



January 17, 2007

Summary of Commentary on Current Economic Conditions by Federal Reserve District

Summary

Prepared at the Federal Reserve Bank of Minneapolis and based on information collected before January 8, 2007. This document summarizes comments received from business and other contacts outside the Federal Reserve System and is not a commentary on the views of Federal Reserve officials.

Most reports from the Federal Reserve District Banks indicated that economic activity expanded at a modest pace since the last report. The New York and San Francisco Districts reported moderate growth, while the Dallas District reported further deceleration from a high level of activity. The Minneapolis District reported slight growth. The Boston District characterized activity as mixed, and the Cleveland District saw softening activity.

Districts generally reported modest increases in retail sales, and vehicle sales were sluggish in several Districts. Tourism spending was up in a number of Districts. Reports on the service sector were generally positive; many Districts reported growth in technical, legal and information services. Manufacturing activity continued to expand in most Districts, with weakness reported mainly for products supporting the residential construction industry. Nearly all Districts reported a continued softening in housing markets, and high inventories of new homes have generally led to a slowing in residential building. In contrast to the housing sector, commercial real estate markets continued to see strong activity in most Districts. Lending activity was mixed, with commercial and industrial lending generally up while residential mortgage origination and refinancing continued to weaken. Overall weather conditions and high prices aided the agriculture sector. Energy production and exploration remained at high levels, and the alternative energy sector increased. Mining output grew.

District reports generally described labor market conditions as tightening and cited examples of some businesses having difficulty finding qualified workers. Despite expanded hiring, Districts reported relatively moderate gains in wages; however, some Districts noted certain business lines that experienced wage increases and have concerns about increases in the benefit portion of compensation. District reports indicated moderate price increases overall as prices for energy and a number of materials eased and competition kept prices for final goods in check.

Consumer Spending and Tourism

Districts generally reported modest increases in retail sales. Several Districts described retail sales increases as slight or moderate. New York reported that sales were on or slightly above

plan in December. Dallas characterized retail sales growth as good, but not great. Retailers in the San Francisco District reported a generally solid performance for the holiday season. However, Boston, Cleveland and Kansas City described retail sales as mixed. New York, Philadelphia, Richmond and Chicago noted strong sales in electronics. New York, Philadelphia and Richmond reported soft apparel sales, particularly in outerwear due to warm weather. In contrast, retailers in the Chicago and St. Louis Districts reported strength in apparel sales. Districts that commented on inventory levels described them as generally favorable or balanced, except for Boston, where several contacts reported higher-than-expected levels.

Vehicle sales were sluggish in several Districts. Philadelphia, Richmond, Atlanta, St. Louis, Minneapolis and Kansas City reported slow vehicle sales. Auto sales were mixed in the Cleveland District, while Dallas reported a pickup in sales and San Francisco described sales as moderate on net. Several reports noted that foreign car sales were stronger than domestic truck sales; however, a few reports indicated strength in SUV demand due to lower gas prices.

Tourism spending was up in a number of Districts. Boston, New York, Atlanta, Chicago, Kansas City and San Francisco provided positive assessments of tourism activity, while Richmond described activity as mixed and Minneapolis noted that tourism was in the doldrums in several areas due to a lack of snow. Tourism activity remained at high levels in most major markets in the San Francisco District, while tourism and travel exceeded expectations in the Boston metropolitan area.

Services

Activity in the services sector generally expanded in most Districts since the last report. Boston, New York, Philadelphia, Richmond, St. Louis and San Francisco reported growing demand for technical services, while Dallas reported that activity was slowing but strong overall. New York, Richmond and Dallas reported growing demand for legal services. Demand for information technology services increased in the Philadelphia, St. Louis, Dallas and San Francisco Districts, but was flat in the Richmond District. Growth in financial services was noted by the New York, Richmond and Dallas Districts. Trucking firms reported slower demand in the Philadelphia and Cleveland Districts, while Dallas saw greater demand for trucking and strong demand for rail transportation.

Manufacturing

Manufacturing continued to expand in most Districts. Boston, Philadelphia, Cleveland and San Francisco reported increased manufacturing activity, while slowing growth was reported by the Chicago, Minneapolis and Kansas City Districts. However, Atlanta reported mixed activity, while Richmond, St. Louis and Dallas reported some declines.

Strong demand for products used in the energy sector was noted by the Boston, Atlanta, Chicago, Minneapolis and Dallas Districts. Philadelphia, Dallas and San Francisco noted increases in food products. Boston, Cleveland, Atlanta, Chicago, Dallas and San Francisco reported continued weakness among manufacturers that support the residential construction industry.

Real Estate and Construction

Nearly all Districts reported a continued softening in housing markets. High inventories of new homes have generally led to a slowing in residential building, with some exceptions.

While single-family construction weakened, New York saw multifamily permits on pace with a year earlier. In Cleveland, some builders reported a stabilizing market. Although Atlanta reported steep declines in Florida home building, activity was mixed in the rest of the District. Chicago saw smaller declines in construction than in the preceding period, with signs of recovery in the Chicago metro area. Minneapolis reported increased remodeling activity in several markets.

All Districts reported slow home sales, except for Richmond, which saw a modest increase. Decreases in home prices were reported by Boston, New York, Atlanta and Chicago, while Kansas City said prices were subdued. In contrast, Dallas reported modest price increases and San Francisco said homes were appreciating but at a slower pace. New York reported that Manhattan's co-op and condo market improved in the fourth quarter of 2006, with flat prices but higher sales volume. Dallas noted that the low-priced home market was slower than higher-priced segments. Realtors in San Francisco were offering significant incentives to sell properties. New York reported rent increases, while Dallas noted that apartment vacancies edged up in the cities of Dallas and Houston, largely due to an exodus of Hurricane Katrina evacuees.

In contrast to the housing sector, commercial real estate markets continued to see strong activity in most Districts. Cleveland, Atlanta, Chicago, St. Louis, Minneapolis and San Francisco saw increases in commercial building. New York reported that relatively little new office space was under construction in New York City, even though rents have increased and vacancy rates have fallen. Atlanta, St. Louis and Minneapolis reported growth in commercial real estate market activity, with Kansas City, Dallas and San Francisco also reporting increased office rents. Chicago saw an increase in office absorption across most of the District, with the exception of the Detroit area.

Banking and Finance

Lending activity was mixed, with commercial and industrial lending generally up while residential mortgage origination and refinancing continued to weaken. New York, Cleveland and Dallas reported decreases in overall loan demand, while Philadelphia, Richmond, St. Louis, Kansas City and San Francisco saw some increases. Demand for residential lending declined in the New York, Philadelphia, Atlanta, Chicago, Kansas City, Dallas and San Francisco Districts, while Richmond and St. Louis saw slight increases. Demand for commercial and industrial loans rose in the Philadelphia, Cleveland, Richmond, St. Louis, Kansas City and San Francisco Districts, was mixed in the Atlanta District and steady in the Chicago and Dallas Districts. Philadelphia saw an increase in credit card usage with a decline in other consumer loans, while Cleveland and Dallas saw consumer lending decrease. Overall credit quality remained good, but New York and Atlanta reported increases in consumer delinquencies and Chicago noted a small increase in mortgage delinquency. New York reported tightening standards for commercial and consumer loans.

Agriculture and Natural Resources

Most Districts reported upbeat agricultural conditions because of weather and high prices. Good weather conditions, which aided the sector, were reported by Richmond, Atlanta, St. Louis, Kansas City and Dallas. However, Minneapolis reported dry conditions, and Kansas City reported storms that adversely affected parts of the industry. High prices for many agricultural commodities were reported by Chicago, Dallas and San Francisco.

Activity in the energy and mining sectors remained at strong levels. Cleveland, Minneapolis,

Kansas City, Dallas and San Francisco reported robust oil and gas activity. Cleveland and Kansas City noted some capacity constraints. Atlanta and Minneapolis reported growth in the alternative energy industry. Meanwhile, mining activity increased in the St. Louis and Minneapolis Districts.

Labor Markets

District reports generally described labor market conditions as tightening and cited examples of some businesses having difficulty finding qualified workers. Atlanta, Minneapolis and Kansas City noted expanded hiring or signs of tightening. Boston reported that engineering and machinist positions were especially hard to fill and that finance and accounting workers were in great demand. In the New York District, hiring of office workers was strong, led by financial and legal services, but slower hiring was noted in manufacturing and distribution. Temporary employment agencies reported generally stronger demand for workers in the Philadelphia and Richmond Districts. In the Dallas District, labor markets remained very tight, with numerous firms continuing to report difficulty finding skilled and unskilled workers. Meanwhile, Cleveland noted that retail hiring was about the same as a year ago.

Despite expanded hiring, Districts reported relatively moderate gains in wages; however, some Districts noted certain business lines that experienced wage increases and had concerns about increases in the benefit portion of compensation. Boston, Philadelphia, Cleveland, Chicago, Minneapolis, Kansas City and San Francisco described wage increases as moderate or continuing at rates similar to those in the preceding reporting period. However, Boston, Philadelphia, Cleveland, Dallas and San Francisco mentioned higher increases for benefit costs, particularly health care. Dallas reported that many contacts said high and rising labor costs, including the cost of health insurance, top their list of concerns for the coming year. A contact in the Chicago District said that salaries for executives were "vigorously competitive."

Prices

Overall prices increased moderately. Prices for energy and a number of materials have eased, and competition has kept prices for final goods in check. Atlanta, Chicago, Minneapolis and Kansas City described price pressures as easing or moderating. Manufacturers in the Boston and Cleveland Districts reported that input prices were stable, although contacts noted some increases in metal prices. Meanwhile, manufacturers in the New York District indicated some increases in input price pressures. Retail prices were steady in the New York, Atlanta and Dallas Districts, but were edging up slightly in the Richmond District. Philadelphia noted that reports of price increases at business firms were not as widespread as they were earlier in the fall. Dallas described price pressures as mixed, while San Francisco said final prices rose at a modest pace.

▲ [Return to top](#)

First District--Boston

New England business contacts cite mixed results in the closing months of 2006. Manufacturers and advertising and consulting firms mostly report satisfactory revenue increases from a year earlier. A number of retail contacts say they are disappointed by their holiday sales results or have been hurt by the housing slowdown. Residential real estate markets are very soft. Price pressures have reportedly moderated, except for selected items, including some metals. While it remains difficult to hire highly skilled workers, firms are

typically adding to headcount only selectively if at all.

Retail and Tourism

Retail respondents in the First District report mixed results for the months of November and December. Same-store sales range from low double-digit decreases to high single-digit increases year-over-year. Several respondents report sales increases, but indicate that they do not meet expectations.

A lumber company reports sales down 11 percent year-over-year primarily because of the housing slowdown. A retailer of clothing and outdoor gear says sales were strong until Thanksgiving, but inexplicably soft "across the board" during the period from Thanksgiving to Christmas. An office supply retailer notes a "lukewarm" holiday, with core business products (ink, paper) and novelty items doing very well, but sales of electronics softer than expected. A discount clothing retailer successfully adopted a new strategy for the holiday season by offering more gift items such as accessories, toys, and jewelry, while a pharmacy chain announced a year-over-year increase of more than 8 percent in same-store sales.

Inventory levels are mixed, with several contacts reporting higher-than-expected levels due to slow sales. Some retail contacts cite cost increases for energy-related products, and several report passing along small price increases to their consumers. Employment has been mostly steady, with some hiring occurring for new store openings. One respondent, however, has cut staff by 18 percent on account of a decline in sales. Capital spending plans are mixed.

A tourism contact reports that tourism and travel have exceeded expectations in the Boston metropolitan area. Business travel was strong in the fall. Revenue per available room in Boston is at an all-time high and is expected to continue to grow; occupancy is also projected to continue to be strong. This contact says advanced bookings are still low, and international travel is weaker than expected.

Overall, most retail contacts are hopeful but cautious in their outlook. Tourism is expected to remain strong, but 2007 tourism and travel may fall short of record-breaking 2006 results.

Manufacturing and Related Services

First District manufacturers and related services providers generally report that fourth quarter 2006 revenues remained "on track" and were above year-ago levels. Sales trends for aircraft and energy sector equipment and biopharmaceuticals are said to be particularly robust. However, contacts note that business segments connected to consumer spending or housing construction deteriorated in late 2006, and for the most part they expect continued softening through the first part of 2007. For example, a semiconductor company said that its consumer electronics customers over-ordered for the holiday season, and a product-labeling firm reported that business "fell off considerably" in November and December.

Some manufacturers report increases in metals costs in late 2006, including unexpected hikes for steel and zinc, and they are raising their selling prices in response. One firm indicates that costs of silicon wafers are rising as a result of strong demand from the solar energy industry, while another notes that costs of polymers have fallen. Otherwise, respondents mostly report that input costs and selling prices are flat or following their normal trends.

Most manufacturing respondents expect their U.S. capital spending and employment levels to hold steady or decrease in 2007. Average merit pay increases mostly are expected to remain in the range of 3 percent to 4 percent, with much higher increases in benefits costs. Contacts

say that engineering and machinist positions are especially hard to fill, and that finance and accounting professionals are in great demand as a result of the Sarbanes-Oxley legislation.

On the whole, manufacturers describe their prospects for 2007 in terms such as "good," "solid," and "decent," while acknowledging the risks of an economic slowdown that could affect their business. However, companies directly dependent on residential construction expect that these markets will continue to soften, and some makers of consumer products express concern about their sales outlook in the new year.

Selected Business Services

All responding First District advertising and management consulting firms enjoyed improving business conditions and revenue growth in the final quarter of 2006, with most firms reporting double-digit gains over a year ago. Most respondents are seeing larger projects or orders from their clients, which they view as a sign of their clients' confidence in their own businesses. Demand for efficiency- and productivity-enhancing consulting services remains strong, and one consulting contact notes an increased demand for outsource consulting.

Most responding companies have earned modest price increases over year-ago levels, and several anticipate making moderate upward price adjustments in the coming months. Input costs are relatively stable, although a few contacts continue to note increased travel costs.

Headcounts are growing in response to demand, but at a slightly slower rate than revenues. Contacts note that the labor market for highly skilled individuals remains tight and is feeding through into wages. Respondents plan to increase wages between 3 percent and 8 percent in 2007.

The majority of contacted New England advertising and management consulting firms expect revenue growth in the first half of 2007 to continue at, or slightly above, the pace in the second half of 2006.

Residential Real Estate

Across New England, the pace of residential sales continues to be slow compared to recent years. Sales volume has declined across New England, with Massachusetts, Connecticut, and New Hampshire all seeing year-over-year reductions in total sales in excess of 10 percent. In Massachusetts, the average number of days on the market has increased by more than 35 days since November 2005, and was around 130 days for single family homes and 120 days for condominiums.

The slower sales pace has translated into significant year-on-year inventory growth across the region. One Rhode Island contact reports having nearly six times as many listings as last year. In Massachusetts, single family inventory increased 25 percent year-on-year in November while condominium inventory was up nearly 37 percent. There is currently more than 11 months of supply in the Massachusetts market; contacts indicate that conditions favor buyers if supply exceeds 7.5 - 8.5 months.

Buyers continue to exercise patience across New England. Contacts now attribute slow sales to this patience and not to unrealistic pricing. Median selling prices continue to decline across the region. The median single family price declined 4 percent from November 2005 to November 2006 in Massachusetts, marking the 10th straight month of price declines. Condominium prices increased nearly 2 percent for this same period, but this was the first

year-over-year price increase in five months. Published repeat-sales home price indexes are also weak, with four of the six New England states registering at least one quarter-to-quarter decline in Q2 and Q3 of 2006.

Contacts note that the declines in sales and prices have slowed in recent months and suggest that New England markets may be approaching a bottom. This indication is by no means clear and contacts report that spring sales will give a more direct image of any possible recovery.

▲ [Return to top](#)

Second District--New York

The Second District's economy has continued to expand at a moderate pace since the last report, though recent performance has been mixed across sectors. There are some indications of a pickup in cost pressures but no discernible acceleration in consumer prices. Retailers generally indicate that holiday season sales were on or slightly above plan, with much of the strength coming in the second half of the month; retail prices were again reported to be little changed, with promotional discounts roughly the same as a year ago. Tourism activity has strengthened further since the last report. Two regional consumer surveys showed confidence retreating slightly in December, but remaining at fairly high levels.

Manufacturers have grown less positive in their assessment of current business conditions in early January, though they remain optimistic about the near-term outlook, and contacts note some intensifying in price pressures. Housing markets remain mixed: New York City's rental market has shown continued strength, and Manhattan's co-op and condo market picked up in the fourth quarter, with sales rising and inventory retreating from very high levels. However, the market for single-family homes in both northern New Jersey and upstate New York remains sluggish. New York City's office market grew increasingly tight at year end with vacancies falling and rents climbing rapidly. Finally, bankers report further weakening in loan demand in the household sector, especially for home mortgages; they also indicate a moderate increase in consumer delinquency rates.

Consumer Spending

Retailers report that sales were on or slightly above plan in December, while merchandise prices were steady. A trade survey of New York State retailers indicates that holiday-season business slightly exceeded expectations, on average. In addition, one major retail chain contact reports that their sales in the District were on plan, while another indicates that sales were slightly above plan. Overall, sales are reported to have been particularly strong in New York City--both Manhattan and the outer boroughs--but more sluggish in northern New Jersey and upstate New York. In terms of merchandise lines, somewhat soft sales of winter clothing and home furnishings and equipment were reportedly offset by fairly strong spending in most other categories, particularly consumer electronics and clothing accessories. Strong gift-card sales throughout the season are reported to have helped buoy post-Christmas sales. Retailers report that both selling prices and the degree of promotional discounting were little changed from a year ago and that inventories are at favorable levels. Retail contacts report that they hired about the same number of holiday workers as in 2005.

Based on the Conference Board survey of Middle Atlantic residents, consumer confidence edged down in November and December, after reaching a 6-year high in October; similarly,

Siena College's survey of New York State households shows confidence levels retreating modestly in December from a 5 1/2-year high in November.

Tourism activity in New York City continued to strengthen since the last report. Broadway theaters report a stronger than usual pickup in business during the holiday season: attendance was up more than 10 percent from a year earlier, while total revenue was up nearly 20 percent. Similarly, Manhattan hotels report continued strong revenue growth in November and December, with many hotels at or near full occupancy and average room rates up well over 10 percent from a year earlier.

Construction and Real Estate

New York City's office market tightened further in the final months of 2006, while housing markets and residential construction activity were mixed. Lower Manhattan's office vacancy rate fell by more than a full point to 7.1 percent from November to December, while Midtown's rate edged down to 5.6 percent; both are at their lowest levels in more than five years. Moreover, rents have continued to climb rapidly since the last report, reaching new record levels; the average asking rent for Class A office space across Manhattan is reported to have risen 2.5 percent in December alone, and ended 2006 up 35 percent from a year earlier. A contact at a leading Manhattan commercial real estate firm notes that there is relatively little new office space currently under construction.

Single family construction activity in New York and New Jersey, as measured by housing permits, continued to weaken in November, slipping by roughly 30 percent from a year earlier, but multi-family permits were roughly on par with a year earlier. More recently, New Jersey homebuilders report that the market stabilized somewhat in December but remains weak. Discretionary sellers in the resale market are reported to be withdrawing from the market, which has reduced the inventory of existing homes on the market, but has also reduced the pool of new home buyers. Builders indicate that they have substantially cut back plans for new development in New Jersey (especially in active-adult communities) and this is seen as slowing construction activity in 2007. New York State Realtors report that both sales and prices for single-family homes were running lower than a year earlier in the fourth quarter. However, Manhattan's co-op and condo market showed resilience in the fourth quarter; though prices were little changed, sales activity picked up noticeably, after a sluggish third quarter, and the number of listings (inventory), though still quite high, declined. Manhattan's apartment rental market has continued to strengthen since the last report; a contact at a major real estate firm characterizes conditions as extremely tight at year end. Compared with a year ago, rents are up an estimated 5 percent, with larger increases on smaller, entry-level units in recent months. While the rental supply is constrained by a limited number of new rental buildings under development, a significant proportion of new condos are being bought by investors, who have then leased them.

Other Business Activity

A major New York City employment agency specializing in office jobs reports strong hiring activity at the start of 2007, again led by the financial and legal service industries. This contact also notes a recent pickup in demand for supervisory and clerical workers in the construction industry. In many occupations, qualified workers are reported to be in short supply. On the other hand, regional business surveys suggest some slowing in hiring in the manufacturing and distribution sectors. Purchasing managers in the Rochester, Buffalo, and New York City areas report some softening in business conditions more generally in December, and manufacturing sector contacts across New York State also report slowing in

early January. Manufacturers generally indicate some increase in input price pressures.

Financial Developments

Small to medium-sized banks in the District report decreased demand for all types of loans, on balance--most notably in the residential mortgage category, for which 63 percent of bankers report a decrease in demand and no bankers report an increase. Respondents also indicate continued declines in refinancing activity. Bankers report some tightening in credit standards on commercial and consumer loans but no change in standards for residential mortgages. Bankers indicate a decrease in loan rates for residential and commercial mortgages, but rates remained unchanged in all other loan categories. Average deposit rates were up slightly, on balance. Finally, bankers report a noticeable increase in delinquency rates on consumer loans but little or no change in other categories.

▲ [Return to top](#)

Third District--Philadelphia

Economic activity in the Third District advanced modestly in December. Manufacturers posted small increases in shipments, but there was virtually no change in the rate of new orders. Retail sales of general merchandise rose slightly. However, auto sales remained weak. Bank lending increased moderately overall, but mortgage lending declined. Service sector activity increased at a nearly steady rate in December compared with previous months.

Third District business contacts generally expect business activity to continue to expand at a steady rate, although several of those polled for this report said the outlook has become more uncertain. Manufacturers expect modest improvement during the first half of the year. Retailers generally expect a steady, albeit slight, gain in sales, although some believe the growth rate might slow further. Auto dealers do not expect sales to pick up in the near future. Bankers generally anticipate increases in business and consumer lending, but their views of mortgage lending are mixed; some expect an increase, but others do not. Service-sector firms expect steady growth in the months ahead.

Manufacturing

Third District manufacturers reported an increase in shipments from November to December, although the rate of new orders was about steady. The increase in shipments was more prevalent among makers of food products, furniture, and machinery than among other manufacturing sectors in the District. Increases in orders were noted among only a few sectors, mainly producers of food products and textiles; in most other sectors orders were either steady or down. On balance, District manufacturers reported an easing in order backlogs and a decrease in delivery times.

Overall, manufacturers expect demand for their products to increase during the first half of the year, but they forecast only modest gains. Among the manufacturers contacted in December, one-third expect their shipments and orders to increase during the first six months of 2007; one-fifth expect decreases. Capital spending plans among Third District manufacturers appear to be moderating. Among the firms surveyed in December, the number planning to increase capital outlays during the first half of 2007 barely exceeded the number planning to reduce capital expenditures.

Retail

Most of the retailers contacted for this report indicated that sales during the holiday shopping

period were only slightly above sales during the same period in the previous year. Sales of jewelry and consumer electronics were relatively strong, but sales of most other lines of merchandise were below retailers' expectations. Sales of outerwear and other clothing were particularly soft. Merchants said unseasonably warm weather discouraged sales of winter apparel. Discounting was widespread during December, although most store executives said the price reductions made before the holidays had been planned in advance. Further price reductions, primarily for apparel, have been taken since the holidays. Looking ahead, retailers generally expect modest, steady growth in sales during the first quarter, although some believe sales growth might weaken through the winter.

Auto sales in the region continued to be sluggish in December. Year-to-year sales comparisons were again better for foreign makes than for domestic makes, although some import dealers noted an easing in growth. Inventories remained above desired levels for many dealers but were gradually being worked down. Auto dealers in the region expect sales to remain slow through the winter.

Finance

The volume of loans outstanding at Third District banks rose moderately in December, according to commercial bank lending officers contacted for this report. Commercial and industrial lending increased for most banks. Credit card lending expanded, with a seasonal acceleration in growth. Growth in other types of personal lending slowed. Demand for residential mortgages and home equity loans continued to soften.

Bankers in the District expect business and consumer lending to increase modestly in the months ahead, but they say the outlook for residential mortgage lending is uncertain. Some bankers indicated that mortgage demand appeared to be firming in their market areas, but other bankers said it remained weak.

Investment companies in the Third District reported strong cash inflows as 2006 came to a close. Executives at these companies said the recent performance of equity markets had stimulated interest in stock funds among individual investors. They also noted that there has been rising demand for a variety of investment vehicles appropriate for retired individuals and those nearing retirement.

Services

Most of the Third District service firms contacted in December reported that activity was rising steadily. Business services firms generally indicated that work done for existing client firms was growing and that they were gaining new clients. Information technology firms generally reported continuing gains. Trucking firms, however, reported that growth had slowed in the final quarter of the year. Employment agencies and temporary help firms reported that, on the whole, demand for workers has been rising, although hiring plans have moderated in some sectors--notably, construction and government--and in some parts of the District. On balance, service-sector firms expect business to continue to advance at a steady rate in the months ahead.

Prices and Wages

Business firms in the Third District noted increases in the costs of raw materials and other inputs in December, although reports of price increases were not as widespread as they were earlier in the fall. Manufacturers noted increases in prices for chemicals, metals, and energy. Looking ahead, manufacturers expect cost increases for energy, raw materials, and

intermediate goods, but they anticipate somewhat smaller increases in 2007 than in 2006. Firms in other industries expect input costs to remain on the rise at about the current pace.

Firms reporting on employment costs in December noted a continuing trend of moderate wage increases but also large increases in benefit costs, especially health care. Many firms have recently taken steps to restrain the rate of increase in benefit costs. Among the measures implemented have been eliminating defined-benefit pension plans and requiring greater contributions toward health-care costs from employees.

▲ [Return to top](#)

Fourth District--Cleveland

Economic activity in the Fourth District has softened since mid November as many businesses and consumers are now more cautious in their outlook. Production levels at District manufacturers were stable to increasing with little change expected for the next six months. Activity in commercial construction was mixed with half the builders experiencing an increase in business. In contrast, most residential contractors reported a continuing decline in sales. Holiday sales by District retailers showed mixed results. Loan demand at District banks was flat to down while core deposits showed modest growth. Energy activity was strong overall. And the demand for trucking and shipping services continues to soften.

On net, employment across the District was largely stable. However, staffing firms were upbeat in the number of job openings. Half our contacts said that openings have increased over the past six weeks and all contacts reported an increase on a year-over-year basis. The greatest demand was in health care and financial services with some weakness seen in manufacturing. With the exception of some energy-related businesses, wages continue to be steady to modestly increasing. Almost all contacts said that, with the exception of metals, input costs have stabilized. Several District manufacturers reported increasing prices since mid November with more than half saying they were successful. And almost all retailers reported that they were holding their prices steady.

Manufacturing

Reports by the District's manufacturers show production levels were stable to increasing since mid November and on a year-over-year basis. However, about half of our contacts reported some idle capacity. Focusing on steel products, demand continues to be soft for most producers due to weakness in the auto, appliance, and residential construction markets. However, steel producers anticipate an up-tick in Q1 of 2007. Although District auto production decreased in November, an increase was reported on a year-over-year basis. The outlook by most manufacturers is best characterized as stable to improving. Those that foresee downturns are primarily in the auto supply market. Almost all manufacturers said that capital expenditures remain on target with slightly more than half expecting little change in the New Year. However, three contacts said they have aggressive capital projects in the works for 2007. Most producers believe that input prices, for the most part, were stable; however, several commented that metal prices remain high or are increasing. Hiring has been limited over the past six weeks and manufacturers anticipate little hiring in the near future. Reasons given include cost containment and monies being allocated for capital improvements. Wage pressures are largely contained; however, several contacts reported benefits, especially health care, continue to rise.

Construction

Reports on new home construction were mixed with most builders saying the decline in sales continued into November. Looking forward, almost all residential contractors expect activity in 2007 will be similar to the second half of 2006. In general, material costs have leveled off with most contacts reporting a decrease in lumber prices. Builders have significantly curtailed, or eliminated, "spec" building. District home prices have been steady during the past six weeks and contractors are hesitant of offering any additional discounting. Many builders reported adjusting the size of their labor force during 2006 to match market conditions and do not foresee laying-off additional workers. Further, contractors said wage increases will not be given in 2007.

The District's commercial contractors were split in their assessment of business activity since mid November. Slightly more than half experienced a pick-up in business while several reported that business is slowing. On a year-over-year basis, most contacts said that their level of business has increased. Although inquiries have generally slowed down, most contractors remain optimistic about 2007 due to healthy backlogs. Segments continuing to show strong activity are health care, education, and public works. A majority of our contacts report that material costs are stable with the exception of steel and concrete which showed small increases. Almost all contractors said that prices remained stable and over half reported small increases in their profit margins. Finally, hiring by contractors was kept to a minimum.

Retail

District retailers showed mixed results for the holiday shopping season; reports ranged from very good to below expectations. Further, most retailers noted that no unusual markdowns or promotions were used to increase sales. Expectations for Q1 of 2007 are also mixed with more than half our contacts anticipating weak sales. Retailers reported that overall supplier prices and other input costs have remained steady over the past six weeks. Wage pressures are contained, and aside from normal seasonal hiring, retailers are limiting employment opportunities to new store openings. Domestic new car sales for the months of November and December were characterized as poor while foreign makes sold reasonably well. Increased SUV sales were attributed to winter weather and lower gas prices.

Banking

Since mid November commercial and consumer loan demand continues to be flat to down for most District banks. On the consumer side, declines were seen primarily in home equity lines of credit and auto loans. Two contacts reported commercial real estate loans are growing, but at a very modest rate. Activity in the mortgage market was mixed with refinancing driving much of the activity. Two bankers saw increases in mortgage applications; however, they were uncertain if this is the beginning of an upward trend. Core deposits showed modest growth and most bankers report no change in credit quality.

Energy

Overall, energy activity remains strong across the District. Rig count is flat to slight increase with almost all contacts reporting difficulty in obtaining drilling equipment. Over half the producers plan to increase exploration activity in 2007. The ability to attract and keep skilled workers is a continuing issue for most drilling companies; resulting competition is putting significant pressure on wages. Mining production is near capacity with three coal producers expressing interest in expanding operations. However, there are no plans to hire additional workers. Minimal wage pressure was reported. Alternative energy representatives see an

acceleration toward more advanced energy technologies and policies. However, the recent drop in oil prices and mild winter weather lessens the sense of urgency for alternative energy projects in the public eye.

Transportation

Demand for trucking and shipping services continues to soften with two contacts reporting a slowdown in the shipment of auto-related products and coal. Trucking companies continue to pass on fuel costs using surcharges and anticipate doing so into the foreseeable future. One contact expressed concern about the price of the new ultra low sulfur fuel. Hiring was attributed to the usual high driver turnover; however, two contacts said their hiring was related to increasing capacity. Wages have remained stable since mid-November.

▲ [Return to top](#)

Fifth District--Richmond

Overview

Economic activity in the Fifth District expanded modestly since our last report, with slowing activity in some sectors offset by firming growth in others. Retail sales were generally solid through the holiday season, and activity held up in early January. Manufacturing measures moved a bit lower as demand for some lines softened. Housing activity edged higher, as sales firmed and home inventories eased lower in some areas. Commercial real estate agents noted that conditions in the sector remained strong, and construction and leasing activity was steady in recent weeks. District labor markets continued to be taut, with strong demand for workers, especially in urban areas. Price pressures were mixed, with some upward drift apparent in raw material costs. In agriculture, unseasonably mild weather boosted crop conditions and extended the grazing season for livestock.

Retail

District retail sales rose moderately in recent weeks with gift card redemptions boosting activity in early January. Electronics, especially high-definition LCD and plasma televisions, sold particularly well during the holiday season--a central North Carolina retailer said he ran out of televisions before Christmas. In contrast, warm weather slowed apparel sales. A contact at a Virginia hardware store chain told us his stores have not felt the homebuilding slowdown yet, perhaps because hardware purchases come at the end of the homebuilding process. The pace of automobile and light truck sales was unchanged in Virginia, but slowed in the Baltimore area of Maryland and the South Carolina Midlands. An automobile dealer in Charleston, W.Va., said customer traffic was down and "buyers are not motivated." Retail price growth edged up slightly since our last report; average wages rose somewhat faster, as well. A West Virginia retailer told us he had raised wages for his lower-end workers because competition for those employees is tight.

Services

Revenues at service-producing firms generally edged higher since our last report, although some firms said growth was flat. Contacts at legal and environmental services firms reported faster revenue growth, and financial services providers in Baltimore and Richmond also said business had picked up. In contrast, architects and interior designers reported flat activity, as demand continued to be held in check by the soft housing market. Executives at healthcare services organizations and computer services firms also said the pace of consumer demand for services was generally unchanged in recent weeks. Services firms continued to hire at a

brisk pace, while price growth eased in the last few weeks.

Manufacturing

District manufacturing activity contracted modestly in December following a pickup in November. Manufacturers told us that factory shipments, new orders and employment pulled back since our last report. Product demand weakened noticeably in the fabricated metals, rubber and plastics, and transportation equipment industries. A manufacturer of plastic packaging supplies in South Carolina said that business had definitely taken a downturn during the last quarter of 2006. In addition, a fabricated metals producer in North Carolina indicated that demand was soft--trimming both volumes and margins. In contrast, an electronic components producer reported business was strong in 2006 but noted that the outlook for 2007 was less optimistic because [business] seemed to be slowing in recent weeks. Raw material prices continued to rise after picking up considerably in November, while finished good prices grew at a more measured pace.

Finance

District bankers reported an uptick in lending activity since our last report. The demand for residential mortgage loans moved up in some pockets within the District. A Charleston, S.C., agent attributed unusually strong December activity to continued low interest rates. In Greenville, S.C., a contact noted that a new program to help poorer households finance home purchases led to an increase in loan volume. According to a Charleston, W.Va., agent, a few particularly nice new housing developments helped increase activity in that area. Commercial lending remained strong. Little change was reported in interest rates or the rates of delinquent loans.

Real Estate

Residential real estate agents reported a modest pickup in home sales since our last report. Contacts in Richmond, Va., reported very strong sales in December, resulting in a nine percent increase in sales volume over 2005 levels, and a two percent increase in units sold over the same period. A contact in Fairfax told us that his area had experienced "a good rebound" in the number of houses sold, and that had caused a nice drop in his inventory level. Likewise, contacts at housing markets in Charlotte and Asheville, N.C., reported strong activity, with December sales in Asheville exceeding those of a year earlier. And in Greenville, S.C., an agent reported having an "extremely strong" housing market where his sales increased 15 percent over 2005 sales. However, in Fredericksburg, Va., an agent told us that inventory remained very high. A homebuilder in the Tidewater area reported no real change in the number of housing starts or building permits, adding that demand is "just not there." House prices held steady across most areas of the District.

Commercial agents across the District reported that leasing and construction activity remained at generally strong levels though recent activity was sluggish. In Washington, D.C., market conditions were characterized as tight, leading to more construction and rising rents. In contrast, agents in some mid-sized cities noted steady activity with varying flat vacancy rates and little pressures on rents. Across the District, contacts noted that former commercial space in downtown areas continued to be converted to residential uses. Several agents said that conditions will likely strengthen in coming months. They cited increased interest in their areas by national firms looking to expand.

Tourism

Tourist activity was generally mixed since our last report. Contacts in coastal areas said that unseasonably warm weather in December and early January had boosted their business. A

hotelier at Virginia Beach, Va., told us that holiday bookings were up 40 percent when compared to a year ago. In contrast, a manager at a mountain resort in Virginia reported that skiing and tubing were down 50 percent from last year because of unseasonably warm weather in that region. On a brighter note, he said that timeshare sales were up nearly 15 percent compared to a year earlier.

Temporary Employment

Temporary employment agencies in the District reported generally stronger demand for workers since our last report. An agent in Richmond, Va., told us that she anticipated a stronger need for temporary workers over the next few months because of the area's low unemployment rate. A contact in Raleigh, N.C., expected demand for workers to rise in early 2007 as businesses' budgets are anticipated to expand. Likewise, a Baltimore, Md., agent reported very strong demand and said feedback from her clients suggest this trend will continue. On a less optimistic note, agents in the Washington, D.C./Maryland area told us that "January through March is usually our slowest period." Workers with computer proficiency, administration, data entry, industrial warehouse, sales and engineering and life sciences were among the skills sought by employers.

Agriculture

Warmer-than-normal temperatures in December coupled with mild, rainy weather in November accelerated the growth of winter grains and extended the grazing period for livestock in most of the Fifth District. Small grains were reported to be in mostly good condition in much of the District. In addition, contacts told us that adequate moisture levels had improved pasture conditions and that the mild winter had benefited livestock.

▲ [Return to top](#)

Sixth District--Atlanta

Summary

Reports from District contacts indicated, on balance, that business activity expanded modestly in late November and December. Retailers reported that holiday spending rose moderately compared with a year ago, and tourism contacts noted solid late-year activity. Continued weakness in housing markets, especially in Florida, was reported by Realtors and homebuilders, and low levels of mortgage loan demand continued to be noted by regional bankers. Several contacts in housing-related manufacturing and transportation operations noted declining orders for building materials. However, post-hurricane rebuilding along the Gulf Coast continued to boost the construction industry in that area. Labor markets remained tight in several industries, while price pressures, particularly in the construction industry, have eased in most parts of the District. Agricultural growing conditions were described as being favorable.

Consumer Spending

Most District retailers reported that sales in December rose modestly compared with a year ago and were generally in line with expectations. The majority said that they were pleased with inventory levels. Merchants noted that gift card sales were strong. Sales reports from New Orleans, Baton Rouge, and South Mississippi were positive, even when compared with elevated post-hurricane levels in December of 2005. Contacts indicated that retail sales growth in most parts of the District is expected to be modest in coming months.

Vehicle sales were reportedly below year-ago levels in most areas. South Florida dealers' noted disappointing traffic and sales during late November and December. Sales of Florida's two best-selling domestic trucks were said to be down sharply from year-ago levels, while sales of foreign brands continued to advance. One regional industry contact reported that sales of trucks and SUVs were boosted by incentives and lower gasoline prices. Meanwhile, two regional import distributors reported slight gains across vehicle segments.

Tourism and Business Travel

Reports concerning the tourism and hospitality sector were generally positive. Some Florida travel industry contacts noted the holiday season was stronger than last year, and travel agencies reported that cruise bookings were up significantly between Christmas and New Year's Day. In Atlanta, visitor numbers to the Georgia Aquarium have eased in recent months, but the estimated 3.6 million people that visited the Georgia Aquarium during its first year of operations far exceeded expectations. Since the aquarium opened, hotels in Atlanta have reportedly had a much more steady flow of traffic than the usual swings associated with conventions. In New Orleans, officials reported that about 70 percent of the events booked before Hurricane Katrina remained committed to the city for 2007.

Real Estate

Weakness continued to be noted in District housing markets, with Florida reporting the largest declines in sales and new construction. Home sales and construction levels were more mixed elsewhere in the District, although inventories of homes for sale remained high across much of the region. Most Florida real estate agents reported price reductions on existing homes for sale, while there were scattered reports of price declines in other parts of the District as well. In southern Louisiana and Mississippi, the outlook for residential construction appears to be strong. Weak market conditions are expected to persist over the next several months in most other areas.

Nonresidential development in the District remained at healthy levels, with infrastructure repairs and improvements continuing to dominate activity in late November and December. Reports from contacts indicated that District commercial real estate markets improved late in the year as office occupancy and rental rates increased.

Manufacturing and Transportation

Factory activity remained mixed, and the slowdown in residential construction affected producers of building materials. For example, a District roofing company cut back a shift in its plant because of decreased demand, and a door and window manufacturer reported that business was down 27 percent from last year. In contrast, a specialty machining operation that provides fittings for the oil and gas pipeline industry noted that business was better than last year, and an aerospace producer reported increased orders and additional hiring.

Trucking contacts reported that business conditions remained weak in late November and December, mainly because of fewer shipping orders from building materials producers. However, rail shipments continued to grow with shipments of inter-modal containers and coal offset lower shipments of autos and building materials.

Banking and Finance

Banking conditions in the District were stable. Residential loan demand remained weak in most parts of the District, especially in Florida. Reports on commercial and industrial lending were mixed. Overall credit quality continued to be described as good, although there were

some reports of increases in consumer loan delinquency in parts of the District. Lending requirements were expected to become more stringent in the coming months.

Employment and Prices

According to most reports, hiring trends remained positive during late November and December. A few retailers experienced labor shortages during peak shopping times over the holidays. Hiring in the construction industry slowed in the residential component, but this has been partly offset by rising payrolls in the commercial construction segment. Some contacts indicated that the demand for business IT professionals is expected to be strong over the coming year. In the New Orleans area, hiring is described as brisk, with many workers relocating from other areas to take advantage of the employment opportunities. Strong demand for skilled workers continued in the energy sector, pushed by strong exploration and production in the Gulf of Mexico.

Prices for some construction supplies continued to decline in December. For instance, contacts noted that the cost of concrete, steel, copper, and framing lumber are all down from recent highs. However, it was also noted that prices were well above the levels experienced two years ago. Gulf Coast contacts reported that construction costs had not declined as much as other areas because of strong local demand. Also, contacts in coastal areas continued to express concern about rising residential and commercial property insurance costs. Retailers reported that strong competition continued to limit price increases on most goods. On the other hand, several contacts in service-providing industries noted that they had successfully passed on cost increases to their customers.

Agriculture and Natural Resources

Weather conditions were mostly favorable for District crops in late November and December. Cotton growers were particularly pleased with high yields and timely weather patterns that benefited late plantings and harvesting. For citrus growers, the prospect of winter freezes and diseases like canker and greening remained a significant industry challenge. Investment in biofuels and other alternative fuel industries remained strong in the District.

▲ [Return to top](#)

Seventh District--Chicago

Summary

Economic activity in the Seventh District continued to expand during November and December, though at a more modest pace than in the previous reporting period. Consumer spending continued to increase at a gradual rate. Business spending and hiring rose again. Residential construction and real estate activity continued to decline in most areas, though the declines were smaller. Nonresidential construction expanded slowly. Manufacturing activity increased at a more gradual pace than in the previous period. Household lending activity moderated further, while commercial lending was little changed. Overall, nonwage price pressures continued to ease a bit, while overall wage increases were similar as in the previous reporting period. Farmers planned to plant more corn acres and fewer soybean acres this spring, reflecting changes in relative prices.

Consumer spending

Consumer spending continued to increase at a gradual rate in November and December. Retailers said holiday sales "met expectations" and were "good, but not as strong as previous

years." The most notable strength came from electronics and apparel; contacts were surprised by the apparel sales given the mild weather. Most contacts said sales in the Midwest were softer than in the rest of the country. Inventories were in line with desired levels. Vehicle dealers reported a slight pickup in sales during December. Dealers said consumers continued to favor smaller, more fuel efficient vehicles, and one added that the lack of snow was holding back demand for light trucks. Tourism in Michigan was up slightly from year ago levels.

Business spending

Business spending and hiring rose again in the District. Capital spending continued to increase at similar rates as in the previous reporting period, though one mid-sized firm reported plans to decrease capital outlays this year and a manufacturer said the bulk of their expansion plans were slated for 2008. Employment continued to increase gradually on net. Manufacturing employment was mixed by industry. Toolmakers and a heavy equipment manufacturer increased employment, while construction materials manufacturers reported they were holding steady or cutting back on shifts. One retailer said it was hiring for new stores only, while another said it was having trouble finding qualified workers. A temporary help services provider said that billable hours in the District were steady, but temp-to-perm conversions and permanent placements were strong.

Construction and real estate

Residential construction continued to fall in the District, though the declines were smaller than in the previous reporting period. Homebuilding slowed in Michigan, while one contact saw signs of a recovery in the Chicago area. Builders reported that the supply of unsold, speculative homes remained high and that showroom traffic edged down. Contacts reported steady or declining home values in many areas of the District, and one in Illinois noted that many builders were adding non-price incentives to sell new homes. Nonresidential construction expanded slowly, led by office construction in the Chicago area. Demand for office space was strong in most cities in the District; the lone exception was the Detroit area. Commercial vacancy rates were little changed, and there were no reported cancellations of projects. One contact revised up their outlook for net absorption of commercial space, reflecting lower energy prices and steady interest rates.

Manufacturing

Manufacturing activity expanded at a slower pace in late November and December than in the previous reporting period. Contacts reported particular strength in the energy, aviation, and aeronautical industries; manufacturers in many other industries were planning to scale back production in 2007 after sluggish sales at year-end led to rising inventories. Sales of large and medium sized heavy equipment for use in the energy sector were doing very well. Demand for tractors was increasing in response to high corn prices. Manufacturers of machine tools and equipment parts reported steady orders in December, even from customers in the auto sector. Inventories of finished steel at service centers have been high since the summer, but producers thought that declining imports and domestic production would bring these stocks down to desired levels by the second quarter. In contrast, a producer of specialty steel products indicated that their order books for 2007 were already filled. Production of diesel engines for over-the-road applications continued at a torrid pace through the end of the year, with an expectation of sharp reductions in output after stricter EPA emissions requirements take effect on January 1. Several manufacturers reported increasing exports, which they attributed to improving economic conditions outside the US and a lower dollar. The weakness in residential construction continued to damp sales of smaller construction

equipment and wallboard.

Banking and finance

Household lending activity moderated further, while commercial lending was little changed from the previous reporting period. The number of mortgage applications for both home purchases and refinancing continued to be low, despite modest declines in mortgage rates. Demand for new home equity loans and outstanding balances declined, but the usage rate of existing credit lines ticked up. Household credit quality generally remained in good shape: though edging up a bit, delinquency rates on mortgages and home equity loans remained at healthy levels. Retail deposit growth was steady. Business lending was mixed by loan type. Asset-based lending remained steady; equipment leasing activity continued to show solid increases; and commercial real estate lending declined in the most recent month but remained up significantly from a year ago. A commercial real estate developer said there was still "lots of capital" available to buyers, and buyers were increasing the amount of leveraged financing used in purchases. Commercial lending conditions continued to be competitive and interest rate margins remained narrow.

Prices and costs

On balance, nonwage price pressures continued to ease a bit, while overall wage increases were similar to the previous reporting period. On net, raw materials prices were down slightly or little changed at high levels. However, one contractor said that volatility in materials prices has made it difficult to predict the costs of projects moving forward. Toolmakers reported further price hikes. Equipment makers announced price increases for construction machinery but were uncertain how much would stick. One contact reported declines in freight rates. Wholesale furniture prices were falling, and one retailer said they were holding back on current purchases in anticipation of further discounting. A general merchandise retailer said their promotional activities for the holidays were within normal levels. Hotel room rates were steady to up, but not enough to cover the high level of energy costs, according to one contact. Wage increases continued at similar rates as in the previous reporting period. A retailer in southeast Michigan said a statewide minimum wage hike had no impact on their wages. One contact said that salaries for executives were "vigorously competitive."

Agriculture

During the reporting period, corn prices hit the highest level in over a decade, and soybeans were higher than at anytime since August 2005; however, both prices have retreated in recent weeks. In response to relative price movements as well as a reduction in fertilizer costs for corn, farmers planned to plant more corn acres and fewer soybean acres this spring. Moisture levels were up in much of the District, and some areas were abnormally wet. Hog and cattle prices were lower. Milk prices increased, but were still below the prices of last year. Plans for expanding acreage contributed to higher rents for farmland.

▲ [Return to top](#)

Eighth District--St. Louis

Summary

Despite contrary changes in some sectors, the economy of the Eighth District expanded modestly since our previous report. Contacts in manufacturing reported a softening in activity, while the services sector continued to grow. Home sales declined in most District

areas, while commercial real estate market conditions firmed throughout the District. Total loans at a sample of small and mid-sized District banks increased slightly between early October and late December.

Manufacturing and Other Business Activity

Manufacturing activity slowed since our previous survey. While some contacts reported plans to open plants and expand operations in the near future, a larger number of contacts reported plans to close plants or lay off workers. Firms in the chemical and plastic products industries reported plans to open new plants in the District and a contact in the coal mining industry reported plans to expand existing operations. In contrast, contacts in the audio and video equipment, motor vehicle parts, wood products, primary metal, and nonmetallic mineral products industries announced plans to close plants in the District. An additional firm in the audio and video equipment industry reported plans to only lay off workers.

The District's services sector continued to expand in most areas. Firms in the newspaper publishing, data processing, educational services, and administrative and support services industries reported plans to build new facilities and expand operations. In contrast, contacts in the telecommunications and spectator sports industries announced plans to lay off a small number of workers. Reports from retailers have been positive since our previous report. December 2006 sales of clothing and sporting goods were cited as particularly strong when compared with year-earlier sales. One discount department store announced plans to open a new facility in the District. Another department store, however, announced plans to close a facility in the District. Car dealers reported that fourth quarter sales in 2006 were down, on average, compared with year-ago levels. While sales of used cars improved slightly, sales of new cars were particularly slow.

Real Estate and Construction

Home sales declined throughout most of the Eighth District. Compared with the same period in 2005, November 2006 year-to-date home sales were up 7 percent in Memphis but fell 4 percent in St. Louis, 2 percent in Little Rock, and 1 percent in Louisville. Residential construction also declined throughout the District. November 2006 year-to-date single-family housing permits fell in every metro area compared with the same period in 2005. Permits declined 30 percent in Louisville, 24 percent in St. Louis, 11 percent in Memphis, and 10 percent in Little Rock.

Commercial real estate markets seem to be firming throughout the District. The 2006 third quarter industrial vacancy rate in Little Rock declined from the second quarter of 2006. Contacts in Memphis report that the office market is tight, and vacancies are at a three-year low. Contacts in Louisville report that overall demand for office space is steady. In Little Rock, contacts report that commercial construction is running strong. Contacts in Louisville report that both the industrial leasing and construction markets are steady.

Banking and Finance

Total loans outstanding at a sample of small and mid-sized District banks increased 0.6 percent between early October and late December. Real estate lending, which accounts for approximately 72.2 percent of total loans, increased 0.4 percent. Commercial and industrial loans, accounting for 17.3 percent of total loans, increased 1.5 percent. Loans to individuals, accounting for 4.3 percent of total loans, increased 0.2 percent. All other loans, roughly 6.2 percent of total loans, increased 1.0 percent. Over this period, total deposits at these banks decreased 1.6 percent.

Agriculture and Natural Resources

Higher-than-normal temperatures and precipitation in December helped improve soil moisture and pasture conditions in many District areas. By year-end 2006, winter wheat was mostly in good condition, although some farmers in Arkansas, Indiana, and Missouri reported some damage to the crop because of standing water in the fields. As of mid-December 2006, year-to-date bales of cotton ginned (separated from the seed) were up 6 percent over the same period in 2005. Total commercial red meat production increased by 16 percent in November 2006 over year-earlier levels, and the total weight of young chickens slaughtered was 1 percent lower for the same period. Total District coal production for December 2006 was 2 percent higher than a year ago, and coal production for all of 2006 increased by 1 percent over 2005 levels.

▲ [Return to top](#)

Ninth District--Minneapolis

Economic activity in the Ninth District increased slightly since the last report. Increases were noted in consumer spending, manufacturing, energy, and mining. Meanwhile, tourism, agriculture, and residential real estate and construction activity decreased. Labor markets continued to show signs of gradual tightening. Overall price increases were modest as a number of energy and materials prices moderated.

Consumer Spending and Tourism

Overall holiday sales increased slightly. A major Minneapolis-based retailer reported same-store sales up more than 4 percent in December compared with a year ago. December sales at a Minneapolis area mall were up about 3 percent to 5 percent from last year, while a manager at another Minneapolis area mall noted that most stores achieved their sales plans and that less merchandise was left over for clearance than in years past. A mall manager in Montana reported that sales at department stores were up, but sales at other stores in the mall were flat on balance compared with last year. December sales at another Montana mall were likely even to up slightly from last year; spending on gift card sales and gift wrap services was up substantially from a year ago. Two major Minnesota-based retailers reported that holiday online sales were up 50 percent compared with a year ago.

Overall vehicle sales were down slightly during November and December in Montana, with SUVs showing the weakest sales and import cars the strongest, according to a representative of an auto dealers association. Vehicle sales were down in South Dakota during the past two months.

In many parts of the District, winter tourism activity was in the doldrums. While making snow has allowed ski hills to open in the Black Hills of South Dakota, overall tourism activity in the area is down substantially from a year ago due to a lack of snow for snowmobiling. Unseasonably warm weather and a lack of snow in northern Minnesota and Wisconsin and the Upper Peninsula of Michigan substantially slowed tourism activity during December.

Construction and Real Estate

Commercial construction continued at a brisk pace. Directors in Bozeman, Mont., and Sioux Falls, S.D., said they expect commercial construction to be solid in 2007. December commercial permits were up in value from year-earlier levels in Rochester, Minn., largely

from retail building. A large electric power cooperative plans to build a \$51-million, 160,000-square-foot headquarters in suburban Minneapolis, with a possible larger second phase, and a medical devices company is adding 110,000 square feet of space. New residential construction was weak, while higher home remodeling activity was reported in several markets, including Rochester and Sioux Falls. A representative of a homebuilders' association in Minneapolis-St. Paul said that although new construction was down significantly for the year, many contractors have focused on remodeling because of strong activity.

Commercial real estate was solid. A number of large transactions took place in Minnesota at the end of 2006, including the \$100-million sale of an office building in downtown St. Paul. According to a commercial Realtor in Fargo, N.D., downtown office vacancy decreased nearly 50 percent from the beginning of 2006, with healthy absorption in the suburban office market; however, newly developed strip-mall retail space is about 20 percent vacant. Meanwhile, residential real estate continued to slide. Bankers and builders in Bozeman characterized the residential real estate market there as oversupplied. While there is still a very high inventory of unsold homes in Minneapolis-St. Paul, in late December it stood at its lowest level since February.

Manufacturing

Activity in the manufacturing sector grew slightly since the last report. A December survey of purchasing managers by Creighton University (Omaha, Neb.) indicated flat manufacturing activity in South Dakota and Minnesota and increased activity in North Dakota. In Montana, a home-production company is building a new facility and a polyethylene pipe manufacturer is expanding a production facility. In Minnesota, a truck parts producer and a boat factory are expanding capacity. In South Dakota, a plastic injection moldings maker is building a new plant, a new bridge component manufacturing plant is planned, and two farm equipment producers are expanding manufacturing facilities. A wind turbine blade company plans to expand production capacity in North Dakota.

Energy and Mining

Activity in the energy and mining sectors grew since the last report. Oil and gas exploration in the District increased from previously reported amounts. In addition, newly announced wind and ethanol projects are planned. Mining production remained at near capacity across the District. Even though the price of copper decreased, a Montana mining official noted that mining activity was "up a little" since the last report.

Agriculture

Agricultural activity decreased since the last report. Dry conditions worsened as the United States Drought Monitor revealed that almost the whole District is either in drought or abnormally dry. In the Dakotas, dry edible bean production in 2006 was down significantly from 2005.

Employment, Wages and Prices

Labor markets continued to show signs of gradual tightening. A call center recently announced plans to hire up to 400 employees, and a home-improvement retailer plans to hire 175 workers in South Dakota. A Minnesota company that supports management software recently announced intentions to hire 225 employees over the next two years. Some Minnesota companies noted difficulty finding nurses, accountants, long-haul truckers, engineers, and workers skilled in precision manufacturing. A recent poll conducted by the

Minnesota Chamber of Commerce showed that 52 percent of respondents expect to hire in 2007, down from 55 percent in last year's poll.

In contrast, a temporary staffing agency survey of Minneapolis-St. Paul businesses revealed that 18 percent of respondents expect to hire workers during the first quarter, while 28 percent expect declines. These results indicated softer hiring relative to a year ago when 29 percent expected increased hiring and 9 percent anticipated decreases. A manufacturer recently announced plans to eliminate over 400 jobs in Minnesota as part of a restructuring plan. A residential window manufacturer laid off 440 Minnesota and Wisconsin workers in December.

While overall growth in wages was moderate, wage pressure was noted in some areas. A bank director in southwestern Montana reported that some salaries were rising in order to attract employees. City park and recreation programs in Aberdeen, S.D., have raised wages in order to ameliorate difficulty finding workers. A union for Minneapolis-St. Paul office building janitors was recently considering a strike due to differences with employers on health care benefits.

Overall price increases were modest as a number of energy and materials prices moderated. Minnesota gasoline prices in the beginning of January were about the same as they were in mid-November and a year ago. Natural gas prices are lower than a year ago. While recent copper prices were much higher than a year ago, they decreased during the past few months.

▲ [Return to top](#)

Tenth District--Kansas City

Growth in the Tenth District economy slowed to a modest pace in December and early January, but expectations suggested higher levels of activity in the coming months. Consumer spending was mixed. Manufacturing expanded at a slower pace while commercial real estate activity remained solid. Lending activity continued to expand while deposits held steady. Energy activity fell slightly but was still high by historical standards. Agricultural conditions were generally favorable, although severe winter weather posed a risk to affected areas. Residential real estate activity continued to decline. Retailers were optimistic about sales in the months ahead while manufacturers expected future activity to increase. Wage pressures moderated even while labor markets continued to expand. Overall price pressures eased slightly since the last survey. Fewer respondents expected price increases in manufacturing. However, some retailers expected to increase prices in the coming months.

Consumer Spending

Consumer spending was mixed in December and early January while expectations for future activity were positive among many retailers. Overall sales continued to edge down at auto dealers while inventories increased modestly. However, several respondents reported strength in the SUV category. A majority of retail stores reported that sales were flat or declined from the previous survey and sales were below expectation. However, retailers reported that overall sales were unchanged compared to a year ago and restaurants and shopping malls reported sales gains. Mall respondents reported strength in jewelry but weakness in shoe sales. Growth in overall holiday sales in the Rocky Mountain region appeared to be depressed by recent blizzards. Heavy snow also interrupted mountain transportation in late December, although holiday travel and tourism activity remained solid overall. District hotels

continued to report high occupancy rates, particularly in resort areas. A significant number of automobile and retail establishments expected sales to increase through the first quarter. Many furniture and appliance retailers expected inventories to decline while a significant number of automobile dealers expected inventories to rise modestly. Most hotel and mall operators expected high levels of activity to continue over the coming months.

Manufacturing

Growth at district manufacturers edged down in December and early January, though plant managers expected activity to rise in the future. Plant managers reported slower growth in production, employment, and shipments. However, some manufacturers reported that new orders rose in December, and capital expenditures were above year-ago levels. In the wake of ice storms in western Nebraska some manufacturers limited production to conserve power. Plant managers were optimistic about future activity. An increasing share of respondents expected increases in production, employment, capital expenditures, shipments, and export orders and declines in finished goods inventories.

Real Estate and Construction

Residential real estate activity continued to decrease in December and early January, while commercial real estate activity remained solid. Home sales declined and inventories remained above year-ago levels. Respondents reported weakness concentrated in the higher-priced segment with some strength in lower-priced homes. Builders indicated that home starts remained weak. Overall home prices were unchanged from a month ago and remained below year-ago levels. Expectations for sales were mixed, with some respondents anticipating declining prices in the coming months and others basing optimism on lower interest rates and a positive economic outlook. Commercial real estate sales were largely unchanged from a month ago. However, absorption of office space increased in most cities, and vacancy rates throughout the District were lower than a year ago. As a result, office prices and rents increased from a month ago and several respondents expected these increases to continue. Commercial real estate contacts anticipated adjustments to absorption and vacancies reflecting a firm market, even while sales were expected to be flat in the coming months.

Banking

Bankers reported that loans increased somewhat since the last survey, while deposits held steady. Demand for commercial and industrial loans and commercial real estate 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 reportedly unchanged.

Energy

Energy activity declined in December and early January 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 above year-ago levels. The recent decline was concentrated in the Rocky Mountain states. Energy contacts reported availability of labor as their top concern, with availability of equipment and services being the next most important factor limiting activity. Most contacts anticipated drilling activity to decline in the next three months.

Agriculture

Agricultural conditions improved in December, although drought continued to affect some areas. In parts of eastern Colorado, western Oklahoma and Nebraska, winter snowstorms disrupted power and transportation for rural residents. Inclement weather limited cattle weight gains and led to animal deaths in some areas. The winter wheat crop appeared to be in better condition in areas receiving recent precipitation. December snows provided cover for winter wheat and improved prospects for soil moisture and stream flows next spring. Corn and soybean yields were down from last year's outstanding levels. Higher crop prices boosted current and future incomes with more prevalent use of forward contracting. Higher crop prices, however, also boosted feed costs and limited profits for livestock producers.

Labor Markets and Wages

Labor markets continued to expand in the District, while wage pressures remained moderate. Hiring announcements continued to outpace layoffs. 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. Lodging establishments reported shortages of housekeepers. Benefits costs were largely unchanged from the previous survey but remained above year-ago levels. The percentage of firms expecting to increase employment remained high but edged down from the previous month, while a lower percentage of firms expected wage pressures to increase.

Prices

Price pressures continued to moderate in December and early January. Most retail contacts reported flat selling prices. A significant number reported declines from the previous month, although retail prices were up from year ago levels. The share of manufacturers reporting increased materials costs edged up, while the share of factories raising finished goods prices dropped slightly. District contacts noted that price increases for some construction materials have moderated and were expected to edge down. Manufacturers expected declines in raw materials and finished goods prices. Many retail contacts reported flat selling prices while a number of respondents expected some increase in prices in the months ahead.

▲ [Return to top](#)

Eleventh District--Dallas

The Eleventh District economy continued to decelerate from mid-November to early January. Activity in the energy sector remained at high levels, but growth was slowing. Manufacturing activity softened. While still strong, service sector activity slowed some. Retail sales growth was weaker than expected, but contacts said growth improved in late December and early January. Overall construction and real estate activity was quite strong but continued slowing. Consumer lending moderated. Commercial lending was strong but expected to slow. Rain improved agricultural conditions, but high costs and low yields have reduced profitability.

Contacts in a number of industries were more optimistic about the outlook than at the time of the last Beige Book--partly because sales growth has not deteriorated as much as they feared.

Prices

Price pressures were mixed. Prices were lower for some raw materials, including petrochemicals, primary metals, copper and aluminum. Competition put downward pressure on selling prices for a number of products, including high tech and retail. Transportation costs are up. Some contacts reported price increases for imported goods because of high

shipping costs and declines in the value of the dollar. Others reported declines in the dollar reduced competitive pressures by raising the cost of imports. Real estate prices and rents were mostly higher.

After strengthening in December, energy prices declined in early January but remained relatively high and a concern for many firms. Henry Hub prices for natural gas fell from \$8 to about \$6 per million Btu.

A major inventory adjustment led many chemicals derived from natural gas to see rapid price declines, including record drops for ethylene and propylene. There were large price declines for polyethylene and polypropylene. Inventories had been built up last summer to protect against any shortages that might be caused by hurricanes and ensuing major plant outages. The inventories were cost effective while natural gas prices were rising, but the recent decline in natural gas prices prompted a rapid reduction of inventory that pushed petrochemical prices down sharply. Weak demand also contributed to price declines for polycarbonate, polystyrene, PET bottle resin, and PVC. In contrast, some oil-based petrochemicals, such as synthetic rubber saw excellent demand, low inventories, good pricing, and solid margins.

Labor Market

The labor market remains very tight, with numerous firms continuing to report difficulty finding skilled and unskilled workers. Many contacts say high and rising labor costs, including the cost of health insurance, top their list of concerns for the coming year. Shortages of skilled labor continued to restrain nonresidential construction. Energy service contacts said workers must be kept "inside the fence" to keep other firms from hiring them off the job. While hiring continued to increase for some manufacturing firms, weak demand led others to slow hiring, eliminate shifts and/or lay off some workers.

Manufacturing

Overall manufacturing activity was weaker. Demand remains weak for products used in residential construction, such as stone, brick, clay, glass, lumber and metals. Inventories have increased for many of these products, leading to reductions in production and scattered layoffs. There was little change in demand for fabricated metals--with most orders supplying commercial and industrial customers.

The paper industry continues to struggle with weakening demand, high inventories and input costs that are rising faster than selling prices. Sales have been weaker than expected for producers of automobiles and high-tech products, causing some of these manufacturers to temporarily shut down factories during the holidays and/or slow hiring.

High-tech firms say that there is uncertainty about the outlook for sales growth. Most contacts believe sales will pick up after a slow first half of 2007, but some fear there may be a more serious downturn. Inventories are mostly in good shape, according to firms, who report some build up and uncertainty about how much stock is being held by distributors and retailers. There was optimism that the finalizing of telecommunications mergers will free up capital spending in the coming year.

Sales of food products unexpectedly rose more than the typical December gain. Producers supplying equipment to the energy industry continue to report strong demand and backlogs. Petrochemical exports increased strongly, with shipments of some products jumping 30 percent. Strong Asian demand was stimulated by declines in product prices and the value of

the dollar. The rush to export resulted in a logjam of railcars at the Port of Houston, and railroads imposed embargoes and rationed capacity.

Refinery production on the Gulf Coast sagged in late November and early December, but utilization rates returned to high levels by year-end. A prolonged fall turnaround season was responsible for the slack in December production, and a heavier than normal schedule of maintenance is expected this spring. Refiners have run plants hard in response to high margins and are using the turnaround period to improve plant performance, but delays are expected because engineering and construction firms are stretched thin, and craft skills are scarce.

Services

Activity slowed a little in the service sector, but there remains a good deal of strength. Temporary staffing firms reported weak demand to supply workers to manufacturing, warehousing and distribution, but continued high demand for professionals with experience and technical skills, especially in the accounting, financial services and IT services industries.

Law firms said demand had improved over the past six weeks, driven by mergers and acquisitions and real estate transactional work. Accounting firms reported little change in demand. Accounting companies are still hiring, and say that it is increasingly difficult to find both experienced accountants and new college graduates.

Demand for rail transportation was strong and increased slightly, with particularly high shipments of grain, chemicals and petroleum products. Trucking activity picked up robustly in December after an unusually weak November. Shipping firms reported good volume growth in both their freight cargo and domestic small parcel business, and indicated that shipping rates were likely to increase in coming months. Airlines reported a weak start to December but a good sales pickup over the holiday season and good bookings into January.

Retail Sales

Retail sales growth was good but not great, according to contacts. Sales were weaker than expected in early December, but picked up strongly as Christmas approached, which increased the optimism about sales growth in 2007. National retailers reported stronger sales growth in Texas than in other parts of the country. Auto sales picked up near the end of 2006. Contacts said inventory remains too high for some types of vehicles, and prices have been falling.

Construction and Real Estate

Residential real estate markets continued to adjust to cooler demand. Home sales have moderated from the vigorous growth experienced throughout most of 2006, and inventories inched up. Builders report an increase in cancellations, leading some to pull back on starts. The market was much weaker for lower-priced homes than for homes at higher price points, and the Dallas/Fort Worth market was weaker than the other major metropolitan areas, some of which were still quite hot. Home prices continued to rise at a modest pace.

Apartment occupancies declined in Dallas and Houston over the past six weeks, but contacts said the decline was expected as Hurricane Katrina evacuees continued to move out. Despite the decline, overall occupancy rates remain above 90 percent. Austin's apartment market was performing better than most--with an occupancy rate of 96 percent and rising rental rate.

Office demand remained strong. Landlords saw multiple tenants compete for unoccupied blocks of space in Dallas. The Houston office absorption rate in 2006 was three times that of 2005. Rent continued increasing at a strong pace. Contacts are optimistic that demand will remain positive in 2007.

Financial Services

Consumer lending moderated--with some softness showing in all types of consumer products: credit cards, personal loans, auto loans, and mortgages. Bankers say the moderation appears to be the result of more careful consumer spending and payback of existing debt. Demand for commercial loans remains steady, but contacts expect commercial activity to slow somewhat in 2007.

Deposit growth has slowed, and contacts say deposits are increasingly difficult to obtain from both consumer and commercial customers. Pricing of all types of loans is still aggressive, but credit quality remains solid.

Energy

The U.S. and Texas rig counts fell slightly over the past few weeks. Demand for energy services remained strong, however, and contacts said their order books have very long and increasing backlogs. Producers will reduce exploration if low natural gas prices hurt their cash flow, but many producers have sold their production forward, which will allow them to keep drilling through any short-lived weakness in prices. Drilling activity is expected to increase in 2007, but growth is projected well below the increases of the last two years. Some contacts say exploration expenditures will shift away from domestic natural gas to finding oil in international markets.

Agriculture

Rainfall improved conditions by replenishing livestock ponds, boosting subsoil moisture and stimulating pasture growth. Still, supplemental feeding of livestock continued, and hay was difficult to locate in many areas. Producers continue to harvest cotton, vegetables and some remaining summer crops. Cotton yields are below last year levels. Contacts say high prices of corn and grain sorghum have reduced prices for stock and feeder cattle.

▲ [Return to top](#)

Twelfth District--San Francisco

Summary

The Twelfth District economy expanded at a moderate pace during the latest survey period. Overall price inflation remained modest, though growth in labor compensation ticked up slightly. Retail sales were solid overall and most service providers saw strong demand. Manufacturers and agricultural producers also reported robust demand for their products. Activity in District housing markets slowed further, while demand for commercial real estate grew at a modest pace. Loan demand and credit quality in the banking sector remained healthy.

Wages and Prices

On net, District contacts indicated that final prices grew at a modest pace. Input prices reportedly were stable overall, though price declines were noted for some building materials used primarily in residential construction, such as lumber and wallboard. Growth in labor

compensation ticked up relative to the previous survey period but remained moderate overall. So far, the pickup in compensation growth has not translated into higher final goods prices. A number of respondents attributed limited price pressures to highly competitive environments, notably for apparel and electronic goods.

Much of the growth in labor compensation during this survey period was reported to be in non-base-wage components such as bonuses and commissions and employer-provided health-care benefits. Contacts indicated that compensation growth was considerably higher for select groups of skilled workers, notably in the health-care, finance, and technology sectors, and in areas with very tight labor markets, such as Idaho and Utah, than it was overall.

Retail Trade and Services

District retailers reported generally solid performance for the holiday season as a whole, with sales up in dollar terms and in unit terms compared to last year. Sales growth was evident for most retail market segments, and the extent of holiday season discounting was about the same as last year. Sales growth was especially strong at department stores and establishments specializing in luxury products, with full-price items reportedly selling substantially better than last holiday season. Overall, most contacts reported that holiday sales met or slightly exceeded expectations, leaving retail inventories in balance. Turning to the auto sector, sales of new automobiles were moderate on net, with strong sales of imports offsetting muted sales of domestic models. Inventories of domestic light trucks and SUVs remained at high levels.

Most service providers saw strong demand. Sales were brisk in the food and beverage, health-care, and technology services sectors. Tourist activity remained at high levels in most major markets. In Hawaii, total tourist visits and spending were up compared to a year ago, despite declines in the number of Japanese visitors during the survey period. In most parts of the District, hotel occupancy rates remained stable, while room rates rose further.

Manufacturing

District manufacturers reported an uptick in demand for their products in late November through the beginning of January. Semiconductor sales expanded at a solid pace, and capacity utilization in the sector generally remained in the range of 90 percent. Vigorous competition among manufacturers held down prices for various semiconductor products. Strong demand for commercial aircraft and defense products kept District producers operating at full capacity to meet ongoing order backlogs. Makers of machine tools saw continued increases in new orders but at a slightly reduced pace, and food manufacturers reported strong sales. In contrast, demand for wood products and selected building materials used primarily in residential construction contracted further.

Agriculture and Resource-related Industries

Demand for agricultural and resource-related products grew at a solid pace and production conditions were stable overall. Robust demand for livestock and most crops, such as pecans and corn, resulted in strong sales and higher prices for these items compared to a year ago. Price declines for fertilizers and freight services continued to ease pressures on production costs. In the resources sector, producers of oil and natural gas saw fairly robust demand and tight inventories overall.

Real Estate and Construction

District residential real estate markets cooled further, while demand for commercial real

estate grew modestly. The pace of home sales and price appreciation deteriorated for existing and new homes in most areas during the survey period. In several previously hot areas, such as parts of Southern California and the San Francisco Bay Area, home price appreciation slowed to low single digits. District homebuilders continued to work down unsold inventory by offering significant incentives to entice buyers. Slower home sales continued to damp residential construction activity, particularly for condominiums. Continued growth in demand for commercial and industrial space was evident in further reductions in vacancy rates and increases in rental rates 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 2006.

Financial Institutions

Contacts in the banking sector continued to indicate that, on net, overall loan demand and credit quality were solid. Demand for commercial and industrial loans continued to outpace demand for residential loans, owing in large part to the drop-off in mortgage originations and refinancing. Contacts reported that indicators of credit quality, such as loan delinquencies, were at favorable levels in general. Tight labor markets for skilled workers in banking and other financial services remained a major concern; employers offered significant signing bonuses and other incentives to attract capable workers.

▲ [Return to top](#)

[Home](#) | [Monetary Policy](#) | [2007 calendar](#)

[Accessibility](#) | [Contact Us](#)

Last update: January 17, 2007