The Federal Reserve Board

July 26, 2006

Summary

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Reports from all twelve Federal Reserve Districts generally indicated continued economic growth during June through mid-July, with numerous individual reports pointing to evidence that the pace of growth has slowed. Several Districts characterized the overall pace of economic growth as "moderate" or "modest," although San Francisco reported that its economic expansion remained "solid" and Atlanta and St. Louis described overall conditions as "mixed." The Philadelphia, Cleveland, Richmond, Chicago, Dallas, and San Francisco reports each highlighted a decline in the overall rate of economic growth in their Districts.

Most reports on retail sales indicated slightly weaker conditions, on balance, than earlier in the year. But tourist spending remained robust, albeit with evidence of slower growth in some areas, and activity expanded for providers of nonfinancial services to businesses and consumers. Reports from the manufacturing sector were strong, with significant gains in output and sales, especially for durable goods. Producers in the agricultural and natural-resource sectors also saw strong demand, although some weather-related difficulties and other supply constraints were noted. Activity in residential real estate markets cooled in most parts of the country, but various Districts reported an ongoing pickup in demand for commercial space. Among financial institutions, lending activity mirrored developments in the economy more generally: commercial and industrial lending expanded further, while most Districts reported a decline in residential mortgage lending and some noted reduced demand for consumer loans.

Increases in wages and in prices of final goods and services remained modest on net. Upward pressure from the elevated prices of energy and other inputs persisted; while this pressure increased further in some cases, a few Districts noted a moderation in prices for some items. Scattered reports from various Districts indicated an increase in manufacturers' and retailers' ability to pass such cost increases on to final prices. More generally, however, Districts reported that vigorous competition held price increases down, and some contacts noted reliance on productivity increases to maintain profit margins in the face of rising input costs. Labor markets tightened a bit further in most areas. Increases in base wages and salaries generally remained moderate, but they were relatively rapid for workers with specialized skills in a wide range of sectors.

Consumer Spending and Tourism

Many reports indicated that consumer spending on retail goods weakened slightly during the survey period. Although most Districts reported gains in retail sales compared with a year earlier, they generally characterized the pace of growth as modest or disappointing. Retail sales were "mixed" or "varied" in Boston, New York, and Atlanta, "flat" in Richmond, "cooling" in Dallas, and "below expectations" in Chicago and San Francisco.

Most Districts reported that sales gains for department stores and smaller retail establishments were limited or below retailers' expectations. Sales were healthy for luxury retailers but relatively weak among "big box" retailers and other low-price outlets. Cleveland and Chicago reported that general retail spending was held down in part by high gas prices, which have squeezed households' budgets and reduced the frequency of shopping trips.

In general, sales of automobiles and light trucks were flat to down. Sales remained healthier for imported vehicles than for domestic makes despite the revival of sales incentives for the latter, as high gas prices continued to nudge buyers towards fuel-efficient models. Inventories reportedly were undesirably high for SUVs and light trucks in some areas.

Activity in the travel and tourism sector generally remained at high levels or increased further, although a few reports indicated that the pace of growth has slowed. New York noted that occupancy rates in Manhattan recently edged down from very high levels. Performance was mixed in Richmond's tourism sector, and Kansas City and Minneapolis reported that summer tourism activity has been at or only slightly above year-earlier levels. Atlanta reported "cautious optimism" in the tourist trade and increased tourist traffic to Florida destinations, while San Francisco reported that tourist activity increased further from very high levels in Hawaii and other destinations throughout the West.

Nonfinancial Services

Activity in the nonfinancial services sectors generally expanded further, although the pace of growth reportedly slowed in the Philadelphia and Richmond Districts. Providers of business and professional services, such as advertising, accounting, management consulting, and technology services, saw solid demand in general and increased activity in the Boston, Richmond, and San Francisco Districts. Providers of permanent and temporary employee placement services were quite active, with modest or better increases in hiring reported in the New York, Philadelphia, Cleveland, Richmond, and Dallas Districts. Reports on the health-care sector were mixed, with "brisk" activity reported by San Francisco but Richmond noting that activity was "flat to lower."

Reports on the transportation sector suggested further increases in activity on net. Philadelphia, Richmond, St. Louis, and Dallas pointed to recent expansion in rail freight and trucking activity, and San Francisco reported strong demand for transportation services. By contrast, Cleveland and Chicago noted slight declines in trucking tonnage and rail tonnage, respectively, with the latter attributed to reduced shipments of construction materials.

Manufacturing

Reports on manufacturing activity indicated significant gains across most Districts during June and July. The only slightly weak reports came from New York, where manufacturers reported decelerating activity in July in the wake of a strong June, and St. Louis, where manufacturing conditions were mixed.

Among products, demand was especially vigorous for various durable goods. Substantial sales gains were reported for makers of electrical equipment and information technology products such as semiconductors, along with further increases in orders and activity for makers of commercial aircraft and products used for national defense. The reports also pointed to a further rise in demand for makers of heavy equipment, machine tools, and steel, offset in part by reduced demand for smaller equipment that is oriented towards residential construction activity. Demand for building materials was mixed but generally positive. Atlanta reported a drop in demand for concrete, but Chicago reported strong demand for wallboard, and Richmond and Minneapolis noted further increases in the production of fabricated metals. Among nondurable products, the reports indicated strong demand and further growth for chemicals, plastics, textiles, and processed food.

The Cleveland, Chicago, and San Francisco Districts noted that capacity utilization was high in various manufacturing sectors and increased a bit further in general. Looking ahead, manufacturers in the Boston, Philadelphia, and Cleveland Districts reported plans to increase their capital spending over the balance of the year, but in the Kansas City District expectations for future capital spending remained low.

Real Estate and Construction

With only scattered exceptions, Districts reported slower activity in residential real estate markets. For new and existing homes, available reports indicated that the pace of sales declined and that the inventory of available homes and time on the market rose in most major metropolitan areas nationwide. Slower sales activity has translated into more limited price gains, and residential construction activity has fallen in most Districts as well.

The St. Louis and Dallas Districts were exceptions to the general slowdown in residential market activity. In the St. Louis District, the pace of home sales was largely unchanged or up slightly compared with a year earlier, although residential construction slowed there. Housing markets have remained resilient in the Dallas District, where despite signs of cooling, "home demand remains strong" and residential building activity has been "robust."

As home demand has slipped more generally, scattered reports indicated a strengthening in demand for rental units. New York reported that the market for apartment rentals has been tightening in Manhattan, and according to Atlanta slower condominium sales in Florida have prompted owners to convert some units to rental property.

Slower activity on the residential side was offset in part by firmer activity on the commercial side. Demand for commercial space was strong in general, and the market tightened further in most Districts. Commercial construction activity was at high levels and increased further in the Dallas, Atlanta, and Richmond Districts. By contrast, Chicago reported a modest slowdown in commercial construction activity, and Kansas City noted that "commercial real estate activity was mostly flat."

Builders in some areas faced moderate constraints on construction activity. High construction costs reportedly were a restraining factor that delayed or caused the cancellation of some building projects in the Cleveland, Chicago, and San Francisco Districts. Moreover, Atlanta reported that some commercial building projects along the Gulf Coast have been put on hold until late fall, after the current hurricane season is over.

Banking and Finance

Overall lending activity remained strong on net but growth slowed in most Districts, as continued strength in business loans was offset by further weakening in loans to households. On the business side, commercial and industrial lending generally was at high levels and rose further in many Districts. The main exceptions were Richmond, where rising interest rates reportedly contributed to a decline in commercial lending, and Atlanta, where commercial lending "remained slow overall."

Loans to households weakened somewhat in most Districts, as ongoing declines in mortgage lending were reinforced by slightly slower consumer lending in some areas. Most Districts reported a reduction in the pace of mortgage lending, although St. Louis saw a slight increase. While consumer lending was reported to be stable in a few Districts, it slowed somewhat in the St. Louis, Kansas City, Dallas, and San Francisco Districts. New York noted overall weakening in loan demand, with especially pronounced declines for consumer loans and mortgages for commercial real estate. In most Districts, credit quality remained high across all loan categories.

Agriculture and Natural Resources
Reports indicated further expansion of demand for most agricultural and natural-resource products, but growing conditions for crops in some regions were hampered by dry weather. Demand was strong for most crops and livestock products, and prices generally remained firm even for products in ample supply. Dry conditions constrained growing in the Chicago, Minneapolis, Dallas, and Atlanta Districts, holding yields on corn, cotton, and other crops below normal levels. Dry conditions also caused pasture deterioration in the St. Louis, Kansas City, and Dallas Districts, increasing operating costs for livestock producers and prompting some to reduce or liquidate herds. By contrast, dry weather contributed to healthy crop conditions for corn, cotton, and other items in the St. Louis District. High input prices reportedly squeezed agricultural profit margins in some areas, with Chicago noting an increase in farmers' reliance on operating loans and Kansas City reporting an expected drop in farm incomes this year.

Activity was robust in the natural-resources sector. Dallas, Atlanta, Kansas City, and Minneapolis reported further increases in extraction activities for oil and natural gas. Demand for labor and equipment was strong, and some producers reported labor shortages and difficulties obtaining needed materials and equipment. Producers of natural gas continued to operate at high levels, although Dallas and San Francisco reported that inventories have risen substantially, causing prices to decline.

Prices and Wages
Increases in prices of final goods and services generally remained modest, despite the pressures from high prices for selected inputs and further increases for some. Manufacturers' and retailers' ability to pass cost increases on to final prices varied. Providers of transportation services have been able to apply fuel surcharges, significantly increasing the price of their services in some areas over the past year. In addition, Atlanta noted rising prices charged by various service providers, and Kansas City reported an increase in the percentage of manufacturers reporting higher prices on finished goods. Other reports indicated more limited pricing power and smaller increases in final prices. Richmond reported that retail prices rose at a slower pace in recent weeks, and Kansas City reported that recent and planned increases in retail prices were unchanged from the previous survey period. Dallas noted that weaker demand of late reduced firms' ability to raise prices in some industries.

District reports indicated that labor markets were tight in general and tightened a bit further in most areas. Increases in base wages and salaries generally remained moderate overall, with scattered indications of faster growth for some workers. San Francisco noted that numerical reports on wage increases generally were in the range of 3 to 4 percent. In the Kansas City District, the fraction of firms reporting "above-normal" wage increases edged up, and Dallas reported significant pay increases for workers employed through temporary services firms. Wage increases remained relatively rapid for skilled workers in many areas, including managerial and professional employees and those with specialized occupational skills in a variety of industries. Moreover, New York reported that the market for recent college graduates has tightened, with starting salaries up 7 percent over the past year in that city.

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