



June 14, 2006

Summary

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Summary

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Prepared at the Federal Reserve Bank of Dallas and based on information collected on or before June 5, 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 from mid-April to early June, but there were some signs of deceleration. Activity moderated in four Districts--Atlanta, Kansas City, Richmond, and San Francisco--and the New York District noted increased concern about the outlook for the second half. Seven Districts--Boston, Chicago, Cleveland, Dallas, Minneapolis, New York, and St. Louis--said growth was similar to the pace reported in the last Beige Book. The Philadelphia District, however, reported an improvement in overall economic conditions.

Consumer spending continued to increase, but District reports suggest that the growth rate slowed. Manufacturing activity still expanded quite strongly, but reports indicate more areas of weakness than in March and early April. Residential real estate markets continued to cool across the country, with slower homebuilding and sales of existing homes. In contrast, commercial real estate activity strengthened, and a few reports expressed concern about too much building in some portions of the real estate market. Activity in service-producing industries was strong or increased in all Districts that reported on that sector. The financial sector continues to report good credit quality. Commercial lending picked up, but there was some slowing in loans to consumers, particularly for mortgages and home equity loans. Growth in the energy industry continued to be robust, with expansion constrained by shortages of equipment and labor. Agricultural conditions varied across the country.

Labor markets continued to tighten, with more Districts reporting employers having difficulty finding skilled workers. Wage pressures remained moderate overall, with the exception being workers with hotly demanded skills. High energy costs were fueling price increases in manufacturing and, to a much lesser extent, retail. Reports of costs being passed forward varied considerably but were more prevalent than in the last Beige Book.

Consumer Spending

Consumer spending continued to increase between mid-April and early June, but reports were varied, and several Districts noted areas of weakness. Some Districts mentioned that sales were slowing or weaker than anticipated at discount stores or to lower income customers. High gasoline prices were cited by a few Districts as changing purchasing patterns or clouding the outlook for sales. A couple of Districts also said that rising interest rates were a concern. Inventories were mostly reported to be at desirable levels, but the Atlanta, Boston, and Kansas City Districts said some retailers had more inventory than they would like.

Two Districts reported weaker retail sales growth--Dallas and Richmond--and retail sales were "down" compared with last year in the St. Louis District. The Boston and New York Districts said results were "mixed," but Boston added that the majority of retailers cited soft year-over-year sales gains. Three Districts--Kansas City, Minneapolis and San Francisco--reported little change in retail sales. Philadelphia said sales in its District increased from April to May, but gains were "varied" among stores. The Atlanta District reported that sales rose at a "solid pace" but "some segments reported lower demand." Improving trends were reported by the Cleveland District, and the Chicago District said consumer spending continued to "increase modestly."

Most reports about auto sales suggested weakness, with particularly poor sales of SUVs and light trucks. Auto sales were reported as "sluggish" or "down" in the Chicago, Cleveland, St. Louis, and Philadelphia Districts. Atlanta reported that sales were "mixed," and Kansas City said auto sales were unchanged from last month but lower than a year ago. Sales increased in the Dallas and San Francisco Districts, but some dealers in the Dallas District reported sizable excess inventory because sales were less than expected over the winter months. The Chicago and St. Louis Districts also reported that inventories were higher than desired, and the Philadelphia District said dealers had limited their orders to manufacturers to keep inventories in check. The Kansas City District reported that inventory levels were satisfactory.

Manufacturing

The manufacturing sector continued to expand quite strongly, but with more reports of softening than at the time of the last Beige Book survey. Strong activity was noted in the production of goods to supply the energy, semiconductor, and aerospace industries. Areas of weakness included production of agricultural equipment and autos. Slower demand for goods to supply residential building, most notably lumber, was mentioned by a few Districts, although the Atlanta and Dallas Districts reported demand for construction-related materials still remained strong overall.

Manufacturing activity was characterized as "strong" or "up solidly" in the Boston, Chicago, Dallas, and Kansas City Districts. The San Francisco District reported that activity expanded overall, with production of commercial aircraft near full capacity and capacity utilization of semiconductor manufacturers at or above 90 percent. Production was "steady to increasing" in the Cleveland District, and firms continued to report generally favorable conditions in the New York District. Activity continued to expand in the Minneapolis and St. Louis Districts. Two Districts--Philadelphia and Richmond--noted some softening or leveling of growth. The Atlanta District said activity remained mixed.

Services

The Boston, Dallas, New York, St. Louis, and San Francisco Districts report "strong" or "robust" activity throughout the service-producing sector. Demand for workers at temporary employment firms picked up in the Chicago, Dallas, and Richmond Districts, while contacts in the Boston, Dallas, and New York Districts indicated "steady" and "solid" activity. Business activity at information technology service firms grew at a steady pace in the Boston and San Francisco Districts, and firms in both Districts indicated an increase in hiring activity. Demand for health-care and professional services was vigorous in the San Francisco District, while demand for professional services in the Dallas District was "typical."

Demand for trucking, shipping, and rail services remained strong across the country, but companies cited difficulty finding and retaining drivers in the Atlanta and Cleveland Districts. The Boston, Chicago, and Dallas Districts indicated strong demand for air travel.

Reports from the tourism and hospitality industries remained upbeat. Tourism activity strengthened in the Boston, Minneapolis, New York, and Richmond Districts and remained solid in the Atlanta, Kansas City, and San Francisco Districts. The Chicago District reported steady tourist activity but noted that pre-bookings were slow. Hotel occupancies were strong in parts of the Atlanta, New York, Richmond, and San Francisco Districts, and the Atlanta District reported that gambling revenues were recovering.

Construction and Real Estate

Residential real estate markets continued to cool across much of the country--with most Districts reporting slower homebuilding and sales of existing homes. In contrast, commercial real estate activity continued to strengthen in most Districts. A few reports noted concern about too much building.

Some softening of the market for existing homes was reported by ten Districts--Chicago, Cleveland, Dallas, Kansas City, Philadelphia, Minneapolis, New York, Richmond, St. Louis, and San Francisco. Dallas and Richmond noted that activity remained quite strong, and Chicago reported slowing from high levels. San Francisco reports hot housing markets in Utah and parts of the Pacific Northwest. Several Districts said sales had weakened for some of the most expensive homes, except in the Dallas District where demand for lower-priced homes "had dipped noticeably." Atlanta reported that residential sales were near year-ago levels in most parts of the District, but that sales weakened and inventories increased in Florida. The Philadelphia District said sales of homes in resort areas have declined sharply. The New York District reports a sharp deceleration in prices in the suburbs around New York City, but a tightening of the Manhattan rental markets.

Homebuilding slowed in most Districts--Chicago, Cleveland, Dallas, Kansas City, New York, Philadelphia, St. Louis, and San Francisco. The New York District reported that some homebuilders in New Jersey are withdrawing from the authorization process and allowing their options to build to expire, noting that increases in fuel and materials costs are pinching profits. Homebuilders in the Atlanta District reported that single-family home construction was near year-ago levels in most parts of the District, except in Florida, where sales slowed. The Atlanta District also reported that Florida condominium sales continued to weaken and several projects were cancelled.

Commercial real estate activity strengthened in nearly all Districts, with mostly positive reports about office markets. Commercial building "improved" in the Cleveland District. Office markets were steady or stronger in the New York City metro area, with scattered signs of accelerating rents. The Philadelphia District said vacancy rates have continued to decline in the region's office markets. The Richmond District reported "fairly strong" office markets. Demand for office space "edged up at a steady pace" in the Dallas District. Office vacancy rates fell and rental rates rose in most major markets in the San Francisco District.

Boston reported that downtown office real estate markets were improving but mostly at the expense of suburban markets. Demand for commercial real estate in the Chicago District continued to expand, but the pace of new commercial construction slowed, according to contacts, who said rents were too low to justify new construction.

The Kansas City District reported that commercial construction remained strong, but received a few reports that high material costs were resulting in the scaling down or postponement of some projects. Construction firms in the Philadelphia District reported that rising costs have caused some construction projects to be rebid or redesigned to reduce the amount of costly materials used. Some builders in the San Francisco District continued to face cost increases

and minor project delays as a result of tight availability of skilled workers and selected materials, such as steel and cement.

The Philadelphia District reported growing demand for industrial space and an increase in construction of industrial buildings both on a speculative and build-to-suit basis. Demand for industrial properties was said to be gradually improving in the Dallas District. The Richmond District also reported growth in commercial leasing in the industrial sector.

Contacts in the Boston, Chicago, and Dallas Districts expressed concern about the level of investment in some portions of the real estate market. The Boston District reported that New England--and Boston in particular--continues to attract large volumes of commercial real estate investment, resulting in price increases that require "ambitious assumptions" to justify the transaction. The Dallas District noted growing concern about overbuilding of condominiums and town homes in Dallas, and contacts "fear that it will end badly." A contact in the Chicago District expressed concern about the potential for overbuilding of large distribution centers in Indiana.

Banking and Finance

Overall lending activity was mixed, and credit quality remained good across the nation. The New York, Chicago, and Atlanta Districts reported continued slowing in loan demand, while lending activity levels held steady in the Dallas, Kansas City, St. Louis, and San Francisco Districts. Only the Philadelphia District noted an increase in overall loan volumes over the past six weeks.

Demand for commercial loans increased or remained steady in most Districts, with only the Atlanta and Chicago Districts reporting a slowing in commercial lending activity. Bankers in the Dallas, and Richmond Districts said loan pricing was very competitive, and contacts in the Richmond District said they had to reduce margins to retain market share. On the consumer side, most Districts reported softening mortgage finance activity, while reports of other types of consumer loans were mixed. Demand for home equity loans weakened in the Chicago and Kansas City Districts but was up in the Cleveland and Philadelphia Districts. Refinance activity was categorized as "brisk" in the San Francisco District but declined in the Chicago, Kansas City, and New York Districts. Slower auto lending was reported by the Atlanta and Cleveland Districts.

Deposit growth was mostly steady, and some Districts noted an increase in interest rates on deposits. Delinquencies declined in the Chicago and New York Districts, but bankers in the Philadelphia District expect rising default rates if interest rates continue to rise. The Kansas City and St. Louis Districts reported no change in lending standards, while the New York District reported an easing in credit standards, especially for consumer loans.

Agriculture and Natural Resources

Agricultural conditions varied across the country. Spring rains boosted moisture conditions in parts of the Dallas and Minneapolis Districts, and most crops were off to a good start in the Chicago, Richmond, and St Louis Districts. Plantings were ahead of last year's pace in the Minneapolis, Richmond, and St Louis Districts, while crop conditions improved in the Atlanta District. In contrast, a dry spell lowered winter wheat crop yields and was hurting cattle producers in parts of the Dallas and Kansas City Districts. Concerns about high fuel and fertilizer costs were reported by contacts in the Kansas City District as well as the Minneapolis District, where agricultural lenders anticipated a decline in farm income in the second quarter.

The energy industry continued to show strong and expanding oil and gas activity in the five Districts that mention the sector--Atlanta, Dallas, Kansas City, Minneapolis, and San Francisco. The Dallas and Kansas City Districts noted that drilling activity is being constrained by shortages of equipment and labor. Expansion of coal-fired power plants, wind farms, and ethanol distilleries was reported as under way in the Minneapolis District. The Kansas City District also reported that a railway expansion is in progress that will allow more coal to be moved out of Wyoming's Powder River Basin to end users.

The Kansas City and Minneapolis Districts reported that overall mining activity is strong, with all open mines in the Minneapolis District producing at or near capacity.

Labor Markets

Labor markets continued to tighten across the country. Shortages of some types of skilled workers were reported by nine Districts--Atlanta, Boston, Chicago, Cleveland, Dallas, Kansas City, Philadelphia, Richmond, and San Francisco. Six of those Districts noted that the shortages had intensified--Atlanta, Boston, Cleveland, Dallas, Philadelphia, and Richmond. District reports mention a variety of skills that are in short supply, including truck drivers, some types of engineers, financial analysts, and oil and gas workers. The Minneapolis and New York Districts noted strengthening labor markets. In contrast, manufacturers in the Richmond District reported that hiring softened after several months of moderate payroll increases.

Salaries continued to rise, but wage pressures were reported to have intensified somewhat in only a few Districts--Dallas, Kansas City, and Philadelphia. The San Francisco District said wage growth remained rapid for selected worker groups with specialized skills. The Cleveland District reported an absence of any accumulating wage pressure outside of a few specific skills. Pay rates were not accelerating in the Boston or Chicago Districts.

The Atlanta District reported that shortages of affordable housing were hampering labor availability in South Florida and the Gulf Coast region.

Prices

Concerns about high or rising costs were expressed by business contacts across much of the country. Cost pressures were pushing up selling prices for manufacturers in several Districts, but few reports indicated that these increases were reaching the retail level. Four Districts--Boston, Cleveland, Dallas, and New York--cited rising selling prices for manufacturers, and just three Districts--Boston, Dallas, and Philadelphia--reported that retailers are having success raising retail prices.

Cost pressures increased in the Atlanta, Boston, Chicago, Cleveland, Dallas, Kansas City, New York, Philadelphia, and San Francisco Districts. Some firms in the Philadelphia District said their suppliers were including automatic price escalation in contracts to cover future increases in the cost of materials. The San Francisco District noted little or no change from the modest upward pressure on prices noted in the previous report. Only the Richmond District reported that raw materials prices increased less rapidly than in the last report.

Higher prices were reported for a number of items, with the products most cited including fuels, metals, petroleum-based products, and many building materials, such as concrete, steel, copper, and zinc. The most notable price decline was for natural gas. A number of Districts reported increases in fuel surcharges. In the New York District, fuel surcharges were being added with relatively little resistance from customers. Increases in delivery charges were noted by firms in all industries in the Philadelphia District. The Cleveland District reports that rising freight costs were affecting retailers.

Retailers in the Philadelphia District said they have raised retail prices significantly for some goods with large plastic or metal content, although they had not implemented major price increases for most lines of merchandise. Several retailers in the Dallas District said that they had passed cost increases through to higher selling prices. Retailers in the Boston District indicated that vendor prices continued to reflect increases for petroleum-related items, and many contacts reported being able to pass on some price increases to consumers. The Atlanta District reported that firms' ability to pass on higher costs to customers remained mixed, citing slowing demand and strong competition restraining price increases. Five Districts--Chicago, Cleveland, Kansas City, New York, and San Francisco--reported little change in retail prices since the previous reporting period. The Richmond District reported that retail price growth eased slightly in May.

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