The Federal Reserve Board

The BEIGE BOOK

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Summary

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Summary

Districts

Prepared at the Federal Reserve Bank of Chicago and based on information collected before March 6, 2006. 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.

Economic activity continued to expand in January and February, according to reports from the twelve Federal Reserve District Banks. Most Districts characterized the pace of expansion as moderate or steady. San Francisco said that the "solid expansion remained on track," and Dallas indicated that activity strengthened. In contrast, the pace of growth moderated in the Richmond District, and Philadelphia said activity expanded at a slow pace.

Nationwide, consumer spending continued to expand. Capital spending increased at a similar pace as in the previous reporting period, and expenditures for business services continued to rise. Employment continued to increase in most locations and in many sectors of the economy. Most Districts said that residential construction and real estate activity slowed from high levels, while commercial markets were generally more active than at the end of 2005. Reports indicated that manufacturing continued to expand during the first two months of the year. Household lending softened, while commercial and industrial lending expanded at a modest pace. Contacts noted ongoing input cost pressures, but prices at the retail level increased at only a moderate rate. Labor cost pressures were little changed. Natural resource activity was very solid overall. Agricultural conditions remained mixed, and a continued lack of moisture generated concern in several Districts.

Consumer Spending and Tourism

Consumer spending continued to expand. Many Districts reported that retail sales showed solid gains during January, which retailers frequently said were spurred in part by unseasonably warm weather and holiday gift card redemptions. Without the added boost from those factors, retail sales during February softened in the New York, Philadelphia, Richmond, Chicago, and Dallas regions. However, sales in the Atlanta, St. Louis, Kansas City, and San Francisco Districts apparently maintained much of their momentum. Retail inventories were generally at desired levels across the country. Light vehicle sales in many areas were described as "sluggish" or "unusually slow," although Philadelphia and Atlanta noted some improvement in sales between January and February. Vehicle inventories were generally above desired levels.

The majority of reports on tourism were positive. Sales were up over last year at winter-sports destinations in the Richmond, Minneapolis, and Kansas City regions; however, ski resorts in New England and New Mexico were suffering from a lack of snowfall. Warm-weather destinations in the Atlanta and San Francisco Districts reported a brisk pace of activity. Atlanta also noted that tourism in the Gulf Coast region was being re-established slowly, though several casinos experienced larger-than-expected increases in revenues.

Business Spending and Hiring

Most reports indicated that capital spending increased at a similar pace as in the previous reporting period. There were some exceptions. Manufacturers in Philadelphia reported a pickup in the pace of investment, and firms related to the heavy equipment industry said that they were budgeting large expansions in capital outlays. In contrast, manufacturers in Atlanta had modest near-term spending plans, and those in Kansas City indicated that they were slowing the rate of increase in their capital spending. In the San Francisco District, the implementation of productivity-enhancing technologies has allowed banks to maintain profit margins and helped producers in the agricultural and resource sectors maintain output levels in the face of input constraints.

Expenditures for most business services continued to rise. Several Districts noted strong revenue gains for insurance, accounting, telecommunications, and health care firms. Boston said that information technology services firms reported strong revenue growth and expectations for steady or faster growth in the next six months. Demand for trucking and rail shipping services remained robust in Cleveland, Atlanta, Chicago, and Dallas; two of those Districts observed tight capacity conditions. Air travel was strong in many parts of the country.

Employment continued to increase in most locations and in many sectors of the economy. Atlanta said labor markets were firm, and Minneapolis saw signs of tightening. Cleveland said job openings had increased but hiring remained sluggish. Kansas City indicated that layoff notices outnumbered hiring announcements. Retail employment was steady in recent weeks, according to Boston, Richmond, and Chicago. New York observed a pickup in manufacturing hiring, but factory employment was steady or showed more limited increases in other regions. Three Districts reported an expansion in service jobs. Demand for temporary workers was strong in most areas, although several staffing firms in the Boston region said that revenues have been lower than expected recently. Almost every District reported shortages of high-skilled workers.

Construction and Real Estate

Construction and real estate activity was mixed by market segment and location. Most Districts said that residential activity slowed from high levels. Homebuilders in many Districts indicated that new home sales were trending down, but contacts in the Cleveland, Kansas City, and Dallas regions said that demand for new homes had improved relative to the end of 2005. Half of the Districts reported that the number of homes for sale had increased. Home price appreciation slowed in many areas, and real estate agents in the Richmond region said that fewer homesellers were receiving multiple offers. Several developers in the Atlanta District reported putting condominium projects on hold because of soft pre-sales or rising construction costs.

In contrast, commercial construction and real estate markets were generally more active than at the end of 2005. Philadelphia reported that the completion of a number of office projects this year would boost the space on the market; Minneapolis noted a number of new development projects; and San Francisco said that building activity had picked up for commercial projects and public structures. Chicago and Richmond indicated that overall commercial vacancy rates were stable. Office vacancy rates fell in the Boston, Philadelphia, St. Louis, Minneapolis, Kansas City, and San Francisco regions, but were mixed in New York. Industrial vacancy rates fell in three Districts, and Philadelphia said that demand for factory space had increased.

Manufacturing
District reports indicated that manufacturing activity continued to expand during January and February. Atlanta and Dallas said that activity picked up, and New York noted continued improvement in conditions, while Kansas City and San Francisco suggested that the pace of expansion had slowed; the remaining Districts indicated that manufacturing conditions were similar to those at the end of 2005. Manufacturers in Boston and Philadelphia generally expected the expansion in activity to continue in the coming months, and factories in Cleveland anticipated a pickup.

In most Districts, the strength in demand for factory goods was widespread across industries. The sectors frequently mentioned as facing strong demand included construction materials, electrical equipment, defense products, tractor trailers, heavy trucks, and heavy machinery. Cleveland reported that steel shipments held steady or increased, and Chicago said that steel production remained strong. Conditions in other metals industries were mixed, as Philadelphia and Chicago reported strong growth in demand, Dallas noted little change, and San Francisco characterized demand as "tepid." Most regions had some weak performing industries, but few were consistently mentioned as underperforming. Several Districts commented on the ongoing struggles of the domestic nameplates in the auto industry. An automaker in the Chicago region reported that slowing sales and high inventories would likely restrain production in the coming months, and automakers in Cleveland noted large declines in output compared to year-ago levels. Atlanta mentioned that many suppliers to the domestic nameplates have seen slower demand, and Kansas City added that a number of partsmakers had ceased production. Dallas noted that a narrowing spread between refined fuel and crude prices led some refineries to briefly reduce production in February. Some refineries in the Gulf Coast region reportedly will have longer maintenance turnaround times this spring because repairs were postponed in the aftermath of the hurricanes last fall.

Banking and Finance
Household lending activity softened, while commercial and industrial lending expanded at a modest pace. Reports on mortgage demand ranged from slowing growth in Richmond, Atlanta, Dallas, and San Francisco to declining activity in New York, Philadelphia, Chicago, and Kansas City. Other types of consumer borrowing were typically characterized as "mixed" or "weak." Interest rates on household loans increased in most Districts.

Business lending increased at a slow pace in the Cleveland, Richmond, Chicago, and San Francisco regions, while it was unchanged in the New York and St. Louis Districts. Bankers in Philadelphia expected growth in commercial and industrial lending, although several indicated that they were limiting real estate development and construction loans. Interest rates on commercial loans increased, according to New York, Richmond, and Kansas City.

Comments about household and business credit quality were mostly favorable. Delinquencies were unchanged in New York and remained low in Atlanta, though a banker in the Chicago region said that there was a noticeable rise in delinquencies and foreclosures in parts of Michigan dominated by the auto industry. Deposit growth was generally steady, and several Districts indicated that interest rates on deposits had increased. Lending was very competitive, which squeezed margins for many banks. Nonetheless, no District reported a change in lending standards.

Prices and Employment Costs
Contacts generally reported ongoing input cost pressures, while prices at the retail level increased at only a moderate rate. Philadelphia observed a steady rate of increase in input costs, and Chicago said that cost pressures remained firm. Cleveland said that cost pressures were less pronounced than in the previous reporting period, but Richmond said that the prices

of most intermediate goods and services were increasing at a somewhat faster pace. San Francisco saw little or no change in modest inflation pressures. At the retail level, Kansas City said price pressures edged up, but Atlanta saw only moderate price increases for non-energy consumer prices, and New York noted little broad-based acceleration in consumer prices.

Elevated energy costs were mentioned frequently. Fuel surcharges remained in place in many locations. Contacts in Atlanta felt that a high degree of uncertainty in the energy markets would cause many firms to leave surcharges in place for the indefinite future, but some large companies in the Chicago region obtained a few reductions. The costs of many non-petroleum materials--including asphalt, cement, gypsum, lumber, copper, and paper--were on the rise, though steel prices stabilized in most places. Airfares and hotel room rates continued to increase.

Labor cost pressures were little changed. Most Districts reported that wages increased modestly on average. The only exception was Philadelphia, which reported that many of its contacts expected a faster rate of increase in average salaries and wages compared with 2005, as firms stepped up counteroffers to workers who were planning to change jobs. A shortage of qualified workers for skilled positions in finance, construction, and manufacturing industries resulted in more rapid increases in pay for those workers.

Energy and Natural Resources
Natural resource activity was very solid overall. Energy extraction improved in the Atlanta, Kansas City, Dallas, and San Francisco regions and remained at a high level in Minneapolis. Most of these Districts reported that output was constrained by shortages of labor, parts, and equipment. Oil and natural gas production in the Gulf of Mexico remained in a slow recovery from last year's hurricanes. Mining activity increased in the Minneapolis District, where several mines were running at or near full capacity.

Agriculture
Agricultural conditions varied across the nation. Unseasonably mild weather boosted output in the San Francisco District and aided field preparations in Richmond and Chicago. Moisture conditions improved in much of the Minneapolis region, but a continued lack of moisture affected farmers and ranchers in the Chicago, St. Louis, Kansas City, and Dallas Districts. The drought concerns limited cattle herd expansion, and some banking contacts in the Dallas region said that they may not finance certain farming operations unless moisture conditions improved. Prices for agricultural products remained generally stable or increased, though poultry prices declined. Agricultural input costs were still high, which limited purchases of fertilizers, chemicals, and machinery.

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