



November 28, 2007

Summary

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Districts

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Prepared at the Federal Reserve Bank of San Francisco based on information collected on or before November 16, 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 twelve Federal Reserve Districts suggest that the national economy continued to expand during the survey period of October through mid-November but at a reduced pace compared with the previous survey period. Among Districts, seven reported a slower pace of economic activity while the remainder generally pointed to modest expansion or mixed conditions.

District reports indicated relatively soft retail spending; most retailers said that they were expecting a slow holiday season, with only small gains in sales volumes compared with last year. By contrast, tourist activity expanded further in most Districts. Providers of nonfinancial services to consumers and businesses generally saw continued solid growth in demand, although a few Districts pointed to reduced demand for transportation services. Reports from the manufacturing sector were mixed across Districts and sectors, suggesting little change in activity on net. Producers in the agricultural and natural-resources sectors saw robust demand, with sales of agricultural products spurred in part by rapid growth in export demand. The glut of available homes continued, keeping downward pressure on prices and construction activity. The demand for commercial real estate remained strong in most areas but showed signs of leveling off in some. Reports from banks and other financial institutions suggested slower growth in overall loan demand, with some Districts noting a reduction in the volume of commercial and industrial lending.

Upward pressures on the prices of final goods and services remained modest overall but were significant for products and services that rely heavily on food and energy inputs. Increases in the costs of energy and selected raw materials pushed up production and transportation costs for firms in various manufacturing and services sectors, although this was offset in part by price

declines for lumber and transportation equipment. Food prices remained on an upward trajectory. Outside of products and services that rely heavily on energy and food inputs, final prices were reported to be largely stable or down a bit. Wage increases were moderate in general; upward wage pressures eased in a few areas where labor markets loosened slightly, although they remained strong for assorted groups of skilled workers.

Consumer Spending and Tourism

Reports on retail spending were downbeat in general, with several significant exceptions. Most Districts characterized sales as weak or indicated that they had softened, with a few reporting that the volume of sales had fallen relative to the preceding survey period or a year earlier. However, the Boston, Philadelphia, Minneapolis, and Kansas City Districts highlighted a pickup in retail sales relative to the preceding survey period. Among product categories, several Districts noted continued solid growth in sales of consumer electronics, while a few also noted that demand for luxury goods continued to rise at a healthy pace. By contrast, sales of automobiles and light trucks were flat to down, with contacts from several Districts expecting declines going forward.

Looking ahead, the reports were slightly pessimistic about prospects for the holiday retail season. Most Districts reported that retailers expect growth in retail sales to be modest at best relative to last year, and retailers generally were described as having a "cautious" attitude about the upcoming holiday season. Consistent with this assessment, the Richmond, Dallas, and San Francisco Districts reported early-season price discounting by retailers. In the Boston and Minneapolis Districts, retailers expressed cautious optimism for holiday sales, but they generally expect consumer spending to weaken in 2008. Several reports indicated that retail inventories have risen a bit of late and were higher than desired levels during the survey period.

Activity in the travel and tourism sector generally was at a high level and increased further in some cases. The Richmond, Minneapolis, and Kansas City Districts reported that tourist bookings grew or were above normal seasonal expectations during the survey period, and tourism activity in New York City remained at a high level. The Atlanta District reported that Florida's tourist trade was up, spurred in large part by foreign visitors. In contrast, visitor travel and business at major tourist destinations in the San Francisco District, including Hawaii and Southern California, have declined a bit from the high levels established in 2006.

Nonfinancial Services

Reports on nonfinancial services generally were consistent with expanding economic activity, with the primary exception of transportation services. Several Districts pointed to continued strong demand growth for health-care services, while the Richmond, St. Louis, and Minneapolis Districts noted an ongoing expansion for providers of legal and other professional services. The Dallas District reported steady demand for legal services but noted a shift toward litigation related to bankruptcy filings, which may signal a slowing

economy. In the San Francisco District, demand for advertising services was held down by weak demand from sellers of automobiles and home furnishings. Providers of temporary staffing services saw strong demand in the Richmond District as well as a pickup from the legal and financial industries in New York City, but demand for temp workers was reported as "sluggish" overall by Dallas.

Available reports on the transportation sector suggest that the level of activity declined somewhat compared with the previous survey period. The Cleveland District reported that trucking volumes were "steady to declining" and that employment has fallen a bit; Dallas noted that overall shipping activity has weakened; and Atlanta reported lower shipping volumes for autos and materials for home construction.

Manufacturing

Manufacturing activity was mixed across subsectors but appeared to be largely stable on balance. Demand remained weak or fell further for machinery and manufactured materials related to home construction, such as lumber and concrete, and automakers have scaled back their production activities this year. By contrast, demand rose solidly for various other types of capital goods, such as non-automotive transportation equipment, information technology products, and machinery used in the agriculture, energy extraction, and mining industries. Chicago reported that steel production increased, in part because of reduced import competition of late, but Cleveland characterized steel shipping volumes as "flat" in that District. Among nondurable products, several Districts noted continued robust demand for food and significant gains for paper and plastics. However, Dallas reported "stable" demand for food and a drop in sales of corrugated boxes, and St. Louis noted that food manufacturers plan to lay off workers in that District. The reports generally indicated that increases in demand were especially strong for products and firms with significant export markets, for which sales have been boosted in part by the lower exchange value of the U.S. dollar.

Reports on capacity utilization suggested that manufacturers on net were operating near long-term average levels, albeit with substantial variation evident across sectors depending on the strength of product demand. The reports also suggested little change in utilization rates during the survey period. A few Districts reported on capital spending by manufacturers and other businesses, noting tentative plans for continued moderate capacity expansion, but with the proviso that actual spending will reflect realized needs as they develop.

Real Estate and Construction

Demand for residential real estate remained quite depressed, with only a few tentative and scattered signs of stabilization amidst the ongoing slowdown. Most Districts pointed to further increases in the inventory of available homes, with the earlier tightening of credit conditions for mortgage lending continuing to create barriers for some buyers. Consequently, prices on new and existing homes sold were reported to be down on a short-term or year-

earlier basis in most Districts. The pace of homebuilding remained very low in general, and builders continued to shelve projects and lay off workers in many areas; contacts generally do not expect a significant pickup in homebuilding until well into next year at the earliest. Among scattered positive signs, however, co-op and condo sales in New York City picked up during the survey period, Richmond reported favorable readings on home sales in a few areas, and Kansas City reported that home inventories fell a bit in the Denver metro area. Weak home demand had mixed effects on conditions in rental markets: Chicago reported that builders' conversions of new homes to rental property put downward pressure on rents, while Dallas noted that demand for apartments picked up, in part because some potential homebuyers are unable to qualify for mortgages.

Demand for commercial, industrial, and retail space generally remained at high levels and expanded further in some areas, although signs of leveling off were evident in several Districts. Vacancy rates on commercial and industrial space remained relatively low in most Districts and declined in some, even where substantial new space has been added of late. Rents have risen accordingly in many areas. In the extreme, New York reported a 30 percent increase in asking rents on Manhattan office space over the past 12 months; however, this represents a smaller increase than in previous surveys, and a recent increase in vacancy rates there is likely to further temper that trend going forward. A few Districts reported emerging signs of declining demand for commercial space: this included assorted indicators of weaker demand in the major metro areas in the Boston District, reduced leasing activity in Philadelphia, commercial construction activity that was described as "flat to down slightly compared with a year ago" in Atlanta, and reduced transactions and rising vacancy rates in some parts of the San Francisco District. Construction of commercial and public buildings and infrastructure projects remained high in most Districts, however, partly offsetting low residential building activity and helping to limit losses in overall construction employment.

Banking and Finance

Lending to businesses generally was at high levels, but the reports suggested a slower rate of growth than in previous survey periods. Commercial and industrial lending activity changed little or declined in the Cleveland, Atlanta, St. Louis, Kansas City, and San Francisco Districts, although it increased noticeably in the Philadelphia District and continued to show modest growth according to Chicago. Lending standards for construction projects and commercial real estate transactions tightened further in the New York and St. Louis Districts, and they remained tight more generally and reportedly held down the volume of lending for these categories in the Boston District. The reports indicated slight increases in delinquencies on commercial and industrial loans and slightly larger increases for commercial mortgages in many areas.

Consumer lending was little changed on net, while residential mortgage lending continued its downward slide. More stringent credit conditions

remained a constraint for residential mortgage lending in general, with additional tightening during the survey period reported by Chicago, Kansas City, and Dallas; scattered reports suggested slightly stricter standards on consumer loans as well. Mortgage delinquencies increased significantly in many areas, and some Districts pointed to slight deterioration in credit quality for consumer loans.

Agriculture and Natural Resources

Most Districts reported strong demand for agricultural products and favorable production conditions, with the primary exception of an ongoing drought in the Richmond and Atlanta Districts. Demand and sales were reported to be quite strong for a wide variety of tree and row crops, dairy products, and livestock. Several Districts noted that the rise in overall demand has been propelled in part by the lower exchange value of the U.S. dollar, which has spurred strong increases in export sales. Harvest and growing conditions were quite favorable in most areas. High corn production and yields were reported by Chicago, Kansas City, and Dallas. St. Louis and Minneapolis described healthy early-season conditions for winter wheat crops, while Kansas City described that crop's progress as normal. By contrast, dry weather undermined pasture conditions and created a need for supplemental feedings to livestock herds in the Kansas City and Dallas Districts. Moreover, drought conditions continued in the Southeast, and this reduced or delayed crop plantings and held down crop yields in the Richmond and Atlanta Districts.

Reports on the natural-resources sector indicated further growth from very high levels of activity. High oil prices have stimulated expanded drilling in the Atlanta and Dallas Districts; Minneapolis reported increased activity in the energy and mining sectors since the last report; and Kansas City reported that "energy activity remained robust." However, Cleveland reported a slight decline in production of natural gas.

Prices and Wages

Increases in prices of final goods and services generally remained modest, except for food and energy. Increases in the costs of energy and petroleum-related materials created upward pressures on transportation costs and the prices of some manufactured items; many producers responded by increasing final sales prices, although limited pricing power forced some to absorb cost increases in profit margins. In addition, food prices continued on their pronounced upward march, and some Districts highlighted price increases on various imported goods resulting from the lower exchange value of the U.S. dollar. Increases in final prices for products related to food and energy were moderate in general, however, and they were accompanied, in large part, by stable or declining prices for other products and services, including various construction materials and assorted retail merchandise.

Labor markets remained relatively tight overall but loosened in some areas, and wage pressures were largely unchanged from the previous survey period. Most reports suggested that wage increases continued at a moderate pace, with numerical reports in the range of 3 to 4 percent on an annual basis. Dallas and

San Francisco reported that labor market tightness eased somewhat, relieving upward wage pressures in some areas, but Kansas City noted that wage pressures picked up. Wage gains remained especially rapid for assorted groups of workers with specialized skills used in expanding sectors, such as engineers in the San Francisco District.

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