The Federal Reserve Board

The BEIGE BOOK

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Summary

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Reports from the twelve Federal Reserve Districts indicate that economic activity continued to expand since the last report, but five Districts indicated deceleration while the remaining seven reported little change in the pace of growth. Some slowing in economic growth was seen in the Boston, New York, Philadelphia, Kansas City, and Dallas Districts, though Dallas still characterized growth as strong. Most other Districts reported continued modest growth, though Atlanta described activity as "mixed", Richmond observed that growth was "slow," while San Francisco noted a "solid" growth pace.

Consumer spending increased slowly in most Districts, weighed down by sluggish sales of vehicles and housing-related goods. While a number of districts noted some bloating in automobile inventories, most non-auto retailers indicated satisfaction with inventory levels. Tourism was generally characterized as steady but relatively strong. Reports on the service sector varied by industry and by district: some found the trucking and information technology industries to be relatively strong, but others provided mixed reports on air transportation and health care. Manufacturing activity continued to expand in all districts, despite pockets of weakness mostly related to autos and residential construction. Reports on real estate and construction were uniformly weak for the residential sector, but fairly widespread strength was recounted in the commercial sector. Financial institutions reported some softening in loan demand, especially for home mortgages, but noted that credit quality was still favorable. Drought-like conditions in much of the nation have hampered crop production and livestock while energy production remained at a high level.

Labor markets were mostly described as steady since the last report, with scattered labor shortages and associated upward wage pressures noted in a number of Districts, especially for workers with specialized skills. Widespread increases in the prices of energy and certain other commodities persisted since the last report, though most of these increases do not appear to have passed through to finished consumer goods.

Consumer Spending and Tourism

Consumer spending increased modestly in most Districts since the last report, though a few Districts reported flat to declining sales. In general, sales of autos and home-improvement and other home-related goods tended to be weaker than for other categories. A number of Districts also indicate that persistently high energy prices are perceived to have crimped consumer demand in general. Overall, retail sales were described as growing modestly in nine Districts: Boston, New York, Philadelphia, Atlanta, Chicago, Minneapolis, Kansas City, Dallas and San Francisco. The Richmond and St. Louis Districts noted weak or declining sales while Cleveland described sales as mixed. Vehicle sales were reported to have weakened in the Philadelphia, Cleveland, Richmond, St. Louis, and Kansas City Districts; however, a pickup in auto sales was indicated in the Chicago District. Vehicle sales were described as mixed in the Atlanta, Minneapolis, Dallas and San Francisco Districts; all four noted a shift in demand toward more fuel-efficient vehicles.

Aside from automobiles, retail inventories were generally reported to be at favorable levels, where specified--in the Boston, New York, Atlanta, Chicago, and St. Louis Districts. Kansas City reported a slight decline in the share of store managers satisfied with inventory levels. However, excessive vehicle inventories were reported in the Philadelphia, Atlanta, Chicago, and St. Louis Districts, and contacts in the Kansas City District anticipate a build-up of vehicle inventories in the months ahead.

Tourism was, on balance, little changed from the last report. The New York, Atlanta and San Francisco Districts indicated continued high levels of tourism activity. Activity was described as mixed in the Richmond and Chicago Districts and as weaker in the Minneapolis and Dallas Districts.

Services
Activity in the service sector was mixed across Districts and across industries since the last report. Regarding the broad service sector overall, Richmond reported an acceleration in service firms' revenues, St. Louis and San Francisco indicated steady growth while New York indicated some slowing in activity. The transportation industry was mixed since the last report. Strong or increased overall activity was reported in the Atlanta, St. Louis, Dallas, and San Francisco Districts; Richmond reported that airports' revenue accelerated. In contrast, St. Louis and Dallas indicated some softening in the airline industry, and Cleveland noted some moderation in trucking and shipping activity. Boston reported steady growth in business at software and IT service firms. The Richmond and San Francisco Districts characterized the health care industry as robust, whereas the St. Louis District indicated impending layoffs in that industry.

Manufacturing
Manufacturing activity was reported as generally expanding in all Districts, and contacts were optimistic that activity would continue to grow in the months ahead. While the pace of manufacturing activity had slowed in the New York, Richmond, and Kansas City Districts, it was reported as increasing in the Philadelphia and Chicago Districts.

Factory activity was reported as declining in some sectors but increasing in others. Several Districts reported a decline in activity in the motor vehicle industry, although Cleveland noted that some of this decline was likely seasonal; Chicago said that heavy-duty truck production and demand for heavy equipment continued to be strong. Steel demand also remained strong according to the Cleveland and Chicago Districts. Activity was reported as rising in aircraft and defense sectors. Reports of slowing in activity related to residential construction and housing-related products were widespread, although demand related to non-residential construction activity was reported as improving. The production of apparel was also cited as having slowed. Energy-related manufacturing activity continued to rise strongly, and capital goods output was reported as generally growing in most Districts.

Real Estate and Construction
Housing markets and home construction activity weakened throughout the nation, but commercial real estate and construction strengthened in most Districts. Virtually all Districts reported declines in home sales, as well as in residential construction activity. Moreover, most

Districts indicated substantial increases in the inventory of unsold homes; Kansas City attributed some of this increase to "sizable numbers of foreclosures" in some areas. In general, residential real estate contacts expected that housing markets would remain weak, if not weaken further, in the months ahead; such concerns were specified in the reports from Philadelphia, Cleveland, Atlanta, and Kansas City.

Relatively flat or declining home prices were noted in the New York, Richmond, and Kansas City Districts, and decelerating prices were reported in the Philadelphia and San Francisco Districts. The high end of the market was described as particularly weak in the Richmond, Chicago, and Kansas City Districts, as well as parts of the Minneapolis District. In contrast, the high ends of both the Dallas District's housing market and the New York District's co-op and condo market were reported to have experienced less softening than the more moderately priced segments. One area of relative strength in residential real estate has been the apartment market--of the three Districts reporting on this, New York and Chicago both indicate fairly strong demand for apartment rentals since the last report, while Dallas noted continued strong demand for condominiums.

Commercial real estate markets were uniformly described as strong and, in most cases, increasingly so. Office markets showed noticeable signs of improvement in the Boston, New York, Philadelphia, Atlanta, Chicago, Minneapolis, Kansas City, Dallas and San Francisco Districts. However, market conditions were described as mixed in the Richmond and St. Louis Districts. The reports on markets for industrial space were not as uniformly positive: Philadelphia, Richmond, and Atlanta reported some firming, whereas Minneapolis noted some softening; industrial markets were described as generally steady in the New York and St. Louis Districts.

With widespread tightening in commercial real estate markets, most Districts also reported increases in commercial development and construction. Increased office construction was reported in the Boston, Philadelphia, Atlanta, Minneapolis, Dallas, and San Francisco Districts. Minneapolis also reported a pickup in industrial construction while Cleveland and Dallas reported increases in retail development. Public construction activity was described as strong in the Dallas and San Francisco Districts.

Banking and Finance

Banks reported mixed but generally slowing trends in lending activity during the summer, with softening demand most evident in the household sector, especially for home mortgages. The New York, Cleveland, Atlanta and Chicago Districts reported declines in overall loan demand, while the Philadelphia and Kansas City Districts reported increases. However, reports of soft and/or weakening demand for residential mortgages were more widespread, as highlighted in the New York, Philadelphia, Cleveland, Richmond, Atlanta, Chicago, and San Francisco Districts. Although refinancing was generally described as soft, both Richmond and Chicago noted an uptick in such activity, which was attributed to homeowners looking to lock in fixed rates. Demand for commercial and industrial loans rose in the Philadelphia, Chicago, and San Francisco Districts but weakened in the New York and Kansas City Districts.

Overall credit quality was generally described as good, and delinquency rates were little changed in most Districts, though a few noted scattered increases. The New York and Philadelphia Districts reported modest increases in delinquencies on home mortgages, and Cleveland noted a slight increase in the commercial segment. Credit standards were reported to be steady to slightly tighter.

Agriculture and Natural Resources

Drought and near-drought conditions persisted throughout much of the country, depressing crop production and livestock sustainability. Conditions were distressed in the Atlanta, Richmond, Minneapolis, and Dallas Districts. Dallas reported that more than 50 percent of key crops were in poor shape, and the consequent acceleration of the liquidation of cattle is expected to cut beef supplies significantly over the next few years. Weather conditions improved somewhat in the Kansas City District; nonetheless, the region's crops continued to suffer from prior drought conditions, and cattle producers there also plan faster liquidation of herds. St. Louis reported mixed conditions. The bright spots were in the Chicago District, where above-average rains reduced stress and improved the crop outlook from earlier drought conditions, and in the San Francisco District, where conditions were reported as favorable.

The demand for oil and natural gas was reported as continuing to be robust, and facilities were operating near capacity. But several reports indicated some softening in natural gas prices. Drilling and exploration activity was reported as rising slightly, but constrained by capacity constraints, with the Dallas District noting that some drilling activity had shifted away from natural gas and toward oil. Mining activity was reported as robust.

Labor Markets
Labor markets around the nation have generally been steady since the last report. Scattered labor shortages continued to be reported in a number of Districts, though these do not appear to have intensified, except in the Dallas District. Job growth was described as brisk in the Kansas City District, and recent acceleration was noted in the Richmond District. Labor markets were characterized as steady or expanding moderately in the other ten Districts. The Kansas City and Dallas Districts reported fairly widespread labor shortages while more specific shortages were cited in a number of other Districts: Cleveland indicated a shortage of truck drivers, Atlanta noted ongoing shortages of construction and hospitality workers along the Gulf Coast (where Hurricane Katrina struck a year ago); Chicago reported shortages of skilled manufacturing workers and engineers; and Minneapolis mentioned some shortages in Michigan's northern peninsula.

Wage pressures were reported in a number of Districts, though they were most often limited to certain sectors and most pronounced for workers with specialized skills. Overall increases in wage pressures were mentioned in the Philadelphia, Chicago, Minneapolis, Kansas City, and Dallas Districts. A number of other Districts reported sharp wage increases or wage pressures for such workers in occupations that are in short supply or for workers in particular industries, such as information technology (Boston), trucking (Cleveland), retail trade (Chicago), and financial and health services (San Francisco).

Prices
Reports of sustained increases in the cost of metals, energy and petroleum-based products, and other raw materials continued to be widespread, although increases in energy costs were reported as moderating in the San Francisco District. Some Districts reported flat to declining prices for natural gas and a moderation in the price of steel. Manufacturers found little ability to pass through higher costs into the prices of manufactured goods, with the exception of energy-intensive goods and services as reported by the San Francisco District. Many Districts reported lower prices for apparel and electronic goods, and most Districts reported that retail prices remained steady.

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