

**October 12, 2006**

Summary

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Prepared at the Federal Reserve Bank of Richmond and based on information collected before October 2, 2006. This document summarizes comments received from businesses and other contacts outside the Federal Reserve and is not a commentary of the views of Federal Reserve officials.

Reports from the twelve Federal Reserve Districts indicate that economic activity continued to expand since the last report. Four Districts reported that economic growth firmed while a couple of Districts noted that growth cooled. Other reports generally characterized growth as moderate or mixed.

Consumer spending increased more quickly in a number of Districts, although several reports continued to note that automobile and home-related sales were sluggish. Tourism was generally strong and added some momentum in the New York and Kansas City Districts. Activity in the service sector expanded in most Districts, but Boston described activity as flat and Cleveland and Dallas identified pockets of softness in some industries. Manufacturing conditions generally held up well, with several Districts indicating that growth increased, though Philadelphia reported that activity edged down. Commercial construction gained strength in most of the country. Reports on residential real estate, however, indicated widespread cooling with the majority of Districts citing lower asking prices, rising inventories of homes on the market and softening sales. A number of reports, however, indicated that residential activity increased in some markets. Financial institutions continued to report that residential mortgage lending had tapered off, but commercial lending activity picked up in several Districts. Agricultural conditions generally improved as rainfall brought relief to drought-stricken areas.

A number of Districts reported that labor markets were tight with some noting shortages of skilled workers. Wage pressures were associated with tightening conditions in a few Districts, though other reports noted that wage pressures were in check. While the majority of Districts characterized price pressures as contained, input prices increased in several Districts and a few reports mentioned increased pass throughs by businesses.

Consumer Spending and Tourism

Most Districts reported stronger growth in consumer spending, although automobile and housing-related sales generally weakened. Solid back-to-school sales helped boost retail revenues in the Philadelphia, Atlanta and Minneapolis Districts. Chicago said back-to-school sales were within expectations, though "nothing stellar." Sales of upscale merchandise picked up in the New York District, while apparel sales grew more quickly in the Boston, Cleveland and San Francisco Districts. Chain department store sales were stronger in the Richmond District and same-store sales increased in the New York District. Softer residential real estate

conditions damped home improvement and furniture sales in the New York, Richmond, Kansas City and San Francisco Districts.

Vehicle sales weakened in several Districts--particularly sales of domestic automobiles, SUVs and light trucks. However, a few Districts reported increased sales of foreign cars and fuel-efficient automobiles. Philadelphia noted that a growing number of smaller automobile dealerships had closed and dealers in the Atlanta District added incentives to move inventory. In the Dallas District, sales of luxury vehicles increased.

Tourist activity strengthened since our last report. New York said that tourism remained robust in New York City. Kansas City reported solid gains in hotel occupancy rates, while tourist activity in the San Francisco District remained at a high level despite some moderation. Tourism in the Richmond District was temporarily dented by Hurricane Ernesto in early September, but rebounded later in the month.

Services

Activity in the service sector generally strengthened across Districts since the last report. The Philadelphia, Richmond, St. Louis and San Francisco Districts reported increased demand for professional and technical services. Boston reported increased demand for consulting and financial services, and along with San Francisco, for healthcare services. Richmond indicated that demand for computer and web-based services firmed and San Francisco noted that demand for media services was stronger. Assessments of transportation services were mixed. Trucking firms reported declining volume in the Philadelphia, Cleveland, Atlanta and Dallas Districts, and in Cleveland, shipping services continued to soften. Chicago said trucking volume was up slightly and cargo shipping increased in the Dallas District. St. Louis reported that freight transportation companies planned expansions. Atlanta indicated that rail companies experienced steady growth in inter-modal shipment volume, and Dallas said that rail demand was strong.

Manufacturing

Manufacturing activity remained generally strong in most Districts. Eight of the twelve Districts indicated that factory output increased, while Chicago and Kansas City noted that the pace of expansion slowed. Minneapolis described factory activity as mixed and Philadelphia reported that factory production edged down. The output of energy-related equipment increased in the Boston, Atlanta and Dallas Districts, while Chicago and San Francisco indicated that orders for machine tools increased. San Francisco reported that semiconductor sales were solid. The demand for steel was especially strong according to Atlanta and Chicago, while Cleveland and Chicago noted that heavy equipment sales continued to be robust. Chicago also reported strength in heavy-duty truck production. In contrast, St. Louis said that producers of motor vehicle parts announced plans to lay off workers and Cleveland reported weakness in the auto industry. Reports of softer demand for housing-related products continued to be widespread, but Dallas noted that strong demand from the commercial construction industry helped offset softer residential demand. Cleveland, Minneapolis, Dallas and San Francisco said that sales of food products had accelerated since our last report.

Construction and Real Estate

Nearly all Districts reported that housing market conditions continued to soften, though several noted that activity increased in some markets. Most Districts reported higher home inventories, and several said that homebuilders and sellers continued to offer incentives to attract buyers. Softer home demand in San Francisco led to layoffs for mortgage brokers and real estate agents. Residential construction remained weak in the St. Louis and Minneapolis Districts except in western North Dakota where residential construction was described as

"robust." New home inventories inched up in the Dallas District despite strong demand in some of its markets and inventories of single family homes and condominiums rose sharply in the Boston District.

New York and St. Louis reported mixed housing activity. On the upside, Manhattan condominium sales showed signs of resilience, and housing sales rose in Memphis, but both Districts noted weakness in most markets. Richmond reported generally weaker housing activity, but also noted increases in some markets. Atlanta said that housing activity rose in its Mississippi Gulf market, and Minneapolis' Sioux Falls market remained on pace with last year's record-breaking level. Dallas reported particularly robust home sales in its Houston, Austin and El Paso markets.

Commercial real estate markets were strong in most Districts, and activity increased at a faster pace in a number. Leasing activity increased in New York, Minneapolis, Kansas City, Dallas and San Francisco, and held steady in Richmond. Chicago and St. Louis, however, said leasing activity was mixed. Rent increases were reported by New York, Minneapolis and San Francisco, with Dallas indicating that pricing power was shifting to landlords.

Nonresidential construction was generally strong. Construction activity was steady in the Cleveland, Richmond, Atlanta, Minneapolis and Kansas City Districts and increased in the Chicago and Dallas Districts. Material costs and budget concerns scaled back some projects in the Atlanta and Chicago Districts. The Chicago and Minneapolis reports noted concerns among some contacts that commercial construction may slow in the coming months.

Banking and Finance

Lending activity was mixed as increases in commercial lending were offset by further weakness in residential mortgage lending. The New York, Richmond and Chicago Districts reported declines in overall loan demand, while Philadelphia, St. Louis and Kansas City reported modest increases. Demand for residential mortgages slowed in the New York, Philadelphia, Cleveland, Richmond, Atlanta, Chicago, Dallas and San Francisco Districts. Demand for commercial and industrial loans rose in the Philadelphia, Cleveland, Atlanta, Chicago, St. Louis, Minneapolis and San Francisco Districts; held steady in the Richmond and Dallas Districts; and declined in the New York District. The commercial lending market was characterized as very competitive by Richmond, Chicago and Dallas. Overall credit quality remained generally good, although increases in mortgage delinquency rates were noted by Philadelphia, Cleveland and Atlanta. Tighter standards for commercial loans were reported by New York and Chicago.

Agriculture and Natural Resources

Agriculture conditions generally improved as late summer rainfall brought relief to drought-stricken Districts, although some rains hindered field work in some areas and damaged crops in others. Richmond indicated that tropical storm Ernesto severely damaged crops along some coastal areas. Chicago and St. Louis reported that recent precipitation and unseasonably cool weather delayed corn and soybean harvests. Crop yields in the Minneapolis District improved with the rainfall, though Chicago reported that yield prospects were mixed. In the Kansas City District, cooler weather and scattered rainfall restored soil moisture and pastures conditions, though cattle producers continued to draw down herds. Dallas, however, said that while September rains assisted wheat producers and eased pressure on livestock producers to liquidate herds, many parts of the District still needed rain. San Francisco reported strong sales for livestock and most crops but indicated that spinach producers put planting on hold.

Activity in the energy industry remained strong according to reports from the Minneapolis, Kansas City and San Francisco Districts. Minneapolis indicated that alternative energy

industries continued to expand at a rapid pace and that mining production was at near-capacity across the District. Kansas City noted that oil and gas drilling rig counts remained above year-ago levels, while San Francisco said that oil and natural gas extraction continued at a rapid pace. In contrast, Dallas reported that activity in the oil and energy producing sector was virtually unchanged although demand for oil-field equipment and energy services remained strong.

Employment, Wages, Prices

Labor market conditions remained taut since our last report. The Boston, Philadelphia, Richmond, Minneapolis and Dallas reports characterized labor markets as generally tight, particularly for skilled workers, while the remaining Districts noted that job growth was steady to stronger. Six Districts mentioned labor shortages, particularly for professional, scientific, and other technical workers. In addition, Kansas City said retailers faced shortages of experienced sales workers and Atlanta indicated that residential construction firms were having difficulty obtaining qualified construction workers, despite the slowdown in building activity. In contrast, Cleveland reported that roughly half of the homebuilders they contacted had reduced their labor force.

Wage growth around the nation was generally modest, although faster wage growth for skilled services workers was cited by a number of Districts. The San Francisco District noted that a short supply of healthcare, finance and construction workers pushed wages higher. In addition, Richmond noted a sharp uptick in retail wages and Atlanta reported that some manufacturers had raised entry-level wages in an effort to attract workers.

Most Districts reported few signs of increased price pressures in recent weeks. A number of Districts said that energy prices moderated, but increases in raw materials prices were noted by Philadelphia, Richmond and Atlanta, and a rise in building materials prices was reported by Minneapolis. Instances of businesses passing on higher costs were scattered across Districts; Cleveland and Atlanta said some manufacturers attempted to raise output prices while Boston reported increases in retail prices. Boston also reported that costs for some businesses had increased--especially for airfare and hotel accommodations. Likewise, the New York District noted that accommodation and theatre ticket prices had risen sharply compared to a year ago.

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