The Federal Reserve Board

October 17, 2007

Summary of Commentary on Current Economic Conditions by Federal Reserve District

Summary

Prepared at the Federal Reserve Bank of Dallas and based on information collected on or before October 5, 2007. This document summarizes comments received from business and other contacts outside the Federal Reserve and is not a commentary on the views of Federal Reserve officials.

Anecdotal reports from the Federal Reserve Banks suggest economic activity continued to expand in all Districts in September and early October but the pace of growth decelerated since August. Growth was similar to that observed in the last Beige Book in seven Districts--Atlanta, Boston, Chicago, Minneapolis, New York, Philadelphia and St. Louis. The economy grew at a slower rate in five Districts--Cleveland, Dallas, Kansas City, Richmond and San Francisco. The expansion was variously characterized as "moderate," "modest" and "mixed."

Consumer spending expanded, but reports were uneven and suggest growth was slower in September and early October than in August. The manufacturing and service sectors continued to expand, but growth weakened--mostly for products and services related to home construction and real estate transactions. Several manufacturing and service firms reported that weaker domestic demand was offset by strong sales to global markets.

Residential real estate markets continued to weaken, and most Districts reported additional declines in home sales, prices and construction. Financial institutions reported an increase in delinquencies and slight deterioration in credit quality. Lenders in many Districts tightened credit standards, particularly for real estate. The majority of reports indicated an increase in business lending but a decline or slower growth in consumer lending.

Activity in the energy industry is still robust but growth has slowed. Favorable agricultural conditions are contributing to a bumper crop throughout much of the country, but drought continues to hamper production in the southeast.

Contacts in a number of industries indicated a higher-than-usual degree of uncertainty about the outlook for economic activity. Many real estate contacts expect housing markets to remain subdued for several months. At firms without direct ties to real estate and construction, contacts are still wary that credit tightening and slowing construction might slow activity in their industry, but there is cautious optimism because few see much evidence of such spillovers at this time.

Job growth eased in some regions, but labor shortages were reported for many occupations in most Districts and are said to be restraining economic activity in some instances. Wages rose moderately except for workers in short supply, where sharp increases were reported for some positions. Upward pressure on input costs are reported in most Districts, but competitive pressures are restraining the ability to pass higher input costs to selling prices in many instances.

Consumer Spending and Tourism

Retail sales increased, but reports were uneven and suggest growth has softened. Sales were weak at department and discount stores and for furniture and other home durables. Purchases of electronics and luxury items remained solid. Unseasonably mild weather dampened apparel sales in some regions.

There appeared to be a high level of uncertainty about the outlook for retail sales, and a few Districts report that retailers have reduced inventories. Vehicle sales were weaker, but reports indicated that sales of fuel-efficient and used cars remained strong. Tourist activity was generally solid.

Manufacturing

Factory activity continued to expand, but reports suggested that growth has been dampened by declining output of products used in home construction. A few Districts noted that export demand for other products helped sustain growth. District reports indicated strong growth of sales for paper, steel, machine tools, agricultural machinery, energy equipment, electrical equipment, defense and aerospace, chemicals and health-related equipment.

The outlook for factory activity is uneven. Boston District contacts noted continued weakness in housing and possible negative spillovers from tight credit but point to export growth and new product development as sources of strength. Manufacturers in the Cleveland District anticipate production remaining at current levels or decreasing slightly. Factories in the Kansas City District cut inventory levels and expect further reductions. Automakers in the Chicago District anticipate weakness in auto sales, but the St. Louis District reports major hiring to support the opening of new facilities for motor vehicle parts manufacturing.

Services

Districts reporting on business services indicated the sector is in expansion but the strength varied. Temporary staffing firms reported increased hiring, with the exception of activity to support financial services and real estate. Shipping activity was mixed and suggests some softening. Container shipments and regional freight activity were softer in the Atlanta and New York Districts, but freight hauling and shipping firms in the Dallas District reported increases in volume. Dallas District airlines say traffic is steady and bookings are solid.

Construction and Real Estate

Home sales continued to fall or increased more slowly in most Districts. In some instances, buyers could no longer secure financing or were unable to sell their current homes. New home inventories remained elevated, and builders continued to curb new home construction. Rising inventories of existing homes added to uncertainty about the overall health of the housing market.

Commercial market fundamentals remained solid. Most Districts reported steady absorption of commercial space. Rental rates were firm to rising across Districts, with sizable increases

for Manhattan office space. Construction activity continued at a steady pace overall. Some softness in commercial investment activity was noted, however, and several Districts reported a move to more conservative financing. Reports suggested developers are becoming more cautious--in some cases shelving or canceling projects.

Banking and Finance
District reports indicated increased delinquencies and a slight deterioration in credit quality. Lenders in many Districts tightened credit standards, including for consumers and all types of real estate. Consumer lending grew more slowly in most Districts. Lending for home mortgages, equity lines and refinancing continued to soften or decline in most Districts, which some reports attributed to tighter lending standards. Overall business lending was up, but tightening lending standards were applied, particularly for real estate.

Agriculture and Natural Resources
Favorable agricultural conditions in much of the country have allowed harvests to run ahead of normal schedules and contributed to above-average crop yields throughout much of the country. A near-record corn crop and above-average soybean yields are expected. Livestock producers reported strong demand and high prices.

Bumper crops have strained storage capacity and caused transportation problems. The Chicago District notes that transportation and storage problems emerged because of the size and speed of the harvest and because cash prices are enough lower than futures prices that farmers have an incentive to store crops until 2008.

Crop production has been hampered by dry or drought conditions in Alabama, the Carolinas, Georgia, Kentucky, Tennessee and Virginia. Shortages of feed and low forage supplies have led some livestock producers in these areas to cull their herds. The Chicago District reports that crop yields in Indiana, Michigan, and Wisconsin were less affected by a summertime drought than had been anticipated by some observers.

Energy activity held at robust levels, and oil production was up slightly. While natural gas drilling activity is still vigorous, there were reports that high costs have or will lead to reductions in production. The Kansas City and Minneapolis Districts reported that overall mining activity was strong and expanding, with mines in the Minneapolis District producing near capacity.

Labor Markets
Labor markets remain tight across much of the country, and there continues to be moderate upward pressure on wages and benefits. Job growth eased in some regions, however, and wage pressures softened.

Most Districts report worker shortages in a variety of occupations, with sizable wage increases for workers in short supply. Positions mentioned as difficult to fill include scientific, technical, accounting, finance, engineering, marketing, health-care, truckers, welders, ironworkers, crane operators, office workers and energy-service workers. Low-skilled and entry-level workers are in short supply in some areas, including those in the retail and hospitality industries.

Prices
Upward pressure on input costs was reported by most Districts. Pushed up by strong domestic and international demand, energy and raw material costs are characterized as high

by several Districts. Prices are up for a broad range of foods, including milk, corn, soybeans, wheat, beef, chicken and vegetables. Declines in the value of the dollar and high shipping costs have made imported goods more expensive. Insurance costs have increased in the Atlanta District.

The ability to pass higher input costs to selling prices was mixed. Some manufacturers raised selling prices as a result of higher costs, such as for food products, chemicals, machinery and oil and gas equipment. But there were also reports of lower prices, particularly for construction-related materials, such as lumber, wood, wallboard and some metals, pushing down construction costs. Competitive pressures are restraining retail price increases in many instances. Prices are higher for food products and at restaurants. Vehicle prices are lower, with dealers using incentive and discount programs or manufacturers adding features to vehicles without raising prices. Reports from the service sector suggest there have been continued increases in fees and fuel surcharges, but the rate of increase has not changed.

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First District--Boston

Business conditions in the First District continue to be mixed. Manufacturers generally report solid demand growth, except for housing-related items. Retail results continue to be varied. The consulting industry cites good revenue growth but some signs of caution among its U.S. customers. Residential real estate markets remain soft, while commercial real estate markets continue to improve on the rental side, but soften on the investment side, at least partly as a result of turmoil in credit markets. Contacts mention price increases for selected inputs. The outlook remains uncertain, but not downbeat.

Retail
Retail respondents in the First District cite mixed sales for the months of August and September. Same-store sales ranged from mid double-digit decreases to mid single-digit increases year-over-year. Health and beauty products, ladies' and juniors' apparel and accessories, televisions and small electronics were all among items that reportedly sold well. Sales of non-luxury cars continue to be down. Several retailers mention substantial increases in week-to-week volatility in sales.

Inventory levels are mixed, with several contacts reporting programs to reduce inventory. Headcounts are also mixed; some respondents report increasing headcount in line with company growth or seasonal hiring, while others report layoffs. Contacts cite price increases in metal-related products, chicken, beef, and dairy. Excess supply has kept lumber prices at record lows. Selling prices are generally stable, with a few companies passing small price increases along to consumers.

Retail respondents are cautious in their outlook. Most express concern about the current upheaval in financial markets as well as the potential impact on consumer sentiment; some respondents expect an economic slowdown and say they are uncertain whether it will turn into a recession, while others feel that it is not a matter of underlying economic weakness so much as consumer confidence. Several retailers anticipate no improvement for another one to two years. However, others remain optimistic in their outlook; as one noted, "for the right deal, people are still buying."

Manufacturing and Related Services

Manufacturers and related services providers headquartered in the First District report that third-quarter sales and orders have been mostly in line with prior trends. Demand continues to increase strongly for defense and aerospace products, biopharmaceuticals, health-related equipment, and various export items. Sales of housing-related products generally continue to run below year-earlier levels. Some contacts note recent sales blips (mostly downward, but some upward) for selected products, but they attribute them more often to temporary or idiosyncratic factors than to changes in the economy.

Most contacts describe materials and energy costs as rising somewhat or remaining stable at high levels. They express concern about actual or anticipated increases in prices paid for metals, nonmetallic minerals, rubber, energy, transportation, and corrugated cardboard. Most firms say that their average selling prices are up between 1 percent and 6 percent over year-earlier levels, and some plan to raise prices further in early 2008 in order to recoup higher materials costs. Respondents note that prices have eroded for some products, such as consumer electronics and automotive and industrial parts.

Contacts generally are adjusting their U.S. headcounts only minimally (up or down), and average wage and salary increases are remaining in the range of 3 percent to 4 percent. Manufacturers report that labor markets remain very tight for scientific, technical, and finance professionals, resulting in hiring delays and signing bonuses. Respondents mostly say that domestic capital spending is likely to be flat to up in coming months; only a couple indicate they recently scaled back their investment plans.

Most manufacturers and related services providers say they are either upbeat or at least reasonably positive about their business prospects. While citing continued weakness in housing and possible negative spillovers from tight credit, they point to export growth, new product development, and positive trends in their industry as reasons for expecting increased revenues in 2008.

Selected Business Services

A majority of contacted First District management consulting firms report that some of their U.S. customers have become more conservative. One firm cites increased renewals as a sign that companies are seeking more stability in their budgets; another indicates that its U.S. financial services clients are delaying purchasing decisions. Consulting contacts with a global footprint mostly report that demand continues to be robust. Pipeline activity is mixed; while the majority of contacts' backlogs are flat or up, a few are softer. Revenues are up between 5 percent and 20 percent year-over-year.

Several firms have put through modest price increases, while others have left bill rates unchanged. Input costs are relatively stable, although a few firms note rising rents. Headcounts are growing in response to demand, but at a slightly slower pace than revenues. Most respondents plan to increase wages by between 3 percent and 7 percent in 2008.

Business services respondents have a mixed outlook; those with softer incoming orders are cautious about the rest of the year, while others are more positive. However, firms with clients in the financial services industry say they expect that segment to have a tough fourth quarter.

Commercial Real Estate

As reported last time, credit conditions in the commercial real estate market have changed significantly in recent months. Contacts characterize the situation as a move to more

"rational" or "conservative" financing, however, not a panic. Financing has shifted away from the Wall Street "conduit" market and toward banks and life insurance companies. Overall transactions volume is down sharply compared to a year ago. Borrowers with low loan-to-value ratios seeking to purchase prime commercial space with good cash flow are still able to get financing, albeit on stricter terms than previously, but speculative investment activity has been sharply curtailed by lack of financing. Contacts report some downward revisions to asking prices (on the order of 5 percent to 15 percent), but primarily for marginal properties such as vacant office buildings away from urban centers. Prime office and retail space continues to sell at strong prices due to a "flight to quality." Unfinished condominium developments (some with only 10 percent to 15 percent of units sold) are in very bad shape, however, and there is talk that some may convert to rental units to cut losses.

Rental rates for class A office space in Boston have remained high, but contacts predict slower rent increases moving forward, claiming some of the bargaining power has shifted back to tenants. Office vacancy rates remain in the single digits; absorption is positive but expected to slow in coming months. Rents are stable in the class B market, where vacancies are higher than for Class A space, but also stable or falling. Suburban Boston, most notably Waltham, continues to be in high demand among biotech and other industrial firms. In Hartford, rents for new industrial space outside downtown are also reported to be on the rise, but the rest of the Hartford market remains stable. Contacts say the industrial market has been "surprisingly strong" in Providence and northern Rhode Island, and office rents in downtown Providence are expected to continue to rise due to declining vacancies and strong job growth.

A risk moving forward is that projects in the planning stages, such as large mixed-use developments, may be delayed or shelved due to the unfavorable financing climate. Some respondents report that property valuations have changed and expect commercial real estate prices to fall even though not much softening has been observed yet. Contacts expect modest economic growth throughout the region, but some see a risk that hiring may become more conservative as managers wait to see what, if any, fallout may occur from financial market disturbances.

Residential Real Estate

Available reports on the Massachusetts residential real estate market are conflicting. Published data from the state realtors' group show increases in sales and median prices for both single-family homes and condominiums between August 2006 and August 2007. But more comprehensive August data (including foreclosure sales, for sale by owner, and new homes sold directly by the builder, as well as sales through realtors) give a more negative picture: According to these data, Massachusetts home sales decreased 1.5 percent as median prices dropped 4.9 percent year-over-year; in addition, condominium sales dropped 2.2 percent and median prices decreased 1.1 percent.

The other New England residential markets are mostly trending downward. Second quarter sales in Connecticut decreased compared to last year, although single-family home prices increased 10.7 percent, with the price increase concentrated among homes with four or more bedrooms. In New Hampshire, home sales declined 8 percent, and prices decreased 1 percent in August 2007 compared to August 2006. A Rhode Island contact also says that prices and sales are dropping.

Respondents express concern about the impact of negative housing-related news stories on

buyers and about unrealistic pricing as sellers try to get more for their house than market conditions allow. In addition, contacts acknowledge that lending standards are tightening.

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Second District--New York

The Second District's economy has expanded at a moderate pace since the last report, while price pressures have remained steady. The labor market has generally been stable and tight. Manufacturers report ongoing expansion in activity in early October. Retailers indicate that sales were on or below plan in September, except in New York City, where sales have been relatively strong and tourism activity has held steady at high levels. Housing markets continue to be mixed: Manhattan's sales and rental markets remained relatively firm in the third quarter, while housing markets in New Jersey and other areas continue to be soft. Office markets in the New York City area have been steady to stronger, with continued steep increases reported in Manhattan asking rents. Bankers report weakening loan demand, particularly for consumer loans and home mortgages; they also report tightened credit standards in all categories except consumer loans, and rising delinquency rates on commercial loans and mortgages.

Consumer Spending
Retailers report that sales were steady to somewhat softer in September, partly reflecting unseasonably mild weather. In terms of 12-month sales growth, New York City continued to out-perform the rest of the region by a wide margin. Apparel sales were characterized as sluggish, but this is attributed largely to the warm weather. Sales of home non-durables are reported to have picked up recently, whereas spending on home durables has remained weak. Overall, selling prices are reported to be steady.

Tourism activity in New York City has been steady at a high level. Hotels remained at close to full capacity in August, with room rates accelerating to a 15 percent year-over-year growth rate, and total revenues up nearly 20 percent from a year earlier. A contact at a leading industry organization characterizes September as another strong month, though not quite as robust as August. Broadway theaters report that activity tapered off a bit in September, but remained at a strong level; both attendance and total revenues were little changed from a year ago, after running 8-12 percent ahead in August.

Construction and Real Estate
Commercial real estate markets across the New York City area were generally stable to stronger in the third quarter. Manhattan's office rental market remained tight: vacancy rates were steady near cyclical lows at the end of September, and asking rents continued to escalate, rising more than 35 percent from a year earlier. Leasing activity is reported to have slowed noticeably in Manhattan, but this is said to largely reflect the lack of available space. However, leasing activity picked up in northern New Jersey in the third quarter--particularly along the Hudson River coastline. Westchester and Fairfield Counties' office markets have strengthened moderately, while Long Island's market remains robust. An industry expert maintains that these suburban markets are being buoyed by spillover from Manhattan's tight market; overall, asking rents in the suburban markets are reported to be up moderately from a year ago.

Housing markets continue to be mixed, as in the last report. New Jersey homebuilders report

that they have reduced new construction activity and have all but ceased seeking approvals for new development. Both builders and sellers of existing homes are reported to have become more negotiable on selling prices, and this has boosted sales activity somewhat. Selling prices for new homes in northern New Jersey are estimated to be down roughly 10 to 15 percent from a year earlier, on average. Based on monthly reports from New York State Realtors, sales of existing single-family homes were down 7 percent from a year earlier in August, while selling prices were down roughly 2 percent, on average--not much different than in prior months.

Manhattan's apartment sales and rental markets were steady and relatively strong in the third quarter. Sales activity for co-ops and condos rebounded more than 60 percent from the depressed levels recorded a year earlier, and the number of listings (inventory) was down by roughly a third, to levels that are characterized as more normal. Overall, selling prices of Manhattan apartments were up slightly from a year earlier, on average, though the high end of the market registered double-digit price appreciation. Similarly, rents on high-end (large) apartments are reported to have risen by more than 15 percent from a year ago, reflecting a severe dearth of available units; rents on studio and one-bedroom units are estimated to be up roughly 7 percent, on average, over the past 12 months.

Other Business Activity
New York State manufacturers report continued moderate expansion in business activity, as well as employment levels, in recent weeks. Contacts also indicate ongoing but steady upward pressure on input prices, and increasingly widespread hikes in selling prices. A contact at a major shipping terminal reports that out-bound container shipments have leveled off, after expanding earlier this year, and that in-bound volume has decelerated in recent months. Nonetheless, more broadly, contacts at non-manufacturing firms in the District indicate some pickup in activity in recent weeks, following a lull in August; they also report steady expansion in employment levels and fairly widespread but steady increases in prices and wages.

A major New York City based employment agency, specializing in office jobs, reports that large financial services firms have pulled back on hiring activity somewhat, but that labor demand remains strong in other industries, particularly legal services. Available office workers reportedly remain in short supply. Starting salaries are estimated to be up roughly 5 percent from a year ago, on average.

Financial Developments
Based on our latest survey, conducted during the first few days of October, bankers report weakening demand for loans in all categories--particularly consumer loans and residential mortgages--as well as continued widespread decreases in refinancing activity. Respondents indicate tightening credit standards in all loan categories, except consumer loans. Bankers report lower average deposit rates, on balance, and also indicate a decrease in the spreads of loan rates over cost of funds for all types of loans; in all loan categories, approximately 35 percent of bankers report lower spreads. Finally, bankers report increased delinquencies in the commercial mortgage and commercial and industrial loan categories, but no change in delinquencies for consumer loans and residential mortgages.

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Third District--Philadelphia

Business activity expanded in the Third District in September. Manufacturers, on balance, reported increases in new orders and shipments. Retailers generally reported sales gains in September compared with August and with a year ago. Auto sales were flat from August to September, and below the year-ago level. Overall bank lending rose in September, but the rate of growth slowed from August. Residential real estate demand remained weak, although some builders had increased sales in response to price reductions. Firms reporting on labor costs generally noted a continuing trend of moderate increase in wages, but several said increases in health care benefits costs were large. Firms reported increases in input costs and output prices in September, although the extent of the increases did not appear to have changed much since August. However, there appeared to be more retail price hikes for food products in September than in August.

Third District firms generally foresee continued growth, except in real estate activity, in the next few months. Manufacturers expect increases in demand for their products. Retailers generally expect sales to increase at their current rate, although they are not unanimous. Auto dealers are not certain of the near-term outlook, but most do not expect the sales rate to strengthen. Bankers anticipate slow expansion in business and personal lending, although some expect a pickup from the current growth rate in these credit categories, but they expect residential mortgage lending to remain weak. Home builders and residential real estate agents expect sales to remain slow. Contacts in commercial real estate anticipate steady demand for office and industrial space, and they believe office and infrastructure construction activity might increase late this year and into next year.

Manufacturing

Third District manufacturers, on balance, reported increases in shipments and new orders in September. Around one-third of the manufacturers surveyed noted increases and around one-fifth noted decreases. Order backlogs, overall, were unchanged from August to September. Firms producing industrial equipment, paper products, and electrical equipment reported increases in orders in September, but firms producing lumber, metal products, and transportation equipment reported decreases.

Nearly half the manufacturing firms contacted for this report expect increases in new orders and shipments over the next six months, and only a few expect decreases. Manufacturing firms in the region plan to increase capital spending during the next six months, on balance, although firms that produce products and materials for residential construction have trimmed capital spending plans.

Retail

Retailers in the Third District reported that sales in September rose from August and from September of last year, although the magnitude of the gains varied. Sales of back-to-school merchandise buoyed results at discount stores, but overall sales growth for these outlets was not strong, and some indicated that the growth rate had slowed from August to September. In contrast, sales of higher price-point goods increased robustly. Sales of fashion items were "well up from last year" according to an executive of a large luxury goods retailer. Merchants said sales of appliances, home furnishings, and home repair and remodeling merchandise continued to be weak. Retailers expect sales to increase in the months ahead at around the current rate. While some expect a strong finish to the year, several of those contacted for this report said the outlook for the year-end holiday shopping period is uncertain.

Auto dealers in the region reported mixed results, but on balance sales were virtually unchanged from August to September, and overall sales remained below the year-ago level. Dealers are uncertain of the course of sales for the remainder of the year, but most do not expect improvement.

Finance

The growth rate of outstanding loans at Third District banks slowed in September, according to lending officers contacted for this report. This slowdown in loan growth seems to be widespread across categories, including business lending, personal lending, and credit card lending. Despite the slowdown in growth of business lending several bankers noted that lending related to mergers, acquisitions, and leveraged buyouts has increased. Demand for residential mortgages remains low. Contacts reported some weakening in asset quality among all credit categories, but indicated that increases in delinquencies have been slight. However, one banker said "residential developers are feeling stress" and several banks have stepped up their monitoring of borrowers involved in commercial and residential development. Looking ahead, bankers generally foresee slower growth in business and personal lending than was the case earlier in the year, although some believe the pace of lending will pick up from its recent slowdown.

Real Estate and Construction

Residential real estate activity continued to be very slow in September, according to home builders and real estate agents contacted for this report, and inventories of both new and existing homes remain high. For the previous few months, builders had reported making large price reductions with little effect on sales, but some builders reported slight increases in sales in September. Although they noted a few "pockets of improvement," with a pickup in sales at the highest and lowest end of their house price ranges, they said that "the middle is dead." Real estate agents reported that existing home sales have declined since August in nearly all parts of the region. Contacts among builders and real estate agents do not expect a quick turnaround until large inventories are whittled down. Several said they expect housing demand to remain subdued for some time, although a contact noted that buyers will "recognize a deal, if you give the houses away."

Commercial real estate firms report that office vacancy rates remain quite low in most of the region, though they have increased in Delaware. Demand for office space has slowly pushed rental rates up over the past few years, and contacts report that gradual rent increases should continue over the next few months. However, new signings for office space hit a lull in the third quarter, though renewals of current leases remained strong. The outlook is mixed; plans for new office buildings were recently announced, but some retail projects have been postponed. Contacts in the construction industry said they expect an increase in infrastructure projects this year and next.

Services

Business services firms generally reported steady growth, and some information technology firms indicated that growth in demand for their services had recently picked up. Employment agencies and temporary help firms reported that demand for workers has been rising fairly steadily, overall. They noted that demand for workers in health services, information technology, and accounting had increased, but demand for workers in the financial and real estate industries had decreased. Service-sector firms generally expect business to continue to increase in the months ahead at around the current pace, although a large business services

firm noted "some trepidation" among its customers about purchasing more services than they currently do.

Prices and Wages
Reports of increases in input costs and output prices from Third District business contacts were about as prevalent in September as they were in August. Manufacturers noted increases in prices of food products, chemicals, and machinery, but also reported some declines in prices of lumber, transportation equipment, and some metals. Construction companies noted that competition among builders for commercial projects has increased as residential construction activity has declined. One builder noted that "jobs that once had three to four bidders now have eight or more." Contacts indicated that the rate of retail price increase has not changed much, although some food prices have risen along with increases in agricultural commodity costs.

Most of the firms reporting on employment costs in September indicated a continuing trend of moderate wage increases. Several firms noted that increases in benefit costs continued to be large, and more firms are looking at ways to limit the increases. As one large employer noted, "health care choices for employees will be limited and they'll pay more" in 2008.

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Fourth District--Cleveland

The economy in the Fourth District continued to grow since late August, but at a slower pace than in the preceding reporting period. The slowing is attributed primarily to a weakening in manufacturing output. Most District home builders experienced a slight uptick in sales since our last report. However, they see this as a seasonal adjustment rather than the beginning of an upward trend. Activity in commercial construction was steady, with several builders citing a small decline in backlogs. With the exception of food products, retail sales in the District were flat to declining. Reports on business and consumer lending showed that, in general, demand was steady or had increased slightly. The mortgage market remains sluggish, while the use of home equity lines of credit saw a slight rise. Oil production was up slightly, while natural gas production declined. And the demand for trucking and shipping services was stable.

Employment levels across the District were generally flat. Staffing firms reported an increase in the number of job openings, primarily in the health-care industry, while the number of job seekers was flat. The majority of staffing contacts told us that it is increasingly difficult to find quality job applicants. Wage pressures were limited to the energy sector and some segments of the health-care and financial services sectors. For the most part, supplier prices and material costs were stable. Several manufacturers told us that they plan to increase product prices effective early in the fourth quarter.

Manufacturing
Most District manufacturers reported that production has been flat or decreasing since late August. Further, a majority said that their companies showed a slight decrease in output on a year-over-year basis. Looking forward, almost all of our contacts anticipate production remaining at current levels or decreasing slightly. Several manufacturers told us that they have experienced a decrease in demand for their products during the past six weeks. One contact said that the housing slump is having a major impact on his business. On the other

hand, auto assembly plants reported a significant production increase on a month-over-month basis. The increase is attributed to assembly lines returning to normal production levels after retooling for model changeovers.

About half of our contacts reported lower capacity utilization rates since our last report. Most manufacturers also stated that capital expenditures were on plan. Respondents who said that they are reducing capital spending cited the need to conserve cash as the reason. During the fourth quarter, capital spending is expected to be consistent with levels seen earlier in the year. When asked about input prices, we received a mixed response; however, a majority said prices were stable. Global demand for raw materials and energy was the most often cited reason for elevated prices. Only a few of the manufacturers surveyed have attempted to increase their own prices during the past six weeks. However, several reported price increases will be going into effect early in the fourth quarter. Employment levels were flat and hiring in the near future is expected to be very slow. Wage pressures have not been an issue; however, a few manufacturers singled out rising health-care costs as a significant concern.

Real Estate

Most District home builders experienced a slight uptick in sales since our last report. However, they see this as a seasonal adjustment rather than the beginning of an upward trend. New home sales continue to be down year-over-year. Our contacts also reported a slight rise in cancellations, which they attributed to buyers having difficulty qualifying for mortgages. Looking forward, respondents remain uncertain about when the housing market will turn around. Home builders reported increasing their level of discounting. As a result, inventories are nearing levels that are appropriate for current sales volume. Material costs remain stable. Several contractors told us that they have reduced their workforces.

Most commercial contractors reported that business has been steady since late August as well as on a year-over-year basis. Segments showing strong activity include health-care, education, and manufacturing, while general office space slowed. Although a majority of our contacts are satisfied with their current backlogs, several have experienced a decline during the past few months. Looking forward, nearly all contractors expect activity in 2008 to be at or near 2007 levels. For the most part, material costs were stable during the past six weeks--though steel prices rose. In turn, almost all builders held their own prices steady. Workforce levels remain unchanged.

Consumer Spending

District retailers reported a slight decrease in general merchandise sales since our last report, while sales of food products were stable. Looking forward, grocery store managers and restaurateurs anticipate a modest increase in sales, while general merchandise retailers were uncertain of future sales trends. With the exception of dairy and meat products, supplier prices were stable during the past six weeks. New and used car sales were flat to declining. However, most dealers were optimistic about sales in the upcoming months due to change in the model mix and a cut in loan rates. Hiring across all retail segments was limited to normal workforce turnover. No wage pressures were reported. Almost all contacts told us that capital spending remains on plan.

Banking

Demand for business and consumer loans was mixed, with half of our contacts reporting a slight increase. Industries seeking loans were broad-based. Auto loans were flat, while a few

bankers experienced a pickup in the use of home equity lines of credit. The mortgage market continues to be sluggish. We heard mixed reports on core deposits. In general, national banks experienced modest to significant growth, while responses from community banks ranged from significant decreases to slight growth. In general, credit quality for consumer and business applicants remained stable. Almost half of our respondents stated that delinquencies have increased slightly, especially in commercial real estate, residential mortgages, and home equity lines of credit. A majority of bankers reported increased capital spending in 2007, especially for new technology.

Energy
Since our last report, natural gas production within the District declined, while oil production was flat to increasing. At the same time, prices received for gas fell and crude prices rose. Several energy producers commented that there may be a decrease in gas drilling because of falling demand and prices. Capital expenditures remain on plan, with no change expected during the next few months. All our contacts said that material and equipment costs have remained stable over the past six weeks. A majority of producers told us that they have recently increased employment and will continue hiring in the near future. However, finding skilled workers remains an issue. Almost all respondents reported continuing wage pressures.

Transportation
Demand for trucking and shipping services was characterized as stable by most carriers. All our contacts reported difficulty in passing increased costs through to their customers. However, fuel surcharges are routinely accepted by customers. Representatives told us that they do not anticipate changing capital spending plans. No wage increases were reported during the past six weeks and most hiring was attributed to driver turnover.

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Fifth District--Richmond

The pace of economic activity in the Fifth District continued to cool in September and early October as weakness in housing markets persisted and services firms reported slower revenue growth. Home sales remained sluggish across most of the District, while the demand for mortgages softened further. Reports from District merchants were also less rosy as retail sales--particularly big-ticket categories--continued to pull back. Additionally, widespread, drought-like conditions curbed crop yields and delayed winter plantings. Assessments of other sectors were more upbeat, however. District manufacturers noted gains in shipments and new orders, and tourism contacts said activity had been solid since the Labor Day holiday. Moreover, commercial real estate agents reported that leasing activity continued to be steady. Turning to labor markets, the pace of hiring moderated somewhat in recent weeks, though District factories added workers for the second straight month. On balance, price growth in the District was little changed since our last report.

Retail
District contacts reported generally softer retail sales in recent weeks due in large part to continued weakness in big-ticket categories. The general manager of a department store in the Washington, D.C., area reported that stronger apparel sales had been overshadowed by a further pullback in furniture sales. Sales of automobiles and light trucks were also slower across the District. A West Virginia automobile dealer said, "the only people buying are the need buyers, not the want buyers." Additionally, an executive at a hardware chain in central

Virginia told us that particularly dry weather during late summer and early fall limited sales of lawn and garden items. On a brighter note, a department store manager in central North Carolina said merchandise had been moving at a steady pace since our last report. On the employment front, retailers across the District said they had begun hiring seasonal employees and most planned to staff the upcoming holiday period at about year-ago levels. Retail price growth was little changed in recent weeks.

Services

Revenue growth at District services firms slowed somewhat since our last report. Contacts at professional, scientific, and technical services firms, in particular, reported softer revenue growth as housing market weakness began to constrain demand for services. An executive at a Maryland technology firm said construction-related clients had begun to delay large projects and a contact at a northern Virginia web-services company noted concern about his business prospects going forward because of the recent housing woes. In contrast, a Virginia airport executive said passenger traffic was up appreciably over the same time last year. In labor markets, the pace of hiring slowed at District services providers, while price growth was generally contained.

Manufacturing

District manufacturers reported that activity expanded at a quicker pace in late August and September. Contacts told us that shipments grew briskly, new orders picked up and District factories added workers for the second straight month. Manufacturers in the electronics, fabricated metals, plastics and transportation industries recorded the strongest gains since our last report. An electronics producer in Maryland told us that domestic orders were "showing some signs of life" and a textile manufacturer in North Carolina said business had strengthened considerably in September. Similarly, a plastics producer in North Carolina said that business had been good and was optimistic about his future prospects as he entered the "busy fall season." Reports on prices were mixed. Contacts indicated that raw material prices grew slightly faster than last month, while growth in finished goods prices increased more slowly.

Finance

On balance, demand for home mortgages continued to weaken across the Fifth District over the last six weeks. Contacts in Raleigh, N.C., and in Charlottesville, Va., reported a significant slowdown in lending activity, while a contact in Greenville, S.C., described only a minor pullback. Lenders also noted that a significant portion of their business had shifted from mortgage originations to refinancing adjustable rate products. Mortgage rates remained generally unchanged across the District in recent weeks, while credit standards continued to be taut in most markets. On the commercial lending side, demand softened with pronounced slowdowns in Charlottesville, Va., and in Charleston, W.Va. Reports on interest rates were mixed. Contacts in Charlotte, N.C., and in Charleston, W.Va., reported slightly lower rates for borrowers with solid credit, while a contact in Baltimore, Md., reported no change. Credit standards on commercial mortgages remained fairly tight across most of the District.

Real Estate

Fifth District Realtors continued to report generally sluggish home sales in September and early October. An agent in Richmond, Va., told us that buyers remained on the sidelines, while a contact in Fredericksburg, Va., advised potential sellers to "stay where you are unless you absolutely have to sell." Likewise, an agent in Greensboro, N.C., reported elevated home inventory levels, commenting that sellers who are not hard pressed to sell have chosen to

"just sit and wait." On the other hand, there were scattered reports of improving conditions. A Realtor in Odenton, Md., noted experiencing a "boatload of activity" in recent weeks and an agent in Greenville, S.C., said that an influx of relocated workers had helped to stabilize his market. Looking ahead, a contact in northern Virginia expected home sales to strengthen in the coming months as financial market concerns had subsided somewhat. Reports on home prices generally indicated very modest appreciation since our last report.

Turning to commercial real estate, the pace of leasing activity in the Fifth District was unchanged over the last six weeks. Contacts in Charlotte, N.C., Greenville, S.C., Richmond, Va., and Charleston, W.Va., reported steady leasing activity across all sectors, while an agent in Washington, D.C., said "activity was stable, though slower than this time last year." Rents were firm for the most part and vacancy rates were generally unchanged. On the investment front, contacts said deals were taking longer to complete as developers and financiers were exercising more caution. Additionally, agents in Washington, D.C., and in Columbia, S.C., noted that some projects had been shelved or canceled altogether. On the other hand, a Richmond, Va., Realtor said "there is still a lot of money out there" and a Baltimore, Md., Realtor reported that he was still seeing "lots of money chasing deals."

Tourism

Reports on tourist activity were generally positive. Along the coast, contacts in Myrtle Beach, S.C., and in Virginia Beach, Va., told us that bookings for the Columbus Day weekend were about on par with a year ago. In contrast, a contact on the Outer Banks of North Carolina reported somewhat stronger activity, which she attributed to a relatively quiet hurricane season. A manager at a mountain resort in Virginia reported that sales of time shares were going well and that the warm, early fall weather had attracted more golfers. Looking ahead, the contact was concerned that ongoing water restrictions might hamper snowmaking and limit ski operations this winter.

Temporary Employment

Fifth District temporary employment agents reported generally stronger demand for workers since our last report. A contact in Raleigh, N.C., reported increased demand for workers, while an agent in Cary, N.C., said hiring had been brisk in recent weeks. Contacts were optimistic about demand in the months ahead--a Bethesda, Md., contact expected stronger than usual demand for workers over the next several weeks ahead of the upcoming holiday season. On a less rosy note, contacts in Richmond, Va., and in Hagerstown, Md., reported somewhat weaker activity in September stemming from ongoing client concerns regarding the health of financial markets.

Agriculture

A dry September intensified the Fifth District's ongoing drought, causing state officials in Virginia and in the Carolinas to seek federal aid and prompting mandatory water-use restrictions in many areas. In addition, depleted ground moisture delayed plantings of winter crops in many regions. District agricultural analysts reported that low forage supplies and higher feed costs led livestock producers to continue to cull their herds, particularly in South Carolina and Virginia. Additionally, the corn harvest was almost complete in South Carolina and Virginia with yields varying widely, while soybean yields were below par in Maryland, South Carolina and Virginia. Despite the wide footprint of the drought, a few pockets of the District received more normal rainfall in recent weeks. Parts of Maryland, for example, saw light rains and cooler temperatures, allowing farmers to plant small grains, harvest corn and prepare fields for the upcoming winter.

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Sixth District--Atlanta

Reports from District contacts indicated that economic activity remained mixed in September. Overall, merchant sales were described as being modestly higher than a year ago. Vehicle sales improved in September for some fuel-efficient models, but other sales were generally disappointing. Reports from the tourism sector were mostly positive with activity exceeding expectations. According to Realtors and homebuilders, the pace of residential home sales and construction continued to decline, and housing inventories increased throughout the District. Manufacturing activity slowed, especially for industries linked to housing markets, and this contributed to reports of weaker regional freight activity. Banking contacts indicated tighter mortgage lending standards and higher foreclosure rates in parts of the District. Several contacts said that the market for skilled workers remained tight, and this contributed to strong wage increases in the skilled trade categories. Florida contacts noted that the overall pace of hiring had slowed. Reports on prices were mixed. Drought conditions continued to adversely affect District crops.

Consumer Spending and Tourism
Most District retail contacts indicated that September sales increased modestly compared with a year ago and were in-line with expectations. Merchants reported that inventories were up slightly compared with a year ago, but most agreed that they were comfortable with current levels. The majority of contacts continued to anticipate modest sales growth over the next several months.

September vehicle sales were mixed. Some foreign make dealers reported improved sales compared with September 2006, led primarily by an increase in sales of fuel-efficient models. In contrast, domestic brand dealers noted another disappointing month with deliveries to both retail and rental fleets off from a year ago.

Reports on the tourism sector were upbeat. Several Florida contacts said that late summer activity met or exceeded expectations. Contacts in the Orlando market noted that theme park attendance was up, and upscale properties were reporting good occupancy and higher room rates. Passenger traffic through Miami International Airport bettered that of a year ago, including an increase in international visitors. Convention bookings continued to improve in New Orleans, but attendance numbers remained below pre-Katrina levels. The Mississippi Gulf Coast casinos reported another strong month in September.

Real Estate
Homebuilders and Realtor contacts reported that new and existing home sales remained well below year-ago levels in September, and the pace of new home construction continued to decline sharply. Most contacts across the region noted the continued rise in home inventories from a year ago. However, some Florida homebuilders indicated that the rise in new home inventory had moderated. The majority of contacts anticipated that the weakness in District housing markets would persist.

September reports on commercial construction continued to indicate that activity was flat to slightly up compared with a year ago. Florida contacts also continued to note that fewer projects were in the pipeline.

Manufacturing and Transportation
Most reports indicated slowing factory activity. The residential construction slowdown continued to adversely affect firms linked to the building industry. Several reports noted weaker orders and sales relative to a year ago, and this had resulted in a reduction in work hours. The District's textile industry contracted further. More positively, several firms linked to the defense and auto parts supply industries continued to expand production. Freight demand continued to weaken through the end of September. Most contacts noted that weaknesses in housing and vehicle sales have negatively affected rail and truck tonnages.

Banking and Finance
Banks in the District reported tighter mortgage lending standards in September. Contacts noted a tighter market for jumbo and other non-conforming loans. Delinquencies and foreclosures were up in some parts of the region. Commercial lending was stable according to most reports.

Employment and Prices
Contacts continued to note difficulty finding workers in certain skilled trade categories, and were paying higher wages as a consequence. For example, welders, ironworkers, and crane operators were reportedly in short supply in parts of the District. The shortage of labor was characterized as being severe in the oil industry. Some contacts suggested that the shortage of skilled workers caused production delays, and increased the cost of projects. In Florida, several contacts noted that the pace of hiring has slowed, with workers laid off from the homebuilding sector finding it more difficult to find alternative employment.

Price information was mixed. Producer prices for metals were characterized as volatile. Fabrication costs for petrochemical and oil and gas equipment continued to escalate. Some residential and commercial builders noted moderating lumber prices, while others noted that cement prices have increased from a year ago. Increases in insurance costs continued to be cited by most contacts.

Agriculture and Natural Resources
Drought conditions in areas of Alabama, Georgia, and Tennessee continued to hamper production of key District crops. Also, the shortage of feed has accelerated the processing of some livestock. The region's cotton harvest is expected to be smaller than in 2006 because of poor weather and crop substitutions during the spring. Poultry producer prices were higher because of improved domestic and foreign demand.

Oil and gas drilling activity declined in September from August, although rigs and platforms in the Gulf sustained no damage from recent tropical disturbances. Refinery production and drilling activity was hampered by mandatory worker evacuations.

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Seventh District--Chicago

Economic activity in the Seventh District continued to expand at a modest pace in September. Consumer spending and business outlays continued to rise. Labor market conditions were mixed by industry and location. Residential construction declined further, while the pace of nonresidential development was generally steady. Manufacturing expanded at a similar pace as in the previous reporting period. Household lending declined, while

business lending edged higher. Overall wage and cost pressures were similar to those in the previous reporting period. The corn and soybean harvest was running ahead of the normal pace and a record corn crop was almost assured.

Consumer Spending

Consumer spending continued to increase at a gradual rate. The back-to-school shopping season ended on a positive note after getting off to a slow start. Retailers were cautious about the upcoming holiday season. One retailer said that it will keep lighter-than-normal inventories because of uncertainty about this year's holiday shopping season. Auto dealers reported flat to modestly improving sales during late August and September. Several dealers noted that used car sales have outperformed new car sales in recent months. A national restaurant chain said sales were increasing at a slower rate than earlier in the year. Tourism activity expanded at a modest rate.

Business Spending

Business spending rose again in the District. Current capital outlays increased slightly from the previous reporting period. Overall, contacts indicated that their capital spending plans for 2008 called for modest gains over expected spending in 2007, and few firms budgeted cutbacks. Freight hauling ran above seasonal norms during September, but one shipper said the first days of October were soft. Changes in labor market conditions were mixed by industry and location. Tool manufacturers continued to try to expand their payrolls, though several said they were struggling to find qualified workers. A trucking firm began to offer mileage guarantees and more generous time-at-home policies in order to attract drivers. Retailers in Illinois were cautious in hiring, and many planned to use a greater-than-normal proportion of temporary workers during the upcoming holiday season. A staffing firm reported that billable hours in District states continued to decline modestly from year-ago levels, and it expected this trend to persist in the near-term.

Construction and Real Estate

Residential construction and home sales continued to weaken in most areas of the District. Contacts said that tightening credit for jumbo mortgage loans has contributed to the declines in local housing markets. Builders added price discounts and incentives, though one said the strongest incentives were aimed at potential buyers of mid-range homes. Showroom traffic became more sporadic throughout the District. Builders' cancellations began to edge up again, with many customers forced to withdraw from contracts after failing to sell their own home. Construction material shortages abated because of the slowdown in building. Looking ahead, a contact from Wisconsin projected building conditions in the area would be little changed until the end of 2008. The pace of nonresidential development continued to be steady. One contact reported concern about the decrease in absorption rates from last year. In the Chicago area, office rents increased from the last reporting period, and in the suburbs office vacancy rates rose. Contacts from across the District noted that the recent volatility in financial markets has decreased the financing available for nonresidential development projects.

Manufacturing

Manufacturing expanded at a similar pace as in the previous reporting period. Manufacturers in a number of industries continue to report strong demand from abroad; this included producers of machine tools, heavy equipment, and steel. Domestic demand for agriculture machinery continued to be robust, and shipments of mining and oil and gas extraction equipment remained strong. In contrast, sales to domestic customers of other heavy

equipment, particularly construction machinery, continued to trend lower, and one analyst said there was heightened uncertainty about the outlook for both residential and nonresidential construction. There was some moderation in sales of machine tools to domestic customers, though as one contact described it, the pace of activity was still "wild." Automakers maintained modest expectations for light vehicle sales; one noted that the slowdown in housing markets was a significant risk for the industry, even bigger than rising oil prices. One automaker said that additional production cuts were likely at the end of this year or early next. Steel producers described domestic demand as soft but stable; still, one steelmaker noted that domestic producers were gaining market share because foreign producers were cutting back their shipments to the U.S. and opting to sell in markets with relatively stronger prices. Steel inventories continued to move lower. Capacity utilization of gypsum wallboard continued to fall, and one contact expected declines to continue into 2008, coinciding with a protracted decline in homebuilding.

Banking and Finance

Household lending declined modestly on balance. Applications for home equity lines of credit were down notably and lines outstanding were lower as well. One banker attributed the trend to both moderating home prices and tighter credit standards. Demand for mortgage refinancing was stable as most borrowers faced higher rates. New mortgage originations continued to trend lower, and lenders were tightening standards and approving fewer applications. Mortgage credit quality deteriorated modestly as delinquency rates for both first and second mortgages increased. Business lending edged higher. One bank noted that its customer base has been "utterly unaffected" by credit market dislocations. Business credit quality remained favorable overall, however quality deteriorated for homebuilders. Standards and terms of commercial loans were little changed. One bank said it was disappointed in the results of its efforts to increase pricing on its loans in the wake of recent credit market disruptions.

Prices and Costs

Overall wage and cost pressures were similar to those in the previous reporting period. Manufacturers indicated that input costs were generally stable. One said they were "not happy" about the price of oil and that some suppliers have been considering, but not yet implementing, energy surcharges. A steelmaker expected steel prices to stabilize in the coming months. Wallboard prices continued to fall in line with the decline in residential construction. In contrast, a toolmaker said it was able to implement price increases. A nationwide retailer said wholesale prices were moving higher but it was limiting the passthrough to consumers; and a restaurant chain said it had not implemented any price increases during the reporting period. A staffing firm reported that its pay rates rose at a steady pace.

Agriculture

Harvesting in the District was ahead of the normal pace at the end of the reporting period, and a record corn crop is almost assured. Contacts reported above-average, though not record, corn and soybean yields in Iowa and Illinois. Yields in Indiana, Michigan, and Wisconsin were less affected by a summertime drought than had been anticipated by some observers. With soybeans drying too fast, many farmers reversed the normal order and harvested soybeans before corn. Transportation and storage problems emerged due to the size and speed of the harvest. The problems were compounded by movement of crops harvested in 2006. In addition, currently, cash prices for both corn and soybeans are enough lower than futures prices that farmers have a big incentive to store crops until 2008. Rail and truck

transport has been slow when available, and storage bins reported that labor was in tight supply. Large export sales helped boost corn and soybean prices during the reporting period. Milk and cattle prices were up; hog prices were down, as meatpackers have been cutting back their purchases in the spot market.

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Eighth District--St. Louis

Economic activity in the Eighth District expanded moderately since our previous survey. Reports from manufacturing contacts were generally positive and contacts indicated that the services sector continued to expand. Home sales and residential construction remained weak throughout most of the District, but conditions in commercial real estate markets continued to be positive. Lending at a sample of small and mid-sized District banks increased from mid-June to mid-September.

Manufacturing and Other Business Activity
Manufacturing activity increased slightly since our previous survey. Several manufacturers reported plans to open plants and expand operations in the near future, while a smaller number of contacts reported plans to close plants and reduce operations. Major hiring occurred in the motor vehicle parts manufacturing industry with the opening of new facilities. Firms in pharmaceutical and medicine manufacturing, transportation equipment manufacturing, food manufacturing, and fabricated metal manufacturing also reported plans to open new facilities in the District and hire workers. Contacts in the transportation equipment manufacturing industry reported plans to hire additional workers. In contrast, contacts in the household appliance manufacturing, wood product manufacturing, and furniture manufacturing industries reported plans to lay off workers and decrease operations. A firm in the chemical manufacturing industry eliminated jobs in order to close a plant in the District.

The District's services sector continued to expand in most areas. Contacts in the business support services and air transportation services industries announced plans to expand facilities and hire additional workers. Retail sales were strong, fueled by back-to-school shopping, despite escalating credit problems and a weak housing market. Auto sales were fairly steady in September compared with the same period last year.

Real Estate and Construction
Home sales continued to weaken throughout the District. Compared with the same period in 2006, August 2007 year-to-date home sales increased 1.4 percent in Louisville but declined 3 percent in Little Rock, 7.4 percent in greater St. Louis, and 13 percent in Memphis. Residential construction continued to decline throughout the District. August 2007 year-to-date single-family housing permits fell in all major metro areas compared with the same period in 2006. Permits declined 5 percent in Louisville, 20 percent in Little Rock, 24 percent in St. Louis, and 34 percent in Memphis.

Commercial real estate market conditions were mostly positive throughout the District. Contacts in Evansville, IN, reported that commercial construction appears to be holding steady but that investors are more cautious. Contacts in Little Rock reported that the number of new commercial construction permits for year-to-date August 2007 was up from the same period in 2006. Contacts in Louisville reported that strong industrial construction will

increase vacancy rates in the near term. Contacts in Memphis reported that a large steel mill expansion project is underway there.

Banking and Finance
Total loans outstanding at a sample of small and mid-sized District banks increased 2.1 percent in the three-month period from mid-June to mid-September. Real estate lending, which accounted for 75.1 percent of total loans, increased 2.6 percent. Commercial and industrial loans, accounting for 16.6 percent of total loans, increased 1.0 percent. Loans to individuals, accounting for 4.2 percent of loans, fell 6.9 percent. All other loans, which accounted for 4.1 percent of total loans, increased 7.0 percent. Over the same period, total deposits at these banks decreased 4.0 percent.

Agriculture and Natural Resources
Recent dry weather throughout most of the District provided good conditions for harvesting crops. The overall harvest of corn is ahead of its normal pace by more than 50 percent; soybeans are ahead by about one-third; sorghum is ahead by almost 10 percent; cotton is ahead by about 75 percent; and rice is ahead by nearly 5 percent. Since our previous survey, crop conditions improved in most states, although more than half of Tennessee's corn and soybean crops and Kentucky's soybean crops were in poor condition. Yield estimates of corn, sorghum, and rice in all District states stayed the same or increased from August to September. However, estimates of soybean yields in Illinois, Indiana, Kentucky, and Tennessee, estimates of cotton yields in each of the District's cotton-growing states and estimates of tobacco yields in Kentucky and Tennessee declined.

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Ninth District--Minneapolis

The Ninth District economy grew modestly since the last report. Growth was noted in tourism, services, manufacturing, energy, mining and agriculture. Consumer spending and commercial real estate growth slowed, while commercial construction was steady. Residential construction and real estate continued to weaken. Employment growth was mixed, with tightening conditions in Montana and the Dakotas, but with unemployment rates higher than a year ago in Minnesota and Wisconsin. Overall wage increases were moderate, while prices increased for diesel fuel and decreased for gasoline and lumber.

Consumer Spending and Tourism
Consumer spending increased at a slower pace than the previous report. A major Minneapolis-based retailer reported it expects same-store sales to increase about 2 percent in September compared with a year ago, down from an earlier forecast of a 4 percent to 6 percent increase. Car sales in North Dakota were relatively steady across the state, according to a representative of an auto dealers association. In contrast, September sales at a North Dakota mall were up about 7 percent compared with a year ago, according to the manager.

End of summer tourism activity increased from last year. Several South Dakota tourism-related businesses reported activity up anywhere from 5 percent to 10 percent, according to an official. Late summer and fall tourism activity was up from last year in northwestern Wisconsin; an official noted that travelers were staying closer to their homes. A representative of a travel company based in Minnesota noted that business travel was up about 5 percent year-to-date through September compared with the previous year.

Services
Contacts from professional business service firms were upbeat. Planning consultants in Minnesota noted strong demand from city and county governments. An architectural design firm noted that despite the downturn in residential real estate, other areas continued to grow. Several accounting and actuarial firms planned to expand staff and space due to increased demand.

Construction and Real Estate
Commercial construction was steady. A Minneapolis commercial developer said activity was up recently, but is expected to decrease as inventory grows. A number of large retailers have recently built or announced plans to build locations in the Rochester, Minn., area. September commercial permits in Sioux Falls, S.D., were up 13 percent in value from the previous year. Residential construction remained slow. The value of permitted units in the Minneapolis-St. Paul area was down 38 percent in August from a year earlier. In contrast, a representative of a western Montana builders' association described recent activity there as consistent with recent strong years. In Sioux Falls the value of new residential construction in September was down slightly from the previous year.

Commercial real estate softened. Contacts in Minneapolis-St. Paul indicated new leasing activity appeared to be down for office space and flat for industrial, while retail vacancy continued to be high. Retail vacancy was also a growing concern for contacts in Fargo, N.D., and Sioux Falls, but other segments of the market in those areas were robust. Residential real estate markets experienced continued sluggishness. Pending sales in early September were down 15 percent from the previous year in Minneapolis-St. Paul. Realtors in Michigan's Upper Peninsula reported mostly slower sales, with the exceptions of the Marquette area and the second home market. However, in Fargo, closed sales in September were up about 6 percent from the previous year, and Sioux Falls Realtors were having another record year.

Manufacturing
The manufacturing sector grew since the last report. A September survey of purchasing managers by Creighton University (Omaha, Neb.) indicated increased manufacturing activity in Minnesota and the Dakotas. A Minnesota metal fabricator plans to increase investment in plant and equipment due to strong sales and rising exports. In North Dakota, an agricultural equipment plant saw a large increase in demand. In western Wisconsin, a manufacturer that supports the oil and gas industry and a machine maker are both expanding investment in plant and equipment due to robust demand. However, the slump in wood product manufacturing and other producers that support the housing industry continued across the district.

Energy and Mining
Activity in the energy and mining sectors grew since the last report. Oil and gas exploration and production in the District continue at a strong pace. Several alternative energy projects are planned or are under construction. Most mines continue to operate at near capacity and are investing in additional equipment.

Agriculture
Strong agricultural conditions were reported across the District. The harvest was ahead of schedule for major District crops and planting of winter wheat had begun. A near record crop of cranberries was expected in Wisconsin. The U.S. Department of Agriculture increased its

yield estimates for corn and soybeans. Estimated small grain yields in Montana were larger than a year ago. In addition to strong yields, high prices for many crops were driving up estimated agricultural revenues.

Employment, Wages, and Prices
Employment growth was mixed. Labor markets generally continued to tighten in Montana and the Dakotas, but unemployment rates were higher than a year ago in Minnesota and Wisconsin. In addition, August nonfarm employment growth was stronger in Montana and the Dakotas (above 2 percent) compared with Minnesota and Wisconsin (below 1 percent).

A bank director and an economist noted that many employers in Montana were having difficulty filling low-skill jobs. A staff person in a municipal human resources department described the job market as the tightest in the past 15 years, while a medical claims processing company and an Internet printing service business each plan to add about 100 new employees in Montana. Representatives from a temporary employment agency in the health care sector noted difficulty finding quality workers in Sioux Falls.

In Minnesota, a medical devices company recently announced plans to eliminate several jobs. August seasonally adjusted initial claims for unemployment insurance in Minnesota were 7 percent higher than a year earlier. A temporary staffing agency survey of Minneapolis-St. Paul businesses showed that 44 percent of respondents expected to hire workers during the fourth quarter, while 24 percent expected to reduce staff. In last year's survey, 36 percent expected increased hiring and 11 percent anticipated decreases.

Overall wage increases were moderate. After a 13-day strike, clerical, health care and technical workers at the University of Minnesota agreed to annual raises of 2.25 percent to 2.5 percent for two years.

Price increases were generally modest. However, early October diesel fuel prices in the Midwest increased almost 20 cents since the last report and were 60 cents higher than a year ago. In contrast, Minnesota gasoline prices at the beginning of October were about 30 cents lower than early September and just slightly higher than a year ago. Hardwood and softwood lumber prices decreased since the last report.

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Tenth District--Kansas City

The Tenth District economy expanded at a more modest pace in September than in the previous survey period. Consumer spending slowed, although tourism and travel remained solid. Manufacturing activity expanded at a slower pace and inventory levels fell. Residential real estate activity weakened further, but commercial real estate activity was solid. Energy activity remained strong heading into the winter heating season and agricultural contacts anticipated record farm incomes with high prices and bumper crops. Bankers reported softer loan demand and tightened credit standards amid weaker loan quality. Most price pressures eased slightly. Contacts reported less intense wage pressures and labor market growth has moderated.

Consumer Spending
Consumer spending eased slightly in September though contacts generally expected sales to strengthen as the holiday season approaches. After rising in the last survey period, retail sales

leveled off and inventories were relatively stable. Apparel, jewelry, and sporting goods sold well, while sales of home-related items remained weak. Auto dealers reported a modest decline in sales with lower demand for large SUVs and trucks, though sales of fuel efficient cars remained solid. Some auto dealers noted the use of incentive and discount programs and expected such programs to continue. Following a robust summer season, tourism activity was higher than expected. Some resort areas attributed an increase in local tourists to higher gasoline prices that restricted travel. Airport passenger traffic, hotel occupancy rates and average daily hotel room rates remained high compared to last year. Restaurants reported flat sales since the last survey period amid rising input costs.

Manufacturing

Growth in manufacturing activity slowed and factories cut inventory levels. After rebounding further in August, production, shipments, new orders, and exports rose slightly in September, but manufacturers remained optimistic about future activity. Factories cut inventory levels during the month and expected further reductions going forward. Employment levels held steady and the lack of qualified workers remained an issue for some firms. Plant managers reported that financial market conditions have had little impact on capital spending plans. Capital spending remained solid in September and contacts indicated that future spending plans remained in place to meet expected sales growth and to ease capacity constraints.

Real Estate and Construction

Residential real estate activity declined further, while commercial real estate activity remained steady. Home sales weakened in September and were expected to slow further due in part to typical seasonal trends. Realtors reported that home prices were flat to down slightly and inventories of unsold homes rose in most major markets. District contacts reported demand for low to mid-priced homes remained strong, but sales of higher priced homes were weak. Commercial real estate sales activity was steady with a slight uptick in prices. The pace of construction eased slightly and the value of non-residential construction put in place edged down, except in the District's energy producing regions where activity remained robust. Developers reported more stringent credit standards and expected credit availability to remain tight. Office vacancy rates were stable and absorption rates declined compared to the last survey period. Rent values remained higher than year-ago levels and were expected to rise.

Banking

Bankers reported weaker loan demand, tighter credit standards, and a rebound in deposits since the last survey. Demand for residential real estate and C&I loans fell moderately. Commercial real estate loan demand also declined modestly, but demand for consumer installment loans strengthened further. Overall loan quality declined slightly and contacts expected further deterioration over the next six months. As a result, banks tightened credit standards, especially for commercial and residential real estate loans. Some banks cited a weaker outlook for the economy and local real estate markets, while others attributed the tightening of standards to a reduced tolerance for risk. Bank deposits expanded moderately in September on the strength of money market accounts and short-term CDs.

Energy

District energy activity held at relatively high historical levels in September. Energy demand was expected to strengthen with the winter heating season. However, fewer contacts expected to expand drilling activity or workforce levels during the winter. The lack of qualified workers was less of a concern for energy producers in the current survey. More District

contacts reported that a lack of equipment and services was constraining drilling activity. District coal production and Power River Basin coal prices strengthened in September. Some ethanol producers idled expansion plans with lower ethanol prices and higher corn prices trimming profits.

Agriculture
Agricultural conditions were favorable as fall harvest activity began. Crop producers were set to harvest a bumper crop this fall, straining existing crop storage capacity. The fall harvest was on schedule with record corn yields projected in many areas for both irrigated and non-irrigated fields. The soybean harvest was underway and winter wheat planting was progressing. Unlike the usual seasonal pattern, crop prices have risen this fall, pushed up by unusually low global crop inventories. Record farm incomes were expected as bumper crops are sold at high prices. Strong export demand continued to support livestock prices and improved pasture conditions aided cattle weight gains. Farm credit conditions strengthened further, fueling investment in farm equipment.

Labor Markets and Wages
District labor markets remained tight in September, although the pace of new job growth slowed and wage pressures eased slightly. Hiring announcements outpaced planned layoffs with most job gains projected in the technology, service, and gaming industries. Demand for skilled workers remained strong, most notably for engineers and mechanical technicians. District contacts in the retail and hospitality industries reported difficulty retaining entry level staff and some were filling positions with temporary workers. Despite labor shortages, wage pressures softened since the last survey, and fewer contacts expected to raise wages in the near future.

Prices
Retail and wholesale price pressures held steady and were expected to ease in coming months. Retailers reported that prices were mostly unchanged in September and most expected selling prices to remain flat. The share of manufacturers reporting higher raw material and finished goods prices held steady and expectations for higher input and output prices softened. Nevertheless, raw material prices remained high with higher prices concentrated in the food sector. Food processors reported paying higher raw material prices and restaurants anticipated raising menu prices in response to higher food and delivery costs.

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Eleventh District--Dallas

The pace of economic activity in the Eleventh District decelerated in September and early October. The economy is still digesting a reassessment of lending standards and slow down in homebuilding and residential real estate, but there continues to be little evidence that this is significantly affecting the broader District economy. The settling of financial markets has spurred some optimism among our business contacts. Retail sales improved. The service sector expanded at roughly the same moderately strong pace as the last Beige Book. Manufacturing activity decelerated. Energy activity and commercial construction are still robust. Consumer lending softened, but commercial lending is still expanding. Agricultural conditions improved.

Prices

There continued to be upward price pressures, particularly from food, energy and transportation. Declines in the value of the dollar and high shipping costs have made imported goods more expensive.

The price of West Texas Intermediate crude oil rose from near $70 per barrel in mid-August to over $80 per barrel in recent days. Diesel fuel prices moved over $3 per gallon, but retail gasoline prices have remained fairly steady. Natural gas prices have risen seasonally. Prices are higher for most chemicals. Most food product prices are up--some substantially--including those for wheat, corn, milk, cheese, shortening, flour and bread.

Many manufacturers reported high or rising input costs, and selling prices are up for some products, such as paper. Softer demand has restrained upward pressure on selling prices for most products used in residential construction. There is downward pressure on real estate prices.

Business service firms reported rising fees. Shipping costs are up, and airlines are raising fares. Retailers say declines in the value of the dollar are putting upward pressure on many products because most are imported or include imported components, but competitive pressures are restraining increases in selling prices. Auto dealers say real selling prices have fallen because manufacturers have added features to vehicles without raising prices.

Labor Market

The labor market remains tight, and wages are rising. Some contacts reported difficulty hiring and retaining entry level workers. Firms reported difficulty finding accountants, IT specialists, engineers, mechanics, welders and workers to supply the energy industry and commercial construction. A temporary service firm said they are running television advertisements to attract workers. There continued to be complaints that stricter immigration enforcement and increases in the minimum wage are pushing up wages.

Manufacturing

Manufacturing activity decelerated. Sales of food products weakened considerably, which contacts attributed to higher food prices. Sales of corrugated boxes to retailers are up but decreased to manufacturers and firms involved in construction. Producers of recycled paper report steady activity. Transportation manufacturers report solid demand, particularly to supply specialized equipment to oil and gas firms.

Demand continues to soften for products related to residential construction, such as lumber, cement, tile and brick. Contacts with national sales say demand from Texas builders is stronger than from the rest of the country. Sales are still strong for products used for building luxury homes and commercial construction. Primary and fabricated metal producers say large commercial projects are keeping activity unchanged overall, despite slowing in homebuilding and smaller commercial projects.

Activity in the high-tech sector is mixed. Domestic demand for manufacturing equipment has slowed because some factory production is moving overseas. Growth in orders for semiconductors is stable to slightly up, buoyed by very strong growth in demand from Asia.

Refinery utilization held at rates over 90 percent, except for precautionary closures and power outages following a hurricane. Domestic demand for chemicals is weak, but exports remained strong.

Services
Accounting, legal and temporary staffing firms reported little change in demand over the past six weeks. Demand remained particularly strong from the energy industry and continued to slow for real estate-related activity.

Overall shipping firms reported a slight increase in volume. Imports have decreased, but exports have increased considerably. Railroads say shipping activity is near capacity but slightly below a year ago. Shipping of products for housing construction continued to weaken. Transport of food and energy products grew but at a slower rate. Airlines continued to report steady traffic and solid bookings.

Retail Sales
Most retailers said sales picked up in September--after being weaker than expected in August--but are still below year ago levels. Sales were particularly good in Houston, and many national retailers said Texas growth was stronger than the nation. Consumers continued to feel the stress of high gasoline costs, according to contacts, and sales of discretionary items remained weak, with the exception of electronics. Despite a small seasonal slowdown, dealers reported increased stability in auto sales. Sales of used cars, parts and services have also held up fairly well over the past few weeks.

Construction and Real Estate
Housing demand and markets continued to soften, particularly for lower priced homes. Builders are curbing construction, and new home inventories are starting to decline. Softer demand has led to a recent increase in existing home inventories, however, causing contacts to push out their forecast for recovery of the housing sector to 2009. Home prices are unchanged, but builders are offering more incentives. Apartment demand picked up, and rental rates increased, causing contacts to be a bit more optimistic. Still, there is concern that competition from rental housing will increase when the peak of adjustable rate mortgage resets occur in 2008.

Office demand is positive, but the pace slowed. Commercial construction activity is robust due to projects underway and planned. Although rents are rising, they are expected to slow with slower absorption. Investment activity was still restrained. Contacts said larger deals are harder to finance and investors are re-evaluating risky deals. Industrial demand continued to rise at a steady pace.

Financial Services
Consumer lending softened noticeably over the past few weeks, but contacts said the slowing was less than expected and some slowing of mortgage and automobile lending was seasonal. Respondents blamed consumer weakness on increased uncertainty and problems with subprime mortgages. Lenders remain concerned that ripples from a slowing national economy will dampen activity, but calming of financial markets has spurred cautious optimism. Commercial lenders say credit quality is still good, pricing remains competitive and deposits are difficult to attract and retain. Commercial lenders are optimistic that growth will continue, and expressed some relief that prudent caution and rationality has returned to lending.

Energy
Energy activity is still robust, but the rig count remains flat. Some producers have expressed concern about the potential for low natural gas prices and have announced cuts in high-cost

drilling. Others have expressed confidence and are moving forward. International drilling continues to grow and is cited as a major source of strength to oil service companies.

Agriculture
Warm weather repaired some rain damaged crops, and yields have improved to above average levels. Near record corn production is beginning to cause storage problems. Higher fuel, fertilizer, machinery and seed costs remain a concern. Cattle producers also report higher expenses. Demand for beef is strong, however, and prices are high. Range and pasture conditions are excellent.

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Twelfth District--San Francisco

The Twelfth District economy continued to expand during the survey period of September through early October, but it showed signs of further deceleration relative to the previous survey period of July and August. Price inflation was modest with the exception of substantial increases in food prices, and increases in labor compensation were moderate on net but remained rapid for selected groups of skilled workers. Sales by retailers and service providers continued to grow, but the pace of growth slowed slightly. Manufacturers and agricultural producers saw further gains in output and sales. Tighter lending standards took a toll in housing markets, exacerbating existing weakness in that sector, but demand for commercial real estate remained solid. Banks noted slower growth in overall lending activity and a larger drop in new residential mortgages than was evident in prior survey periods.

Wages and Prices
District contacts reported that price inflation was modest in general, with the primary exception of continued rapid increases in food prices. Contacts in a few areas noted that construction costs have fallen because of lower prices on selected raw materials, including wood, wallboard, and cement. Rapid price increases continued for dairy products, corn, and wheat, and the inflation rate for final prices on various foods ranged from 3 to 4 percent in most cases to as high as 7 percent for some products.

Wage pressures were moderate on net, with contacts noting only small changes in overall labor costs. Wage pressures continued to ease in Southern California because of slight loosening in labor markets this year. In many parts of the District, compensation growth remained rapid for skilled workers in finance, engineering, marketing, and some other specialized fields.

Retail Trade and Services
Reports on retail sales suggested growth on balance but at a slower pace than in the last few survey periods. Sales slowed slightly at department stores and inventories rose a bit as a consequence; luxury goods continued to perform better than lower-priced items. Demand for home furnishings fell further as the slowdown in housing markets intensified. Sales of new automobiles were reported to be sluggish, especially for domestic makes, although demand for used vehicles remained strong.

Reports from service industries indicated slightly slower demand growth than in the last few survey periods. Sales decelerated for advertising agencies and providers of media services, as weak demand for automobiles and home furnishings held down advertising expenditures by manufacturers and retailers in those sectors. Demand growth for professional services, such

as accounting and consulting, also slowed. Tourism activity was mixed but positive on net; reports from Las Vegas suggested continued solid growth, while tourist visits and hotel occupancy rates have fallen slightly in Hawaii but remained high by historical standards.

Manufacturing
Demand for products manufactured in the District grew further during the survey period of September through early October. Production activity and new orders remained very strong for makers of commercial aircraft and their suppliers. A manufacturer of industrial equipment in the Pacific Northwest reported solid sales gains and a backlog of work through the fourth quarter of this year. Demand for information technology products continued to grow at a moderate pace; semiconductor inventories were balanced and prices firmed somewhat following a sharp drop earlier this year. Sales growth remained robust for food manufacturers, while apparel makers saw largely stable demand and inventories.

Agriculture and Resource-related Industries
Agricultural producers reported further demand growth and limited supply constraints. Sales of various fruits, nuts, and vegetables were strong in volume terms, and prices generally remained stable. Some contacts noted that high grain prices have increased supply costs and posed a challenge for livestock herding, but cattle inventories were reported to be steady. Availability of agricultural labor was mixed, with shortages reported in Idaho but higher availability and a reduction in upward wage pressures noted in Arizona.

Real Estate and Construction
The slowdown in District housing markets intensified during the survey period, while demand remained strong in commercial real estate markets. Tighter lending standards for home mortgages contributed to further reductions in sales of new and existing homes in most areas. Reports from providers of title and escrow services indicated that sales activity fell as much as 40 percent in some areas during the last few months. The reduced pace of home sales has reportedly restrained price growth throughout the District, particularly for lower-priced homes, which have been most affected by changing credit terms and conditions in the subprime-mortgage market. In contrast to housing markets, demand for commercial real estate advanced further, and positive absorption continued in most areas despite the availability of substantial new construction. The main exception to strong conditions for commercial real estate was in Las Vegas, where the market for office space was described as "soft" due to growth in newly built space that has outstripped demand.

Financial Institutions
District banking contacts reported that overall loan demand grew but at a reduced pace compared with the past few surveys. Reports on commercial and industrial lending and consumer lending suggested stability or modest growth during the survey period, although scattered reports pointed to a decline in loan volumes. The decline in mortgage lending deepened as a result of tighter lending standards for most types of mortgages and increased rates on "jumbo" mortgages. Delinquencies and defaults increased a bit further for home mortgages, but credit quality otherwise was described as quite favorable.

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