



September 5, 2007

## Summary of Commentary on Current Economic Conditions by Federal Reserve District

### Summary

---

Prepared at the Federal Reserve Bank of Cleveland and based on information collected before August 27, 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.

---

Reports from the Federal Reserve Districts indicate that economic activity has continued to expand. St. Louis and Kansas City described the pace of activity as moderate; Cleveland, Chicago and Minneapolis said their economies were expanding at a modest rate; and Boston and Atlanta reported that activity was mixed. New York cited continued expansion. The economies in Philadelphia, Richmond, Dallas, and San Francisco continued to grow; however, the pace of activity has slowed.

Most Banks reported that the recent developments in financial markets had led to tighter lending standards for residential mortgages, which was having a noticeable effect on housing activity, and several noted that the reduction in credit availability added to uncertainty about when the housing market might turn around. While several Banks noted that commercial real estate markets had also experienced somewhat tighter credit conditions, a number commented that credit availability and credit quality remained good for most consumer and business borrowers. Outside of real estate, reports that the turmoil in financial markets had affected economic activity during the survey period were limited.

Retail sales were generally positive, with increases characterized as modest to moderate. However, several Districts described motor vehicle and furniture sales as slow. Manufacturing activity expanded across most Districts, with reports of softening demand for building materials and autos. The weakness in the housing market deepened across most Districts, with sales weak or declining and prices reported to be falling or flat. Most Districts reported a continuing contraction in the residential mortgage market. Commercial real estate activity was generally stable to expanding. Demand for business loans held steady or weakened, while consumer lending was mixed. Agricultural conditions varied widely across Districts, with several reporting damage to crops and pastures as a result of excessive heat and drought conditions. Activity in the energy and mining sectors remained positive in all of the Districts reporting on these sectors. Nearly every District reported at least modest

increases in employment during the recent survey period. Most Districts characterized their wage increases as moderate or steady. Wage pressures were intense only in isolated professions in short supply. And most Districts reported little change in overall price pressures.

### **Consumer Spending and Tourism**

Districts generally reported modest to moderate increases in sales, although Boston, Cleveland, and San Francisco described retail sales as mixed. Dallas reported little change in consumer spending growth. Richmond reported that retail sales posted modest gains in July but pulled back sharply in August. New York, on the other hand, described July sales as somewhat below plan, but August sales as ahead of plan.

Furniture sales declined in Philadelphia, Richmond, St. Louis, and San Francisco while Boston experienced stronger sales. Merchants in New York and Chicago reported a slight pickup in sales of home furnishings. Retailers in Philadelphia, Richmond, Atlanta, and Kansas City noted solid-to-strong back-to-school sales. However, Chicago and Dallas reported difficulty comparing back-to-school shopping with last year because of school-year timing. Boston and Kansas City reported strong sales of apparel items while New York and St. Louis experienced mixed results. Some weakening in apparel sales was seen in Philadelphia, Cleveland, and Chicago.

Vehicle sales were described as slow or subdued in many Districts. Cleveland, Richmond, Atlanta, Chicago, St. Louis, Dallas, and San Francisco, all reported sluggish new vehicle sales. In contrast, auto dealers reported that sales increased modestly in Kansas City and picked up slightly in Philadelphia. Cleveland and San Francisco noted strength in used vehicle sales. Many auto dealers reported anxiety about future sales due to tighter household credit conditions.

Districts that commented on retail inventory levels generally described them as at or above desired levels. Several retailers reported that they planned to or had already heavily discounted merchandise to move inventory.

Most reports on tourism were positive, with the New York, Atlanta, Minneapolis, and Kansas City Districts reporting particularly solid growth in tourist spending. Minneapolis cited dry, warm weather for helping the tourism industry. Two Districts were less positive on tourism: San Francisco experienced slowing tourist activity and Chicago described a pessimistic outlook for the rest of the year despite a slight pickup in some parts of the District in August.

### **Services**

Reports on the service industry were generally neutral to positive. Several Districts posted strong gains in financial services, health care, information technology, and technical and professional services. Demand for legal services was stable or showed modest increases. Demand for transportation services showed signs of softening--Atlanta and Dallas reported decreased activity while Cleveland and Chicago cited no change. Reports from Boston, Richmond, Minneapolis, and Dallas indicated that the recent volatility in financial markets may slow down the pace of business activity.

### **Manufacturing**

Most Districts reported that manufacturing activity expanded during late July and early

August. New York, Richmond, Minneapolis, and San Francisco indicated solid growth. Philadelphia, Chicago, and St. Louis stated that manufacturing expanded but at a slower pace. Manufacturing was stable to increasing slightly in Cleveland, Kansas City, and Dallas, but was described as mixed in Boston and Atlanta.

The automobile and building materials industries showed weakness across most reporting Districts. Cleveland, Atlanta, Chicago, and Dallas all indicated that the auto sector had softened, though one report suggested that some of the reduction in production was related to model changeovers. Six Districts said that industries related to housing experienced weakness, including building materials and construction equipment.

Industries showing improved conditions varied markedly across Districts. High-technology manufacturing was strong in the Kansas City and San Francisco regions and showed steady growth in the Dallas District. A number of Districts reported steady to solid growth in aircraft and electrical equipment production and strength in exports. Chicago noted that some steel producers have started exporting steel regularly for the first time. Most Districts indicated that input price pressures held steady or rose modestly compared to the previous report. Expenditures for plant and equipment remained close to plan in Boston and Cleveland. Contacts in San Francisco reported that productivity improvements continued on trend in 2007. Looking forward, contacts in New York, Philadelphia, Richmond, and Kansas City expressed near-term optimism about business conditions in their sectors; reports from Cleveland and Dallas were somewhat more cautious.

### **Real Estate and Construction**

Residential real estate and construction weakened further in most Districts while the commercial market remained steady. Most Districts reported weak or declining residential sales and declining or stable prices. Markets in a few Districts did show some strength. Both sales and prices have been increasing in the Massachusetts housing market; the New York City apartment market remains tight as rents rise; and home sales rose in Louisville. Inventories of unsold homes are generally reported to be high. Moreover, contacts in Philadelphia, Cleveland, Richmond, Atlanta, Chicago, Kansas City, and Dallas believe softness in the market will continue in the near future, with potential for further declines.

Commercial real estate and construction markets were generally stable to expanding across the Districts. Philadelphia, Minneapolis, and San Francisco indicated continued expansion in nonresidential construction and commercial real estate. Dallas described the level of nonresidential activity as high, and St. Louis said commercial construction remained strong. New York, Cleveland, Richmond, Atlanta, Chicago, and Kansas City indicated commercial construction and real estate markets were steady or stable. Vacancy rates are reported to be low or declining in most Districts, and rents are rising modestly in many. Boston, New York, Richmond, Chicago, Kansas City, and Dallas noted some tightening of credit in the commercial real estate market.

### **Banking and Finance**

The demand for residential mortgages continued a downward trend in most Districts. Consumer lending softened in New York, Cleveland, Chicago, and Dallas, while St. Louis reported stable activity. In Philadelphia, personal loans increased on credit card lending. Looking forward, lenders in Dallas do not expect any further deterioration in consumer lending after the softening that was reported earlier in the year. Bankers in Philadelphia

continue to see growth in personal lending over the next few quarters, albeit at a slower rate than in the first half of the year.

More than half of the Districts reported a tightening in credit standards. Boston, New York, Richmond, Chicago, Kansas City and Dallas mentioned tightening for both residential mortgages and business loans, while financial institutions in Atlanta and San Francisco said tighter standards were aimed primarily at home mortgage products. Delinquencies in consumer loans and mortgages rose slightly in Cleveland, Atlanta, Chicago, and St. Louis, while New York reported no change in delinquencies across all loan categories.

Demand for business loans was steady or weakening in New York, Cleveland, Chicago, and St. Louis, while Philadelphia reported an increase in demand. Commercial real estate lending increased in Kansas City and was quite strong in San Francisco, where "some banks reportedly are approaching regulatory limits on loan concentrations for this segment."

### **Agriculture**

Agricultural conditions varied across Districts. High temperatures and drought conditions resulted in damage to crops and pastures in the Richmond, Atlanta, Chicago, and St. Louis Districts. According to some estimates, the drought could cost Georgia and Florida farmers over \$2 billion in lost production. Nevertheless, a report from Chicago indicated that even with unfavorable weather, the District was poised for a record corn harvest because farmers had planted more corn at the expense of soybeans. In the Dallas and San Francisco Districts, favorable summer rains boosted pasture growth and livestock conditions. Rains in the Kansas City District resulted in above-average wheat yields and improved growing conditions for corn and soybeans, which placed some downward pressure on crop prices. Further, livestock prices remained solid, although rising production costs trimmed margins for hog producers and cattle feedlot operators. In the San Francisco District, demand for agricultural products continued to grow, and supply conditions were largely favorable. Some agricultural contacts reported that pressures on input costs eased overall, but others noted that prices of feed grain increased further.

### **Natural Resources**

Activity in the energy and mining sectors remained positive as increases were observed in all Districts reporting on these developments. In Dallas, energy activity remained robust--domestic drilling has flattened out, while international drilling is growing and remained the primary source of strength for service companies. Kansas City reported stable drilling activity and expected increased activity heading forward. Cleveland's oil and gas producers reported production levels were flat to increasing slightly since mid-July. Both Cleveland and Kansas City cite the lack of qualified labor as a continuing strain on expansion. In the Minneapolis District, activity increased since the previous report, with mining production remaining at near capacity. The Atlanta District reported that Hurricane Dean did not have a significant impact on energy production along the Louisiana coast.

### **Labor Markets, Wages, and Prices**

Nearly every District reported at least modest increases in employment during the recent survey period. The lone exception was Chicago, which, instead, characterized employment conditions as mixed. Philadelphia and San Francisco made no statement characterizing overall changes in District employment. New York, Richmond, Atlanta, Minneapolis, and Dallas described their labor markets as tight. Nine of the twelve Districts reported that there were shortages of some skilled workers, including those in the information technology,

accountancy, legal, and health care professions. In addition, Kansas City noted shortages for workers with lower skills, such as housekeepers and waiters, while San Francisco reported that agricultural workers were in increasingly short supply. Staffing services firms reported more demand for temporary workers in several Districts (Boston, Richmond, and Dallas), but less demand in Cleveland. Several Districts reported declines in construction employment, though the San Francisco District reported that, in some areas, rising commercial construction has helped keep overall construction employment stable.

Though some Districts described employment condition as tight, most reported that wage increases were moderate or steady. Wage pressures were intense only in isolated professions in short supply. Several Districts also noted that costs of health care benefits continued to post large increases, although they were not accelerating.

Most Districts reported little change in overall price pressures. There was downward pressure on residential real estate prices across nearly all Districts. Three Districts--Boston, Philadelphia, and Dallas--reported lower lumber prices, while Atlanta reported that these prices stabilized. Three Districts noted discounting among retailers during the back-to-school selling season (New York, Philadelphia, and Dallas), while two others reported overall declines in retailers' prices (Richmond and Kansas City). However, higher food costs continued to be widely reported and were said to be putting upward pressure on grocery and restaurant prices.

 [Return to top](#)

## **First District--Boston**

For most first District businesses contacted in the second half of August, recent results are similar to the last few reports--some up, some down--but they express increased uncertainty looking forward. Many contacts report that turmoil in financial markets is obscuring their near-term outlook. Price pressures are said to have eased somewhat, while selected professional and technical workers remain in short supply.

### **Retail**

Retailers in the First District report mixed sales results during the summer months. Same-store sales ranged from low double-digit decreases to single-digit increases. Furniture, apparel and accessories, and computers were among the items that reportedly sold well.

Inventory levels are mixed, while headcounts are generally stable (except in connection with store openings). Capital spending is also varied, with several retailers reporting slight increases in spending levels because of acquisitions, store openings, and systems upgrades. Contrary to recent periods, most contacts cite decreased vendor price pressure, with the exception of paper and some metals. One contact says excess supplies of lumber have pushed prices down. Selling prices are generally stable.

Respondents are cautious though optimistic in their outlook; most expressed concern with consumer confidence going forward. While one retailer expects fallout from the current turmoil in financial markets to be manageable, another asked "will the consumer step up to the plate and keep shopping and buying?"

## **Manufacturing and Related Services**

Manufacturers and related services providers headquartered in the First District report that sales and orders have been mixed in the second and third quarters, largely depending on product line. Sales of housing-related equipment continue to run below year-ago levels, with no sign that a pickup will occur later this year (except for normal seasonal variation). A firm that sells equipment associated with the manufacture of consumer electronics detects signs that holiday-related production may be weaker than expected. However, sales of equipment related to transportation (other than autos), energy, and commercial building continue to grow at a robust pace. Several firms mention growth in foreign markets.

Most manufacturers describe materials costs as remaining stable. Some note dips in prices of natural gas, metals, and other commodities in the past several weeks. Selling prices are mostly holding steady, with any increases characterized as selective or only partially successful.

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. There are scattered reports of difficulties finding qualified applicants for factory jobs, or of increased turnover among selected professionals. Manufacturers' domestic capital spending patterns vary widely but are holding to plan.

Some manufacturers continue to expect "more of the same" for the remainder of 2007, while others indicate they have become more cautious or more watchful for signs of weakness than before the recent turmoil in financial markets. For example, several contacts mention that their customers' spending is likely to be held down as a direct result of tighter lending standards or a general reluctance to make discretionary purchases.

## **Software and Information Technology Services**

The majority of software and IT services contacts in the First District report mid-single-digit revenue growth for the most recent quarter. Respondents say demand from the banking and financial services industries was robust; demand for security and compliance technology also remains strong. Half of respondents are adding to headcounts in revenue-generating positions such as sales and consulting; the remaining half expect headcounts to be unchanged. Firms that are hiring report tight labor markets for software engineers. All contacted firms in this sector have raised (or plan to raise) pay in 2007, generally between 3 percent and 5 percent compared with 2006.

The majority of New England software and information technology firms are projecting revenues to continue growing at current rates. However, several contacts note that they are concerned about current financial market conditions and worry that this will "give customers pause."

## **Staffing Services**

Staffing respondents in the New England region report steady growth throughout the second quarter. Companies with Boston locations note a marked increase in local revenues, often citing it as their strongest location. Demand for temporary labor is outpacing permanent, which has flattened for all but two firms. Demand for high-end labor has increased the most, causing bill rates to rise. Indeed, both bill rates and pay rates are slightly higher for most companies, with one respondent reporting a 9 percent increase in bill rates from a year ago. On the supply side, firms cite a shortage of skilled labor, especially in legal, accounting,

consultant, engineering, secretarial, and executive administrative positions. Respondents report stabilizing costs; while healthcare costs are still rising, the rate of increase has slowed.

Contacts express concern with the impact of financial volatility on the staffing industry. One fears that demand for labor in the financial sector will decline, while another attributes the already perceptible slowdown in demand for permanent hires to the instability, as companies are less willing to commit to permanent positions when the economy is unpredictable. Nonetheless, all contacts have a positive outlook, expecting stable growth through the end of the year.

### **Commercial Real Estate**

Mirroring the general unrest in credit markets, commercial real estate markets in New England are said to be experiencing a significant tightening of credit. One contact reports that some primary lenders in Boston stopped lending altogether a few weeks back; while they are back in business now, spreads are up sharply. Respondents expect that, with the stricter requirements lenders have been demanding, sales activity will experience--in one contact's words--"a major disturbance" in the near future, despite the fact that underlying fundamentals in the region's commercial markets appear relatively robust. One contact expects the biggest impact to fall on sales of retail buildings and multi-unit apartment buildings. Respondents say there is already evidence of significant downward pressure on prices.

Across the region, office rents have been either flat or increasing in recent months, with vacancy rates either flat or declining. Boston has seen some significant increases in rents for new, Class A office space and in some suburban properties that rent to the biotech sector. Vacancies hover around 10 percent or less downtown. In the rest of the region, rents and vacancies have been stable, with vacancies in the single digits in some regions of Connecticut and Rhode Island.

Respondents say upward pressure on rents should ease as sales prices soften from recent highs, but rents are mostly expected to hold steady. Some contacts see downside risks to rental demand, based on the possibility of economic slowdown. Some new inventory is expected in the region, but may take a year or more to come on line; in the meantime, vacancies are expected to decline slowly. The region's smaller markets expect less fallout from a commercial real estate downturn because fewer risky deals were made, while a Boston contact predicts a rise in defaults around 2009 as balloon payments come due.

### **Residential Real Estate**

Home-sellers say the Massachusetts residential real estate market performed fairly well in July. The Massachusetts Association of Realtors reports sales rose 6 percent and the median sales price of single-family homes increased 1.3 percent compared to July 2006. Condominium sales remained almost steady year-over-year, while median condo prices increased 6.3 percent over the same period. Furthermore, supply has decreased to what contacts consider to be "balanced" levels, 8.6 months for both single-family homes and condominiums, down from more than 10 months in 2006.

However, this moderate improvement was not shared throughout the region. A Connecticut contact reports decreases in sales volume and steady prices, while respondents in New Hampshire, Rhode Island, and Maine indicate markets remain soft. In New Hampshire, the

median sales price dropped 1.5 percent year-over-year in July, as sales dropped about 12 percent. Single-family sales volume in Rhode Island declined 6.3 percent year-over-year in the second quarter, while the median price decreased 1.7 percent.

Contacts note that currently available data do not reflect the effects of the most recent developments in financial markets and express concern about potential fallout. Several contacts note that widespread news reports of tighter lending standards and increased foreclosures may drive away some potential home buyers.

 [Return to top](#)

## **Second District--New York**

The Second District's economy has continued to expand since the last report, while price pressures have been stable. Housing markets remain mixed: as in the last report, New York City's apartment rental and purchase markets are both tight; however, the sales market in surrounding suburbs, as well as much of upstate New York, has stayed sluggish. Office markets in the New York City area are described as steady since the last report. Bankers' reports received in late August reveal some further weakening in loan demand--particularly for consumer loans--as well as some further tightening in credit standards, but little or no change in delinquency rates. The labor market remains tight and hiring activity is characterized as steady and strong; overall, businesses in the District continue to expect a modest increase in their employment levels, on balance, over the next six months. Manufacturers report ongoing expansion in activity in July and August; while they note some leveling off in selling prices, a sizable proportion still plan to hike prices over the next six months. Tourism has continued to expand briskly. Retailers indicate that sales were slightly below plan in July but on or ahead of plan in the first half of August; inventories are said to be at favorable levels, and selling prices are reported to be steady.

### **Consumer Spending**

Retailers report that sales were somewhat below plan in July, but somewhat ahead of plan in the first half of August. New York City continued to out-perform the rest of the region in terms of 12-month sales growth. Sales of home furnishings and equipment, though still fairly sluggish, are reported to have picked up somewhat recently. Apparel sales were mixed. Inventories were reported to be in good shape, though contacts indicate that discounts to clear out summer clearance merchandise were a bit steeper than usual. Overall, selling prices have remained steady.

Tourism activity in New York City has continued to expand briskly since the last report. Hotels remained at close to full capacity in July and early August, with room rates running 10 to 15 percent higher than a year ago. Broadway theaters report increased strength in business in July and early August, with attendance up 10 percent and revenues up 15 percent from a year earlier--a bit stronger than in recent months.

### **Construction and Real Estate**

Commercial real estate markets across the New York City area were steady in July and early August. Manhattan's office building purchase market remains strong, though some tightening in credit standards has put moderate downward pressure on prices; still a contact at a major commercial leasing firm notes that purchase prices remain well ahead of this time last year. Manhattan's office rental market remains particularly tight: vacancy rates were



steady near cyclical lows at the end of July, and asking rents were up 30 to 40 percent from a year earlier--about the same as in recent months. Leasing activity has slowed somewhat, but this is attributed, in part, to a dearth of available space. Office markets in the rest of the New York City area are also characterized as stable in July, though a good deal more slack than Manhattan's--particularly in northern New Jersey (except for Jersey City, where the market is fairly tight). Asking rents in these suburban markets are generally little changed from a year earlier.

Housing markets have remained mixed since the last report. New Jersey homebuilders report that the market has taken on a weaker tone in recent weeks--largely attributed to nervousness among buyers and somewhat tighter mortgage lending standards. Sales are reported to have slowed more for existing than new homes, reflecting sellers' reluctance to lower asking prices. New York State Realtors report that the median selling price for existing single-family houses was down 5 percent from a year earlier in July, while the number of transactions slipped 2½ percent.

In New York City, however, market conditions remained strong in July and early August, with no contacts reporting any significant impact, thus far, from the recent developments in financial markets. Sales of Manhattan apartments were brisk in July, while prices were reported to be steady to up about 5 percent from a year ago. Real estate contacts report no discernible weakening in the market in recent weeks; however, August is typically a quiet month and, thus, difficult to gauge. The number of listings (inventory) has declined fairly steadily since the start of the year and remained low through the first three weeks of August. One contact does report a steady increase in the volume of foreclosures over the past year but from very low levels. New York City's rental market remained especially tight in Manhattan as well as nearby areas: two contacts report that rents are up 10 to 15 percent from a year ago on market-rate apartments; moreover, the inventory of units on the market (vacancy rate) remains exceptionally low, especially for larger units. Contacts indicate that demand remained brisk in the first three weeks of August.

### **Other Business Activity**

New York State manufacturers report sustained expansion in business activity in July and August. Contacts continue to express widespread optimism about the six month outlook and plan to increase employment modestly, on average, in the next six months. Manufacturers indicate ongoing moderate increases in input prices but little change in selling prices. In general, non-manufacturing firms in the district again report moderate expansion in general business activity, but express somewhat less optimism about the general business outlook, and have reduced their hiring and capital spending plans somewhat since the last report.

A major New York City employment agency, specializing in office jobs, reports that the labor market has remained tight in July and the first half of August, and that hiring activity by its clients--dominated by legal and financial firms but not including mortgage lenders--has shown no signs of slowing since the last report. Wages are reported to be steady, after sharp escalation earlier this year, but are still up quite a bit from a year ago. There is a persistently short supply of qualified workers.

### **Financial Developments**

Based on our latest survey of Second District banks, conducted from August 20th to 22nd, respondents generally report weaker demand for loans--particularly consumer loans, where close to 40 percent indicate weakening demand. There are also further declines reported in

demand for home mortgages. Banks, on net, report some tightening in lending standards in all categories, but more on commercial loans and mortgages than on the household side.

Bankers report some increase in loan rates for consumer credit but no change in rates for commercial credit. Most noticeably, roughly one in two bankers reports a rate increase for residential mortgages. Bankers also reported a higher average deposit rate. Reports on the spreads of loan rates over cost of funds were also split. Despite tighter supply, bankers indicated declining spreads for consumer loans and commercial mortgages, and no change for the remaining categories. Finally, bankers reported little or no change in delinquencies across all loan categories.

 [Return to top](#)

### **Third District--Philadelphia**

Business activity expanded in the Third District in August, although the pace of expansion appeared to ease somewhat. Manufacturers, on balance, reported increases in new orders and shipments, although the number of firms reporting increases declined from a month ago. Retailers generally reported year-over-year gains in August in line with previous months, although some stores had weaker than expected sales. Auto sales improved slightly from July to August but remained below the level of a year ago. Overall bank lending rose slightly, with gains in business and personal lending, but residential mortgage activity declined. Residential real estate demand has weakened considerably since our last report, but demand for commercial real estate has remained strong. Firms reporting on labor costs generally noted moderate, steady rates of increase in wages, but several said increases in non-wage benefits costs were large. Firms reported increases in input costs and output prices in August, although the extent of the increases did not appear to have changed much since July.

Third District firms generally foresee continued growth in the next few months, although several contacts said they expect the rate of growth to ease. Manufacturers expect some increases in demand for their products in the months ahead, and, except for some manufacturers of building products, they have plans to increase capital spending. Retailers generally expect sales to increase at their current rate. Auto dealers are not certain of the near-term outlook, although they expect sales for the year as a whole to be below those of last year. Bankers anticipate further growth in business and personal lending, albeit at a slower pace, but they expect residential mortgage lending to decline. Home builders and residential real estate agents expect sales to remain slow. Most contacts in commercial real estate anticipate continued strong demand for office and industrial space, but several contacts believe office construction activity could decline late this year and into next year.

### **Manufacturing**

Third District manufacturers, on balance, reported increases in shipments and new orders in August. Around one-third of the manufacturers surveyed noted increases and around one-fifth noted decreases. However, compared with the previous month, fewer firms reported increases and slightly more reported decreases. Order backlogs, overall, were unchanged from July to August. Firms producing apparel, chemicals, and industrial equipment reported increases in orders in August, but firms producing lumber, building materials, and transportation equipment reported decreases.

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. Firms in most of the major manufacturing industries in the region have scheduled increased capital spending in the next six months, although makers of wood and metal products have trimmed planned capital expenditures.

### **Retail**

Retailers in the Third District reported that sales in August picked up for back-to-school shopping. Most indicated that the year-over-year gain was similar to the annual increases that were posted in previous months. However, some apparel specialty stores noted weaker gains. Merchants also said sales of consumer durable goods, particularly appliances and home furnishings, have slackened. Some store executives said price discounting increased during the back-to-school shopping period compared with spring and early summer.

Retailers expect sales to increase in the months ahead at around the current rate, although several of those contacted for this report said the outlook is becoming more uncertain, and some said they were putting expansion plans on hold.

Auto dealers in the region generally reported a slight pickup in sales from July to August, but they are uncertain that the higher rate of sales will continue. Most expect sales for this year as a whole to be below those of last year. Foreign makes continued to have better year-over-year sales comparisons than domestic makes, and dealers believe reorganization and other managerial changes at domestic manufacturers could hamper marketing efforts and limit possibilities for increasing sales of their vehicles. Consolidation and closings of dealerships continue, mainly for domestic makes.

### **Finance**

The volume of outstanding loans at Third District banks remained on a slight upward trend in August, according to lending officers contacted for this report. Loan growth is mainly in business and credit card lending. Demand for residential purchase mortgages has declined, but refinancing applications have increased as borrowers seek to switch from adjustable-rate to fixed-rate mortgages. Demand for home equity loans has been gaining, but the rate of expansion has eased, according to some of the bankers surveyed in August. In general, bankers noted slight increases in delinquencies on mortgages and credit cards. Looking ahead, bankers foresee continued growth in business and personal lending, although many expect the rate of increase to be slower in the next several quarters than it was in the first half of the year. Virtually all contacts concerned with residential mortgage lending expect activity to remain slow for the rest of this year and into next year.

Contacts in secondary debt markets reported a sharp drop-off in demand for collateralized debt obligations in mid-August affecting securities backed by residential as well as commercial real estate debt. Contacts said that concern about underlying credit quality has risen among investors in collateralized debt obligations. However, some contacts reported that further decreases in prices would probably prompt purchases of secondary market securities that can meet more critical scrutiny for risk. Despite any possible improvement in secondary markets, however, most contacts do not expect the residential mortgage origination business to rebound soon.

### **Real Estate and Construction**

Residential real estate activity has slowed dramatically since mid-summer, according to home builders and real estate agents contacted in late August. The sales rate for new homes

has declined by half or more, according to some builders, and cancellations have increased. Builders reported making large price reductions with little effect on sales. Sales of existing homes have also dropped. Inventories of existing homes for sale remain high, but the rate of new listings has slowed. The falloff in sales of both new and existing homes has occurred in nearly all parts of the region, including areas that had recently experienced strong sales. Contacts among builders and real estate agents do not expect a quick turnaround. Several said they expect housing demand to remain subdued for a year or more, even if mortgage credit becomes more readily available.

Commercial real estate firms report that office vacancy rates in the region have continued to decline over the past several months, and rental rates have increased. Demand for office space has grown as firms in the region have expanded. Although new buildings have added to available space, conversion of older buildings to other uses has removed some space from office markets.

Construction is up in many office markets in the region, on both a build-to-suit and a speculative basis. Industrial real estate firms report that overall demand for industrial space remains strong. Vacancy rates have moved down and rents have risen moderately. Construction of industrial buildings has increased. Looking ahead, some contacts in the commercial real estate sector are not certain that construction of commercial buildings will continue to rise, but several contacts indicated that they expected public infrastructure construction to pick up, mainly for roads and bridges and for utilities.

### **Prices and Wages**

Reports of increases in input costs and output prices from Third District business contacts were about as prevalent in August as they were in July. Grain prices have been rising, leading to higher prices for meat and bakery products. Prices of some metals, chemicals, and industrial machinery were also reported to be increasing. In contrast, prices of lumber and wood products were reported to be easing. Price discounts to boost back-to-school sales were fairly common among retailers, limiting the year-to-year increase in effective prices of much seasonal merchandise.

Most of the firms reporting on employment costs in August indicated a continuing trend of moderate wage increases. Several firms noted that increases in benefit costs continued to be large, although not accelerating. Nevertheless, employers in the region said they were continuing to look for ways to reduce benefit costs.

 [Return to top](#)

### **Fourth District--Cleveland**

The economy in the Fourth District continued to grow at a modest pace during the past six weeks. In general, manufacturing output was stable to increasing. Activity in commercial construction was steady, with backlogs at acceptable levels. Home builders remain uncertain as to when the housing market will turn around. Some do not expect an upturn until turbulence in the housing finance markets subsides. Retail sales in the District were mixed. Reports on commercial and consumer lending show demand was steady or decreased slightly. The mortgage market remains sluggish, while auto lending increased. Oil and

natural gas production showed little change. And price competition in the trucking industry intensified.

On net, reports point to a slight increase in employment levels across the District. Staffing firms reported an increase in the number of permanent openings, while the number of temporary job openings decreased slightly. The greatest demand for workers was in the health care industry. Overall, the number of job seekers has declined since mid-July and on a year-over-year basis. Wage pressures were limited to the energy sector and some highly technical and professional occupations. Manufacturers and builders told us that input prices are stable, though some are stable at an elevated level.

### **Manufacturing**

Most District manufacturers reported that production has been stable to increasing since mid-July. Further, a majority said they had increased their output on a year-over-year basis. Looking forward, almost all of our contacts anticipate production remaining at current levels or increasing slightly. However, several respondents told us that they are expecting some softening in their respective markets due to the housing slump, tightening credit, and higher commodity prices. Auto assembly plants reported a significant production decline on a month-over-month basis, most of which is attributable to retooling for model changeovers. Although both domestic and foreign nameplates saw declines due to model changeovers, the rate of decline by domestic producers was almost double that of their foreign-nameplate counterparts. Shipments by steel producers and service centers were relatively stable, even though July is traditionally a slow month. Strong end markets for steel include non residential construction, energy, and defense.

In general, plant utilization rates were at normal levels to 100 percent capacity. Manufacturers reporting idle capacity were primarily in the chemical and auto industries. Almost all manufacturers told us that capital expenditures were on plan since mid-July. However, since the last reporting period, the number of respondents who had expected to increase their capital investments in the next 12 months has declined. The decline was ascribed primarily to a softening economy. When asked about input prices, the majority of producers we contacted said they were stable, or stable at an elevated level. Global demand for metals and energy was the most often cited reason for elevated prices. Only a few of the manufacturers surveyed had attempted to increase their own prices during the past six weeks. Looking forward, over half said they either have plans to increase prices during the fourth quarter or they will try to raise prices if raw material costs remain high. With respect to their workforce, about 20 percent of our contacts reported adding employees during the past six weeks. Hiring in the near future is expected to be slow, with little wage pressure anticipated.

### **Construction**

New home sales continue to be slow and are down on a year-over-year basis. The conversion rate of traffic to sales remains low; however, cancellations are no longer a concern for most builders. Looking forward, contractors remain uncertain about when the housing market will turn around. A few said they do not expect an upturn until turbulence in the housing finance markets subsides. Most of our contacts reiterated that inventories are approaching acceptable levels and that they are using discounting as a means of managing inventory. In general, new home prices have been stable since mid-July. Several builders

told us that they have reinstituted workforce reductions or have not replaced personnel who have left voluntarily.

Most commercial contractors told us that business has been steady since mid-July as well as on a year-over-year basis. Segments showing strong activity include healthcare, transportation, and manufacturing. The majority of our respondents is satisfied with their current backlogs and is optimistic about business opportunities in 2008. For the most part, material costs were stable during the past six weeks--metals being the exception. In turn, almost all builders held their own prices steady.

### **Retail**

District retailers reported mixed results since mid-July. In general, apparel retailers experienced declining sales, whereas general merchandise sales held steady or increased slightly. Looking forward, merchants anticipate little change in sales trends. On balance, supplier prices were stable during the past six weeks. Hiring has been limited to new store openings. Any wage pressures are reported to be the result of the recently enacted minimum wage law. On net, automobile sales have been slow, with used vehicles showing increased sales figures and new vehicles posting declines. Sluggish showroom traffic was attributed to very hot weather. Dealer expectations for the next few months are mixed.

### **Banking**

Demand for commercial and consumer loans has held steady or decreased slightly since mid-July. Industries seeking loans were broad based. The majority of our banking contacts reported an increase in auto loans, while demand for home equity loans was mixed. The mortgage market continues to be sluggish, with no improvement expected in the near future. Core deposits were stable to increasing slightly. In general, credit quality for consumer and business applicants remains stable, while almost half of our respondents stated that delinquencies have increased slightly.

### **Energy**

Oil and gas producers reported production levels were flat to increasing slightly since mid-July. Plans for drilling additional wells are on target. Since our last report, prices received for natural gas have declined while crude prices increased. Producers noted a moderating trend in rising material and equipment costs. Hiring was widespread, with a few contacts saying that it is difficult to find qualified employees. Almost all respondents told us that wage pressures are continuing, especially for skilled field personnel.

### **Transportation**

Demand for trucking and shipping services was characterized as flat during the past six weeks by most carriers. Representatives told us that there is intensifying price competition within the industry. As a result, it is very difficult to pass on increased costs to customers. Further, the ability to recover 100 percent of fuel costs through surcharges is beginning to erode. Capital expenditures, primarily for truck engines, have been flat to declining. Wage increases were limited to annual cost-of-living adjustments. And a few carriers reported hiring drivers in order to increase capacity.

 [Return to top](#)

## **Fifth District--Richmond**

On balance, economic activity in the Fifth District grew at a somewhat slower pace in late July and August as weakness in housing and retail sales offset firming in manufacturing. Residential real estate agents reported declines in sales and more widespread softness in home prices. Additionally, mortgage activity slipped since our last report, though financing continued to be available for those with solid credit. Adding to the less than upbeat tone, District merchants reported weaker retail sales as big-ticket categories continued to slump. Moreover, agricultural conditions across the District worsened over the last six weeks as unrelenting heat and a lack of rain took their toll on crops. Assessments of other sectors were rosier, however. District manufacturers reported increases in shipments and new orders and tourism activity remained strong. Additionally, services firms noted continued healthy revenue growth, while commercial real estate and commercial lending activity were generally steady. On the employment front, despite complaints of tight worker availability, District hiring remained fairly brisk, including the first expansion of manufacturing payrolls in eight months. Price growth in the District edged up slightly during recent weeks.

### **Retail**

Our contacts reported that retail sales pulled back sharply in August after posting modest gains in July, as a further drop off in furniture and automobile sales weighed on overall growth. A contact at a department store in the Washington, D.C., metro area reported a drop in furniture sales during the last six weeks, though he added that apparel and jewelry sales were up, fueled, in part, by the start of back-to-school shopping. In contrast, a department store contact in Virginia Beach, Va., reported higher-than-normal levels of inventory, despite good back-to-school shopper traffic and the state's recent tax-free holiday. In addition, a retailer in Charleston, W.Va., said sales had declined since mid-July. On the employment front, retailers generally trimmed payrolls, though those trying to hire said they continued to struggle to find quality workers. On balance, retail prices moved lower in recent weeks, although a contact at a large grocery supplier told us higher costs of meats and dairy products had placed increased pressure on their margins.

### **Services**

Revenue growth at services firms remained healthy in recent weeks, though contacts indicated that the pace of expansion eased somewhat since our last report. Contacts at professional, scientific, and technical services firms in the District reported steady revenue growth in late July and August. Additionally, contacts at education and health care firms said customer demand was unchanged. However, the administrator of a large senior living facility in Virginia said that the housing market slowdown was starting to trim his business as prospective residents were having difficulty selling their homes. Similarly, an executive at a financial services firm in Baltimore, Md., noted that the recent volatility in financial markets had unnerved some clients, resulting in slower business. The pace of hiring at District services firms also slowed somewhat in recent weeks, while price growth in the sector was contained.

### **Manufacturing**

District manufacturers reported that activity moved higher in late July and August. Contacts noted solid increases in shipments and new orders, and manufacturing payrolls expanded for the first time since last November. Producers of electrical equipment, food, industrial machinery, and rubber and plastic products posted the strongest gains in output. A plastics producer in North Carolina told us that business had been particularly good in August--both current production and new orders turned higher. In addition, he anticipated that the recent stronger activity would continue into the fall months. Similarly, a manufacturer of packaging

materials in South Carolina said demand was "heating up" and that there was a good chance he would be even busier in the coming year. On the price front, contacts indicated that the pace of growth in raw material prices was little changed since our last report, while growth in final goods prices increased slightly.

### **Finance**

On balance, demand for home mortgages continued to weaken across the Fifth District during recent weeks. Sources in Bethesda, Md., and Virginia Beach, Va., noted a sharp slowdown in activity, while contacts in Raleigh, N.C., and Charleston, S.C., noted more modest decreases. In contrast, contacts in Richmond, Va., and Parkersburg, W.Va., reported that demand was steady. Lenders said that tighter credit standards were partly responsible for decreased activity. Contacts said they had reduced the number of mortgage products offered, set higher credit score requirements, and raised the interest rates charged on mortgages to address credit and loan quality. Contacts in Baltimore Md., Richmond, Va., and Raleigh, N.C., generally believed the ripple effects from the subprime market will be contained, though they report that standards for commercial mortgage loans have tightened somewhat. A contact in Charleston, W.Va., said their commercial loan standards tightened as they were following guidelines "more strictly." Nonetheless, District bankers generally reported steady demand for commercial mortgages over the last six weeks.

### **Real Estate**

District Realtors reported a further drop off in home sales across the District since our last report. Agents indicated that activity had declined more noticeably in the last six weeks, in part because concern about the health of financial markets has increased. "We haven't been as busy this year as we were three or four years ago, but activity has fallen off even further here recently as more and more clients, spooked by the evening news, remain on the sidelines," noted a Wilmington, N.C., Realtor. Contacts said that recent developments in financial markets have greatly thinned their subprime business, but that clients pursuing conventional loans continue to have adequate access to financing. Despite softer sales, listing activity has remained generally on track in recent weeks, though a Realtor in Raleigh, N.C., noted some clients were considering converting their unsold homes to rental units. Residential agents also reported an increase in the number of foreclosures, and noted higher inventories with the average number of days on the market continuing to rise. Moreover, contacts indicated that home prices moved lower in many markets in recent weeks as sellers set more "realistic" prices. One agent in Hagerstown, Md., remarked, "...sellers are finally getting the message on prices." Realtors throughout the District generally said that they view the recent downturn as a "necessary correction" needed to move to more sustainable levels of activity.

On the commercial side, agents reported a slight slowdown in office leasing in late July and August, while retail and industrial activity remained generally healthy. Contacts in Washington, D.C., and Columbia, S.C., reported that a normal, seasonal pause during the height of summer vacations contributed to softer leasing activity. Reports on vacancy rates were mixed. In Washington, D.C., and Raleigh, N.C., contacts reported that office vacancy rates were steady in recent weeks, while agents in Columbia, S.C., and Charlotte, N.C., noted slight decreases in office vacancies. Retail vacancy rates across the District were generally unchanged during the last six weeks. Reports on rental rates varied. Office rents were said to have risen a bit in late July and August, though one contact in Washington, D.C., noted a slight dip in rates in some office submarkets. Amid fears of tightening credit, agents in northern Virginia and Washington, D.C., indicated that financing was still



available for new projects, though lenders were exercising more caution. Contacts reported little to no new construction activity.

### **Tourism**

Tourist activity remained strong in late July and August. Along the coast, contacts in Myrtle Beach, S.C., and on the Outer Banks of North Carolina reported brisk restaurant and retail sales, which they attributed to near-perfect weather and later starting dates for North and South Carolina schools. Similarly, a hotelier in Virginia Beach, Va., told us that bookings had picked up since our last report. On the western edge of the District, a manager at a mountain resort in Virginia said that sales of time shares were going well and that tourists were "not holding back" when it came to spending at his establishment.

### **Temporary Employment**

District temporary employment agents generally reported stronger demand for workers in recent weeks, noting that it remained difficult to find qualified, skilled workers. In addition, agents in Raleigh, N.C., and Richmond, Va., expected demand for temporary workers to strengthen further over the next several months, as businesses resorted to temporary workers amid especially taut local labor markets.

### **Agriculture**

Severe, drought-like conditions persisted in many areas of the Fifth District in July and August. Despite widespread rainfall during the second half of August, soaring temperatures and depleted ground moisture reduced potential crop yields, particularly in Maryland, where over 60 percent of the soybean crop and 55 percent of the corn crop were reported to be in poor to very poor condition. In Virginia, a contact reported that the supplemental feeding of livestock continued as pasture conditions deteriorated further. In addition, cattle farmers in Virginia were culling their herds to get ahead of possible feed shortages this fall and winter.

 [Return to top](#)

## **Sixth District--Atlanta**

Reports from District contacts indicated that economic activity remained mixed from mid-July through August. In the consumer sector, retail sales improved modestly, the tourist industry indicated strong activity, while vehicle sales continued to weaken. Home sales stayed well below year-ago levels in most parts of the District, and construction levels declined further because of the large unsold inventory. Contacts indicated that they expect weakness in housing markets to persist for several months. Manufacturing activity was mixed, with weakness noted in the building materials and automotive segments. Regional freight activity declined. Banking contacts reported increased loan delinquencies and tighter lending standards. Labor market conditions were described as being tight, especially for skilled positions, whereas layoffs continued to increase in housing-related industries. Overall, reports on prices and wages indicated no unusual developments. The persistent drought and severe heat in most areas has adversely affected crop production.

### **Consumer Spending and Tourism**

Most reports from District retail merchants noted that sales improved somewhat in July and August on a year-over-year basis. Early August sales-tax holidays appeared to have boosted back-to-school sales in many areas. The majority of contacts reported that sales were below plan, but most also expected improved sales over the next several months. Overall, the

softest retail spending reports continued to come from Florida contacts, and this is consistent with a weakening pattern of sales-tax revenues in recent months.

According to industry contacts, vehicle sales in July and August remained subdued. Although gasoline prices retreated, auto dealerships continued to report that fuel economy remains an important consideration for buyers. Contacts reported that promotions did little to improve sales, particularly for full-size trucks and SUVs. Distributors of some regionally produced foreign brands observed moderately higher sales in July and August, but sales still lagged behind the national pace for these foreign makes. Industry reports noted an increase in auto loan delinquencies, higher financing costs for sub-prime buyers, and a decline in the number of customers financing vehicles from home-equity lines of credit.

Most reports indicated positive tourism activity. Strong hotel bookings were reported by contacts in Orlando, boosted by robust theme-park attendance. Also, activity during August was described as being higher in South Florida than a year earlier. The recovery of Mississippi's Gulf Coast casinos continued, with revenues in July exceeding pre-Katrina levels. Casinos were adding to payrolls, although housing shortages remained a problem in attracting workers. New Orleans' Louis Armstrong International Airport reported that passenger numbers continued to improve only gradually.

### **Real Estate**

Homebuilders and Realtor contacts reported that new and existing homes sales were well below year-ago levels in July and August, and new construction declined across the region because of high inventory levels. Most Florida contacts noted a sharp drop in new home sales compared with a year ago in July, reversing an improving pattern of sales in May and June. The vast majority of contacts expected the weakness in District housing markets to persist over the next several months. The pace of commercial construction was described as flat to slightly up in most areas. However, contacts reported a decrease in the number of projects in the pipeline in Florida.

### **Manufacturing and Transportation**

Reports on manufacturing activity remained mixed in July and August. Several auto parts manufacturers noted weaker demand from auto assemblers, and manufacturers of building materials reported lower orders because of declines in home construction. In both cases, contacts indicated that they were cutting hours and/or payrolls in response. However, some increases in production were reported by contacts in other industries, such as carpet production, machine tools and electrical equipment. In addition, further expansions were announced for the District's aerospace and defense industry. A number of manufacturers indicated that they had made significant investment in new energy conservation projects because of higher energy costs.

Reports from transportation industry contacts indicated weak freight demand. Declines in shipments to and from firms associated with construction and autos continued to be noted. However, Georgia trucking contacts also reported that shipments to retailers were slowing.

### **Banking and Finance**

Contacts observed that consumer and mortgage loan delinquencies increased in some parts of the District in July and August. Some reports also cited increased problems with commercial customers in the residential building industry. Several banks noted that they had tightened lending standards for sub-prime customers. Some mortgage brokers have closed

operations in the District, and a large District bank announced it would be cutting 2,400 jobs by the end of 2008, although that decision was not attributed to declines in their mortgage business.

### **Employment and Prices**

Labor markets remained tight in some sectors during July and August. For instance, positions in healthcare, education, accounting, and IT were reportedly hard to fill. Increased layoffs were observed in residential construction and related industries. Price information was mixed. Some building material costs stabilized. For instance, framing lumber prices were said to be similar to a year earlier, and were down about 25 percent from two years ago. Several contacts noted rising business costs related to electricity, real estate taxes, and insurance. Wage pressures remained consistent with the variation in supply and demand across industries.

### **Agriculture and Natural Resources**

Persistently high temperatures and lack of rain worsened existing drought conditions in much of the region during August. Farm contacts reported significant damage to crops and pastures. According to some estimates, the drought could cost Georgia and Florida farmers over \$2 billion in lost production. Florida officials were also concerned about Lake Okeechobee's low water readings, which have dropped 3-4 feet below normal levels.

Hurricane Dean did not have a significant impact on energy production along the Louisiana coast. Crude oil deliveries to refineries in the Gulf of Mexico region reached its highest post-Hurricane Katrina level in late July.

 [Return to top](#)

## **Seventh District--Chicago**

Economic activity in the Seventh District continued to expand at a modest pace in July and August. Only a few contacts reported impacts on real economic activity from recent financial market developments, though a number said the developments had led them to lower their expectations for the rest of the year. Consumer spending and business outlays continued to rise. Labor market conditions were mixed by industry and location. Residential construction declined further in most areas, while the pace of nonresidential development was generally steady. Manufacturing expanded at a slower pace. Household lending declined, while business lending was flat. Overall wage and cost pressures were similar to those in the previous reporting period. The District was poised for a record corn crop, although first dry weather and then storms hurt corn and soybean conditions.

### **Consumer Spending**

Consumer spending continued to increase at a gradual rate. One retailer noted a sluggish start to the back-to-school shopping season compared to last year but thought the slowness reflected a later start to the school year in many districts. Furniture sales were up slightly from a year ago. A discount shoe retailer noted sales declines owing to a falloff in store traffic. Inventories were generally in line with desired levels. Vehicle sales in central Indiana were slower than usual in early August and generally little changed from July. One dealer said that vehicle shoppers were not talking about the recent financial market volatility in their decisionmaking, but the dealer thought it would be some time before the full impact is

felt. Tourism activity in Michigan picked up slightly in August compared with earlier in the summer, however most contacts were pessimistic about the outlook for the rest of the year.

### **Business Spending**

Business spending rose again in the District. Capital expenditures continued to increase in line with previous plans for modest gains. A large biofuel plant came on line in northern Indiana, and an analyst noted that the wallboard industry continued to add capacity on net. In contrast, a health care provider cancelled plans for a strategic expansion. Freight hauling was little changed from the previous period. Commercial electricity sales were strong, though one utility marked down its expectations for the rest of the year. Changes in labor market conditions were mixed by industry and location. An analyst in Illinois reported modest job growth overall, with gains at professional business service firms and manufactured goods exporters offsetting losses at retailers and construction firms. Employment declined in Iowa on balance. An engineering firm planned to add staff in southeast Michigan, while a software developer was hiring in Indiana. In contrast, mortgage brokers announced layoffs in several locations. A staffing firm reported that bookings in the past six weeks were below expectations, in part because some large customers were holding back hiring in response to heightened uncertainties surrounding the recent developments in financial markets.

### **Construction and Real Estate**

Both residential construction and home sales continued to fall in most areas of the District. A Chicagoland homebuilder reported that it has seen its steepest decline in construction since the early 1990s. One homebuilder in Michigan projected its activity to be slow for the next two to four years. Builders' cancellations began to taper off from high levels. Price discounts and incentives continued to grow for potential homebuyers. The pace of nonresidential development was generally steady. One contact from Michigan reported concern about the potential for overbuilding of medical offices. Office and industrial vacancies were steady or improving in many District cities, and office rents moved higher. Contacts generally noted that the recent volatility in the financial markets currently has had little effect on the demand for nonresidential space but has restricted developers' ability to obtain financing for projects.

### **Manufacturing**

Manufacturing expanded at a slower pace than earlier in the year. Manufacturers in a number of industries, including machinery and machine tools, reported strong demand from abroad; steel producers began exporting regularly for the first time. Domestic demand for agriculture machinery continued to run higher than was expected at the beginning of the year, 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 contact in the industry was not expecting much of a turnaround. Domestic machine tool sales slowed in August, though contacts were waiting to see how September turned out before getting concerned that this trend would persist. New heavy truck orders in the US were weaker than expected, with one analyst pointing to a larger-than-expected impact from the slowdown in housing as a key factor. An automaker said that nationwide sales were running below expectations in August, and vehicle makers planned cuts in production for the fourth quarter. A steel producer said domestic business conditions seemed soft, though the seasonal lack of business at this time of year made it difficult to judge the true strength of demand. Steel inventories continued to

move lower and were at desired levels. Shipments of gypsum wallboard continued to fall, and one contact expected declines to continue into 2008.

### **Banking and Finance**

Household lending declined modestly. Applications for home mortgages continued to trend lower, and lenders were tightening standards and approving fewer applications. Consumer credit quality deteriorated modestly; delinquency rates for both first and second mortgages increased. Foreclosures increased in every state in the District except Illinois. A banker in Indiana noted that title companies were requiring mortgage brokers to settle via wire transfer rather than by check. Several contacts in the auto industry said that it was becoming more difficult to underwrite auto loans for borrowers with less-than-perfect credit. Business lending was little changed in most areas. Business credit quality remained favorable. Standards and terms of commercial loans tightened somewhat, and lenders have been adding back protective covenants. Spreads on bank loans widened, and one bank said it sent a message to its loan officers that they should be able to get broader spreads in the current market environment. Small- and medium-sized banks reported little impact from recent financial market developments, though one large bank in the District changed its lending practices after having problems securitizing some of its loans.

### **Prices and Costs**

Overall wage and cost pressures were similar to those in the previous reporting period. Almost every contact noted the high level of energy prices; diesel prices moved up, boosting operating costs for farmers. Commercial construction contacts reported increases in structural material costs. A toolmaker reported plans to increase its catalog prices early next year, adding that it was confident those prices would be in place for some time because material price volatility had fallen. A specialty steel producer indicated that nickel prices were down significantly since the start of the year, but it would not have an impact on their final prices for a while because of the lead times in their business. Retailers in Michigan suggested that price increases were more modest, though food and beverage prices continued to rise noticeably. A staffing firm reported that its pay rates rose at a steady pace.

### **Agriculture**

Crop conditions fared poorly with dry weather earlier in the reporting period and too much precipitation later. Recent storms damaged fields across the District, trimming yields. Only corn in Illinois and Iowa and soybeans in Iowa were in better shape than a year ago. Nonetheless, the District was poised for a record corn harvest, because farmers had planted more corn at the expense of soybeans. Grain storage construction increased, but not enough to alleviate concerns about storage and transportation issues at harvest. Corn prices declined in July but recovered in August. Soybean prices were lower at the end of the reporting period. Milk prices increased, while hog and cattle prices were little changed on balance. Ethanol and hog operations continued to expand. There were reports of higher prices for farmland at Iowa auctions.

 [Return to top](#)

## **Eighth District--St. Louis**

Economic activity in the Eighth District has continued to expand at a moderate pace since our previous report. Retail sales are generally up from the previous year, although some weakness has been noted in furniture and auto sales. Manufacturing activity continued to

increase, albeit somewhat unevenly. Home sales and residential construction remain weak throughout most of the District, but commercial construction activity remains strong in most areas. Overall lending activity at District banks has remained steady. Contacts report that recent financial market volatility has had little impact on District banks, with problems limited to specific subsectors. Ongoing drought conditions are taking a toll on agriculture in most parts of the District. Crop yields for corn, soybeans, and cotton are all expected to be adversely affected by continuing dry, hot conditions.

### **Consumer Spending**

Contacts reported that retail sales in July and the first half of August were up 8 percent, on average, over year-earlier levels. About 55 percent of the retailers saw increases in sales, while 32 percent saw decreases. Approximately 63 percent of the retailers noted that sales levels met their expectations, 32 percent reported that sales were lower than anticipated, and 5 percent reported sales above expectations. Jewelry, men's apparel, books, and sofas were strong sellers, while women's apparel and furniture (especially bedroom and dining room items) were moving more slowly. About 56 percent of the contacts noted that inventories were at desired levels. Many of those reporting higher-than-desired inventories plan to use more discounting than usual. The majority of retailers are positive about the sales outlook for September and October, with about 62 percent of contacts expecting sales in those months to increase over 2006 levels.

Car dealers in the District reported that, compared with last year, sales in July and the first half of August were down 6 percent, on average. About 65 percent of the car dealers surveyed reported a decrease in sales, while 27 percent reported an increase. Approximately 35 percent of the respondents reported recent increases in rebates and incentives, while 8 percent reported fewer rebates. About 15 percent reported more rejections of finance applications, but 12 percent of the contacts reported more acceptances. About 27 percent of the car dealers surveyed reported that their inventories were too high (mostly on trucks and SUVs), while the same percentage reported that their inventories were too low (mostly on fuel-efficient and used vehicles). Slightly more than half of the car dealers expect increased sales in September and October; the remaining contacts are divided equally between expectations for unchanged sales and lower sales.

### **Manufacturing and Other Business Activity**

Manufacturing activity has continued to expand since our previous report. However, contacts expressed some concern about future growth. Firms in the fabricated metal manufacturing industry reported plans to hire additional workers. Contacts in the aerospace product and parts manufacturing, nonmetallic mineral products, and the transportation equipment industries reported plans to expand existing facilities and operations.

Manufacturing firms in the areas of power transmission equipment, manufactured homes, chemicals, and pharmaceuticals reported plans to open new facilities in the District. Conversely, manufacturing firms in the apparel, electrical equipment, household appliances, motor vehicle parts, and plastics announced that they will close plants in the District. The net impact of these developments is positive, with new and expanded operations more than offsetting cutbacks in other areas.

The District's service sector has continued to expand steadily since our previous report. Contacts in the business support services and educational services industries reported plans

to hire additional workers in the District. A firm in the air transportation industry reported plans to expand operations.

### **Real Estate and Construction**

Home sales and construction activity have weakened in most parts of the District, although sales in the Louisville area have remained stronger than in other regions. Compared with the same period in 2006, July 2007 year-to-date home sales increased 2 percent in Louisville but declined 2.4 percent in Little Rock, 6.7 percent in St. Louis, and 12 percent in Memphis. Residential construction continued to decline throughout most of the District. June 2007 year-to-date single-family housing permits fell in nearly all metro areas compared with the same period in 2006. Permits declined 26 percent in Memphis, 14 percent in Little Rock, and 10 percent in St. Louis. An exception to the downturn was in Louisville, where permits increased 5.5 percent.

Commercial real estate markets were mixed throughout the District. The second quarter 2007 industrial vacancy rates in Memphis, St. Louis, Louisville, and Little Rock all saw a slight increase over the first quarter of 2007. During the same period, the office vacancy rate increased slightly in Memphis and Louisville and decreased slightly in St. Louis.

### **Banking and Finance**

A survey of senior loan officers at a sample of District banks showed little change in overall lending activity in the three months ending in July. Credit standards for commercial and industrial loans remained basically unchanged for both large and small firms, while demand for these loans ranged from unchanged to moderately weaker. Credit standards for commercial real estate loans ranged from unchanged to somewhat tightened, while demand for these loans was unchanged. Meanwhile, credit standards for consumer loans remained unchanged, while demand for these loans was moderately weaker. Demand for both prime and nontraditional residential mortgage loans remained unchanged, while credit standards for both types of loans ranged from basically unchanged to slightly tighter.

More recently, while contacts in the banking industry have indicated some concern about financial market volatility, none report any significant impact on their business. Mortgage delinquency rates are up slightly over the past several months but problems appear to be isolated. Credit availability has tightened considerably for non-conforming loans, but agency-eligible loans are experiencing only minor pricing issues.

### **Agriculture and Natural Resources**

Drought conditions have worsened in the District since our previous report, especially in western Tennessee. The extremely hot and dry weather has caused soil moisture ratings and pasture conditions to deteriorate since mid-July. Also, a higher percentage of the overall corn, soybean, cotton, and sorghum crops were rated poor or very poor: Between 14 percent and 25 percent of each of those crops obtained poor ratings, compared with 11 percent in July. As of August 1, yields for most crops were expected to be at least 92 percent of last year's yields; however, corn and soybean yields in Kentucky and Tennessee and winter wheat yields (in all states except Mississippi) were expected to be less than 87 percent of last year's yields.

 [Return to top](#)

## **Ninth District--Minneapolis**

The Ninth District economy grew modestly since the last report. Growth was noted in consumer spending, tourism, services, commercial construction and real estate, manufacturing, energy, mining and agriculture. Residential construction and real estate activity was slow. A number of contacts reported tight labor conditions in their industries or regions, and overall wage increases were moderate. Prices for gasoline have eased since the last report.

### **Consumer Spending and Tourism**

Consumer spending increased moderately. A major Minneapolis-based retailer reported it expects same-store sales to increase about 6 percent in August compared with a year earlier. July sales at a Montana mall were about 5 percent above last year's levels. A mall in North Dakota reported traffic up about 2 percent in August compared with a year ago. Steady traffic during late July and August was reported at a mall in the Minneapolis area. Business at two Minnesota auto dealers was up over the past couple of months, especially for more fuel-efficient vehicles. However, looking forward, a contact noted that some retailers are concerned about the impact year-end adjustments in mortgage interest rates could have on household cash flow and holiday spending.

Tourism activity was higher than a year ago. A tourism official in South Dakota reported that activity was up about 8 percent in July compared with a year ago; relatively high gas prices didn't seem to deter travelers to the area. Retailers and tourism-related businesses in northwestern Wisconsin reported solid traffic and sales; dry, warm weather generally helped tourism activity, although river water levels were low for kayaking and canoeing. A tourism official in Montana reported year-to-date visits to Glacier National Park up 11 percent and Yellowstone National Park up 9 percent.

### **Services**

Contacts from the professional business services sector noted continued growth. Law firms reported strong billings and increased competition. Contacts that support the health care industry saw increased demand. Activity was up at an information technology consulting firm. An executive search firm reported that activity was "heating up." A representative from a large management consulting firm indicated solid growth in billings and new business. Contacts from the financial services industry reported some disruptions to operations due to credit market constraints.

### **Construction and Real Estate**

Commercial construction was up. July commercial building permits in St. Cloud, Minn., increased 15 percent from a year ago. Developers announced plans for a 500,000 square foot retail center along the I-94 corridor in Hudson, Wis. Minneapolis will receive \$250 million in federal funds to replace the collapsed I-35W bridge. Residential construction remained slow, but showed signs of improvement in some areas. Permitted units in July were down 7 percent in Minneapolis-St. Paul from a year earlier. In Sioux Falls, S.D., July residential permits were up 9 percent over year-earlier levels.

Commercial real estate was up slightly. Vacancy rates for office, industrial and medical space in Minneapolis-St. Paul all declined through the second quarter of this year, though retail vacancy increased slightly. A contact in Fargo, N.D., said market activity there was moving at a healthy pace. Residential real estate was slow, with some exceptions. Home



sales in Minneapolis-St. Paul increased 2 percent from June to July, but were down from year-earlier levels, and the inventory of homes for sale is large and growing. However, in Sioux Falls, sales were on track to match or beat last year's record levels. A director from western Montana indicated sales are still strong, but inventory is up significantly compared with the past two years.

### **Manufacturing**

The manufacturing sector grew since the last report. A July survey of purchasing managers by Creighton University (Omaha, Neb.) indicated increased manufacturing activity in Minnesota and the Dakotas. In South Dakota, a trailer manufacturer recently announced plans to build a new plant, and a mining equipment company plans to expand a facility. In North Dakota, an agricultural processing plant is expanding.

### **Energy and Mining**

Activity in the energy and mining sectors increased since the last report. New wind energy projects were recently announced. Oil and gas exploration and production in the District were level from previously reported amounts. Production at most mines remained at near capacity; several mines are looking to expand, and permitting activity is under way. An iron mining company plans to build a nugget plant in the Upper Peninsula of Michigan.

### **Agriculture**

Agricultural conditions improved since the last report. Preliminary results of the Minneapolis Fed's recent survey of agricultural credit conditions indicate that lenders expect overall agricultural income and spending to be up in the third quarter of 2007 due to higher selling prices and decent yields. Growers in North Dakota expect higher income with a record wheat crop and strong prices. Bountiful fruit harvests are occurring across the District. The U.S. Department of Agriculture reported that crop progress was ahead of the five-year average for many District crops. However, yield expectations were reduced in many parts of the District due to increased drought. Recent heavy rainfall caused flooding and crop loss in southeastern Minnesota and western Wisconsin.

### **Employment, Wages, and Prices**

A number of contacts reported tight labor conditions in their industries or regions. While some employers in the construction industry noted less difficulty finding workers than in the past couple of years, finding qualified workers in a number of specialty trades was difficult. In eastern South Dakota, companies in light industrial manufacturing and health care were having trouble finding qualified workers. An economist in Montana reported that employers often note difficulty finding skilled and well-trained employees. Some fast food employers in Montana have hired younger workers or have outsourced drive-through orders to a call center. The opening of a bank call center this fall in northwestern Wisconsin will create 70 jobs in the area. In contrast, a plant in Minnesota that makes frozen products for retail bakeries and food services recently announced plans to eliminate 95 jobs.

Overall wage increases were moderate. Wages for manufacturing workers increased 1.7 percent for the three-month period ended in July. Hired workers at farms in Michigan, Wisconsin and Minnesota were paid only 4 cents per hour more in July compared with the same period a year ago.

Prices for gasoline have eased recently. Minnesota gasoline prices in mid-August were almost 30 cents per gallon lower than in mid-July and slightly lower than a year ago. Recent

increases in natural gas prices showed signs of easing in late August. A bank director noted that while increases in health insurance costs remained relatively large, insurance rates for workers' compensation were slightly lower than a year ago.

 [Return to top](#)

## **Tenth District--Kansas City**

The Tenth District economy expanded at a moderate pace in late July and August. Consumer spending increased, driven by strong tourism spending, and labor markets continued to expand. Manufacturing activity rebounded slightly, and commercial real estate activity continued at a solid pace. Energy activity remained at strong levels, and agricultural conditions were favorable. On the other hand, residential real estate weakened further. Some banks tightened real estate lending standards, but bankers tended to report that overall loan demand was up slightly. Wage pressures remained largely contained and most price pressures eased slightly.

### **Consumer Spending**

Consumer spending increased from the last survey period, and contacts generally expected solid future growth. Most retail stores reported a slight uptick in sales from previous months, with several contacts indicating favorable returns from the back-to-school season. Sales of apparel and technology items were especially strong, while sales of home-related items remained weak. Store inventories continued to be relatively flat, with a reduction expected in coming months. Auto dealers reported a modest increase in sales and saw little effect from high gasoline prices, though sales of SUVs and trucks slowed somewhat. Some dealers reported concerns about the slumping housing market and the possible impact on credit availability for automobile purchases. Travel and tourism activity expanded solidly in late July and August. Hotel and tourist attraction revenues were up markedly from a year ago, and contacts expected further growth. Restaurants also reported strong sales growth, despite rising food input costs.

### **Manufacturing**

Manufacturing activity rebounded slightly following sluggish growth in the last survey period, and producers remained optimistic about future activity. Plant managers reported moderate increases in production, shipments, and orders from earlier in the summer, particularly among producers of machinery and high-tech equipment. On the other hand, factory employment was largely flat, as turnover and the lack of qualified workers was still an issue for some firms. Although most contacts reported continued solid capital spending, a few firms planned slight reductions in expenditures due to the recent volatility in financial markets.

### **Real Estate and Construction**

Residential real estate activity declined further, while commercial real estate activity continued at a healthy pace. Home sales weakened in late July and August and were well below year-ago levels. Most contacts expected the slowdown to persist for some time, until foreclosures stabilize and the oversupply of homes is reduced. Although home inventories leveled off somewhat, they still remained higher than a year ago and were projected to rise in coming months. Home prices throughout the District edged down and are anticipated to continue this trend. Builders in several cities reported steady recent activity, but expected decreases in the future due to a tightening of mortgage standards. Commercial real estate

activity remained solid. Vacancy rates edged down in most cities and absorption rates were steady. Rent values remained elevated from a year ago, and prices for office space were expected to rise in the near future. Most contacts were upbeat about future commercial activity despite some decrease in the availability of credit.

### **Banking**

Bankers reported that loan demand edged up and deposits held steady since the last survey. Commercial real estate loans accounted for most of the increase in loan demand. While most banks reported no change in deposits, a few said they had experienced inflows from commercial customers with ample supplies of cash. Although most respondents continued to report no change in credit standards, several said they tightened standards for real estate loans. Most banks reported little or no exposure to subprime mortgages. However, some noted that recent difficulties in this segment could make it harder to sell mortgages to secondary lenders or reduce the supply of qualified mortgage borrowers. A few respondents said they viewed the turmoil as an opportunity to expand their share of the local mortgage market. As a whole, banks expected little change in overall loan quality over the next six months.

### **Energy**

Energy activity continued at solid levels in late July and August. The majority of contacts reported stable drilling activity and expected increased activity heading forward. However, the lack of qualified labor continued to put a strain on expansion, and the recent fall in natural gas prices caused some firms to cut back on exploration. One Wyoming firm reported natural gas storage capacity at all-time highs due to the lack of available pipelines.

### **Agriculture**

Agricultural conditions remained generally favorable in late July and August. Nebraska and Colorado reported above-average wheat yields after June rains limited the wheat harvest in Oklahoma and Kansas. After a period of dry weather, August rains improved growing conditions for the corn and soybean crops, which placed some downward pressure on crop prices. Livestock prices remained solid, although rising production costs trimmed margins for hog producers and cattle feedlot operators. Farm credit conditions continued to be strong and spending on crop equipment rose, led by a boom in grain storage facilities.

### **Labor Markets and Wages**

Labor markets continued to expand, and wage pressures remained largely contained. District hiring announcements outpaced layoff announcements, and a sizeable number of firms experienced labor shortages. Several firms reported difficulties in filling sales and manager positions, and in hiring production, technical, housekeeping, and restaurant wait staff. Wage pressures were flat versus the previous survey period, although contacts anticipated a slight increase in coming months.

### **Prices**

Price pressures moderated in late July and August, with slower growth of manufacturing prices and a slight easing in retail prices. District manufacturing contacts reported fewer increases in raw materials prices, especially for food and metals, with further easing expected. Factory finished goods price increases also slowed slightly and were projected to remain relatively constant in coming months. The majority of retailers reported flat selling

prices but expected prices to rise slightly heading forward. Restaurants anticipated a further increase in menu prices in response to pass-through of past food cost increases.

 [Return to top](#)

## **Eleventh District--Dallas**

The pace of economic activity in the Eleventh District continued to decelerate in July and August, but respondents with national operations said the District economy remained stronger than much of the rest of the country. Tighter credit standards curtailed some residential construction, which caused home building to decelerate at a slightly faster pace. The level of nonresidential construction is still high, but tighter credit standards have restrained some commercial investment. Manufacturing activity picked up slightly in recent weeks. Demand for business services was mixed, but overall activity was similar to the last report. Retail sales continued at roughly the same pace, but auto sales were softer. Energy activity remains robust, and agricultural conditions were mostly positive.

Contacts within the lending and real estate communities are highly focused on recent changes in the perception of credit risk and most have taken steps to cut costs and/or reduce employment. A few companies reported serious financial stress. Others remain optimistic that, while the cost of funds has increased for some borrowers, markets will settle within 60 to 90 days leaving little long-lasting effect.

Outside the lending and real estate communities, contacts are much less focused on or concerned about recent changes in credit markets. A few expressed relief that the adjustment has finally occurred and conditions are not worse. While cautious, many firms reported seeing no impact so far for their customers or their company. Retailers who lend to customers said they have experienced an increase in delinquencies that has led them to become more careful scrutinizing the credit worthiness of customers. A few are looking forward to lower costs for commercial real estate. While many business leaders expressed increased nervousness about the outlook, most were optimistic that there would be no material impact on their firm and had not changed their business plan.

### **Prices**

Energy costs remained high, and fuel surcharges are commonplace. Strong demand for corn for ethanol has resulted in higher costs for many food items, and contacts say these costs are being passed to selling prices. Strong demand led to price increases for most chemicals, and increased feedstock costs pushed up plastic prices. Declines in the value of the dollar have raised import costs for several industries. High input costs are resulting in double-digit price increases for paper products. High-tech manufacturers report upward pressure on some prices, such as flash memory and flat panel glass. Airfares are higher.

There is downward pressure on real estate prices. Upward price pressures have abated for many construction-related products; steel prices are steady at high levels, and prices have fallen for lumber, aluminum and copper. Retailers say discounts are pushing down selling prices. Auto dealers have increased incentives for both domestic and imported models. High-tech firms say overcapacity is pushing down DRAM prices. Natural gas prices have fallen, and the energy industry reported less upward price pressure for some items used in

drilling. Wholesale gasoline prices fell as growing capacity utilization by refineries pushed domestic inventories back up to the bottom of the normal range for this time of year.

### **Labor Market**

The labor market remained tight, particularly for skilled workers. Wages are rising substantially for some positions, such as lawyers. The current adjustment in homebuilding and financial services had led to layoffs and hiring freezes in those industries. A few contacts said workers with financial experience are in hot demand, and some who have lost their jobs are being actively solicited by other firms. A number of industries continued to report difficulty finding workers. Some firms expressed concern that the already tight labor market will tighten further because of stricter enforcement of immigration laws, including the recently implemented no-match program that requires closer scrutiny of some workers' social security numbers.

### **Manufacturing**

Factory production continued to slow for products supplying residential construction, such as brick, lumber, cement and primary metals. Most producers expect further deterioration in sales, except in the lumber industry where contacts believe the current slow level will persist but not worsen. Demand remained solid to supply products related to nonresidential construction, such as for schools, infrastructure and commercial projects. Fabricated metals producers reported a pickup in activity, as crews returned to work following rain disruptions earlier this summer.

Demand for paper products was mixed. Firms supplying cleaning supplies and other paper products to offices reported strong increases in demand and an optimistic outlook. Sales of corrugated boxes to manufacturers continued to soften, and the outlook was more uncertain.

Producers of high tech products said sales and orders continued to grow at about the same or a slightly faster pace. Equipment manufacturers reported a slow down in orders that they expect will continue through the end of the year.

Food producers said demand was solid, although contacts are wary about a possible slowdown as price increases are passed to consumers. Factories producing transportation parts and vehicles reported continued solid or strong activity, with the exception of automobiles, where weaker demand led at least one factory to reduce production.

Refineries moved back over 90 percent utilization rates. Petrochemical sales were strong, boosted by a weak dollar and buoyant global demand. Sales of most plastics have been climbing steadily for most of this year. Weakness in the housing market has hurt sales of PVC pipe and siding.

### **Services**

Temporary staffing firms said demand improved slightly, with a pickup for call centers, manufacturing and energy. Orders were strong for workers with accounting and IT skills, mixed for financial services and soft for construction. Accounting activity was steady and strong--up a bit from last year. Demand in the energy, audit and tax sectors was solid. Law firms say activity is unchanged and slightly below last year. One contact said "credit issues" dampened transactional work.

Rail, small parcel, and intermodal transportation firms reported small decreases in cargo volume over the past month. Airlines say loads and bookings are stronger than expected, and there is no sign that consumer or business travelers are slowing down.

### **Retail Sales**

Retailers reported little change in the growth of consumer spending in July and August but noted that a number of factors are making it difficult to interpret trends, including a shift in the start of back-to-school and stocking up that occurred in anticipation of a hurricane. Sales continued to be below the level of a year ago but were stronger than in the country as a whole. Purchasing patterns and payment histories suggest customers are under more financial stress than earlier this summer. Most firms have become more nervous about the outlook but have not changed their plans. Automobile sales have been soft over the past six weeks--down significantly from a year ago for both car and service sales. Contacts expressed nervousness because, they say, the automotive market tends to follow the mortgage market.

### **Construction and Real Estate**

Residential real estate markets showed more signs of weakness in July and August. Home sales continued to soften due to lower demand, tighter credit standards and buyers having difficulty selling their current houses. New home cancellations are still high. Contacts said credit standards were tightened for lower-priced homes two to three months ago, and now buyers of homes above \$500,000 are having problems obtaining financing. Inventories are rising, leading a few respondents to express concern about potential weakness in home prices. The outlook is mixed; many contacts expect the lending adjustment to be short-lived, resulting in a sales rebound in 2008. Others-- particularly builders--are more pessimistic, projecting a rebound in 2009.

Office leasing activity remained slower than last year, but market fundamentals are relatively good, with positive absorption and rising rents. Developers say financing terms are changing mid-deal, with lenders appearing unsure of how to price loans. According to some respondents, there are fewer investors seeking property, and some investment and/or development deals have been canceled. Contacts are nervous but think the situation will correct itself soon. However, they fear investor confidence will erode if problems continue into September.

### **Financial Services**

Banks and credit unions reported a pick up in deposit growth and good credit quality. Consumer lending softened earlier this year and further deterioration is not expected. The financial services industry has become more cautious about lending and has tightened credit standards while they're evaluating risk management. Uncertainty about how to measure and assess risk has led to changes in the structure, leverage and pricing of loans. Contacts expect these changes to continue over the next several weeks until the market stabilizes. With the exception of homebuilders, they say their clients' businesses look good and economic fundamentals remained strong.

### **Energy**

Energy activity remained robust. Domestic drilling has flattened out in recent months, causing a sharp slowdown in demand for durable equipment, such as drill pipe and rigs. Day rates for land rigs are flat to down slightly. Demand is still strong for services delivered at the wellhead or for machinery and supplies consumed during the drilling process. Pricing

remained very profitable, but the flat market has seen some "some push-back" by producers and "sharper negotiations." International drilling is growing and remained the primary source of strength for service companies.

Contacts expressed concern that the growing inventory of natural gas may push prices down to levels that will restrain some activity. Unconventional natural gas has been an important element of the current level of drilling, and high natural gas prices are required to justify this drilling. There are no signs of a slowdown so far, and pressure pumping--a service closely associated with unconventional drilling--was described as improving in demand and pricing in recent months.

### **Agriculture**

Soil moisture was adequate in most areas, boosting pasture growth and livestock conditions. Cotton acreage was maturing well, and harvest was in full swing in several parts of the District. Strong summer rains temporarily halted field activities and deteriorated crop conditions in some areas. The grain sorghum crop took the brunt of wet weather, resulting in both yield and quality losses.

 [Return to top](#)

## **Twelfth District--San Francisco**

The Twelfth District economy expanded during the survey period of late July through late August, but the reports suggest that the momentum has slowed a bit. Price pressures were limited overall, and upward pressures on labor compensation were moderate on net, although they remained strong for selected groups of skilled workers. Sales by retailers and service providers were uneven, with the reports suggesting modest growth on balance. Manufacturing activity expanded further, and agricultural producers saw solid sales gains and generally stable supply conditions. Housing market activity slowed further in most areas, and most contacts from this sector expect further sales declines in coming months due in part to more restrictive credit standards and higher interest rates for residential mortgages. Demand for commercial real estate continued to grow. Banks and other financial institutions reported growth in loan demand but some pullback on credit availability, primarily for residential real estate transactions.

### **Wages and Prices**

Reports from District contacts indicated that price inflation was modest overall. Upward pressures eased for some manufacturers and service providers as prices for energy and some raw materials fell, but significant price increases continued for food products. Increases in final prices to consumers reportedly were restrained by vigorous competition, with scattered reports pointing to reduced profit margins rather than price increases in response to cost pressures.

Wage pressures were moderate on net, with contacts noting only small changes in overall labor costs. Scattered reports suggested some easing in upward wage pressures, such as in the Los Angeles area, where labor markets have loosened slightly this year. Shortages of some types of skilled labor, especially engineers and selected groups in the financial and professional services sectors, have kept wage increases rapid for these groups; such skill shortages reportedly have reduced some employers' ability to increase overall productivity.

### **Retail Trade and Services**

Reports on retail sales were mixed and suggested modest growth overall. Contacts noted that sales growth remained solid for luxury items and for higher-end retailers in general, but sales were weak for discount chains. The slowdown in housing markets in most areas has caused sales of household items to fall, with especially large drops for furniture and smaller but significant declines for appliances. Sales of new vehicles reportedly weakened further, especially for domestic makes. By contrast, demand for used vehicles remained strong and sales grew accordingly, despite a reduced supply of used vehicles from rental car companies.

Service providers saw further demand growth on net but with slowing evident in some sectors. Demand continued to grow at a strong pace for providers of health care, media, technology, and various professional services. However, activity fell further for providers of services related to home sales, such as real estate agencies and title companies. Growth in tourist activity has slowed in major District markets: it was flat to down in Hawaii and largely flat in San Francisco and Los Angeles, reportedly due to growing consumer caution in the latter city. Reports on productivity growth were mixed in the services and retail sectors, with some contacts indicating a reduction in their ability to capture gains from new technologies and organizational efficiencies and others reporting substantial payoffs to ongoing investments in those areas.

### **Manufacturing**

Demand for District manufactured products expanded on net during the survey period of late July through late August. Production activity and sales remained very strong for makers of commercial aircraft and their suppliers. Manufacturers of information technology products saw further modest gains in sales and capacity utilization relative to earlier this year, while makers of industrial equipment continued to report "steady" conditions. Food manufacturers reported strong growth in sales. By contrast, demand fell further for manufacturers of building materials, furniture, and household appliances, and apparel makers noted a recent decline in sales relative to a year earlier. Various manufacturing contacts reported that productivity gains have continued at their previous trend rate thus far in 2007, due to the introduction of new production techniques and ongoing growth in product demand.

### **Agriculture and Resource-related Industries**

Demand for agricultural products continued to grow and supply conditions were largely favorable. Sales growth was strong for most row and tree crops and yields have been good. Unexpected summer rains helped to improve grazing conditions for cattle ranchers in the Southwest. Some agricultural contacts reported that pressures on input costs eased overall, but others noted that prices of feed grain increased further and labor availability tightened in some areas.

### **Real Estate and Construction**

The District's housing market slowdown continued, while activity in commercial real estate markets rose further. The slide in home sales and building activity continued in most parts of the District, and sales prices for new and existing homes were flat to down slightly. Most contacts from this sector expect further sales declines in coming months, due in part to more restrictive credit standards and higher interest rates for residential mortgages. By contrast, construction and leasing activity for commercial and industrial space grew further and vacancy rates have reached low levels in some cities, most notably Los Angeles and Las Vegas. Moreover, in the Pacific Northwest and Utah, rising construction activity for



commercial and public works projects has fully offset declining residential construction activity, keeping overall construction employment stable or growing this year.

### **Financial Institutions**

District banking contacts reported that loan demand grew on net, but the slide in mortgage lending deepened due in part to more restrictive credit conditions. Commercial lending activity grew in most areas, although a few contacts noted slower growth late in the survey period. Contacts reported a sharp shift towards tighter credit standards and higher interest rates for residential real estate lending; the shift was largely limited to this one sector, although contacts also provided scattered reports of a more general tightening in credit availability. Lending activity for commercial real estate projects continued at very high levels, and some banks reportedly are approaching regulatory limits on loan concentrations for this segment.

 [Return to top](#)

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

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

**Last update: September 5, 2007**