year earlier in the second quarter, while prices were up roughly 5 percent. Separately, a major real estate firm notes that sales of Manhattan's co-ops and condos slowed sharply in June, following fairly brisk business in May, while selling prices continue to run a bit higher than a year ago. Both contacts note that the inventory of unsold apartments has increased sharply and steadily over the past year, driven largely by new development. In contrast, a major Manhattan real estate agency notes further tightening in the rental market in June and early July: the inventory of available units continues to decline, and rents are up across the board, with gains of more than 10 percent in certain neighborhoods.

Office markets across the New York City area were mixed to stronger in the second quarter. Throughout Manhattan and in Fairfield County (Ct.), office availability rates fell to their lowest levels in roughly five years, while asking rents showed sturdy increases of 6 percent or more from a year earlier. However, vacancy rates rose in Long Island and edged up in Westchester and northern and central New Jersey; asking rents in these areas are little changed from a year ago.

Other Business Activity

A securities industry contact notes exceptionally strong conditions in the second quarter, driven by strong growth in trading revenue and mergers & acquisitions; however, the outlook is more mixed, as recent levels are not seen as sustainable. A major New York City employment agency, specializing in office jobs, reports a pickup in business in June, compared with April and May, led by continued strong business from the financial sector and a recent spate of hiring from executive search firms expanding their own staffs. Fewer recent college graduates are reported to be looking for work, at this point in the season, than in recent years, reflecting the tight labor market. Salaries are said to be up 7 percent from a year ago for recent college graduates and up over 10 percent for experienced workers at middle-range positions.

June surveys of purchasing managers in the Rochester and Buffalo areas indicate continued strong improvement in business conditions, along with widespread but steady price pressures. In our more recent July Empire State Manufacturing Survey, respondents report decelerating business activity, following a strong June, but firms express increased optimism about the near-term outlook. In general, manufacturers do not report significant disruptive effects of the flooding in late June, though one central New York firm notes that, due to some disruptions, it will be running overtime through the end of July. There is no indication that New Jersey's government shutdown, during the first week of July, had a significant impact on business activity in the northern (2nd District) part of the state.

Financial Developments

Small to medium-sized banks in the District report decreased demand for all types of loans--particularly consumer loans and commercial mortgages, where more than four times as many bankers report decreases as increases. Bankers note tightened credit standards for consumer loans and commercial mortgages, while credit standards for residential mortgages and commercial and industrial loans remained unchanged. A large majority of bankers continue to report increased rates on both loans and deposits. Finally, delinquency rates were unchanged across all loan categories except commercial and industrial loans, for which 20 percent indicate that delinquencies are down, while 6 percent say they are up.

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Third District--Philadelphia

Overall economic activity in the Third District increased in early July, although the rate of growth appeared to be easing. The manufacturing sector improved but not as much as in June. Retail sales of general merchandise rose, but auto sales were flat. Bank lending increased, although demand for residential mortgages continued to fade. Service industry activity rose, but the pace of growth has slowed somewhat from the first half of the year.

Third District business contacts generally expect business activity in the region to expand in the second half of the year, but not quite as strongly as in the first half. Manufacturers expect further gains, but not a strong advance. Retailers anticipate sales to continue growing near the current rate, but they say it is difficult to predict how successful the fall season will be. Auto dealers expect sales to remain sluggish through the rest of the year despite the reintroduction of manufacturers' incentives. Banks anticipate a moderate increase in overall lending, but they forecast a further decline in mortgage lending for home purchases. Service-sector firms expect business to continue to rise in the second half of the year, but not as rapidly as in the first half.

Manufacturing
Manufacturing activity increased in early July, but the upward momentum was slight. Around one-half of the Third District manufacturing companies contacted for this report said that shipments and new orders in the first weeks of July were level with June; only a few more firms reported increases than reported decreases. On balance, area manufacturers reported a decline in order backlogs and a shortening in delivery times. Demand increased in July for metals and industrial materials but slipped for many other manufactured products. Firms supplying the residential construction industry noted sharp drops in orders.

Overall, manufacturers expect business conditions to improve in the second half of the year, but they do not anticipate a strong advance. Somewhat fewer than half of the firms contacted in early July expect their shipments and orders to increase during the next six months; about one-fourth expect decreases. On balance, capital spending plans among District manufacturers call for modest increases in expenditures.

Retail
Most of the retailers contacted for this report indicated that sales in June and early July increased from the same period a year ago. The increases varied among stores. Stores specializing in luxury items posted stronger annual gains than stores specializing in low-priced goods. Among types of merchandise, apparel sales were relatively strong, boosted in part by clearance sales. Some stores reported better customer traffic than usual for this time of year, as did some restaurants. Third District retailers expect sales to be seasonally slow until the back-to-school shopping period gets under way. Although they are uncertain about the prospects for fall, they do not see any signs that sales growth will slip from the recent pace.

Auto sales in the region were virtually steady in June and early July but below the level recorded in the same period a year ago. Dealers said domestic manufacturers' incentives and discounts were propping up their sales, but foreign models continued to have better year-to-year sales comparisons than domestic models. Inventories were above desired levels but appeared to be steady. Despite support from manufacturers' incentives, dealers in the region expect sales to be sluggish for the rest of the year.

Finance
The volume of loans outstanding at Third District banks rose modestly in June and early July, according to commercial bank lending officers contacted for this report. Commercial and industrial lending increased for most banks. Credit card lending expanded, but other types of personal lending have been virtually flat. Demand for residential purchase mortgages eased. Deposit interest rates were rising at commercial banks amid competition among financial institutions within the region as well as from those outside the region.

Bankers in the District expect continued growth in business and consumer lending in the months ahead, although they believe the rate of growth is slackening. They also expect gains in credit card lending, but they expect little if any growth in other types of personal lending. They expect residential mortgage demand to decline further.

Services
Most of the Third District service firms contacted in early July reported that activity was increasing, but for many firms growth has moderated from the pace set earlier in the year. Business services firms generally indicated that many of their client firms were attempting to

limit growth in the use of outside services as they deal with rising energy and commodity prices. Trucking firms reported continuing increases in activity. They noted that transportation capacity in general is tight, and that demand for quick delivery of time-critical shipments has not been diminished by rising charges. Employment agencies and temporary help firms reported that demand for workers has been rising at a nearly steady pace. Service-sector firms expect business to continue to advance, but they expect growth to be slower in the second half of the year than it was in the first half.

Prices and Wages
Business firms in the Third District reported continuing increases in the costs of raw materials and intermediate goods. Manufacturers noted recent increases in prices for lumber, metals, petroleum-based products, and chemicals. Firms in all industries indicated that high energy prices continued to contribute to elevated operating expenses. Some firms have postponed maintenance and improvement projects, where possible, in response to higher than budgeted costs.

Employers in a range of industries reported that labor markets remain tight. Most of the firms contacted for this report indicated that wage and salary levels have been edging up. Employers said they have been having difficulty filling certain professional and managerial positions, and they have raised salaries more for these positions than for others.

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Fourth District--Cleveland

The District's economy continued to expand in June and early July, but showed signs that growth was beginning to moderate. Most manufacturers reported steady production in the six weeks ending in early July. Retailers, however, reported a softening in sales, attributing this to high gasoline prices and rising interest rates. While commercial building continued to show modest growth, residential construction has weakened since May. Demand for trucking and shipping services continued to be strong and broad-based. And while commercial and consumer borrowing generally remained steady, there were reports of some deterioration in consumer credit demand.

In general, hiring continued to be limited throughout the District. Staffing-services companies reported that job openings increased only modestly in June. However, demand is still high for healthcare and insurance industry workers. Only a few manufacturers were concerned about wage pressures and this was mainly due to expiring labor contracts. Almost all contacts reported some increase in input costs, especially for petroleum products and metals. Commercial builders, nondurable goods manufacturers, and trucking firms frequently reported that they could pass these costs along to their consumers relatively easily. Retailers, however, reported that they were generally holding prices steady.

Manufacturing
For the six weeks through early July, the District's durable good producers generally reported steady production, at levels above those of this time last year. Among important District industries, steel producers continued to see steady demand from an array of industry segments, including the energy, heavy truck, aerospace, and commercial construction sectors. Steel shipments to the automotive market, however, were generally weak. District auto production appeared to echo this, with production weakening recently, as well as on a

year-over-year basis. Most durable goods producers expected current levels of activity to continue through the end of the year. Most also reported that they had little idle capacity, and accordingly planned to increase their investment spending. Hiring was widely reported, with many firms indicating an intention to continue to hire through the rest of this year.

Production at the District's nondurable goods facilities also appeared to be steady in the six weeks through early July, but only above year-ago levels for half of the companies contacted. About half also expected activity to improve through the remainder of 2006. However, few firms planned to increase their investment spending in the coming months, and few planned any staff additions.

Among all manufacturers, wage pressures were not widespread, though increases in materials costs were widely reported, in particular for some petroleum-based products and copper. Nondurable goods producers generally sought price increases more frequently than their durable-goods producing counterparts.

Retail
Sales at District retailers were soft through the six weeks ending in early July. Most contacts attributed weaker sales to high gasoline prices and rising interest rates. Among apparel retailers, sales were reported to be on-plan, but less than a year ago. Contacts were rather pessimistic or uncertain about activity in the near future. Sales at discount stores were soft and below-plan in June. These contacts reported that shopping traffic slowed and that lower-income customers were making fewer purchases. Finally, sales at drug stores were mixed.

Almost all retailers noted that utilities, shipping, and construction costs were up dramatically on a year-over-year basis; nevertheless, product prices were holding steady. Most retailers noted no unusual activity in hiring, however, one contact cited a slow-down due to business uncertainty.

Regarding sales of new vehicles, foreign nameplates continued to outsell their domestic counterparts. Used vehicle sales remained relatively steady. All dealers reported that showroom traffic was down and that, to a significant extent, sales continued to be dependent importantly on incentives.

Construction
New home sales since late May continued to weaken, with sales down on a year-over-year basis. Traffic was also less than at this time last year. In addition, some builders reported an increase in cancellations, with the inability of individuals to sell their own homes offered as a partial explanation. Under the circumstances, many contractors have radically reduced their speculative building. In general, builders' backlogs have also fallen from year-ago levels. Regarding materials costs, most builders thought that overall costs changed little in recent weeks, though several reported rising copper and petroleum-product costs. Several contacts also reported trimming their staffs, while subcontractors are reportedly readily available. About half of those contacted noted that they had increased incentives or discounts recently.

The District's commercial contractors reported that the economic environment remained better than at this time last year, and that customer inquiries continued to be strong. However, some contractors reported a softening in sales since the end of May. Still, for most firms, backlogs remained relatively strong. Among the segments where sales remained robust were manufacturing, health care, and education. Input cost increases were widely reported, notably for petroleum-products and copper. Most builders reported that they can easily pass these price increases through to their new customers, but aren't generally able to adjust current contracts with existing customers. Few firms changed their staff sizes in recent weeks.

Banking
At District banks, both commercial and consumer borrowing remained relatively steady since the end of May. However, some smaller institutions noted a further deterioration in consumer credit demand. A contact at a large institution reported an increase in the demand for commercial credit lines; however, he indicated that this had yet to translate into additional borrowing. This was interpreted as a possible sign of underlying uncertainty. Credit quality continued to be strong, though there were some reports of rising delinquencies. Finally, in general, growth in core deposits was described as steady.

Transportation
Demand for trucking and shipping services remained strong through early July, although most contacts noted a small decrease in tonnage compared to a year ago. High fuel costs remain a concern. However, trucking companies continue to easily pass on these costs to end-users using surcharges. As previously reported, carriers are coping with high driver turnover and shortages. Nevertheless, most contacts reported little movement in wages.

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Fifth District--Richmond

District economic activity generally grew more slowly since our last report, with only manufacturing output and temporary hiring showing much life in recent weeks. Retail sales were flat over the period for the most part, with big-ticket sales softening and domestic automobile inventories increasing. Revenues at services firms grew, but at a slower pace. Factory output bounced up in early July after holding steady in June, and new orders firmed as well. Residential real estate markets continued to cool and commercial activity took a breather. District hiring was mixed, with the pace of activity softer in retail, unchanged at services firms and stronger in manufacturing. Prices continued to be pressured by pass-throughs of higher raw materials prices, but there were hints that the pace could be lessening. In agriculture, widespread rainfall in early July helped stressed crops and pastures.

Retail
District retailers reported that on balance, their sales flattened in recent weeks. A sporting goods supplier in West Virginia said that sales growth was unchanged since our last report. A contact at a department store in Virginia Beach, Va., reported flat sales in recent weeks, and retailers in West Virginia and central Maryland told us that apparel sales declined. A domestic automobile dealer in the Tidewater, Va., area also reported lower sales, adding that there was an "overload of cars right now." Another dealer in the DC beltway region told us that his customer traffic declined by as much as 20 percent in recent weeks. Contacts at building materials stores said demand generally softened as interest rates and gasoline prices rose. In contrast, a building supply store manager in central Virginia said that his sales picked up in the first half of July. Retail prices and employment in the District grew at a slower pace in recent weeks.

Services
Revenues at District services firms generally increased more slowly in recent weeks, according to contacts. District healthcare facilities reported that demand for their services

was flat to lower, although several hospitals in North Carolina reported strengthening demand. Administrative, professional, scientific, and technical firms characterized revenues growth as unchanged, though a few reported a pick-up since our last report. Freight companies said revenues rose at a faster pace in recent weeks. Price growth in the sector slowed since our last report and the pace of hiring was unchanged.

Manufacturing
Manufacturing activity was nearly flat in June but picked up steam in early July. Manufacturers told us that shipments, new orders and employment expanded at a solid clip in the past two weeks. Manufacturers in the chemicals, fabricated metals, furniture, plastics and textiles industries reported increased production. A textile manufacturer in North Carolina told us that while their shipments were strong, they were experiencing a profit squeeze because of rising raw materials prices. In addition, a chemical producer in North Carolina noted that customer demand remained strong and that inflationary pressures were increasing. Despite continued concerns about high raw materials prices, most contacts indicated that prices of raw materials increased less quickly since our last report.

Finance
Bankers in the Fifth District said that loan demand grew more slowly in late June and early July. A mortgage banker in Charlotte, N.C., said that high gas prices "have really reduced discretionary spending by consumers," contributing to lower demand for mortgages. Hot coastal housing markets showed signs of deceleration, leading a Charleston, S.C., mortgage lender to remark that "this softening…will finally bring some normalcy back to our business." Lending for commercial loans also softened. A Charleston, W.V., lender reported that businesses were putting off capital expenditures as long as possible due to higher interest rates.

Real Estate
District residential real estate agents continued to report a general slowdown in home sales. An agent in Washington, D.C., said sales in his market had dropped sharply compared to last year, and he described recent activity as "the worst he had seen in 8 years." In contrast, a Northern Virginia agent described sales levels as "adjusting back to a more normal state." Several agents reported that houses were staying on the market longer and that inventory continued to build. Consistent with slowing sales activity, home price declines were more widespread across the District. Several contacts commented that higher interest rates were a factor in slower sales. Although low- to middle-priced houses remained the best sellers, agents in a few areas reported that higher-priced homes had picked up recently.

Commercial real estate agents reported slowing leasing activity, although several noted increases in the office and industrial segments of the market. A contact in Richmond, Va., said that high commercial rents in northern Virginia had caused a number of companies to relocate to the Richmond area, boosting demand there. Little change was reported in overall vacancy and rental rates, however. Commercial real estate agents reported a small increase in new construction. An agent in Raleigh, N.C., noted that most construction coming to market is "already pre-leased and therefore will not affect vacancy rates."

Tourism
Tourist activity was mixed since our last report. Hoteliers along the coast reported solid bookings during the weeks surrounding the July 4th holiday--facilitated by good weather and more aggressive discount packages. Tourism at mountain resorts in Virginia and West

Virginia was mixed, however. While a contact at a mountain resort in Virginia said holiday bookings were much stronger than a year ago, a counterpart at a West Virginia resort indicated that his bookings were weaker.

Temporary Employment
Temporary employment firms in the District continued to report generally strong demand for workers since our last report. An agent in the Washington, D.C., area told us that the demand for workers had remained at a solid level. He said that a lack of skilled workers was a growing problem and would become a bigger problem if the economy continued to grow on pace. Agents in Richmond, Va., and Raleigh, N.C., reported ongoing demand for direct-placement hires; the Raleigh agent expressed optimism that continued strengthening in his local economy would continue to underpin demand for workers in coming months. Computer skills, sales and administrative support skills remained highly sought by employers.

Agriculture
Wetter-than-normal weather brought much needed rainfall to crops and pastures in the Fifth District in late June and early July. While the Carolinas remained generally dry, the summer showers greatly improved soil moisture conditions and yield prospects for corn and soybeans. In addition, the rainfall revived pasturelands across much of the District. Heavy rains in Maryland and Virginia, however, caused some localized flooding which damaged crops in low-lying areas. On a brighter note, small grain harvesting neared completion in the Carolinas, and peach crops in Maryland, and West Virginia remained in good-to-excellent condition.

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Sixth District--Atlanta

Reports from Sixth District business contacts were mixed in June and early July. Retail sales varied by type and location, with strongest reports coming from high-end retailers and in the areas affected by last year's hurricanes. Automobile sales continued to lag, especially in the domestic truck and SUV segments. Housing contacts reported further declines in home sales in most Florida markets, and some moderation was noted in other areas as well. Nonresidential construction displayed modest growth, spurred by Gulf Coast infrastructure repairs. In coastal areas, the availability and sharply higher cost of insurance coverage has emerged as a major concern for homeowners and businesses. Reports on factory activity were generally positive, and transportation contacts continued to report they were operating near capacity. Tourism contacts remained cautiously optimistic. Lower real estate loan demand was noted in most areas outside the Gulf Coast. Reports of shortages of skilled labor continued to be widespread. Price pressures persisted, although the ability to pass on higher costs remained limited. Agricultural production was adversely impacted by drought conditions in many areas. Oil production in the Gulf Coast improved.

Consumer Spending
Retail sales performance was varied in June and early July. The strongest reports came from merchants in Katrina-damaged areas and from high-end retailers, whereas several low-end retailers noted sluggish sales. Most merchants anticipated modest sales growth over the next few months.

District vehicle sales remained mixed. Domestic dealers struggled with declining demand for full-sized trucks and SUVs despite increased promotional rebates and incentives. In contrast, most foreign auto distributors reported another good month.

Real Estate

Reports from single-family homebuilders and Realtors indicated that housing activity outside of the hurricane-affected areas weakened in June and early July, and inventories of unsold homes rose. Most of the weakness remained concentrated in Florida, where contacts noted that home sales declined further and some homebuilders started offering various sales incentives. Florida Realtors reported that more sellers were lowering the asking price on existing homes than earlier in the year. The higher cost and lower availability of homeowner insurance in coastal areas was said to be one factor that was limiting the pace of home sales. Sales of condominiums declined further in several Florida markets, and in some cases condominiums were being reconverted back into rental units.

District nonresidential commercial contractors reported that new development during June and early July was slightly ahead of last year's pace. Infrastructure repairs continued to dominate the recovery effort along the Gulf Coast, although some commercial projects have been put on hold until after the hurricane season.

Manufacturing and Transportation

Reports on manufacturing activity were generally positive. A building products manufacturer reported an increased volume of new orders and employment, and a manufacturer of electrical equipment was operating at near capacity and experiencing increased order backlogs. Defense contractors reported new orders while a manufacturer of automobile and industrial belting and hoses is in the process of expanding because of increased demand from local automobile assemblers. However, a furniture manufacturer reported a decline in sales, and a supplier of pre-stressed concrete in south Florida observed a decline in new orders.

Reports from transportation sector contacts continued to be upbeat. Inter-modal centers in Huntsville and Atlanta were reportedly benefiting from a steady growth of regional domestic and global trade. Georgia Ports recently announced an $82 million capital improvement plan to upgrade port facilities in Savannah and Brunswick.

Tourism and Business Travel

Reports from the tourism sector were cautiously optimistic. According to the Mississippi Gaming Commission, employment at the ten Gulf Coast casinos is expected to approach Pre-Katrina levels by fall. However, the availability of affordable housing was viewed as a critical limiting factor. Despite hurricane season fears and higher gas prices, reports on Florida's tourism sector were mostly upbeat. Traffic was reportedly higher than a year ago in Orlando and at some coastal resorts. In Nashville, occupancies and room rates at several hotels were higher than a year earlier.

Banking and Finance

Real estate loan activity softened further in June and early July, although a New Orleans contact noted that real estate loans were up significantly in the Gulf Coast area. Commercial lending remained slow overall. Credit quality continued to be strong across the District. Overall deposit growth was flat and characterized by intense competition, although strong deposit growth was reported by contacts in hurricane-impacted areas.

Employment and Prices

Contacts continued to report labor shortages in certain sectors. Florida builders continued to report shortages of qualified workers in all trades, and a Tennessee temporary help agency reported that business was strong for high-skilled positions. However, in New Orleans, hotels were said to have difficulty finding workers at any skill level. AirTran Airways recently announced that it expects to add about 2,500 jobs in Georgia over the next few years.

Contacts noted continuing price pressures. A building-supply company reported that prices for all petroleum-based products such as roofing, vinyl flooring and insulation were still increasing. A large producer of asphalt reported that rising prices will have a tremendous effect on the cost of state and federal highway programs. Insurance costs have also jumped sharply higher for businesses in coastal areas. Businesses reported that they were coping with rising input costs in various ways, including lower levels of staffing and service, and increased productivity. Many companies continued to state that they were unable to pass on all their energy cost increases because of competition, and were thus faced with eroding profit margins. However, some medical service providers, attorneys, restaurants, and roofers have reportedly been able to successfully implement price increases.

Agriculture and Natural Resources
Drought-like weather has impacted farmers across the District, with low-moisture conditions most dramatic in areas of Alabama, Georgia, and Mississippi. Most areas without irrigation systems were experiencing crop losses. Contacts reported that Florida's citrus crop this year would be lower because of last year's storms and disease problems, and could be impacted further by the shortage of migrant labor.

Crude oil availability from the Gulf of Mexico continued to improve in June with one major platform returning to production. Reports also indicated strong demand for labor and equipment.

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Seventh District--Chicago

Economic activity in the Seventh District expanded at a moderate pace again during June and early July, though a few reports suggested the pace of expansion slowed from earlier in the year. Consumer spending continued to increase modestly. Business spending and hiring increased again. Manufacturing activity remained strong, though some contacts noted a slower pace of growth than in the previous reporting period. Residential construction and real estate activity continued to decline from high levels. Demand for commercial real estate space continued to increase; however, the pace of new commercial construction slowed. Mortgage demand was down again, while the expansion in commercial lending continued at a slower pace than in the previous report. Nonlabor input cost pressures remained firm in June and early July, but increases in retail prices and wages were modest. Growing conditions for corn and soybeans retreated some, due to below-average rains.

Consumer Spending
Consumer spending continued to increase modestly in June and early July. Retailers in Illinois and Indiana said June sales were "OK" or "pretty good;" nonetheless, they said sales were generally a bit below expectations. Retail sales in Michigan during June were held back by sluggish results in vacation destinations, but one analyst said that overall activity has been busier so far in July. High gasoline prices reportedly dampened spending in the District, both by squeezing budgets and by leading shoppers to make fewer trips to the store. Retail

inventories were at desired levels. Retail promotions generally followed the usual seasonal patterns, though some big grocery chains were said to be advertising more aggressively than normal. Auto dealers said that vehicle sales have held up well and showroom traffic has been brisk relative to earlier in the year. New vehicle inventories were moving down toward desired levels. Tourism activity in Michigan was running below a year ago.

Business Spending
Business spending and hiring expanded again in the District. For the most part, capital spending continued to increase at similar rates as in the previous reporting period. Several small manufacturers maintained their plans to increase capacity, and a bank in the District reported an increase in information technology spending by its commercial lending divisions. Rail freighthauling expanded at slower pace than in recent months, as shipments of lumber and other construction materials moderated. Overall labor market conditions were little changed, with small gains in employment on net. Factory employment ticked up, led by growth at heavy equipment manufacturers and toolmakers. Shortages of skilled manufacturing workers persisted, and there were new reports of difficulty in filling engineering and finance job openings. A temporary help services provider said that demand growth in the District held firm but continued to moderate in the rest of the country.

Construction and Real Estate
Residential construction and real estate activity continued to decline from high levels in most areas, though there were a few regions with persistent strength. One large builder reported new orders have declined, but a solid backlog of orders was keeping construction activity afloat. Existing home sales slowed as well, though Realtors in Wisconsin noted an uptick during June. Most builders and real estate agents indicated that the supply of new and existing homes for sale was growing. The pace of new commercial construction moderated; however, demand for commercial real estate space continued to strengthen. A developer in the Chicago-area said that net absorption of office space remained strong in the second quarter, contrary to expectations, with demand driven by a large number of small deals. High construction costs were reportedly constraining development of speculative office space. A developer in Iowa that also operates in other parts of the country said that it had passed on three developments and moved to reduce its "bare ground" holdings after observing "an abrupt halt" in sales of both commercial and residential space.

Manufacturing
Manufacturing activity remained strong during June and early July, though some contacts reported a slower pace of expansion than earlier in the year. Demand for heavy equipment continued to be solid, led by the mining and energy sectors. Orders for large construction equipment typically used in nonresidential projects were holding up well, while orders for smaller equipment were weakening. Heavy-duty truck orders fell in June, largely because order books are full for 2006 and there are no more spots to pre-purchase trucks before new EPA standards go into effect at the beginning of next year. Nonetheless, the decline in orders was less than expected. Orders for medium-duty trucks remained solid, and demand for trailers was steady at high levels. Toolmakers reported strong demand and high order backlogs, and said that their production was running at high capacity utilization rates. Steel producers reported strong demand growth from most markets. Inventories at steel service centers were increasing but remained in line with sales. Cement consumption showed robust growth year-to-date, but growth was expected to tail off in the second half. A wallboard producer noted its order growth remained very strong and production continued at high rates, but added that it has yet to see much of a slowdown in bookings from residential builders.

Banking and Finance
Lending activity moderated further. Bankers noted additional declines in mortgage applications for both purchases and refinancing, though the fall-off in refinancing was more marked. Demand for home-equity loans was "losing steam," with the total volume of loans outstanding down slightly and usage rates unchanged. Mortgage delinquencies remained low, while delinquencies on home equity loans edged up. Credit scores on newly approved loans increased at one bank, though the improvement largely reflected lending officers stepping up their scrutiny and turning down less-qualified borrowers. Commercial lending continued to expand, but at a slightly slower pace than earlier in the year. Commercial lending conditions were "crazy competitive" according to one contact, with banks turning away from more deals because the customers were asking them to give up too many protections. Spreads edged down further in some segments, and fee income declined. Commercial credit quality remained in good shape. Deposits increased at a steady pace, but pricing was competitive and net interest margins were narrowing.

Prices and Costs
Nonlabor input cost pressures remained firm in June and early July, while increases in retail prices and wages were modest. Almost all contacts reported higher energy costs. One manufacturer said it had not seen any further increases in plastics and resin costs, but they were expecting surcharges in the coming months. Other materials prices were increasing as well, including copper, steel, concrete, wallboard, and paper. The ability to pass these cost increases on to customers varied. Price increases at the consumer level were modest. Prices of used compact cars were up sharply, while prices of used full-size sport utility vehicles declined noticeably, raising automakers' concerns about residuals on leased vehicles. Apartment rents in Michigan were little changed. Wage pressures were limited to certain professions facing skill shortages.

Agriculture
Most of the District experienced below-normal precipitation during June and early July. The lack of rain expanded the drought in Iowa, and extended it into Illinois and Wisconsin. Some ponds in Iowa dried up, forcing ranchers to haul water for livestock. Crop conditions deteriorated in all District states except Indiana. Nonetheless, corn and soybean conditions remained better than a year ago in Illinois and Indiana. Subsoil moisture in parts of the District sustained plant growth, but subsoil reserves were drained in many areas. The lack of rain also reduced potential crop yields, with the possibility of greater damage from the recent hot weather. Crop futures prices increased relatively more than cash prices, due to the stocks of crops left over from last year. Hog and cattle prices increased from the previous reporting period. Higher operating costs, especially for energy and interest on loans, exacerbated cash flow problems. Some farmers took out operating loans for the first time in years.

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Eighth District--St. Louis

Reports from business contacts in the Eighth District were mixed in June and July. While the services sector continued to expand, reports in manufacturing did not present as clear a picture. Many contacts in retail trade reported gains relative to last year, although reports from auto dealers indicated decreases in sales relative to this time in 2005. Commercial real estate market conditions improved throughout the District, while home sales reports varied across the District. Lending activity at a sample of small and mid-sized District banks increased from late March to mid-June.

Manufacturing and Other Business Activity

In the period since our previous survey, several manufacturers announced plans to expand operations, open new facilities, or hire additional workers, and a similar number of contacts reported plans to close plants and lay off workers. Firms in the machinery and beverage manufacturing industries reported plans to open new facilities in the District. Contacts in the water transportation equipment, chemical, medical equipment, and plastics industries reported plans to expand existing facilities and hire additional workers. In contrast, contacts in the furniture and food industries announced plans to close plants and lay off workers in the District. Contacts in the fabricated metal product, motor vehicle, and household appliance industries announced plans to lay off or temporarily idle workers.

The District's services sector continued to expand in most areas. Contacts in the freight transportation and business support services industries announced plans to expand facilities and hire additional workers. General and big box retailers reported sales increases in June compared with the same month in 2005. Convenience and grocery retailers reported that year-to-date sales were up in mid-July. Auto sales were down in June and the first half of July compared with the same period last year. Auto dealers indicated that sales of domestic cars were particularly slow.

Real Estate and Construction

Home sales reports were mixed throughout the Eighth District. Compared with the same period in 2005, May year-to-date home sales were up 14 percent in Memphis and 2 percent in Louisville; in contrast, May year-to-date home sales were down over 3 percent in Little Rock and remained unchanged in greater St. Louis. Residential construction remains weak throughout most of the District. May year-to-date single-family residential permits declined in most areas. Compared with the same period last year, permits declined 44 percent in Louisville, 14 percent in St. Louis, over 6 percent in Little Rock, and over 2 percent in Memphis. Permits, however, increased by 30 percent in Fayetteville, Arkansas and Jackson, Tennessee.

Commercial real estate market conditions improved throughout much of the District. Contacts in St. Louis reported that office vacancy rates are at their lowest level in several years, and contacts in Memphis reported increasing demand for office space. In Louisville, contacts reported that the central business district office market is doing well and that industrial space is in high demand. In Memphis, contacts reported that commercial and industrial construction markets are strong. Contacts in Fort Smith, Arkansas reported that commercial development is expanding, and contacts in St. Louis reported that a large industrial park is pending final approval.

Banking and Finance

Total loans outstanding at a sample of small and mid-sized District banks increased 2.7 percent from late March to mid-June. Real estate lending, which accounts for 72.0 percent of total loans, increased 2.0 percent. Commercial and industrial loans, accounting for 17.9 percent of total loans, increased 6.6 percent. Loans to individuals, accounting for 4.4 percent of total loans, fell 4.9 percent. All other loans, roughly 5.8 percent of total loans, rose 4.8 percent. During this period, total deposits at these banks increased 0.6 percent.

Agriculture and Natural Resources
Dry conditions throughout most of the District have helped corn, soybean, sorghum, and cotton development. As of mid-July, at least 88 percent of all major District crops were rated in fair or better condition. The winter wheat harvest is at least 95 percent complete in all District states, except Indiana, where about 70 percent of the harvest is complete. Total winter wheat production in the District states is expected to be nearly 50 percent larger this year than last year. Because of the dry weather, pasture conditions have deteriorated throughout the District, and 60 percent of the pastures in Mississippi and Missouri are rated in poor or very poor condition.

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Ninth District--Minneapolis

The Ninth District economy grew moderately since the last report. Increases in activity were noted in consumer spending, manufacturing, mining, energy, agriculture, and commercial real estate. Meanwhile, residential real estate and construction softened. Tourism and commercial construction were steady. Since the last report, labor markets showed signs of tightening and wage increases were moderate. Significant price increases were noted for fuel, shipping, and brass.

Consumer Spending and Tourism
Overall consumer spending increased slightly. A major Minneapolis-based retailer reported same-store sales up almost 5 percent in June compared with a year ago. A manager of a Minneapolis-area mall reported that recent sales were about 4 percent higher than a year ago; apparel sales were particularly strong. In Montana, a mall manager noted that most stores posted sales gains in June compared with a year ago, and overall year-to-date sales were much higher than last year.

A Minneapolis area domestic auto dealer noted weak June sales, but an uptick in early July; overall truck sales were slow. Recent domestic vehicle sales were very slow, while foreign car and light truck sales were relatively strong, according to an auto dealer in Minnesota.

Despite higher gas prices, overall tourism activity was on a par with a year ago. A recent survey of Minnesota hotel and resort owners showed that about 75 percent of respondents expect the summer tourism season to match or exceed last year. A chamber of commerce official in northeastern Minnesota observed that traffic and lodging levels in May and June were about the same as a year ago. In the Upper Peninsula of Michigan, a tourism official said that tourism businesses are hoping for a summer as good as last year's strong season, but they don't expect to surpass it. A South Dakota tourism official reported that activity was level compared with last summer. Tourism officials in Montana expect the summer season to equal or surpass year-ago levels. Visits to Yellowstone National Park were up 2 percent in May from a year earlier, while Glacier National Park visits were down 23 percent because of late road openings due to heavy winter snowfall.

Construction and Real Estate
Commercial construction was steady, while residential construction slowed. Building began on two large biodiesel plants in North Dakota, at a combined cost of more than $100 million, and plans for a $120 million ethanol plant were announced. A 550,000-square foot multi-use development will accompany construction of a new hospital in a Minneapolis suburb.

However, June year-to-date residential permits were down from 2005 levels in Rochester, Minn., and Grand Forks, N.D. In contrast, residential permits were up in Fargo, N.D., and Sioux Falls, S.D. Home building continues at a strong pace in western Montana, particularly for condominiums and rental properties.

Residential real estate was slow, whereas commercial activity was brisk. June sales volume was down 14 percent from year-earlier levels in Minneapolis-St. Paul. Realtors in Fargo and Sioux Falls reported slower sales than at this time last year. A director in western Montana reported softening as homes stayed on the market longer and prices remained level. Meanwhile, the Minneapolis-St. Paul industrial market finished its sixth consecutive quarter of positive absorption. An analyst characterized the office market there as having finally left its recovery phase and headed into an expansion.

Manufacturing

Manufacturing activity expanded. A July survey of purchasing managers by Creighton University (Omaha, Neb.) indicated robust growth of manufacturing activity in the Dakotas and Minnesota. A western Wisconsin paper mill that closed in March due to bankruptcy may reopen under new ownership by the end of the summer. A digital billboard maker in South Dakota is greatly expanding production due to strong demand. To keep up with increased orders, a Minnesota metal fabricator is doubling the size of a factory. However, due to weak sales, a light truck assembly plant in Minnesota has temporarily shut down.

Energy and Mining

Activity was up slightly in the energy and mining sectors. Oil and gas exploration and production in the District increased since the last report. In addition, expansion in the alternative energy industry continued. Mining production is robust across the District. An official from an iron mining company expects strong production at District mines throughout the year. Several companies continue to explore new mining sites throughout the District.

Agriculture

Agricultural activity improved since the last report. Crop progress is ahead of last year and the five-year average for most District crops. In addition, the number of cattle on feed increased from a year ago. Prices increased for most District agricultural products, especially for wheat and calves. However, lack of rain has increased dry conditions from central Montana through the Upper Peninsula of Michigan. In addition, exceptional drought has hit the central portion of the Dakotas and is stressing small grain production.

Employment, Wages and Prices

Since the last report, labor markets showed signs of tightening. A temporary staffing agency survey of Minneapolis-St. Paul companies showed that 33 percent of respondents expect to increase staffing levels during the third quarter, while 13 percent expect declines. A medical device manufacturer plans to transfer 300 jobs to Minneapolis over the next two years. An architectural and engineering firm in northern Minnesota reported difficulty filling open positions. Results of a recent St. Cloud (Minn.) Area Business Outlook Survey indicated the tightest local labor market conditions since December 1999. A Montana bank director noted that skilled and unskilled workers are in short supply in a number of areas.

In contrast, a financial services company recently announced plans to close a Minnesota call center due to company restructuring that will lay off 450 workers. A Minneapolis area hospital recently announced plans to cut 250 jobs in response to stagnant patient admissions and low government reimbursement rates.

Overall wage increases were moderate with a slight increase in trend for lower-skilled jobs in some parts of the District. The aforementioned St. Cloud survey shows that 51 percent of respondents expect to increase employee compensation over the next six months. Employers hiring workers for low-skilled positions in Billings, Mont., have recently raised pay to attract qualified applicants.

Price increases were noted for fuel, shipping, and brass. Early July gasoline prices in Minnesota were more than 80 cents a gallon higher than a year ago. Two manufacturers in the Minneapolis-St. Paul area noted that fuel surcharges have increased shipping costs between 10 percent and 20 percent. Liquified petroleum gas prices were about 30 percent higher than a year ago. Brass prices were up significantly compared with a year ago. Several bank directors noted a slowing in the increase in health care costs over the past year for companies in their area.

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Tenth District--Kansas City

The Tenth District economy expanded moderately in June and early July. Consumer spending increased, labor markets continued to firm, and energy activity rose further. Growth in manufacturing activity also remained solid, although firms expressed less optimism about future activity. Drought conditions eased in the agricultural sector but were still a concern. Commercial real estate conditions were little changed, and residential construction remained sluggish. Wage pressures and wholesale price pressures increased somewhat, while retail price pressures held steady.

Consumer Spending
Consumer spending expanded moderately in June and early July. Most retail contacts reported that sales were higher than in the prior survey period and above year-ago levels. In addition, a larger share of store managers was satisfied with inventory levels than in the previous survey. Retail contacts generally remain optimistic about sales in the next several months. Auto dealers reported that sales in June and early July increased from the previous survey period, but were below those of a year ago. Sales of fuel efficient cars were said to be strong at some dealerships. Inventory levels were reported to be satisfactory, and contacts generally expect further sales increases in the months ahead. Travel and tourism contacts reported activity improved modestly since the previous survey. Passenger counts at most District airports edged up, and hotel contacts said that occupancy rates were generally at or above year-ago levels. Travel and tourism contacts continue to expect solid activity through the remainder of the summer travel season.

Manufacturing
Growth in manufacturing activity in the District remained solid in June and early July, but optimism about future activity declined. Production, shipments and new orders increased. However, plant managers were not as optimistic about future activity, especially new orders, as they were in the prior period. Expectations for future capital spending were also low for the second survey in a row. Several contacts noted difficulty acquiring materials, including petroleum-based chemicals and steel, and these problems are not expected to be resolved quickly.

Real Estate and Construction

Residential construction remained below year-ago levels, while commercial real estate activity was generally unchanged. As in the previous survey, most home builders reported that starts were sluggish, and contacts in most parts of the District do not foresee an increase in home construction in the next several months. In some areas, the slowdown in home building was reported to be causing substantial delays in payments to subcontractors. For the most part, there were no significant problems reported in obtaining construction materials, and none are anticipated to arise heading forward. Residential real estate agents in most areas said that home sales increased slightly since the previous survey but remained below year-ago levels. Inventories of unsold homes continued to rise across the District, in part due to an increase in foreclosures of low-end homes. However, many real estate agents noted that the high-end market was weak, as well. Home price appreciation remained modest in most areas, and contacts expect that both home sales and prices will generally remain flat going forward. Mortgage lenders reported that demand for home purchase loans was up slightly since the previous survey, while demand for refinancings was unchanged and remained below year-ago levels. Lenders generally expect both home purchase loans and refinancings to hold steady in the coming months. Commercial real estate activity was mostly flat in June and early July. Vacancy rates and rents for commercial space were unchanged in most markets and, for the most part, commercial real estate agents do not expect conditions to change much in the months ahead.

Banking

Bankers reported that both loans and deposits increased since the last survey, leaving loan-deposit ratios unchanged. Demand rose slightly for commercial and industrial loans, commercial real estate loans, and construction loans, while demand for consumer loans declined somewhat. On the deposit side, demand deposits, MMDAs, and large CDs were all higher than in the prior period. All respondents raised their prime lending rates and consumer lending rates since the last survey, while most of them reported that lending standards were unchanged.

Energy

Energy activity continued to expand in the District during June and early July. The count of active oil and gas drilling rigs in the region increased slightly since the prior survey period and remained well above year-ago levels. Many contacts continued to report that shortages of equipment and labor were constraining drilling activity, although there were some reports that rigs had become more readily available in certain areas. Drilling is expected to expand further in the months ahead.

Agriculture

Drought conditions eased in some areas in June and early July, although a lack of moisture remained a problem in much of the District. The District wheat crop was down from last year due to the drought, but in some areas the harvest was not as poor as had been expected. The development of spring crops is slightly ahead of the 5-year pace, with the corn crop generally reported to be in good shape. Some pastures, however, continue to weaken, causing producers to use supplemental feed or trim herds. On the financial side, respondents report recent weakness in loan repayment rates as well as lower-than-expected farm capital expenditures. Farm incomes are expected to fall this year due to higher fuel costs and the effects of the drought.

Labor Markets and Wages
Labor markets continued to firm in June and early July, and wage pressures increased. As in previous surveys, hiring announcements outpaced layoff announcements by a wide margin. Many of the new jobs announced were at manufacturing firms, and several call centers also announced plans to add workers. The percentage of contacts reporting labor shortages was similar to the previous survey, but the fraction of firms reporting above-normal wage increases edged up. Among the workers reported to be in short supply were engineers, auto technicians, oil and gas workers, and skilled manufacturing workers.

Prices
Wholesale price pressures edged up slightly in June and early July, while retail price pressures were little changed. The percentage of manufacturers reporting higher prices for raw materials was basically unchanged from the previous survey. However, the share of firms reporting higher finished goods prices increased. Expectations for future increases in raw materials and finished goods prices were both slightly higher than in the previous survey period. Home builders indicated that materials costs edged up slightly from the previous survey, and they expect further increases going forward. Both the share of retailers reporting higher prices than a year ago and the share planning price increases in the next several months held steady.

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Eleventh District--Dallas

Eleventh District economic activity continued to expand at a strong pace from early June to mid-July, but there were some signs of cooling. Energy activity remained robust, and activity was still quite strong in the manufacturing and service sectors. Retail sales reports continued to weaken, with high gasoline costs squeezing other consumer spending. Nonresidential construction strengthened, and the level of new home and apartment building was unchanged, but there was a noticeable softening of demand for homes and apartments. Financial service firms reported favorable conditions, although there was some weakening of demand for consumer loans. Agricultural conditions remained dry.

Prices
Price pressures were mixed. High energy costs continued to be reported, and prices were rising for many products that contain oil or one of its derivatives. Transportation costs were also up. Still, natural gas prices are lower, and a few industries reported that weakening demand was making it more difficult to raise selling prices. After increasing for several months, some product prices declined slightly in recent weeks, such as those for lumber and most petrochemicals made with natural gas.

Surging demand for gasoline and geopolitical tensions pushed oil prices to record levels in current dollars--rising briefly above $78 per barrel. Crude inventories are 11 percent above the 5-year average. Weak demand throughout most of the period pushed natural gas prices down to $5.60 per million Btu at Henry Hub. Natural gas in storage is 20 percent above normal and at the highest level in 8 years for this time of the year, but rising crude prices and the threat of tropical weather provide some support for prices.

Labor Market
All sectors of the economy report growing difficulty finding qualified workers, and in some

instances, the challenge to obtain workers with particular skills has become intense. Wages are increasing for some positions. Temporary service firms say pay rates have finally increased--as much as 5 to 10 percent--and it has become harder to find workers. Some contacts, particularly those in the restaurant industry, expressed concern that tightening immigration enforcement will make it even more difficult to find and retain workers, pushing up employment costs.

Manufacturing
Manufacturing activity expanded at a solid pace, but there was some cooling, particularly for materials used in home construction. Food and apparel manufacturers reported continued solid demand. Sales of paper products were unchanged, but contacts said insufficient capacity had pushed up prices.

Reports from construction-related manufacturers were mostly still strong. Some contacts noted recent softening which they attribute to weather disruptions and a decline in demand from builders. Primary metals producers said a rebound in nonresidential construction nearly offset cooling in the housing market. Producers of stone, clay and glass said demand mostly held steady at high levels. Lumber and fabricated metals manufacturing was unchanged.

Overall high-tech manufacturers say production continued to grow at a good pace since the last survey. Demand is strong for most devices, particularly cell phones, but weaker sales of PCs led to excess capacity and a build up of inventory for some chips. Sales of semiconductor manufacturing equipment have been lower than expected, with some orders being cancelled or delayed. Industry executives say this cooling demand will not necessarily lead to a downturn in the semiconductor cycle because PCs are a smaller percentage of the market than in previous years.

There was little change in the demand for chemicals, except for PVC, where demand has weakened with slowing housing construction nationwide. Refining utilization on the Gulf Coast pushed up to 95 percent, the highest levels since the hurricanes last year. However, utilization rates remain below normal for late June and early July. Mechanical problems are common, and refiners are delaying maintenance due to high cost, labor shortages, or inability to schedule needed work. Refiners also are earning strong margins of $15-$20 per barrel, making them reluctant to reduce runs.

Services
Temporary service firms report that activity levels remain high and revenues are up significantly compared with last year. Legal firms report continued strong demand, particularly from the business sector. Accounting firms report steady activity with some signs of growth.

The railroad industry continues to operate near full capacity and expects to set record volume levels this fall. Recent increases in traffic volumes were observed for coal, metals, petroleum products, grain and crushed stone for highway construction. Traffic volumes declined for products supplying home building, such as metallic ores, lumber and non-metallic minerals.

Trucking cargo volumes continue to rise, but contacts say the rate of growth is slightly slower than a year ago. Shipping firms say cargo volume has increased modestly over the past month. Demand was led by durables in wholesale, manufacturing, and retail areas. International traffic continued expanding strongly. The airline industry reports very strong demand and growing domestic capacity.

Retail Sales
Retail sales continued cooling. Reports remain very mixed, and contacts say customers are still modifying purchasing patterns because high energy costs are taking a larger share of their paycheck. For example, a food retailer noted increased sales which he attributes to lower income customers cooking at home instead of eating at restaurants. National retailers say that sales to stores in Texas are stronger than in the country as a whole.

Auto sales have been soft, according to dealers, who say high gasoline prices are dampening sales of SUVs and other vehicles that obtain relatively poor gas mileage. Inventories and inventory costs are high at dealerships and factories.

Construction and Real Estate
Home demand remains strong, according to contacts who say there has been an acceleration in relocations. Demand is particularly strong for homes priced over $200,000, but sales to first-time buyers continued falling. The market is showing more signs of cooling--buyers are taking longer to make decisions, and inventories are rising. Building continues to be robust, and there has been an increase in builder incentives, especially in Austin, Dallas and Fort Worth. Apartment leasing slowed over the past six weeks, which contacts blame partly on the increase in builder incentives luring renters away from apartments. Office markets continued to improve over the past six weeks. Occupancy rates are edging up, and rents are up significantly. Commercial construction activity is rising, especially in Dallas.

Financial Services
The financial services industry continues to report favorable conditions. Demand for commercial loans has been very strong, but there has been some softening in demand for loans from consumers, particularly for automobiles and mortgages. Deposit growth has been "pretty good," which one contact attributed to a "flight-to-safety" because of recent stock market volatility. Credit quality is good, with few past due or problem loans. Some contacts say there has been some weakening of credit structures, with bankers cutting corners, weakening loan covenants or using "air ball" financing, where a portion of the loan is backed by expectations of business growth rather than hard assets.

Competition for commercial loans is intense, according to respondents, who say it is affecting pricing but not credit quality. One firm reports exceeding their latest monthly goal by a factor of three times and said there appears to be a lot of momentum for future growth. Rising interest rates have caused some clients to rethink deals but none have fallen through. One contact referred to activity as "scary good" because loan quality is better than expected but he fears lenders might be missing something important as they continue to aggressively compete for new loans.

Energy
The rig count continues to rise. Weaker natural gas prices have led some drilling to switch from natural gas to oil, although producers generally believe the recent the price decline is mostly weather-related and temporary. The recent cooling in activity has caused day-rates for land rigs and the price of some other services to rise more slowly after a long period of sustained increases. Demand for oil services remains strong, with continued heavy backlogs and labor shortages.

As hurricane season approaches, a few rigs are leaving the Gulf of Mexico in search of higher rates or lower insurance premiums. Hurricanes are causing a general rethinking of drilling activity in the shallow waters of the Gulf of Mexico. Insurance costs have skyrocketed in the Gulf as a result of last year's hurricanes.

Agriculture
Rain in early July improved soil moisture conditions in a few areas, but drought continues to stress crops and forage across much of the District. Dryland corn, sorghum and pecan acreage production is "way off" normal levels, and most of the corn harvested in North Central Texas is being made into silage. The cotton crop is expected to yield 3.2 million fewer bales than last year. Irrigated crops were mostly in fair shape.

Range and pasture conditions are poor. Hay supplies remain short, and stock tanks are low. As a result, livestock producers continue to liquidate herds, and some have completely sold out. Good demand for dairy products and solid cattle prices are helping ranchers and dairy farmers.

Bankers expressed concern about the financial condition of producers because of drought, high fuel prices and rising borrowing costs.

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Twelfth District--San Francisco

The Twelfth District's solid economic expansion continued during the survey period of early June through mid-July, but reports indicated that the pace of growth moderated somewhat. Wage and price inflation were limited on net, although wage growth remained rapid for selected worker groups with specialized skills. Growth in retail sales was modest, falling below some retailers' expectations, while demand for services remained robust. Manufacturers saw solid demand, as did producers of agricultural and resource-related products. Residential construction activity, sales, and price appreciation continued to soften in most areas, while activity in commercial real estate markets picked up further. District banks reported strong loan demand on net but slight slowing for some categories.

Wages and Prices
Contacts reported that upward pressure on prices was modest overall. Significant increases in final prices continued to be largely confined to products and services for which energy costs are a significant component, such as construction and transportation services. Some contacts reported increased pricing power for selected retail items and manufactured goods, while others noted that increases in input costs have moderated over the past few months.

District labor markets tightened a bit further. Wage increases were moderate overall, reportedly in the range of 3 to 4 percent on an annual basis, but they remained more rapid for workers with specialized skills in many sectors. Contacts in various sectors reported that employers increasingly relied on hiring bonuses and incentive packages to attract and retain qualified workers. Growth in employers' costs for employee benefits, particularly for health insurance, reportedly has subsided from the rapid pace reported in previous survey periods.

Retail Trade and Services
Retail sales grew modestly on net, reflecting slight weakening relative to the previous survey period. Sales held steady or grew slightly for department stores and various small retail establishments but reportedly were below some retailers' expectations. Demand for automobiles was mixed. High gas prices reportedly held down demand for large SUVs and

light trucks, keeping inventories at very high levels, but sales of selected fuel-efficient imported vehicles remained strong.

Most service providers continued to see robust demand. Activity was brisk in the health-care services and professional services sectors. Providers of telecommunications and transportation services saw strong demand. Travel and tourist activity was robust in most major markets. In Hawaii, further increases in domestic tourist arrivals and spending more than offset a continued decline in visits by Japanese tourists. Hotel occupancy rates generally remained high and room rates rose further there and in other tourist destinations throughout the District.

Manufacturing
Demand for District manufactured products was solid on net during the survey period of early June through mid-July. Orders and sales of semiconductors were strong and inventories were balanced; capacity utilization has been running at or above 90 percent for many products, and the industry recently increased its 2006 sales forecast. Production activity for commercial aircraft remained vigorous in the Pacific Northwest, as further growth in orders and an existing backlog kept aircraft manufacturing establishments operating near full capacity. Contacts reported solid demand growth and balanced inventories for apparel and processed food. Conditions were mixed for manufacturers of building materials, with some seeing modest sales growth and others facing weaker demand due to recent declines in residential building activity.

Agriculture and Resource-related Industries
Demand for District agricultural and resource-related products was strong. Sales were robust for most crops, especially for organic products, and inventories generally were balanced. Prices received for some crops were high compared with last year, due in part to supply constraints caused by earlier excess moisture and cool weather in various parts of the District. Contacts reported that high costs for fuel and fertilizers remained a concern, putting upward pressure on final prices. In the resources sector, producers of oil and natural gas saw robust demand and little or no excess capacity, although one contact noted that inventories of natural gas remained high, causing prices to decline.

Real Estate and Construction
Activity in residential real estate markets continued to decelerate in most areas, while activity in commercial real estate markets expanded further. Contacts from Arizona, California, and Nevada reported that the pace of home sales and price appreciation moderated further. In the Pacific Northwest--where residential real estate markets had remained hot earlier this year--home sales reportedly softened and permits for new residential construction fell, with the exception of continued robust activity in the market for condominiums in downtown Seattle. Residential real estate markets also remained hot in most parts of Utah, especially in Salt Lake City. On the commercial side, office and retail vacancies fell further throughout the District, and rental rates have been rising steadily this year. Construction activity for commercial and public structures remained strong in most areas, largely offsetting slower home building. In some rapid growth areas such as Salt Lake City and parts of Oregon, builders continued to face significant cost increases due to tight supplies of skilled workers and selected construction materials.

Financial Institutions
District banking contacts reported strong loan demand on net but slight slowing for some

categories. Commercial and industrial lending remained robust. By contrast, residential mortgage origination and refinancing activity slowed further, and some contacts noted slight weakening in demand for consumer loans. Scattered reports indicated slight erosion in credit quality for residential mortgages and consumer loans.

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