



April 26, 2006

Summary

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Summary

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Prepared at the Federal Reserve Bank of Boston and based on information collected on or before April 17, 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.

Reports from all twelve Federal Reserve Districts indicate that economic activity continued to expand in March and the first half of April. Three Districts--Minneapolis, Kansas City, and San Francisco--characterize growth as "solid," while a number of others describe the rate of economic activity as "modest," "moderate," or "steady." Richmond notes a quicker pace of growth, and Dallas indicates that activity continued to strengthen. By contrast, New York says the rate of growth may have slipped a bit since the last report.

Most Districts report that orders or revenues in the manufacturing sector continue to come in ahead of year-earlier levels, although New York notes some deceleration in manufacturing activity, and Atlanta says that manufacturers' results were mixed. Non-auto retail sales are up from a year ago, as well, according to most Districts, although the shift of Easter from March last year to April this year makes comparisons difficult. Activity levels in service industries--including temporary help, health services, professional and technical services, and transportation and shipping--are also expanding according to District reports. The pace of housing market activity is said to be moderating in many Districts, while commercial activity is firming. A majority of Districts note that labor markets, at least for skilled workers, are tight or are tightening. While energy costs are high and costs for selected other inputs are rising, businesses continue to have limited ability to raise their selling prices.

Consumer Spending and Tourism

The majority of Districts cite improving retail sales overall, but Richmond and Cleveland experienced sluggish or disappointing results. Boston, New York, Philadelphia, Atlanta, Chicago, St. Louis, Minneapolis, Kansas City, Dallas, and San Francisco all report modest to solid gains, although year-over-year comparisons have been complicated by Easter's shift from March in 2005 to April in 2006. Several Districts report strong sales in home and garden products and building goods. Reports on apparel and grocers are mixed. Retail inventories were generally at desired levels across the country.

Auto sales were mixed across the Districts. Many Districts report that sales were short of year-ago levels, but Philadelphia, Cleveland, Richmond, Kansas City, and Minneapolis all indicate that sales improved from the prior survey period. While demand in San Francisco was stronger than expected, Boston, Atlanta, and Dallas all cite flat sales. Many Districts continue to say that sales of imports and used cars are stronger than new domestic vehicles.

Most of the reports on travel and tourism are positive. Atlanta, Chicago, Minneapolis, Kansas City, and San Francisco all cite modest to strong improvements, and while New York saw

tourism softening slightly, it was still at high levels. In contrast, tourism was mixed in Richmond. Ski resorts in the Boston District continued to suffer from lack of snowfall, but tourism was thriving in the Boston metro area. A record-setting ski season was reported in Virginia, and Minneapolis saw a positive ski season in parts of the District.

Services Industries

All Districts reporting on nonfinancial services note increased activity during the first quarter relative to a year ago. Health-care services expanded in the Richmond, St. Louis, and San Francisco Districts. Professional and technical services activity increased according to Boston, Philadelphia, Richmond, St. Louis, and Dallas, while San Francisco notes mixed conditions in information technology services.

Temporary employment firms in the New York, Philadelphia, Richmond, Atlanta, Minneapolis, and Dallas Districts report modest demand growth in the first and early second quarters. A large New York employment agency found increased demand for legal and financial services employees, while Dallas contacts noted increased demand for temporary workers in high-tech and light industrial manufacturing.

Transportation services activity improved this quarter, according to reports from the Atlanta, Dallas, and San Francisco Districts. Trucking and shipping respondents from the Philadelphia, Cleveland, and St. Louis Districts report increased growth relative to a year ago. While Cleveland's contacts continue to express concern about fuel costs, many now believe that they can increase their base rates, given the strength of demand.

Manufacturing

Reports on manufacturing activity remain positive. Districts describe shipments and orders as continuing to strengthen--significantly in some cases and gradually or steadily in others. Only Atlanta characterizes overall manufacturing activity as mixed, although New York indicates a retrenchment in orders and shipments in early April followed a strong March. All Districts mentioning near-term forecasts say that, on balance, manufacturers expect business to remain on an upward trajectory.

Multiple Districts note strong or expanding production of steel, construction inputs, machine tools, aircraft equipment, and food. Production capacity for mining equipment in the Chicago District is reportedly booked through 2007. Chicago described heavy- and medium-duty truck orders as remaining solid, but light vehicle sales as flat, with some signs of excess auto inventories. Other District updates on auto assembly and parts production were mixed--some up and others down. Trends in apparel-making also varied, with Richmond and Dallas citing increases but Atlanta, St. Louis, and San Francisco indicating shutdowns or disappointments.

Although several Districts describe labor demand in the manufacturing sector as mixed, most report some form of pickup. For example, Richmond says that "factory employment grew modestly," Cleveland notes more hiring on the part of durable goods producers, and Boston indicates that most manufacturers were hiring in order to obtain a "higher skill mix." District reports on capital spending tend to be either modestly positive or mixed.

Real Estate and Construction

Most Districts report cooling and moderation in their residential real estate markets. In general, year-on-year price appreciation seems to be lower than in quarters past, with San Francisco, Cleveland, Kansas City, Richmond, New York, and Boston all reporting more modest price growth in residential sales. Several Districts' contacts noted that slower price increases were a healthy market outcome. Residential inventories are increasing; Kansas City, Minneapolis, Chicago, Atlanta, New York and Boston all saw increases in residential

inventories compared with the first quarter of last year. The Dallas District, by contrast, registered particularly strong residential sales.

Residential construction is more regionally differentiated than overall residential sales and prices. In the West, Dallas and San Francisco both cite high levels of residential construction activity, with Dallas homebuilders reaching record sales for the first quarter of 2006. In the Midwest, Kansas City, Minneapolis, and St. Louis report declining residential construction. As well, the Chicago District mentions slower residential building in most areas. In the South, Atlanta indicates that single family construction remained strong but that some condominium projects have been postponed or cancelled.

The commercial real estate outlook appears to be predominantly positive across the reporting Districts--none report weakening commercial demand. San Francisco, Dallas, Minneapolis, St. Louis, Atlanta, and New York all register strong commercial activity. Kansas City, Chicago, and Richmond report steady to improving levels of activity. With vacancies declining in many locations, rents appear to be edging upwards.

In the West and the Midwest, commercial construction appears to be responding to increased commercial demand. Dallas, Cleveland, Minneapolis, Chicago, and St. Louis all report increasing or soon-to-be increasing commercial construction. San Francisco cites continued high levels of construction activity. In the South, Richmond reports little change in new construction, while overall development in Atlanta remained at low levels. The New York District featured relatively stable commercial construction.

Banking and Finance

Reports of lending activity are mixed, as most Districts reporting on financial services continue to see decreases in demand for consumer loans and residential mortgages, coupled with moderate expansion of commercial and industrial lending. St. Louis and Kansas City, in particular, saw a decrease in consumer lending, while both Chicago and Kansas City witnessed decreased demand for home equity loans. Almost all Districts report declining demand for residential mortgages. Meanwhile, commercial and industrial lending increased in nearly all Districts, with only St. Louis reporting a decline. Bankers in Richmond noted that commercial lending for mergers and acquisitions and construction remained high. Respondents in San Francisco mentioned an increase in venture capital financing.

While reports of credit quality are positive across the board, delinquency reports are more varied, with low delinquency rates in Atlanta, commercial and industrial delinquency rates increasing slightly in New York, home mortgage delinquency rates increasing somewhat in Dallas, and respondents in Philadelphia predicting a possible future increase in delinquencies due to rising interest rates on adjustable-rate mortgages. Deposit growth was steady in Cleveland and Kansas City, sluggish in Chicago, and flat in Dallas. Philadelphia, Dallas, and San Francisco all report fierce competition for loans and narrow net interest margins. However, credit standards remained virtually unchanged in all Districts except for New York, where standards tightened slightly for consumer loans.

Agriculture and Natural Resources

Adverse weather conditions and high energy costs are affecting agricultural prospects in much of the country. Although recent rains have brought some relief, dry weather has reportedly stressed pastureland and crops in the Richmond, Atlanta, Chicago, Kansas City, and Dallas Districts. By contrast, unusually wet weather has delayed fieldwork in the San Francisco District. Ranchers facing poor pasturage in Kansas City and Dallas are culling their herds and giving supplemental feed unusually early; as a result, Kansas City reports downward pressure on prices for feedlot cattle. In San Francisco, prices received by ranchers

have softened but remain at a high level. St. Louis and Minneapolis report that one-half to two-thirds of the winter wheat crop is in good to excellent condition, but the Kansas City crop is described as poor, and Dallas reports that half the District wheat crop will be lost. Reflecting relative crop prices and the high cost of fertilizer, Chicago and St. Louis farmers are said to be shifting acreage from corn to soybeans. Contacts in Dallas and San Francisco also note the high cost of fertilizer and fuel, while Chicago and Dallas indicate that these costs are combining with dry conditions to cause cash flow problems for farmers.

In the energy sector, demand for oil and natural gas or oil services remains robust and energy activity continues to expand, according to contacts in the Dallas, Kansas City, and San Francisco Districts. Minneapolis reports that energy activity is stable at a high level. Dallas and Kansas City indicate that the count of active oil and gas rigs continues to rise. In the Gulf of Mexico, Dallas notes that the rig count is close to pre-Katrina levels, while Atlanta reports that the share of oil and gas still "shut in" amounted to just 23 percent for oil and 14 percent for natural gas in early April. Dallas, Kansas City, and San Francisco contacts see little or no excess capacity in the energy sector. In particular, Kansas City contacts say that shortages of equipment and workers are constraining drilling activity; pipeline capacity is also limited in some areas. In the Minneapolis District, almost all open mines are producing near capacity.

Prices and Wages

High energy prices were at the forefront of most Districts' mentions of cost pressures. Manufacturers in most Districts cite rising costs for other inputs, with metals mentioned most frequently along with petroleum-related products. While no District reports that cost increases have intensified in the latest survey period, Kansas City says that firms were having greater difficulty obtaining steel and aluminum. Services firms are also reported to be facing higher costs, notably for utilities, shipping, and transportation. Many Districts describe firms as attempting to raise selling prices but having mixed success, with price increases generally either smaller than the cost increases or less widespread. Richmond, Cleveland, and Chicago, for example, mention manufacturing firms' limited ability to recoup higher costs; Boston and Dallas say competitive pressures are constraining some price increases, and Atlanta notes that the ability to pass on cost increases varies across firms, depending in part on the strength of demand and contract arrangements. Construction materials costs have also risen, or supplies are tight, according to reports from Philadelphia, Cleveland, Atlanta, Chicago, Minneapolis, and Dallas.

A number of Districts, including Cleveland, Richmond, and Dallas, cite high energy prices as an explanation for weaker than expected tourism results, auto sales, or retail sales, especially to lower-income consumers, with the impact occurring both directly by constraining consumers' driving and indirectly by reducing the income available for purchases after paying for home fuel and transportation fuel. Atlanta and Chicago note the possibility of such energy cost impacts as a risk to the summer outlook.

District reports from Boston, New York, Richmond, Kansas City, and Dallas say that labor markets are tightening, especially for skilled positions. Philadelphia, Minneapolis, San Francisco, and Atlanta indicate that labor markets remain tight in at least some parts of their Districts. Contacts in Atlanta, Richmond, Cleveland, Kansas City, and Dallas state that truck drivers are in short supply. Wages continue to move up, but only a few Districts--New York, Dallas, and Kansas City--mention a pickup in the pace of raises, while Philadelphia cites firms more often paying in the high end of salary ranges. Richmond reports no pickup, but a continuation of "brisk" wage increases in services. Boston says manufacturing wage increases are in the same range as last year, Chicago cites a steady pace of labor cost increases, and Cleveland notes no reports of accumulating wage pressure, while Minneapolis and San Francisco mention moderate overall wage increases.

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