



July 27, 2005

## Summary

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### Summary

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Prepared at the Federal Reserve Bank of Kansas City and based on information collected on or before July 18, 2005. This document summarizes comments received from businesses and other contacts outside the Federal Reserve and is not a commentary on the views of Federal Reserve officials.

Reports from all twelve Federal Reserve Districts indicate that economic activity continued to expand in June and early July. Richmond and Dallas reported that the rate of economic growth increased, and Cleveland said economic growth was stronger and more balanced than in the spring. New York was the only District to report a slowing in the rate of economic growth. Among the other Districts, Atlanta, Minneapolis, Kansas City, and San Francisco characterized the pace of expansion as solid, while Chicago described the rate of economic growth as moderate. Boston, Philadelphia, and St. Louis did not characterize the overall pace of expansion, although Boston noted that locally-based retailers were not sharing in the expansion.

Most Districts reported increases in retail sales, and vehicle sales in nearly all Districts were boosted by a new round of price discounting. Demand for most services, including tourism, continued to increase across the country, and most Districts noted moderate to solid expansions in manufacturing activity. Commercial real estate activity improved in most Districts. Residential real estate activity remained strong overall but showed a few signs of cooling in some Districts. Bankers reported solid or increasing loan demand.

Labor markets generally continued to improve, although hiring in several Districts was mixed. Skilled worker shortages were reported in several Districts, but nearly all Districts said wage pressures remained moderate. Overall price pressures eased slightly or remained unchanged in most Districts, despite substantial increases in energy costs.

### Consumer Spending

Most Districts reported increases in retail sales, and reports on retailers' expectations were generally positive. Dallas said sales growth had been stronger than expected given high gasoline prices, and Atlanta noted that higher gasoline prices did not appear to have cut into spending on other items; Cleveland and Chicago said warmer weather may have boosted sales in their Districts. Minneapolis and Kansas City reported solid year-over-year retail sales gains, and sales also increased in the Philadelphia, Richmond, and San Francisco Districts. The weakest report on retail sales came from the Boston District, where sales were flat or down from a year ago and retailers were less optimistic than in previous surveys. New York also reported a softening in sales in early July following solid growth in June, while St. Louis said reports on retail sales were mixed in June.

Nearly all Districts that reported on vehicle sales noted improvements, which were generally attributed to a new round of price discounting by some automakers. Cleveland reported

dramatic gains, saying all types of dealerships benefited from increased buyer traffic. San Francisco also said vehicle sales rose substantially in response to the price cuts. Only St. Louis cited mixed reports on auto sales. Sales of most types of vehicles were characterized as strong, although Philadelphia and Kansas City reported some weakness in sales of large SUVs. Auto dealers in the Philadelphia and Dallas Districts were somewhat concerned about future auto sales, but Kansas City said dealers expect strong sales to continue.

### **Services and Tourism**

Demand for services continued to increase in June and early July. Boston reported healthy growth in demand for advertising and management consulting, and Philadelphia contacts noted increased activity in information services and business support services. Richmond also reported increased demand for business-to-business services. Demand for health care was reported to be flat in the Richmond District but robust in the San Francisco District. Dallas and San Francisco noted an increase in demand at transportation firms, while Cleveland and Chicago said that demand for trucking was steady and that overall conditions for the industry remained favorable. On the other hand, Atlanta reported some transportation firms have seen activity fall slightly from the high levels experienced earlier in the year.

Tourism continued to show strength throughout much of the country. New York reported that hotel occupancy rates in Manhattan were near record levels and that room rates were up substantially from a year earlier. In addition, Atlanta said hotel occupancy rates in the Miami area were at record levels, and theme park attendance was ahead of last year's pace. Chicago and Kansas City also noted an increase in demand for hotel rooms since the previous survey. Tourism activity over the Fourth of July was characterized as being particularly strong in parts of the Richmond and Minneapolis Districts. San Francisco reported continued strong growth in visits to key tourist destination states.

### **Manufacturing**

Most Districts reported moderate to solid expansions in manufacturing activity, and expectations for future factory activity were generally upbeat. New York saw a rebound in manufacturing production in July, adding that manufacturers' expectations had also risen. Chicago reported continued solid growth, and Atlanta said that reports from District manufacturers were positive. Boston said sales and orders remain on an upward trend. Philadelphia, Minneapolis, and Dallas noted increases in activity as well. St. Louis and Kansas City reported moderate expansions in factory activity, and San Francisco said demand for manufactured goods rose slightly after slowing in the previous survey period. Cleveland said durable goods production had been flat since the previous survey but nondurable goods production was steady or rising. Richmond reported a softening in factory activity in June but a solid increase in shipments and new orders in July. Despite the overall expansion in manufacturing activity, as well as generally positive reports on capital spending, factory hiring remained sluggish in most Districts that reported on employment.

Activity in a wide variety of manufacturing industries was characterized as strong. Boston and San Francisco reported strength in aircraft and high-tech manufacturing, and Atlanta and Dallas said refineries were doing quite well. Several Districts also noted strong activity for producers of construction materials--especially cement--as well as for producers of industrial equipment and materials. While most factory sectors were strong, some weakness was noted among producers of metals and textiles.

### **Construction and Real Estate**

Residential real estate activity remained robust overall but showed a few signs of cooling in some Districts. Boston reported that residential real estate markets were still strong. However, housing activity and home price appreciation in Massachusetts moved from "hot" to

"normal," and housing inventories in the District as a whole became somewhat less tight. Housing activity was described as robust in the New York District, but housing inflation slowed in New Jersey and the condo market in Manhattan was less frenzied than in the spring. In the Richmond, Atlanta, and San Francisco Districts, housing activity remained strong but eased in a few markets that had been especially hot--Washington, D.C., several Florida markets, and parts of southern California. Dallas also described housing demand as strong but noted that the supply of new homes was sufficient to keep housing inflation from exceeding overall inflation. Housing activity was brisk in the Chicago District and solid in the Kansas City and Minneapolis Districts, although homebuilding edged down in the Kansas City District. The weakest report came from the Cleveland District, where homebuilders have faced slightly softer conditions since early spring and new home prices have been flat.

Commercial real estate activity improved in most Districts. Cleveland said commercial builders were experiencing steady improvement and higher backlogs of orders. In the Atlanta District, new construction projects moved forward, and office vacancy rates trended downward but were still high. Contacts in the Chicago District described commercial activity as busier than normal, although activity was slower in Michigan. Commercial real estate activity was described as strong in the Richmond District and as improving in the Minneapolis, Kansas City, and San Francisco Districts. Dallas reported that speculative office construction increased, apartment construction remained high, and hotel markets were hot. Some of the increased real estate demand in the Dallas District was attributed to outside investors attracted by the area's lower real estate prices.

### **Banking and Finance**

In Districts reporting on banking conditions, loan demand increased or remained solid. Overall lending increased in most Districts, with growth ranging from slight in the Cleveland and Kansas City Districts to solid in the Dallas District. Atlanta and San Francisco both characterized loan demand as strong. In most Districts, loan growth was attributed to increases in home mortgages, home equity loans, or business loans. Credit quality was generally strong, although there were some concerns about loans to auto suppliers and farmers in the Chicago District and loans for Florida condominium developments in the Atlanta District. Dallas indicated that competition for large commercial loans had intensified, and Chicago said that competitive pressures had led to some easing of commercial credit standards. Outside of the banking sector, cash inflows to investment companies increased in the Philadelphia District, and venture capital rose for the first time in five years in the Chicago District. New York and Richmond also reported increased activity in the financial services sector as a whole.

### **Agriculture and Natural Resources**

Although conditions remained favorable in most agricultural Districts, dry weather was a problem in some areas. Richmond reported that substantial rainfall brought on by two tropical storms generally improved soil conditions in the District. Atlanta reported only limited damage to crops from the storms and favorable crop conditions overall, although citrus canker continues to be of some concern in Florida. Kansas City and Minneapolis also said that crop conditions were mostly favorable, and winter wheat yields were above year-ago levels in both Districts. Some Kansas City contacts reported concern about higher energy prices boosting irrigation costs. Drought conditions were reported in the Chicago, St. Louis, and Dallas Districts, and Chicago noted these conditions had led to an increase in corn and soybean prices. The lack of rain caused pasture conditions to deteriorate substantially in the St. Louis and Dallas Districts. San Francisco reported little or no impact on cattle prices from renewed fears about mad cow disease, while Kansas City reported that the resumption of live cattle imports from Canada was contributing to downward pressure on cattle prices.

Activity in the energy industry remained strong. Oil and gas activity increased in the Dallas and San Francisco Districts and remained steady in the Minneapolis and Kansas City Districts. Kansas City reported that drilling was constrained due to a shortage of available rigs and regulatory factors, and some oil service firms in the Dallas District were turning down available work due to limited capacity. Dallas contacts also noted difficulty finding qualified engineers and training crews. Atlanta reported a temporary shut-in of some oil and natural gas supplies in the Gulf of Mexico due to Hurricane Dennis. Minneapolis respondents said that mines are operating at full capacity, with exploration activity in full swing across the District.

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

The demand for labor continued to increase in most Districts, although hiring in several Districts was mixed. Atlanta, Chicago, Minneapolis, Kansas City, Dallas, and San Francisco all noted an overall firming in labor markets. Boston reported moderate increases in services employment and mostly steady employment in retail and manufacturing. In the Richmond District, jobs increased moderately at services firms but declined slightly at manufacturing firms. New York said labor markets were a bit softer overall despite a pickup in hiring in financial services. Several Districts reported increased demand for temporary workers, while no Districts reported weaker demand for temps. Skilled workers were said to be in shorter supply in several Districts, and truck drivers were reported as scarce in the Cleveland, Richmond, and Atlanta Districts.

Despite generally tighter labor markets, nearly all Districts said overall wage pressures remained moderate. The only wage pressures cited by the Dallas District were in the accounting and energy industries, and Chicago said the only sizable wage gains were in some skilled professions experiencing labor shortages. San Francisco also reported only modest overall wage growth but noted an increasing use of incentive compensation by some employers to attract workers. Rising health-care costs continued to be a concern for contacts in the Atlanta and San Francisco Districts, but Chicago reported that one large health insurance firm plans to implement the smallest premium increase in a decade.

Overall price pressures either eased slightly or remained unchanged in most Districts, despite substantial increases in the costs of energy and some building materials. Manufacturers in the New York District reported a marked deceleration in input prices and expect substantially less upward price pressure in coming months. Some moderation in input price increases was also noted in the Richmond, Kansas City, and Cleveland Districts. Overall cost and price pressures were described as mild in the Richmond District, moderate in the Chicago District, and largely unchanged from the second quarter in the Philadelphia District. Kansas City and Minneapolis noted some softening in the costs of steel. However, many Districts reported substantial increases in the costs of energy, petroleum-based products, and building materials such as concrete and plywood. Chicago, Cleveland, and Dallas said that transportation firms were able to pass on much of their increased fuel costs to customers. However, in a number of Districts, firms outside the transportation sector were reported as having only limited success passing on cost increases. Retail prices were reported as either flat or up moderately from the previous survey.

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