



July 25, 2007

## Summary

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### Summary

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Prepared at the Federal Reserve Bank of Chicago and based on information collected before July 16, 2007. 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 the twelve Federal Reserve Banks indicated that economic activity continued to expand in June and early July. New York, Richmond, St. Louis, Minneapolis, and San Francisco described the pace of growth as "moderate" while Cleveland and Chicago saw it as "modest." Philadelphia noted that economic conditions improved. Kansas City said the regional economy continued to grow but at a moderating pace, and Dallas characterized its economy as strong but said it decelerated. Boston and Atlanta described business contacts' reports as "varied" or "mixed."

On balance, consumer spending rose at a modest pace, although a number of Districts indicated that sales were mixed or below expectations. Several reports indicated that capital spending increased, and expenditures for most business services continued to rise. Employment increased further in most regions and in many sectors of the economy. Most Districts said that residential construction and real estate activity continued to decline. Commercial construction and real estate markets were generally more active than during the previous reporting period. District reports indicated that manufacturing activity continued to expand during June and early July. Household lending declined in most regions, while commercial and industrial lending expanded at a modest pace. Contacts generally reported ongoing input cost pressures, particularly for petroleum-related inputs, while prices at the retail level continued to increase at a moderate rate. Energy and natural resource activity remained at high levels, or in some instances, rose further. Many Districts described overall wage gains as moderate and/or similar to the previous reporting period. Agricultural conditions varied widely, as the impacts of drought were felt east of the Mississippi River and heavy rains affected the Dallas and Kansas City Districts.

#### Consumer Spending and Tourism

On balance, consumer spending rose at a modest pace, although a number of Districts indicated that sales were mixed or below expectations. Cleveland, Chicago, St. Louis, and Minneapolis all shared the general assessment that consumer spending rose modestly, while Philadelphia said retail sales growth was quite strong in May but "closer to trend" in June. New York, Atlanta, Kansas City, and Dallas reported sales as flat and/or below expectations. The remaining regions described sales as mixed. A number of Districts noted that high gas prices restrained spending; Chicago also noted a negative impact from high food prices, and Dallas mentioned that wet weather depressed sales. Five regions indicated that retail sales of items related to housing--such as furniture and home repair materials--were weak or declining. Retail inventories were generally at desired levels across the country, while Atlanta

and San Francisco observed some increases. New vehicle sales in many areas were described as "flat" or "lackluster," although dealers in Philadelphia and Chicago noted some improvement between June and early July. Many Districts commented on the relative strength of demand for fuel-efficient vehicles compared with larger automobiles and of foreign brands compared to domestics.

The majority of reports on tourism were positive. Strong gains were noted in many sections of the New York, Richmond, Minneapolis, Kansas City, and San Francisco Districts. Minneapolis noted an increase in the number of Canadians visiting and shopping in the region, but Boston and San Francisco said that international tourism was down.

### **Business Spending and Hiring**

Several reports indicated that capital spending increased. Firms in New York, Cleveland, and Chicago said capital outlays increased according to plans. Current investment was mixed in Boston; Kansas City said capital expenditures were trimmed slightly during the reporting period but were expected to rebound to prior levels in coming months. Philadelphia indicated that investment plans increased compared with two months earlier.

Reports on expenditures for most business services were generally positive. Several Districts noted strong gains by consulting, advertising, health care, scientific and technical, and telecommunications firms; demand for legal services was reported as mixed or unchanged by the Reserve Banks that commented on it. Philadelphia noted a significant increase in demand for business services from start-up and early-stage firms, and some contacts in the region expected further growth in overall service demand in the coming months. Demand for trucking firmed during recent weeks in Richmond and Dallas; reports in Cleveland ranged from strong growth to softening, while Atlanta and Chicago pointed to declines. Small-parcel shipping volumes were good in the Dallas region, and contacts there also expected a pickup in the future. Rail freight volumes declined in Cleveland and Dallas. Air travel was strong in Chicago and Dallas.

Employment continued to increase in most locations and in many sectors of the economy. Richmond said hiring "intensified," Minneapolis indicated that labor markets tightened, and Atlanta and Dallas said labor markets remained tight. Kansas City said employment expanded at a slower pace than previously. Cleveland reported a slight increase in manufacturing employment over the past six weeks, and Richmond indicated that the weakness in factory payrolls in the region had moderated, while Boston said manufacturing employment was unchanged. Retail hiring was limited to store openings in the Cleveland District. Employment in several service-providing industries increased in five Districts. Demand for temporary workers was strong in Richmond and Minneapolis, while Chicago reported a decrease in billable hours. Seven Districts referred to shortages of skilled workers in several industries including retail, construction, manufacturing, accounting, and engineering. Looking ahead, contacts in the New York report anticipated a moderate increase in manufacturing payrolls and a faster rate of nonmanufacturing hiring in the second half; respondents in the Philadelphia report projected that the rate of hiring in the third quarter would match that of the second quarter; a temporary help agency in the Chicago region expected demand to firm in the second half; and in the Minneapolis District, more firms expected to increase payrolls than decrease.

### **Construction and Real Estate**

Most Districts said that residential construction and real estate activity continued to decline on balance. Many Districts, however, noted increased activity in some individual market locales or segments. Atlanta, Chicago, St. Louis, and Minneapolis said construction decreased. Boston and Kansas City said housing markets remained "soft" and "weak,"

respectively, while San Francisco indicated that residential markets were weak and had slowed further in some areas. New York said markets were mixed but stable. Two notable exceptions were the Cleveland and Richmond regions, which experienced slight increases in sales. Atlanta said home inventories remained high, as did Dallas (even after a slight decline in the recent period). Inventories increased in Kansas City, but they declined in New York, and contacts in Boston and Cleveland described the number of homes for sale as "normal" and "acceptable," respectively. District reports on home price appreciation were mixed: Boston noted a return to price appreciation and Kansas City indicated slower rates of decline. But Richmond and Chicago reported slower rates of increase or the beginning of declines, and in the Dallas District, some contacts projected a correction in entry-level home prices. Looking ahead, contacts in the Cleveland District were uncertain about how long it would be until the market turned, and analysts in Dallas had revised their housing outlook down. Contacts in Atlanta expected further declines overall, though they anticipated the market in Florida would be flat.

Commercial construction and real estate markets were generally more active than during the previous reporting period. New York said markets strengthened and San Francisco reported continued firming. Cleveland, Atlanta, Minneapolis, and Kansas City indicated small gains in development. Richmond and Dallas described local markets as still "solid" and "robust," respectively. Chicago said the pace of development was steady, and St. Louis said markets were mixed. Richmond and Chicago observed that overall commercial vacancy rates were stable. Office vacancy rates fell in four regions. Demand for industrial space increased in four Districts, while net absorption in the Minneapolis District was negative. Richmond, Kansas City, and San Francisco reported increases in rental rates for commercial space, and New York said that the asking rents for space "continued to soar."

### **Manufacturing**

Most District reports indicated that manufacturing activity continued to expand during June and early July. Richmond said that activity rebounded, and manufacturing appeared to expand in the New York, Philadelphia, Cleveland, St. Louis, Minneapolis, and San Francisco regions. Atlanta and Chicago pointed to general stability in the sector, while Kansas City and Dallas said activity "slowed" and "cooled," respectively. Boston said half of their manufacturing respondents pointed to year-over-year declines while the rest said activity was expanding at "normal" rates.

In most Districts, the increases in demand for factory goods were spread across a number of industries. The sectors consistently mentioned as facing strong demand included fabricated metals, defense-related products, aerospace, rubber, and processed food. A number of Districts noted that strong export demand boosted activity. Cleveland reported auto production had increased and was expected to continue moving higher, and an auto parts maker in the St. Louis region planned to increase output. San Francisco reported generally steady demand for information technology products, but noted that semiconductor sales had increased. Chicago reported stronger-than-expected demand for agricultural machinery and projections of further gains in the second half of the year. In contrast, manufacturers of housing-related products (lumber, stone, glass, cement, appliances, and furniture) typically reported declines. Looking ahead, manufacturers in Boston, Philadelphia, and Cleveland expected activity to increase at a modest pace; the expectations of contacts in the Kansas City region improved; and manufacturers in the New York District expressed broad-based optimism. Cleveland noted that steel service centers expected to maintain or slow shipments in the third quarter, while a steel contact in the Chicago region thought that an inventory build would be needed by the end of the summer.

## **Banking and Finance**

Household lending declined in most regions, while commercial and industrial lending expanded at a modest pace. New York, Richmond, Chicago, Kansas City, and San Francisco noted decreasing demand for mortgages, which in many cases was coupled with tighter underwriting standards. Cleveland indicated that consumer lending was flat to declining. In contrast, Philadelphia and Dallas reported that consumer lending was flat, and St. Louis said loans to individuals rose. Lenders in Philadelphia said it was unlikely they would meet their targets for this year, and bankers in Cleveland noted that they expected mortgage demand to remain weak into 2008. Interest rates on household loans increased in many Districts.

Business lending increased in the Philadelphia, Cleveland, Atlanta, Chicago, St. Louis, Dallas, and San Francisco regions, but lending appeared to be flat in Richmond and Kansas City. Three Districts said commercial real estate loans were a notable source of strength, though New York reported declines in these loans.

Household credit quality deteriorated marginally, while business credit quality remained mostly favorable. New York, Richmond, Chicago, and San Francisco observed higher delinquencies on mortgages and other consumer loans. Richmond reported an increase in commercial loan delinquencies, while Philadelphia said late payments on commercial real estate loans remained low, and Chicago indicated that business credit quality was unchanged. Cleveland and Dallas reported no change in overall credit quality. Deposits were up slightly in St. Louis, flat in Atlanta, flat to down in Cleveland, down in Kansas City, and "difficult to obtain" in Dallas.

## **Prices and Labor Costs**

Contacts generally reported ongoing input cost pressures, particularly for petroleum-related inputs, while prices at the retail level continued to increase at a moderate rate. Notable exceptions were the Richmond District, which reported faster rates of price increases as local businesses passed along higher input costs, and the Kansas City region, which experienced an easing in overall price pressures. Almost every region said that oil and gasoline prices were either rising, high, or "an issue." But the cost of natural gas decreased in the Cleveland and Dallas Districts. Prices of some construction materials, such as lumber and cement, declined in parts of the country. A few Districts reported high prices for metals, notably copper. Trucking firms generally passed along higher fuel costs through surcharges, but shippers were unable to implement any other price increases. Prices of manufactured goods increased or were expected to increase further in the Boston region. But Minneapolis reported that fewer contacts than in the past expected to be able to increase the prices of their products, and Cleveland said wholesale prices were steady. New York indicated that retail prices were steady or increasing modestly, and Kansas City said they were flat or lower. Reports on vehicle incentives were mixed, with Chicago saying they were steady and Dallas pointing to new discounts. Restaurateurs in the Kansas City District expected to raise prices in the future due to the higher cost of fresh foods.

Many Districts described overall wage gains as moderate and/or similar to the previous reporting period. However, many also pointed to significant upward pressure on wages and salaries for in-demand, high-skilled workers.

## **Energy and Natural Resources**

Energy extraction and refining activity continued at high levels in June and early July, with growth reported in four Districts. Deep-water drilling in the Gulf of Mexico and activity in the Kansas City District pushed up demand for drilling rigs, equipment, and personnel. Utilization rates for Louisiana Gulf Coast refineries remained high. The Cleveland and

Minneapolis Districts cited the development of alternative energy projects. Mining activity was flat, though near capacity, in the Minneapolis District.

### **Agriculture**

Agricultural conditions varied widely across regions. Above-average heat and a lack of moisture affected the Atlanta, Chicago, Richmond, and St. Louis Districts, while excess moisture impeded wheat and hay harvests in the Dallas and Kansas City Districts. The Atlanta District bore the brunt of an expanding drought, which hurt crop development in the Chicago and Richmond Districts as well. Crop conditions were generally favorable in the Dallas, Kansas City, Minneapolis, and St. Louis Districts. Forage and pastures were bad enough in the Atlanta and Richmond Districts that livestock herds were reduced, whereas pastures and ranges improved in the Dallas and Kansas City Districts. Prices for many agricultural products increased during the reporting period, with corn, hogs, and cattle as notable exceptions. Due to price movements combined with higher feed costs, hog and cattle producers faced tightening margins. Increased exports supported agriculture, particularly in the San Francisco District.

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