The Federal Reserve Board

The BEIGE BOOK

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Summary of Commentary on Current Economic Conditions by Federal Reserve District

Summary

Prepared at the Federal Reserve Bank of Atlanta and based on information collected before November 20, 2006. This document summarizes comments received from businesses and other contacts outside the Federal Reserve and is not a commentary on the views of Federal Reserve officials.

Most Federal Reserve Districts reported continued moderate growth since the last report. However, New York and Richmond observed that growth accelerated, whereas Dallas said the pace of activity continued to decelerate from high levels, and Atlanta described activity as mixed.

Despite continuing softness in automobile and housing-related sales, most Districts reported that consumer spending increased during October and early November, and the retail sales outlook for the holiday season was cautiously optimistic. According to most reports, growth in other service-producing industries remained generally solid. Manufacturing activity was positive overall, with the weakest reports concentrated among auto and housing-related producers. Reports on housing markets continued to indicate an overall decline in single-family home sales, and there were some reports of lower home prices. Indicators of single-family construction continued to weaken in most Districts. However, housing demand continued to be strong in a few specific markets, and nonresidential activity generally improved. Many Districts noted a continued slowing in mortgage lending, while reports on other lending were mixed. Some Districts reported a slight increase in delinquencies.

A number of Districts continued to report that labor markets were tight, especially for high-skilled occupations. Wage growth remained generally moderate, although some Districts gave accounts of stronger wage pressures for some specialized professions. Most Districts reported that prices moderated for construction materials and energy products.

Consumer Spending

Most Districts reported increased consumer spending overall. However, there was some regional variation in the rate of increase. For instance, solid increases were reported by Kansas City and Richmond, while modest improvements in retail spending were noted in the Atlanta, Chicago, Minneapolis, New York, and St. Louis Districts. Meanwhile, sales softened in the Boston District and were below expectations in the Dallas District. Strong selling products varied by region, but most Districts reported that sales of home-related items remained weak. Several Districts noted a cautiously optimistic outlook for the holiday season. Atlanta reported that high-end and electronics merchants were upbeat, while more modest gains were expected from other retailers. Kansas City and Minneapolis District merchants were said to be positive headed into the holiday season, and sales in the New York, San Francisco, and St. Louis Districts are expected to exceed year-ago levels. However, retail contacts in Boston remained concerned about the downturn in the housing market, and Dallas described retailers as more guarded.

Most Districts reported continued softness in vehicle sales, led by weaker sales for the Big Three U.S. auto makers. Slow or declining sales were noted by Philadelphia, Cleveland, Kansas City, Dallas, and San Francisco, and high vehicle inventories were reported by several Districts. The only account of improved vehicle sales came from St. Louis, while Chicago described auto sales as steady.

Services and Tourism

The demand for services remained healthy according to most reports. Boston reported that conditions were good for firms providing software and information technology services, particularly for companies catering to the health care and energy sectors. San Francisco noted that service providers experienced generally strong demand, especially in the food and beverage, health care, and transportation sectors. New York and Richmond noted solid business activity in the financial services sector.

The Atlanta, Boston, Minneapolis, New York, and Richmond Districts indicated that temporary staffing firms experienced solid demand for their services, although Chicago and Dallas noted that the demand for temporary workers had softened. The Atlanta and Cleveland Districts reported disappointing demand for freight services. Atlanta noted that much of the weakness was concentrated in businesses specialized in moving building materials, while Cleveland reported softness for shipments of auto-related products. St. Louis noted that the local freight transportation sector was expanding. Dallas observed that transportation demand was good, although contacts are anticipating slower growth in coming months.

Reports from the tourism industry were generally positive. Atlanta said that the Mississippi Gulf Coast gaming revenues returned to near pre-Katrina levels in October on the strength of re-opened casinos. Kansas City noted continued high hotel occupancy and solid airport traffic. Boston reported that tourism was currently "going gangbusters" and that business travel was strong. Richmond and New York also observed that tourism was stronger than in the last report.

Manufacturing

Manufacturing activity was generally positive in most Districts. New York said manufacturers noted brisk growth in activity. Boston, Dallas, Kansas City, and San Francisco reported that production trends in high-tech industries were positive. Cleveland reported that durable goods production was up slightly on a year-over-year basis, although demand for steel products continued to soften. Manufacturing in the Chicago District expanded at a modest pace, with manufacturers of machine tools and equipment reporting strong demand outside of the motor vehicle industry. Dallas noted that energy-related manufacturing activity remained strong. In the Philadelphia region, manufacturers posted small increases in shipments, but there were also marginal declines in new orders. Most Districts reported that orders for homebuilding materials and related equipment have trailed off substantially. In addition, some softness in auto and auto-related production was noted by Atlanta, Chicago, Cleveland, Kansas City, and St. Louis.

Real Estate and Construction

Almost all Districts reported that overall housing market activity continued to slow, especially in the single-family segment. Most Districts cited declining sales and rising home inventories. There were also scattered reports of price reductions, while the use of non-price sales incentives was reported in the Cleveland, Dallas, New York, Philadelphia, and San Francisco Districts. Most Districts reported declines in residential construction. For instance, according to Cleveland, contractor backlogs decreased about 30 percent and fewer spec homes were being built. Several Districts indicated that weak conditions are expected to persist over the next several months. New York and Dallas noted improved demand for rental housing, while Dallas reported that condominium construction remained robust. Atlanta observed rising condominium vacancy rates in some markets.

According to most reports, nonresidential markets improved since the last report. Strengthening demand for office space was seen in the Boston, Dallas, Kansas City, Minneapolis, New York, and Philadelphia regions. However, some slowing was noted in the Chicago District. Atlanta noted that the overall level of nonresidential construction remained modest. In the San Francisco District, commercial and public project activity continued to expand, although the pace of growth was slower than earlier in the year.

Banking and Finance

Lending activity was mixed since the last report. Most Districts noted fewer mortgage originations, although Chicago reported that mortgage refinancing activity firmed. The demand for commercial and industrial loans was stable or slightly higher in some Districts. Overall credit quality was described as good, although Chicago, Cleveland, and San Francisco reported small increases in delinquencies. Tighter credit standards were noted in the St. Louis and Richmond Districts.

Labor Markets and Prices

Reports suggest that labor markets remained tight since the last report, especially for high-skilled occupations. Richmond reported strong demand for workers with sales, life sciences, engineering, and financial skills. Boston said that there was strong demand in industries such as health care, biotechnology, and engineering. Kansas City noted shortages of engineers, oil field workers, accountants, welders, sales people, and truck drivers. New York said that labor markets have strengthened in a number of industries, including manufacturing, legal services, and banking. Atlanta and Philadelphia reported that retailers were finding it difficult to fill holiday-related positions. Dallas noted that labor shortages were acting as a capacity constraint for some firms. Overall labor market conditions were little changed according to Chicago, with small gains in employment on net.

Wage growth remained generally moderate, but Boston, New York, and San Francisco reported faster wage growth for some specialized professions. San Francisco noted continued rapid wage growth for health care, finance, and construction workers. According to Boston, pay levels for professional and technical jobs were being boosted in order to recruit new workers and reduce staff turnover. Employers in the Philadelphia District indicated that wages have been rising more rapidly in the past few months than earlier in the year, whereas the pace of wage increases was steady according to Chicago.

Most Districts reported that prices moderated for construction materials and energy products. Kansas City noted that prices for some building products have moderated because of the combination of lower demand and reduced transportation costs. However, Minneapolis reported further price increases for roofing shingles and foam rubber, and Cleveland noted that prices for petroleum-related products remained high. Atlanta and Chicago observed that lower energy prices had led to a decline in some fuel surcharges. According to Philadelphia, price increases were not as widespread as they were earlier in the fall. Richmond said that prices for manufacturing inputs and finished goods rose since the last report, and Chicago noted that toolmakers and food processors reported raising prices.

Agriculture and Natural Resources
Farm conditions were generally good, although there were reports that excessive rains delayed harvest and field work in the St. Louis and Richmond Districts. Higher prices for corn and soybeans benefited farmers in the Minneapolis and Kansas City Districts. However, the higher feed costs hurt poultry and livestock producers in the Atlanta, Chicago, Kansas City, and Dallas Districts.

Activity in the energy and mining sectors was generally robust in late October through mid-November. Dallas, San Francisco, and Minneapolis reported that energy extraction activity was strong, while Kansas City noted that activity declined moderately but remained high by historical standards. Atlanta said that much of the post-hurricane infrastructure repair work had been completed in the Gulf of Mexico, and Dallas noted that the Gulf Coast refineries are now operating at high levels.

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First District--Boston

Business contacts in the First District are fairly upbeat, with the exception of most retail respondents. Revenues in the fall months were generally ahead of year-earlier levels, with double-digit increases for software and information technology services firms and also for staffing firms. Commercial real estate markets continue to strengthen. By contrast, while tourism-related businesses are doing well, most contacted retailers say sales have softened; in addition, manufacturers report that orders or sales of products related to housing have weakened. All respondents say the high end of the labor market continues to tighten. Pricing is mixed, as energy-related cost pressures have eased but selected other input and vendor prices are rising.

Retail
With the exception of one contact, retail respondents in the First District report softening sales during the fall. Same-store sales in September and October range from down 15 percent to up 8 percent from a year earlier. A drugstore chain reports that business is improving, and expects sales to remain quite strong. However, another company reporting a sales increase notes that sales have "taken a real whack," but are ahead of last year because of strong performance early in the year. A respondent in the home and lumber business indicates that sales continue to be "way below plan," which he attributes to the downturn in the housing market; a hardware contact also reports negative fallout from the housing market. But a discount furniture seller, a retailer selling home electronics, and a family restaurant chain all attribute their slowdowns to consumers' weaker finances or other non-housing-related causes.

Inventory levels are mixed, but most changes are in line with plans. Some retail contacts report cost increases for energy related products, including rubber and plastics; increases are also reported for steel and selected food products. However, the price of flat-panel televisions is rapidly declining. Several contacts report passing along small price increases to their consumers. Employment has been mostly steady, with some hiring occurring for new store openings. Many respondents are scaling back capital spending plans in response to slower sales growth.

A tourism contact reports that "it's been a really good fall," with all New England areas enjoying a good fall foliage period. Tourism is currently "going gangbusters" in the Boston area, but starting to slow elsewhere. Business travel is strong and the convention centers are doing well. Advanced bookings are still low, with a lot of people purchasing at the last minute on the Internet. Foreign tourism remains strong. While capital spending on tourist-related facilities is occurring in the Boston area, including a surge in new spas, there is reportedly little development elsewhere.

Many retail contacts remain concerned about the downturn in the housing market. Overall, most are cautious in their outlook. Tourism is expected to remain strong in the winter months.

Manufacturing and Related Services
First District manufacturers and related services providers generally report that revenues in late 2006 have been running somewhat ahead of year-ago levels. Trends for aircraft, energy, and scientific equipment are particularly robust. Firms making home furnishings and equipment say orders are flat or up a little from a year ago. On the other hand, contacts report that orders for homebuilding materials have trailed off substantially of late, and a couple of capital goods manufacturers indicate that sales have weakened as a result of what they perceive to be temporary adjustments on the part of customers.

Manufacturers note that rising costs for metals and paper are continuing to exert pressure on margins. Heavy buyers of these inputs have raised their selling prices in 2006 and generally expect to increase prices further later this year or in early 2007. Respondents indicate that their costs for fuel and most other oil-related inputs have stabilized, although they express some concern about their high levels. Several firms mention that their business customers' finances have improved, causing them to be more willing to pay higher prices. Otherwise, input prices and selling prices mostly are either flat or declining in line with their recent trends.

Regardless of whether their domestic headcounts increased, decreased, or remained unchanged over the past year, most manufacturers anticipate that their U.S. employment levels will hold steady or drift down in coming months. Base pay increases mostly are expected to remain in the range of 3 percent to 4 percent in 2007. Production workers are tending to receive lower raises, while experienced technical and accounting workers are receiving larger increases. Some contacts indicate that they need to boost pay of professional and technical workers considerably in the Boston and New York City areas in order to recruit or to stem turnover. Contacts remain concerned about escalating health care costs.

Several companies report that they plan to expand domestic capacity in either 2007 or 2008. Apart from these projects and some anticipated acquisitions, manufacturers' U.S. capital spending plans appear to be modest.

The majority of manufacturing respondents expect business to be "pretty good" in 2007, boosted in part by the introduction of new products. The remaining contacts express some uncertainty or have diminished expectations concerning revenue growth, especially during the first half of the year.

Software and Information Technology Services

The majority of software and information technology (IT) services contacts in the First District report double digit year-over-year revenue increases in the most recent quarter; however, a couple were down and a communications IT firm saw revenues decline 30 percent. Growth is particularly strong in the health care and energy and utilities segments. One energy software company observed that the combination of energy legislation from 2005 and their clients being "flush with cash" has made them "willing to loosen their purse strings." By contrast, a custom applications developer notes that "it is still tough to get people to spend on IT." Most New England software companies have left selling prices unchanged as a result of a competitive market environment.

Approximately half of the contacted IT companies are adding technology workers and sales staff, with companies serving the healthcare sector reporting that they are hiring aggressively in order to keep pace with demand. Two firms are downsizing their U.S. labor force; one plans to tighten slightly to be consistent with their run rate, while another is looking to shift headcount to India. Those with plans to hire report a tightening in the New England labor market, especially for specialized technical positions. Respondents cite annual wage increases for most employees between 4 percent and 8 percent.

Software and IT services contacts indicate that capital and technology spending is at "normal" levels. Several report that financing has become easier. New England software and IT firms are generally positive in their outlook, anticipating steady or accelerating growth.

Staffing Services

Business is booming for New England-based staffing firms, with most respondents citing double-digit year-over-year revenue growth. Staffing firms see strong demand from a variety of "high-end" sectors, including allied health and nursing, biotech and pharmaceuticals, engineering, IT, and the financial sector. Contacts also report growth in temporary-to-permanent and permanent hiring. Manufacturing remains the only customer sector with flat or negative revenue growth. New England staffing respondents agree that this has been a record year for the staffing industry as a whole, and believe that the New England region is matching or exceeding growth rates in the rest of the country.

With the supply of engineers, nurses, IT specialists, and other skilled professionals remaining tight, both bill rates and pay rates continue to increase. Respondents are uncertain regarding the degree to which new health insurance legislation in Massachusetts and Vermont will affect them, but most are concerned that it will drive up costs. One contact is worried about a possible increase in the minimum wage in Massachusetts. Despite these concerns, contacts are optimistic about 2007, expecting business to continue to expand as long as the economy is strong.

Commercial Real Estate

Centrally located office space continues to perform well across New England. Vacancies continue to fall in Boston's core business district, moving down to about 8.5 percent overall. Availability (vacancies plus sublease) has also improved, albeit slightly. Rents are stable or up across the region, with premium office space above the 15th floor priced at nearly $60 per square foot in Boston.

Contacts report improved leasing fundamentals in regional office space markets, reflecting job growth. Higher rents and lower vacancies in downtown markets have led some expanding tenants to move to suburban areas. As a result, suburban markets are beginning to see increased rents and decreased vacancies.

There remains a remarkable amount of real estate investment in New England, with contacts continuing to express surprise at the assumptions supporting aggressive pricing. Though real estate yields are low overall, there is some evidence that they are increasing slightly as improving market fundamentals have increased real estate income.

Overall, contacts expect slight decreases in vacancies and slight increases in rental rates going into the New Year. In addition, real estate investment is expected to continue to be strong.

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Second District--New York

Second District economic activity appears to have accelerated since the last report, while price pressures are little changed. Labor markets have apparently strengthened in a number of sectors, including manufacturing. Manufacturers more generally report increasingly brisk growth in activity and little change in price pressures since the last report. Retailers indicate that sales were on or above plan in October and early November, with prices little changed. Tourism activity showed signs of strengthening. Two regional consumer surveys showed confidence rising sharply in October.

Housing markets remain mixed: New York City's rental market has tightened further, and there has been some pickup in co-op and condo sales, stemming the rise in the inventory of unsold units. In contrast, northern New Jersey's housing sector remains sluggish. Permits to build single-family homes fell sharply in the third quarter, but multi-family construction permits remained strong. Office markets in and around New York City generally tightened in October, with Manhattan Class A rents jumping to record highs. Finally, bankers report some weakening in loan demand in the household sector but little change in the commercial sector; they also note little change in credit standards and delinquency rates.

Consumer Spending
Retailers report that sales were on or above plan in October and early November, while merchandise prices were steady. Retail contacts generally indicate sluggish sales of furniture and other home-related goods, but fairly strong sales in other categories. Retail contacts continue to characterize current inventory levels as favorable. Looking ahead to the holiday shopping season, retailers generally expect same-store sales gains to range from 2-5%. Contacts also report that they expect to hire about the same number of holiday workers as in 2005. Surveys of consumers in the region show confidence rising sharply in October: Siena College's survey of New York State residents shows consumer confidence jumping to a 7-month high, while the Conference Board's survey of Middle Atlantic (New York, New Jersey and Pennsylvania) shows confidence at a 6-year high.

Tourism activity has shown increasing strength. Broadway theaters report that both attendance and total revenues rose steadily in October and early November, following a dip in September; in recent weeks, attendance has been running roughly 4 percent higher than a year earlier, while revenue is up nearly 12 percent. Manhattan's hotel occupancy rate remained close to 90 percent in October, which is little changed from both September and a year earlier; however, rising room rates pushed total revenue nearly 15 percent above comparable 2005 levels in October--the largest 12-month gain recorded this year. Hotels in the Buffalo-Niagara Falls area report rising occupancy rates over the past year.

Construction and Real Estate
Both residential construction activity and housing markets continue to be mixed, with New York City generally out-performing the rest of the District. Permits to build single-family homes in New York and New Jersey weakened noticeably in the third quarter, falling more than 25 percent from a year earlier, whereas multi-family permits remained strong, rising 7 percent from 2005 levels, led by New York City. A contact in New Jersey's homebuilding industry reports that both demand and traffic are weak, and that steep discounts are being offered to sell completed or almost completed units; selling prices are now said to be down from a year ago. A contact also notes that home re-modelers have seen a marked slowdown in business, except at the high end.

In contrast, New York City's housing market has remained fairly robust: a major Manhattan appraisal firm reports that sales activity picked up in October and that selling prices remain moderately higher than a year ago. The inventory of unsold homes, though still fairly high, is reported to have leveled off in recent months, but there is a substantial volume of new construction in progress, much of which will flow onto the market during 2007. A major real estate firm reports that Manhattan's rental market has continued to tighten, in particular noting a shortage of large units, which has pushed up rents.

Commercial real estate markets across the New York City area showed further signs of tightening in the third quarter. In Manhattan, office vacancy rates fell to new cyclical lows at the end of October, while asking rents on Class A properties surged to their highest levels on record. Suburban markets were more mixed, but still generally strong on balance: office vacancy rates edged down to cyclical lows in Fairfield and Westchester Counties and were virtually unchanged in northern New Jersey; Long Island's vacancy rate, though still fairly low, climbed to its highest level since a year ago.

Other Business Activity
A major employment agency reports that the labor market has grown increasingly tight, and that recruiters are using referral bonuses more aggressively to find skilled workers; moreover, firms are reported to be making increasingly widespread conversions from temporary to permanent positions. Hiring is reported to be particularly strong in the legal services and banking industries; a rebound in demand is also noted for workers in public relations and advertising. A contact at a financial industry association indicates that business activity, revenues and profits have strengthened in recent months, and that hiring activity has been solid. Wall Street bonus payments (largely paid out in January) are expected to be up more than 15 percent from the prior year, following a comparable gain in 2005-06.

Various regional business surveys point to strengthening conditions in October and early November. Purchasing managers in the Rochester and Buffalo areas report increasingly widespread improvement in business conditions in October, and steady to lower price pressures; the Rochester-area survey also indicates a pickup in hiring. More recently our November Empire State Manufacturing Survey points to some acceleration in activity, a pickup in hiring activity, and some tightening in price pressures after some easing-off in recent months. Contacts in non-manufacturing industries also report expanding employment at their firms and anticipate widespread increases in wages over the next six months.

Financial Developments
Small to medium-sized banks in the 2nd District report little change in loan demand from the commercial sector but some (largely seasonal) weakening in demand for consumer loans and especially residential mortgages: more than one in two respondents report declining demand for home mortgage loans, while fewer than one in seven report increasing demand. Bankers report some tightening in credit standards on commercial mortgages but little or no change in other segments. Bankers indicate a decrease in loan rates for residential mortgages but little change in other loan categories. Fairly widespread increases are again reported for average deposit rates. Finally, delinquency rates remained steady in the household sector but were up slightly for commercial mortgages.

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Third District--Philadelphia

Economic conditions in the Third District improved slightly in November. Manufacturers posted small increases in shipments, but there were also marginal declines in new orders. Retail sales of general merchandise rose. However, auto sales did not increase. Bank lending increased overall, although not strongly, but mortgage lending declined. Residential real estate activity continued to decrease; by contrast, commercial real estate markets tightened further.

Third District business contacts generally expect business activity to continue to expand, but at a slow pace; however, they anticipate further softening in residential real estate. Manufacturers expect some improvement during the winter. Retailers are forecasting increased sales for the upcoming holiday season compared to a year ago. Auto dealers do not expect sales to pick up in the near future. Bankers anticipate slight gains in business and consumer lending but a further decline in mortgage lending. Residential real estate agents and builders expect further slowing in home sales through the winter. Contacts in commercial real estate expect demand for office and industrial space to remain strong.

Manufacturing
Third District manufacturers reported little change in business conditions from October to November. On balance, they reported a slight increase in shipments and a slight decrease in new orders. The decrease in orders affected most of the region's major manufacturing sectors, although makers of food products and apparel generally noted rising demand. Area manufacturers reported an easing in order backlogs but also a small increase in delivery times.

Overall, manufacturers expect demand for their products to increase, but they are not forecasting strong gains. Among the manufacturers contacted in November, a little more than one-third expect their shipments and orders to increase during the next six months; about one-fifth expect decreases. The capital spending plans of Third District manufacturers increased between October and November. On balance, however, the number of firms scheduling increased outlays remained below the number that raised capital spending earlier in the year.

Retail

Most of the retailers contacted for this report indicated that sales have increased in recent weeks, although the strength of growth varied among stores. Department stores and most apparel specialty stores reported that sales of new fall merchandise have been up solidly compared with a year ago. Sales growth for most other types of stores and lines of merchandise has not been robust, and sales of home improvement items have been generally below retailers' plans. Looking ahead, area retailers expect current trends to last through the holiday shopping season. Area retail executives expect sales growth to continue at the current rate for department stores, most apparel specialty stores, and for luxury merchandise. They say prospects for growth are less strong for discount stores and for home furnishings, appliances, and consumer electronics.

Auto sales in the region showed no signs of increasing in November, and some dealers reported a slowing in sales. Year-to-year sales comparisons continued to be better for foreign makes than for domestic makes. Inventories remained above desired levels for many dealers but did not appear to be increasing. Auto dealers in the region expect sales to remain sluggish through the winter, and they say the outlook for 2007 is uncertain.

Finance

The volume of loans outstanding at Third District banks rose slightly in November, according to commercial bank lending officers contacted for this report. Commercial and industrial lending increased for most banks, but many said the rate of growth had slowed recently. Credit card lending expanded, but the rate of increase has eased somewhat. Growth in other types of personal lending also slowed, and some banks reported substantial softening of demand for personal credit. Demand for residential mortgages continued to decline.

Bankers in the District expect business and consumer lending to increase slowly in the months ahead, but they foresee a further decline in the demand for residential mortgages. Bankers noted that both business and personal loan quality was good. However, several bankers said they are concerned that builders, land developers, and other firms involved in residential real estate and construction might soon face cash flow problems, and they are monitoring these borrowers closely.

Real Estate and Construction

Commercial real estate firms reported that vacancy rates in the region's office markets have continued to decline in the past few months, and rents have risen. The amount of leased space has increased in both the Philadelphia and Wilmington central business districts and in suburban markets throughout the region. The increase in occupancy has resulted in a scarcity of large blocks of available space. Commercial real estate contacts report that there has been an increase in the construction of buildings to accommodate anticipated demand for large blocks of space with up-to-date features, while demand for space in older buildings is falling. Demand for office space and high-tech research and manufacturing facilities is expected to increase into next year, with much of the demand coming from firms in the financial, health care, and pharmaceutical industries.

Residential real estate agents and homebuilders surveyed in November indicated that sales were declining, continuing the sharp slowdown that began during the summer. Real estate contacts noted that the number of existing homes for sale and the time they are on the market have risen. Home builders reported significant increases in cancellations. They have reduced prices for resold houses and increased the value of free upgrades for all houses sold. Price appreciation of existing homes in recent months has been well below the pace recorded over the past few years. Homebuilders and real estate agents expect the pace of sales to slow further during the winter. While most expect sales to recover next spring, several said they do not anticipate a substantial rebound.

Prices and Wages
Business firms in the Third District noted increases in the costs of raw materials and other inputs, although reports of price increases were not as widespread in November as they were earlier in the autumn. Manufacturers noted continued increases in prices for metals and energy, although the incidence of such increases appears to have slowed since the summer. Retailers indicated that they have implemented price reductions for some lines of merchandise, especially consumer electronics and home appliances, but that prices for most other types of goods have been kept near plan.

Employers in many industries reported that labor markets remain tight for skilled workers and some professional occupations. Retailers noted that they have had some difficulty in hiring temporary sales workers for the holiday season. In contrast, the slowdown in residential construction has resulted in greater availability of construction workers. Area employers indicated that wages have been rising at a nearly steady rate in the past few months, somewhat above the rate of increase recorded earlier this year and a year ago.

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Fourth District--Cleveland

Economic activity in the Fourth District grew at a moderate pace since early October; however, the housing market, restructuring in the auto sector, and some raw material prices have tempered enthusiasm. Production at District manufacturers was steady to increasing with the expectation that production will remain at current levels for the next six months. Several commercial builders report activity has slowed, but business remains relatively strong overall. New residential construction was mixed with a few builders experiencing a pick-up in activity. Sales by District retailers were more in line with expectations after a somewhat disappointing September. Loan demand at District banks was flat while core deposits were up slightly. And the demand for trucking and shipping services continues to soften.

On net, hiring across the District was stable. Staffing firms reported increased job openings since early October with some contacts saying that openings were up across the board. Wage pressures are not seen as an issue at this time. Almost all contacts said that, with the exception of metals, the rise in input costs continues to moderate. Manufacturers attempting to raise their prices met with a mixed degree of success. And almost all retailers reported that they were holding their prices steady.

Manufacturing
Since early October, production by the District's durable goods manufacturers was stable or up slightly with higher production levels reported on a year-over-year basis. Demand for steel products continues to soften due to weakness in the auto, appliance, electrical distribution, and residential construction markets. Although District auto production increased in October, a decline was seen on a year-over-year basis. The outlook by most durable manufacturers is for production to remain at current levels over the next six months. Two contacts expecting lower production attribute it to seasonal adjustments. Almost all

manufacturers said they were operating at normal capacity and that capital expenditures remain on target. Although a majority of the producers expect little change in spending, five respondents said they were going to increase capital expenditures in 2007. Input costs were mixed with higher costs being attributed almost exclusively to metals. Hiring has been limited over the past six weeks; however, four contacts said they are planning some hiring in the near future. Wage pressures are largely contained. Several contacts reported that benefits, especially health care, continue to rise.

Production levels at the District's nondurable goods facilities were steady to increasing since early October and on a year-over-year basis. Expectations for the next six months are mixed with one manufacturer saying that the auto industry could affect their output. About half of our contacts reported idle capacity. Most manufacturers said capital expenditures met or exceeded projections; further, about half expect to increase spending during the next few months. Input costs were relatively stable. Most manufacturers said they have no plans to hire in the near future and three reported reducing their workforce during the past six weeks. Wage pressures remain contained.

Retail
Sales by District retailers since early October were more in line with expectations after a somewhat disappointing September. However, customers are highly selective in their purchases. Drug stores report particularly strong sales driven primarily by pharmaceuticals. Overall, vendor prices have remained stable during the past six weeks with decreases seen in lumber and generic drugs. Retailers have passed on this price stability to customers. Most contacts report wage pressures are contained, but the cost of health care benefits continues to rise, albeit at a more moderate rate. Aside from normal seasonal hiring, retailers are limiting employment opportunities to new store openings. One contact reported reducing their workforce through attrition. Retailers are expecting a very competitive Christmas season.

Most contacts said that new car sales declined in October for a second straight month; further, purchases continue to be heavily dependent on dealer incentives. Reports on SUV sales are mixed with high-end SUVs holding their own.

Construction
Residential contractors in the District are continuing to adapt to the housing market correction through workforce cutbacks, delaying land purchases, and building fewer spec homes. Since early October, new home sales have been mixed with about half our contacts reporting a pick-up in sales while the other half report slow to declining sales. Almost all builders expect that the correction will continue until at least mid-2007. Backlogs for most contractors have decreased about 30 percent. Discounts or incentives being offered to prospective buyers are in the range of 5-8 percent of a home's asking price. Material costs are mixed with builders seeing declines in lumber, drywall, and cement; however, petroleum-related products remain high. Contacts report that land and development costs continue to increase.

The District's commercial contractors reported that activity has slowed since early October, but remains relatively strong overall. Most contacts have experienced an increased level of business on a year-over-year basis. Contractors are anticipating a strong first half in 2007 due to current backlogs and stable inquires. Segments continuing to show strong activity are health care and public works; manufacturing-related construction is beginning to pick-up. Material cost increases continue to slow or have stabilized which is contributing to a small increase in profit margins. Contractors reported little change in the size of their workforce, although a few have hired or are looking to hire.

Banking
Since early October, commercial and consumer loan demand was flat to declining for most District banks. Nearly all contacts reported a slight gain in core deposits. Activity in the mortgage market continues to be slow; customers looking to refinance are showing a preference for fixed-rate mortgages. Several bankers are concerned about small increases in delinquencies; however, credit quality remains relatively strong. The consensus outlook by District bankers is for a continuation of tight margins and a modest deterioration in credit quality.

Transportation
Demand for trucking and shipping services continues to soften with a slight volume decrease on a year-over-year basis. Most contacts reported a slowdown in the shipment of auto-related products. Trucking companies continue to pass on fuel costs using surcharges; however, it's becoming more difficult due to competition and customer resistance. Trucking companies were hiring, but activity was limited to finding replacements due to driver turnover. One contact reported laying-off workers. Wages have remained stable during the past six weeks.

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Fifth District--Richmond

Economic activity in the Fifth District expanded at a somewhat stronger pace from late October through mid November, despite continued sluggishness in housing markets. Revenues at services firms grew slightly faster, aided by firmer demand at health care organizations and government contractors. Retail sales grew briskly, despite sluggishness in most big-ticket categories. Manufacturing reversed its October dip, posting increased shipments and orders in recent weeks. Commercial leasing remained strong, while housing activity continued to weaken somewhat, with softer prices more in evidence. Mortgage lenders, however, noted some firming in loan demand following several months of weakening activity. Tourism was healthy, with most areas reporting gains in recent weeks. Labor markets tightened further, with some reports of higher wages and shortages of skilled workers. Price pressures were mixed, moderating in retail and services, but ramping up in manufacturing. Mild temperatures and ample rainfall helped small grains, but limited fieldwork opportunities for District farmers.

Retail
Contacts reported that retail sales grew at a substantially faster pace in early November, although weakness remained in most big-ticket categories. Chain department stores and grocery stores noted stronger sales, and big box retailers said electronics sales were especially robust. In addition, a contact at a large hardware store in central Virginia said sales growth had picked up, even with significant price increases on "anything made with steel or petroleum." In contrast, sales slowed at home improvement and building supply stores as housing activity remained sluggish. The pace of automobile and light truck sales was generally unchanged from a month ago, though a few dealers said their sales declined in recent weeks. Retailers were upbeat but somewhat guarded about holiday sales this year; some looked for holiday sales to increase about 4% compared to last year. Although a few District automobile dealers and furniture stores reduced staff, hiring picked up at most retail

businesses. Wages grew more quickly at retail establishments, while price growth slowed.

Services

District services firms indicated that their revenues grew slightly faster since our last report. Customer demand strengthened at healthcare organizations and utilities, and federal government contractors said that business had picked up with the new federal fiscal-year budget. Additionally, a financial services consultant in Virginia characterized demand as steady, and he noted improving client attitudes regarding the economy. Contacts at services firms said the pace of hiring moderated this month. Wage and price growth also slowed.

Manufacturing

Activity in the manufacturing sector picked up during the first half of November following a contraction in October. Contacts told us that factory shipments, new orders and employment expanded at a solid pace in recent weeks. Activity was particularly strong at chemicals, food, industrial machinery and transportation equipment firms; a turbine producer in South Carolina, for example, said that the oil industry was driving his business. He indicated that they had received three large turbine contracts for Saudi Arabia. A plastics producer was also upbeat, noting, "November was a good month; we've had a flurry of new orders and our backlogs are strong." In contrast, a furniture manufacturer in North Carolina reported that sales had reached their lowest level since the post September 11, 2001 period. Prices for both raw materials and finished goods picked up considerably in November after rising moderately in October.

Finance

District bankers reported that loan demand steadied since our last report. Residential mortgage lending remained weak, but some increased demand in the new homes sector helped to stabilize loan volume. Some contacts said that builders were slashing prices which "caused more people to get in on the action." A number of mortgage lenders reported that loan standards had tightened. A Charleston, S.C., banker noted that his bank was more carefully scrutinizing "the type of properties receiving loans, but not applicants." The demand for commercial loans held firm in October and November. Little change was reported in interest rates or the rates of delinquent loans.

Real Estate

Residential real estate agents across the District reported continued weakness in home sales. A Washington, D.C., agent told us that sales were down 17 percent from a year earlier, and he predicted that this trend would persist for another two years. In Richmond, Va., home sales were also reported to have fallen below 2005 levels. An agent there told us that buyers were not rushing to make purchasing decisions--they could afford to "pick and choose." Home inventories continued to rise modestly and some sellers were trimming asking prices. In contrast, a contact in Greenville, S.C., reported "positive sales" which he attributed mostly to large companies locating there recently. Several contacts noted modest decreases in home prices.

Commercial real estate agents across the District reported that leasing activity remained healthy in recent weeks. In the Raleigh market, a contact said industrial activity was "on fire," driven by strong population growth in the area. Contacts generally reported that vacancy rates edged down since our last report and several noted a slight uptick in rental rates.

Tourism
Tourist activity was generally stronger since our last report. A contact on North Carolina's Outer Banks said hotels and resorts were booked solid for the Veteran's Day weekend. She attributed the increase primarily to their first marathon which attracted 4,400 runners. In addition, a manager at a mountain resort in western Virginia noted record-breaking time-share sales--up nearly 20 percent over last year. In contrast, a hotelier at Virginia Beach reported that some corporate clients had scaled down their budgets--resulting in less money being spent on food and beverages.

Temporary Employment
Temporary employment agencies in the District continued to report generally firmer demand for workers since our last report. In some areas, tight labor markets had made it difficult for companies to fill needed positions. Workers with sales, life sciences, engineering and financial skills remained in strong demand.

Agriculture
Mild, rainy weather conditions assisted small grain development in most areas of the District, but rains delayed field work in some regions. Analysts in Virginia and Maryland told us that soggy field conditions hindered soybean harvests. They noted, however, that higher grain prices in recent weeks encouraged farmers to continue small grain plantings when the weather permitted. In South Carolina, harvesting of sweet potatoes and apples was ahead of schedule, while corn and soybean harvests fell behind schedule in West Virginia. Harvests of cotton, peanuts, sweet potatoes, sorghum and soybeans were nearing completion in North Carolina, and Christmas tree producers in that state said they were preparing for the holiday season.

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Sixth District--Atlanta

Reports from Sixth District contacts indicated that business activity remained mixed for October through mid-November. Retail sales were described as modest while auto sales were varied. Construction activity continued to decline, as cuts to residential building were only partially offset by modest growth in nonresidential development. Manufacturing reports were mixed. For instance, defense-related industries noted stronger activity, while building material suppliers reported weaker demand. Transportation firms also observed slower-than-expected demand. Banking conditions were little changed. Shortages of workers in several professional and technical occupations were noted throughout the District, and lower-skilled workers were in short supply on the Gulf Coast and in South Florida. These shortages were being reflected in higher wages. Most industrial contacts noted that input prices had moderated.

Consumer Spending
Most District retailers said that sales in October through mid-November were modestly higher than a year ago. Merchants in Louisiana and Mississippi noted that sales were down relative to last year's post-Katrina surge in spending on replacement goods. Strong reports came from electronics and high-end retailers, and their outlook was very upbeat heading into the holiday season. Other District retailers were cautiously-optimistic about the holiday season and anticipated modest sales growth compared with last year. The majority of retailers

surveyed in October indicated that inventory levels were up slightly from the same time last year.

District auto sales remained uneven across vehicle brands and market areas. Domestic auto dealers reported soft sales, while imports continued to gain market share. High inventory levels caused a large South Florida-based auto dealer to cut fourth-quarter orders from domestic automakers by 30 percent. Contacts from regional import distributors reported stronger October performances, with regional sales better than comparable sales nationally.

Real Estate

Weakness continued to be reported in District housing markets, with Florida continuing to experience the most significant declines. Contacts reported that new home construction and home sales remained well below year-ago levels in Florida. Condominium markets in some coastal areas have experienced particularly high vacancy rates. Inventories of unsold single-family homes reportedly continued to rise across much of the District, and weak market conditions are expected to persist over the next several months. Reports suggested that some small builders are facing financial difficulties, but there were no indications that this was a large scale problem in the District.

Growth in nonresidential construction remained modest, with infrastructure repairs and improvements continuing to dominate activity in the District. The most significant increase in activity was noted in Louisiana. Most commercial builders continued to expect modest growth in the coming months, although the pace of activity is expected to accelerate along the Gulf Coast.

Manufacturing and Transportation

Manufacturing activity varied by sector in October and early November. Layoffs associated with a major plant closure idled thousands of District auto workers. The slump in the residential construction industry led to production cutbacks by some suppliers of housing-related materials such as flooring, framing lumber, wallboard and plywood. A producer of heavy-truck trailers reported a decline in new orders. More positively, a large military contractor reported increased orders from the U.S. Navy, and a pipe producer reported that demand from the energy sector was strong.

Trucking contacts reported disappointing freight demand, with much of the weakness concentrated in the retail and building materials sectors. Trucking industry contacts in Atlanta noted that retailers were not increasing inventories to the levels usually seen at the beginning of the holiday-shopping season. Trucking firms servicing the construction industry reported a decline in orders.

Tourism and Business Travel

Most reports from the tourism industry were positive. Attendance at major trade shows and conventions increased in central Florida. Nashville and Atlanta's hospitality industry also reported improved business, with hotels enjoying increasing occupancy rates. Mississippi Gulf Coast gaming revenues were near pre-Katrina levels in September and October as many of the damaged casinos have re-opened. According to gaming officials, employment at the casinos on the Mississippi Gulf Coast had also returned to near pre-hurricane levels.

Banking and Finance

Overall banking conditions were little changed in October. Weak loan demand continued to be noted in most parts of the District, lead by lower levels of mortgage lending. Deposit growth was mixed, with some parts of the District noting strong deposit growth, while others observed flat to slow growth in October and early November. Credit quality remained strong in the region. Commercial and industrial lending slowed overall, though there were reports of stronger demand in southern Louisiana.

Employment and Prices
Skilled workers remained in short supply in parts of the District. Contacts in South Florida and Nashville noted shortages of nurses, while North Alabama reported difficulty filling engineering positions. In Louisiana, shortages of skilled workers in the energy extraction industry were noted. Some shortages were posted for other types of labor as well, especially along the Gulf Coast and South Florida. An Alabama temporary staffing firm has seen increased demand from manufacturing and defense-related companies. In addition, some retail contacts expressed concern about their ability to find additional workers for the holiday period, and some holiday-related temporary positions have experienced higher wages as a result. Wage increases were also reported in the hotel, financial services, and healthcare industries. Some layoffs in the construction industry were reported in Florida, and wages were said to be stabilizing.

Most reports indicated that commodity prices had moderated. According to construction industry contacts, lumber prices dropped in November. Also, energy and related feedstock costs have declined for industrial users. Pulp and paper, chemical, and plastics manufacturers noted that costs for their oil and gas inputs had eased, and this has helped profitability. Some reports also noted that the decline in gasoline prices was feeding through to lower fuel surcharges on shipping.

Agriculture and Natural Resources
Poultry and livestock producers reported an escalation of feed costs, partly resulting from the growing use of corn for ethanol production. Most of the post-hurricane infrastructure repair work has been completed in the District's energy sector.

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Seventh District--Chicago

Economic activity in the Seventh District expanded at a modest pace during October and early November. Consumer spending continued to increase at a gradual rate, and business spending expanded again. Overall labor market conditions were little changed, with small gains in employment on net. Residential construction and real estate activity continued to decline in most areas, while nonresidential construction was steady on balance. Manufacturing expanded at a modest pace. Lending activity moderated further. Overall, nonwage price pressures eased a bit, while overall wage increases were similar as in the previous reporting period. Prices for corn and soybeans rose, as this year's yields turned out to be smaller than were expected in September.

Consumer Spending
Consumer spending continued to increase at a gradual rate in October. Retailers said Halloween sales were "positive," and one contact thought this boded well for the holiday shopping season: "If they'll spend at Halloween, just think how much they'll spend at Christmas!" Nonetheless, retailers were said to have taken a conservative approach to inventories. Restaurant sales were higher than expected over the past six to eight weeks; one

contact suggested that lower gas prices helped support demand. Auto dealers reported that sales remained relatively steady in recent weeks, though showroom traffic was soft. Tourism was similar to a year ago.

Business Spending

Business spending and hiring rose again in the District. For the most part, capital spending continued to increase at similar rates as in the previous reporting period. A toolmaker reported plans for further capacity expansions in 2007, a restaurant chain increased its planned outlays for renovations, and a manufacturer noted continued strong levels of spending on high-tech equipment. Overall, labor market conditions were little changed, with small gains in employment on net. Manufacturing employment was mixed by industry. Toolmakers increased employment but noted continued shortages of skilled workers. In contrast, an automaker said that the planned reductions in their workforce were running ahead of their targets. A temporary help services provider said that billable hours growth in the District was a bit softer, but the firm's outlook was favorable as forward orders had maintained their previous trends.

Construction and Real Estate

Residential construction and real estate activity continued to decline in most areas and market segments. One notable exception was the Milwaukee area, where homebuilders reported high traffic through model homes and strength in the construction of upper-end homes. One contact said that lot sales were soft and that some people who already owned lots were waiting for construction costs to come down before building. Nonresidential construction was steady on balance: new development was flowing at a steady pace, and there were few reports of project cancellations. A contact in Michigan reported strong demand for medical space, while net absorption of office space in Chicago slowed. Commercial rents were creeping up in Indianapolis, but flat in Michigan and Illinois.

Manufacturing

Manufacturing activity expanded at a modest pace in October and early November. Sales of large- and medium-sized heavy equipment continued to grow at solid rates. Demand for equipment related to nonresidential construction was expected to expand at a slower rate in 2007, while demand for smaller equipment used in home construction was expected to decline further. Manufacturers of machine tools and equipment parts reported continued strong order growth in most market segments outside of motor vehicles. One partmaker noted that demand was led by the electronics and semiconductor industry. Another toolmaker noted that its exports continued to grow faster than the rest of its business. Light vehicle manufacturers reported softer sales nationwide. They indicated that there was little room to alter production plans for the fourth quarter but cuts in the first quarter schedules were possible. A steelmaker noted that vehicle production cuts continued to show through in weaker orders for flat-rolled steel, but other segments of the steel market were slowing as well and were expected to remain sluggish through the first quarter. Steel production in the Midwest was said to be slowing more sharply than in the rest of the nation. Steel inventories moved further above desired levels. Wallboard shipments fell, and capacity utilization in the industry declined.

Banking and Finance

Lending activity moderated further. Bankers noted continued stagnation in mortgage applications for home purchases. But refinancing activity firmed in October and early November as lower interest rates stimulated demand. Demand for new home equity loans declined further, but the usage rate of existing credit lines ticked up. Household credit quality generally remained in good shape: delinquency rates on mortgages were stable, but delinquencies on home equity loans edged up. Retail deposit growth slowed, as some depositors sought higher returns in money market accounts. Business loan demand was flat. Lending for equipment and inventories remained steady, but real estate lending leveled off following a period of solid gains. A banker in the Chicago area said that institutional real estate investors remained active, though there had been some slowdown by smaller investors. Commercial lending conditions continued to be competitive and interest rate margins remained narrow. One banker noted that commercial real estate borrowers were starting to seek interest-only and other alternative loan structures. Commercial credit quality remained in good shape, with steady ratios of non-accruing loans.

Prices and Costs

On balance, nonwage price pressures eased a bit, while overall wage increases were similar as in the previous reporting period. Several contacts reported continued declines in energy costs, and a few transportation firms had begun rolling back surcharges. Prices for hot rolled and scrap steel declined, and wallboard prices also fell. In contrast, toolmakers reported further price hikes, and many food prices increased as well. There were no reports of significant changes in price movements at the retail level. One automaker increased discounting, and incentive activity was expected to increase further as inventory levels remained high. Wage increases continued at similar rates as in the previous reporting period. A temporary help firm noted that wages for high-skilled positions were moving "appropriately" higher, but their customers were reluctant to increase wages for lower-skilled positions, even though these jobs were getting a bit more difficult to fill.

Agriculture

Most farmers completed their harvest during the reporting period. Corn and soybean yields were at least average, though not as good as expected last reporting period. Corn and soybean prices increased to substantially higher levels than a year ago. Many farmers held grain off the market as they waited for prices to move even higher. Contacts indicated that more farmers than usual already had locked in prices for the next growing season and some were writing contracts for even farther in the future. Ethanol production kept rising, but some plans for new plants and expansions of existing facilities have been postponed or put on hold. In some cases, construction delays stemmed from the lack of availability of equipment for the plants. In other cases, investors reassessed the feasibility of their plans based on the rapid increase in ethanol supply and zoning issues. Livestock and poultry operations were hurt by higher feed costs. In addition, District dairy producers struggled with low milk prices.

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Eighth District--St. Louis

Economic activity in the Eighth District expanded at a moderate pace since our previous report. Manufacturing activity increased modestly, while growth in the services sector remained strong. Contacts reported that retail and auto sales increased slightly in October and early November compared with a year ago. Home sales reports were mixed and commercial real estate market conditions varied across the District. Lending activity at a sample of District banks changed little in the three-month period ending in October.

Consumer Spending

Contacts reported that retail sales in October and early November were up, on average, over year-earlier levels. About 65 percent of the retailers saw increases in sales, while 17 percent saw decreases. About 39 percent of the retailers reported that sales levels met their expectations, 33 percent reported that sales were above what they had anticipated, and 28 percent reported sales below expectations. Apparel, food, and electronics were all strong sellers, while home furnishings were moving more slowly. Two-thirds of the contacts reported that inventories were at desired levels; 29 percent reported that inventories were too high, and 5 percent reported that inventories were too low. About 70 percent of contacts expect that upcoming holiday sales will increase over 2005 levels, while 13 percent expect decreased sales.

Car dealers in the District reported that sales in October and early November were up, on average, over year-earlier levels. About 35 percent of the car dealers surveyed reported an increase in sales, while another 35 percent reported a decrease. About 30 percent of the car dealers reported that used car sales had increased relative to new car sales, while 9 percent reported the opposite. Also, 26 percent reported an increase in low-end vehicle sales relative to high-end vehicle sales. About 22 percent of contacts reported tighter financing options, but over 90 percent of the contacts reported no change in acceptance or rejection rates of finance applications. Nearly 36 percent of the car dealers surveyed reported that their inventories were too high, while 23 percent reported that their inventories were too low. About 30 percent of the car dealers expect that sales for the next two months will increase over 2005, while 26 percent expect decreased sales.

Manufacturing and Other Business Activity

Manufacturing activity expanded modestly since our previous report. While the majority of contacts reported plans to expand operations or hire additional workers in the near future, several manufacturers reported plans to close operations and lay off workers. Firms in the primary metal, biofuel, plastics, chemical, aerospace, packaging, and paper manufacturing industries announced plans to open or expand facilities in the District. Contacts in the food, chemical, and plastics industries reported plans to hire additional workers. In contrast, firms in the beverage and auto parts industries reported plans to close plants in the District. Firms in the appliance, machinery, furniture, and auto parts industries reported plans to lay off workers.

The District's services sector continued to expand in most areas. Contacts in the freight transportation, professional, and financial services industries reported plans to open or expand facilities in the District. A contact in the data processing services industry reported plans to expand operations and hire additional workers. In contrast, a contact in the business support services industry reported plans to lay off workers.

Real Estate and Construction

Home sales reports were mixed throughout the District. October 2006 year-to-date home sales increased 8 percent in Memphis but declined 1 percent in Louisville and about 3 percent in Little Rock and St. Louis. Residential construction remains low throughout the District. September year-to-date single-family housing permits declined in nearly every metro area compared with the same period in 2005. Permits declined 33 percent in Louisville, 23 percent in St. Louis, 12 percent in Little Rock, and 11 percent in Memphis. In contrast, permits increased roughly 3 percent in Jackson, Tennessee.

Commercial real estate market conditions remain mixed throughout the District. The third-quarter 2006 industrial vacancy rate declined from the second quarter in St. Louis and Memphis but increased in Louisville. During the same period, the office vacancy rate declined in St. Louis, Memphis, Louisville, and Little Rock. Contacts in Little Rock reported that September year-to-date commercial construction permits are down roughly 5 percent over 2005. In west Tennessee, contacts reported that commercial construction has increased substantially. Contacts in Louisville reported that several large distribution centers are planned for construction in 2007, and contacts in St. Louis reported that industrial construction remains active.

Banking and Finance
A survey of senior loan officers at a sample of District banks showed little change in overall lending activity in the three months ending in October. During this period, credit standards and demand for commercial and industrial loans remained unchanged for both large and small firms. During the same period, credit standards for commercial real estate loans tightened somewhat, while credit standards for residential mortgages and consumer loans remained basically unchanged. Demand for commercial real estate and consumer loans remained unchanged, while demand for residential mortgages was moderately weaker.

Agriculture and Natural Resources
Recent wet weather throughout much of the District has slowed the pace of crop harvesting. Nevertheless, about 90 percent of all corn, soybeans, sorghum, and cotton and all of the rice in the District have been harvested. The rains have delayed some planting of winter wheat, especially in Kentucky and Mississippi, but over 88 percent of the emerged winter wheat in each District state is rated in fair condition or better.

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Ninth District--Minneapolis

The Ninth District economy grew since the last report. Increases in activity were noted in consumer spending, manufacturing, energy, mining, and agriculture. Meanwhile, tourism activity was mixed, and residential real estate and construction activity decreased. Signs of a tighter labor market were noted. Overall price increases were modest as fuel prices decreased.

Consumer Spending and Tourism
Overall consumer spending rose moderately, and prospects for holiday sales were generally positive. A major Minneapolis-based retailer reported same-store sales up about 4 percent in October compared with a year ago. Recent sales at a Minneapolis area mall were up 4 percent from a year ago; expectations for the holiday season were positive. Sales at a North Dakota mall were up 3 percent in October compared with last year, according to the mall manager, and store owners were optimistic for the holiday season. According to members of the Minneapolis Fed's board of directors, retailers in the Bozeman, Mont., area are expecting robust holiday sales and retailers in the Billings, Mont., area are expecting sales at levels similar to last year. A survey of holiday spending plans in the Minneapolis-St. Paul area by researchers at the University of St. Thomas suggests that holiday spending in 2006 will be up slightly from 2005. A St. Paul area mall manager said that recent sales activity was comparable with last year. New and used car and truck sales were relatively solid during the past two months, according to an auto dealer in Minnesota.

Overall tourism activity was mixed. Fall tourism in northern Minnesota and Wisconsin was up from last year, according to Bank directors. The number of deer hunting licenses issued this fall was slightly above last year's level in Minnesota. After a strong September, October tourism activity was down about 7 percent from last year's level in western South Dakota, according to an official. Crossings at the International Bridge in the Upper Peninsula of Michigan were down 6 percent in October compared with a year ago.

Construction and Real Estate
Commercial construction was up. Recent commercial construction activity was robust in the Bismarck, N.D., area, according to a representative of a commercial real estate firm there. The value of October commercial building permits in Sioux Falls, S.D., was about even with last year's record levels, and office construction was up slightly. A Minneapolis developer hired a design firm to begin plans for a large new office tower in its central business district. Plans were announced for the redevelopment of a historic skyscraper into a luxury hotel in downtown Minneapolis. However, residential construction continued to slow. October residential construction permits for Rochester, Minn., were down 42 percent in value from a year earlier. The value of new permitted housing in October fell 17 percent in Sioux Falls from last year's record levels.

Commercial real estate activity continued at a fast pace. Industrial, retail and office markets in the Minneapolis area saw positive absorption in the third quarter; office absorption is expected to top 1 million square feet there by year end, and lease rates are rising. Residential real estate continued to slide. The median home sales price for Minneapolis-St. Paul fell 1 percent in October, and closed sales were down almost 20 percent. A Bank director in Billings, Mont., reported that home sales were down slightly from a year earlier, but dollar volumes were down more. Preliminary results indicate more than three-quarters of respondents to the Minneapolis Fed's business outlook poll (November) expect housing starts to be down in their communities this year, but most don't expect that to adversely affect their sales, profits, investment or hiring.

Manufacturing
Growth was evident in the manufacturing sector. Based on preliminary results from the Minneapolis Fed's annual business outlook poll, respondents from the manufacturing sector expect growth in company sales, employment and capital investment in 2007. Meanwhile, a November survey of purchasing managers by Creighton University (Omaha, Neb.) indicated increased manufacturing activity in North Dakota and Minnesota and reduced activity in South Dakota. A brewery in western Wisconsin is building a new plant. In South Dakota, a visual communication systems manufacturer plans to add a facility.

Energy and Mining
Activity in the energy and mining sectors grew since the last report. Oil and gas exploration and production in the District were level with previously reported amounts. However, the alternative energy industry, including wind, biodiesel, and ethanol, continued to expand at a solid pace. In addition, $5 billion worth of new traditional power plants are planned to supply the mines and other industry in northern Minnesota. Mining production remained at near-capacity across the District.

Agriculture
Agricultural activity increased since the last report. Higher corn and soybean prices were

welcomed by District crop producers. Good harvests were reported in many parts of the District. In Minnesota, the corn harvest was a strong 1.1 billion bushels, soybean production was up from last year and a record amount of sugar beets was produced. In addition, record harvests of corn and soybeans were forecast in North Dakota. Meanwhile, most of the winter wheat crop has emerged in good to excellent condition. However, preliminary results of the Minneapolis Fed's third-quarter (October) agricultural credit conditions survey indicate that overall agricultural income will be down in the fourth quarter of 2006 due to higher input costs.

Employment, Wages, and Prices
Signs of a tightening labor market were noted. According to preliminary results of the Minneapolis Fed's business outlook poll, 58 percent of respondents describe securing workers as a challenge or serious challenge. Two boat manufacturing plants in Minnesota are expected to add 140 jobs as a result of company restructuring. Businesses in western Minnesota are having difficulty hiring temporary employees, and a shortage of welders was reported in South Dakota.

However, in Minnesota almost 300 jobs at a department store's head offices and a distribution center will be eliminated by next spring, a vending machine manufacturer recently laid off 200 workers, a printing services provider will close a plant resulting in 72 job losses and a newspaper plans to eliminate about 40 positions. In the Upper Peninsula of Michigan, a manufacturer announced plans to lay off 170 workers.

Overall wage increases were moderate. The aforementioned business outlook poll showed nearly three-quarters of respondents expect wages and salaries in their community's businesses to increase between 2 percent and 3 percent. However, a member of the Advisory Council on Small Business and Labor reported that wages at mines in Montana were up over 10 percent and generous signing bonuses have been offered.

Overall price increases were modest as prices for fuel declined. Prices for many fuels and natural gas were down since the last report. Mid-November gasoline prices in Minnesota were about the same as they were at the end of September, but down 81 cents per gallon since August. Price increases were noted for roofing shingles and foam rubber.

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Tenth District--Kansas City

The Tenth District economy continued to experience moderate growth in October and early November. Consumer spending strengthened despite slightly weaker auto sales, and labor markets continued to expand. Commercial real estate activity also increased further, while manufacturing grew modestly. Energy activity fell slightly but was still high by historical standards, and agricultural conditions were generally favorable. Residential real estate activity continued to decline. Wage pressures were generally moderate, while price pressures eased slightly.

Consumer Spending
Consumer spending increased solidly in October and early November, despite a slight easing in auto sales. The share of retail stores reporting increased sales from the previous survey continued to rise following a slowdown in the summer, and recent sales were higher than expected at many stores. Gains were reported across a variety of market segments, with sales

of apparel particularly strong. On the other hand, sales of home furnishings remained relatively weak. Contacts generally expected a solid holiday sales season. Auto dealers reported a modest decline in sales from the previous survey, which pushed inventories above desired levels at many dealerships. However, vehicle sales remained above year-ago levels and contacts were generally optimistic about the future. Travel and tourism activity remained strong in October and early November. District hotels continued to report high occupancy rates, and airport traffic was solid. Most hotel and tourist attraction operators expected high levels of activity to persist through the end of the year.

Manufacturing

Manufacturing activity in the District expanded modestly in October and early November. Plant managers continued to report slower growth in production, shipments, and new orders than earlier in the year, and order backlogs and finished goods inventories fell for the first time in over a year. Producers of automotive, residential construction, and agricultural equipment reported especially slow sales. On the other hand, manufacturers who supply equipment to the energy, railroad, aircraft, commercial office, and high-tech industries reported strong demand. Plant managers expressed less optimism about near-term output than in previous surveys, and one contact reported a reduction in productivity due to limited skills and motivation among recently-added employees. However, factory activity was still well above year-ago levels, and capital spending plans remained solid.

Real Estate and Construction

Residential real estate activity decreased in October and early November, while commercial real estate activity strengthened further. Builders indicated that home starts continued to drop and were below year-ago levels. Further easing in home construction is expected in the months ahead. Residential real estate agents reported continued declines in home sales, and additional decreases are anticipated. Inventories of existing homes were still well above year-ago levels but largely unchanged from the previous survey. Home inventories were generally expected to begin falling in the months ahead, with the slowdown in construction. Home prices were steady in most cities and still well up from a year ago in Albuquerque and Oklahoma City. Many contacts in Colorado, however, reported moderate price declines and expected further easing in the future. Commercial real estate activity continued to improve. Sales and absorption of office space increased in most cities, and vacancy rates were lower than a year ago throughout the District. As a result, office prices and rents increased further. Most commercial real estate agents anticipated continued strengthening in the months ahead, although a few contacts were concerned about potential over-building of single-story suburban commercial space.

Banking

Bankers reported that loans increased somewhat since the last survey, while deposits held steady. Demand for commercial and industrial loans rose, while demand for residential mortgage loans edged down. On the deposit side, interest bearing deposits such as CDs and money market deposits were slightly higher than in the prior period, while demand deposits were lower. Lending rates and lending standards were basically unchanged.

Energy

Energy activity declined moderately in October and early November but remained strong by historical standards. The count of active oil and gas drilling rigs in the region fell slightly compared with the previous survey but was still well above year-ago levels. The recent decline was concentrated in the Rocky Mountain area, where contacts reported the cost to drill, equip, and produce wells was becoming prohibitive. One contact also noted that many exploration companies had moved their offshore drilling rigs in the Gulf of Mexico to other parts of the world due to difficulties in obtaining hurricane insurance. Most contacts anticipated steady drilling activity going forward, as energy prices remained relatively high.

Agriculture
Agricultural conditions remained generally favorable in October and early November despite a lack of moisture across much of the District. The corn and soybean harvest was nearly complete, and winter wheat emergence was progressing normally. The unseasonably warm and dry weather aided harvest activities but continued to deplete soil moisture in many vulnerable parts of the District. Higher market prices benefited producers of wheat and corn. Livestock producers, however, faced higher feed costs combined with weak pasture conditions.

Labor Markets and Wages
Labor markets continued to expand in the District, while wage pressures remained moderate. Hiring announcements continued to outpace layoff announcements in the region, and several contacts noted increases in newspaper and radio job advertisements. The majority of businesses reported some type of labor shortage, especially for skilled and specialized workers, including engineers, oil field workers, accountants, welders, sales people, and truck drivers. Given the overall shortage of workers, one contact lowered language standards for new employees. Several contacts said more firms were hiring workers away from other companies, resulting in higher wage expectations. Still, the overall share of businesses experiencing wage pressures remained steady.

Prices
Price pressures eased somewhat in October and early November. The share of manufacturers reporting increased materials costs continued to fall, and the share of factories raising finished goods prices also dropped slightly. Builders reported metal prices remained high, but prices for some other construction materials have moderated due to both lower demand and lower transportation costs. More manufacturers than in previous surveys expected prices to rise in the coming months, and builders said any increase in fuel costs would lead to price hikes. Most retail contacts reported flat selling prices and expected little change in prices in the months ahead. However, several restaurants in Colorado planned to raise menu prices to cover expected increases in labor costs resulting from the passage of a new minimum wage law.

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Eleventh District--Dallas

In October and the first half of November, the Eleventh District economy continued to decelerate from high levels. While there remains strength in the manufacturing, construction, finance and service sectors, there are also areas of softness. Many industries reported increased caution about the outlook. Energy activity was strong overall, but there was still little change in the rig count. Retail sales were weaker than expected. Manufacturing activity remained strong to supply the energy industry but continued to report slowing sales to residential building. Service sector activity was also mixed, with a dip in demand for temporary workers. Nonresidential building is strong, but home sales and home building weakened further. Financial service firms reported softer consumer lending, but credit quality is healthy and commercial lending is good. Agricultural conditions improved over the past six weeks.

Prices

Energy prices have stabilized at relatively high levels. West Texas Intermediate crude oil prices have floated between $57 and $61 in recent weeks. U.S. demand for crude oil has risen as refiners return from seasonal maintenance, but crude oil inventories remain high. Gasoline prices at the pump fell sharply, boosting gasoline consumption and reducing inventories. Demand for heating oil and diesel has been strong, but inventories have built up with mild weather, while pump prices have stayed near $2.50 per gallon as the result of reduced sulfur requirements. Natural gas prices strengthened seasonally during the period, from $6 to $8 per million Btu at Henry Hub. Inventories are at very high levels and a mild winter is expected, which has some contacts raising the possibility that natural gas prices might take a downward bounce.

Other prices were mixed. Overall home prices are unchanged, but prices have declined in some metropolitan areas, particularly in Dallas and Fort Worth. Building costs to supply nonresidential construction are unchanged, but prices are lower for products supplying home building. Paper prices were unchanged, but prices of corrugated boxes were lower. Accounting firms raised fees to cover rising salaries. Prices for corn, grain sorghum and wheat were up sharply.

Labor Market

The labor market remains very tight, and wages were rising in many industries. Workers shortages were reported by service, manufacturing, finance and energy firms. A lack of labor is a capacity constraint for some firms and, in some areas, companies have resorted to using billboards in an attempt to attract workers. While the shortage extends to many types of skilled and semi-skilled workers, of particular note in this survey were reports of difficulty finding engineers, electricians, high-tech technicians, certified mechanics and accountants. Some firms have reached out to community colleges in an attempt to boost the supply of qualified workers.

While the labor market remains tight, softening sales have led some manufacturers to slow hiring as a precaution. The shortage of qualified truck drivers seems to have eased some.

Manufacturing

Manufacturing activity continued to cool. Demand remained strong for refining, some chemicals, and for products to supply commercial construction and oil and gas drilling. However, sales to homebuilders slowed further, pushing up inventories for some products and causing some firms to reduce production. Food producers report an increase in demand. Sales of paper products increased slightly, but demand for corrugated boxes softened some. High-tech manufacturers reported generally good growth in production and orders, although there were a few firms that reported some recent softening in orders.

Gulf Coast refineries are now operating at high levels. The return from maintenance was delayed in some cases by labor and construction shortages or by relatively weak margins that offered less incentive to produce. Refining margins have been strong by historical standards, but are only half to one-third of the high margins enjoyed over the summer.

Petrochemicals were mixed. Ethylene production was affected by a series of planned and unplanned outages that have supported prices and kept profit margins high. There was a sharp seasonal decline in demand for polyethylene, and the decline in homebuilding has hurt demand for PVC pipe. In contrast, demand for synthetic rubber is very strong. Prices are high, and margins are excellent. Demand for isobutylene, used in many consumer products, weakened in September and October but returned strongly and has been pushing capacity limits in early November.

Services
Temporary staffing firms say activity slowed earlier than expected and the volume of new orders was below last year levels. The slowdown was concentrated in manufacturing; however, contacts noted that they had seen a fall off in demand in other industries as well. Demand for legal services held steady over the past month but activity was up compared with a year ago. Accounting firms saw no change in activity.

Shipping firms report good demand but anticipate slower growth in coming months. Cargo volumes remained flat and continued to be buoyed by domestic demand for nondurable goods. Container trade activity rose sharply, with growth partly coming from an increase in steel imports. Railroads indicated no change in overall volumes but noted that shipments of lumber, wood and other building products were down substantially over the past month. Trucking firms said demand softened further which, according to contacts, helped ease the shortage of truck drivers in the industry. Airlines report continued good demand overall.

Retail Sales
Retail sales growth has been weaker than expected. Some contacts had expected a greater pick up in sales following the drop in gasoline prices. Sales continue to be weakest to lower income customers who were more affected by high energy costs. Sales were weakest for home items, particularly for furniture. Respondents have become more cautious about the outlook for holiday sales, which they say will be very competitive. Inventories are in good shape, although retailers say they are watching them closely.

Demand for autos remains soft, although lower gasoline prices have resuscitated sales of some domestic vehicles. There were reports of higher than desired inventories.

Construction and Real Estate
District home sales continued to slow, but activity has been mixed. Sales are still strong in some areas, such as Houston, but sales and traffic are down significantly in the Dallas/Fort Worth area. Cancellations have edged up, especially for lower priced homes. Homebuilders and real estate agents noted increased uncertainty and uneasiness among buyers that they blamed partly on reports of weakness in other parts of the country. Builders have pulled back on starts and increased buyer incentives in an attempt to manage rising inventories.

Apartment demand remained solid, and rents are rising. Despite the departure of Katrina evacuees, apartment occupancies are at or above 90 percent in most Texas metros. Multifamily construction activity was still strong, but contacts said a shortage of building sites and high construction costs have held back construction of Dallas-area apartments.

Demand for office space remains strong, and rents continue to increase. Contacts say investor interest remains high. Occupancy rates are edging up--and in Austin have reached a five-year high. A Houston respondent said rents were up dramatically in some areas. Office construction continues in all major metros. Dallas contacts remain optimistic that demand will be sufficient to absorb the increased volume of speculative projects currently under construction.

Financial Services
Consumer lending continued to slow for all types of products, including mortgages, credit cards, personal and auto loans. Credit quality is still good, and mortgage delinquencies do not appear to be a problem for District lenders. Commercial lending is very good, although contacts expect activity to slow. Competition for experienced and talented lenders continues to be intense.

Energy
Energy activity remained generally strong, but the rig counts continued to be mostly unchanged in the United States and Texas. Oil service companies are working through an extensive backlog of orders, and there are still shortages of people and equipment. Day rates continue to rise but more slowly than earlier in the year. International activity continued to grow strongly.

Contacts are cautious about weak natural gas prices and rising drilling costs, and say that drilling for natural gas in high cost areas is the most vulnerable. Firms have completed extensive hiring and training of new employees and made large commitments to internal capital expansion and R&D. Companies say they can shift crews and equipment across basins or around the world, wherever backlogs continue.

Agriculture
Recent rains boosted cattle grazing conditions, and many producers are optimistic they will get a good cutting of hay before the first freeze. Still, supplemental feeding of herds continues in the driest regions, and rapidly rising feed costs--particularly for corn--have substantially lowered calf prices. Rain has helped wheat and oat crops get off to a good start, but were too late for cotton, pecan, peanut, soybean and sorghum. Harvest of these crops is underway, and yields are better than expected but below last year's levels.

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Twelfth District--San Francisco

Economic activity in the Twelfth District continued to expand at a moderate pace on net during the survey period of October through mid-November. Reduced energy prices reversed upward price pressures for some products, while the pace of wage growth remained contained overall but exerted upward price pressures in some industries and areas. District retailers generally reported improved sales and service providers saw strong demand. Orders and output grew further for most manufacturers and agricultural producers. District housing markets continued to cool, while demand for commercial real estate expanded but at a slower pace than previously. Banks reported solid loan demand and good credit quality in general.

Wages and Prices
Upward price pressures diminished somewhat, as prices for energy and related products receded from previously high levels, reducing overall production costs in some sectors. Prices fell further for selected building materials used primarily for residential construction. More generally, respondents noted relatively stable input prices. The primary exceptions were selected commodities such as flour and sugar: significant price increases of late for these inputs are expected to show up in the final prices of some food products in early 2007.

Overall wage growth remained moderate. However, wage growth continued to be more rapid for selected groups of skilled workers, notably in the health-care, finance, and construction sectors, and in areas with very tight labor markets overall, such as Idaho and Utah. Scattered reports also suggested employers were becoming increasingly reliant on using hiring bonuses to recruit skilled workers who are in short supply. These compensation increases exerted noticeable upward pressure on final prices in some cases.

Retail Trade and Services
District retailers reported improved sales growth and balanced inventories for items other than motor vehicles. Sales at department stores and specialty shops picked up relative to the previous survey period, spurred in part by increased spending power arising from lower gasoline prices. Considering early sales figures, retailers are cautiously optimistic in their forecasts for the holiday season as a whole, with expected sales growth generally in the range of 4 to 6 percent relative to last year. Demand for automobiles weakened slightly compared with the previous survey period. Sales of fuel-efficient import vehicles continued at a solid but slightly reduced pace, while the recent drop in fuel prices did little to offset sluggish sales for large, fuel-inefficient domestic models; inventories of domestic light trucks and SUVs reportedly were at record highs.

Service providers reported generally strong demand. Sales grew significantly in the food and beverage, health-care, and transportation sectors. Contacts in various sectors reported that fuel surcharges have been trimmed due to lower energy costs, reducing the price of transportation services. Overall tourist activity remained at high levels, although a Southern California contact noted that recent convention business there has not kept pace with last year.

Manufacturing
Demand for District manufactured products expanded further in October and early November. Sales of semiconductors grew at a solid pace in line with industry forecasts, and capacity utilization generally remained in the range of 90 percent. Producers of commercial aircraft and their parts suppliers continued to operate at full capacity to meet ongoing order backlogs, while makers of machine tools indicated that new orders grew but at a slightly reduced pace. Food manufacturers reported continued strong sales. By contrast, demand for selected building materials used primarily for home building fell further, and some sawmills in the Pacific Northwest have sharply curtailed production or closed due to reduced demand for wood products.

Agriculture and Resource-related Industries
Demand for District agricultural and resource-related products was strong and production conditions were stable overall. Sales rose for livestock and most crops, and prices received for these items increased compared with a year ago, notably for selected commodities such as corn. Prices for fertilizers and freight services have fallen significantly, easing upward pressures on production costs. In the resources sector, producers of oil and natural gas continued to see robust demand, although one contact reported that demand for natural gas slowed somewhat due to reduced sales of new homes.

Real Estate and Construction
Activity in residential real estate markets fell further, while demand for commercial real estate expanded but at a slower pace than previously in some areas. The pace of home sales and price appreciation continued to slow for existing and new homes, with particularly weak conditions noted for the latter. To work down unsold inventory, home builders have been

offering significant incentives to entice buyers; these incentives reportedly have been valued as high as 10 percent of the listed prices. Residential construction activity has fallen substantially along with demand for homes. On the nonresidential side, vacancy rates for commercial space fell further and rents rose a bit in most areas. Construction activity for commercial and public projects continued to expand, largely offsetting the decline in residential construction, although the pace of growth was slower than earlier in the year. Some contacts noted that investors and builders have grown more cautious about committing to nonresidential projects, due in part to the high costs of land, labor, and building materials.

Financial Institutions

District banking contacts reported solid loan demand and good credit quality overall. Further growth in commercial and industrial loans continued to offset declines in residential mortgage originations. Demand for consumer loans fell slightly in some areas but remained relatively strong. Credit quality was high in general with few delinquencies. However, contacts provided scattered reports of delinquencies on loans to home builders, and banks have increased their vigilance over these loans. Venture capital and private equity financing reportedly remained on a modest but steady growth path.

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