



September 5, 2007

Summary

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Summary

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Prepared at the Federal Reserve Bank of Cleveland and based on information collected before August 27, 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 Federal Reserve Districts indicate that economic activity has continued to expand. St. Louis and Kansas City described the pace of activity as moderate; Cleveland, Chicago and Minneapolis said their economies were expanding at a modest rate; and Boston and Atlanta reported that activity was mixed. New York cited continued expansion. The economies in Philadelphia, Richmond, Dallas, and San Francisco continued to grow; however, the pace of activity has slowed.

Most Banks reported that the recent developments in financial markets had led to tighter lending standards for residential mortgages, which was having a noticeable effect on housing activity, and several noted that the reduction in credit availability added to uncertainty about when the housing market might turn around. While several Banks noted that commercial real estate markets had also experienced somewhat tighter credit conditions, a number commented that credit availability and credit quality remained good for most consumer and business borrowers. Outside of real estate, reports that the turmoil in financial markets had affected economic activity during the survey period were limited.

Retail sales were generally positive, with increases characterized as modest to moderate. However, several Districts described motor vehicle and furniture sales as slow. Manufacturing activity expanded across most Districts, with reports of softening demand for building materials and autos. The weakness in the housing market deepened across most Districts, with sales weak or declining and prices reported to be falling or flat. Most Districts reported a continuing contraction in the residential mortgage market. Commercial real estate activity was generally stable to expanding. Demand for business loans held steady or weakened, while consumer lending was mixed. Agricultural conditions varied widely across Districts, with several reporting damage to crops and pastures as a result of excessive heat and drought conditions. Activity in the energy and mining sectors remained positive in all of the Districts reporting on these sectors. Nearly every District reported at least modest increases in employment during the recent survey period. Most Districts characterized their wage increases as moderate or steady. Wage pressures were intense only in isolated professions in short supply. And most Districts reported little change in overall price pressures.

Consumer Spending and Tourism

Districts generally reported modest to moderate increases in sales, although Boston, Cleveland, and San Francisco described retail sales as mixed. Dallas reported little change in

consumer spending growth. Richmond reported that retail sales posted modest gains in July but pulled back sharply in August. New York, on the other hand, described July sales as somewhat below plan, but August sales as ahead of plan.

Furniture sales declined in Philadelphia, Richmond, St. Louis, and San Francisco while Boston experienced stronger sales. Merchants in New York and Chicago reported a slight pickup in sales of home furnishings. Retailers in Philadelphia, Richmond, Atlanta, and Kansas City noted solid-to-strong back-to-school sales. However, Chicago and Dallas reported difficulty comparing back-to-school shopping with last year because of school-year timing. Boston and Kansas City reported strong sales of apparel items while New York and St. Louis experienced mixed results. Some weakening in apparel sales was seen in Philadelphia, Cleveland, and Chicago.

Vehicle sales were described as slow or subdued in many Districts. Cleveland, Richmond, Atlanta, Chicago, St. Louis, Dallas, and San Francisco, all reported sluggish new vehicle sales. In contrast, auto dealers reported that sales increased modestly in Kansas City and picked up slightly in Philadelphia. Cleveland and San Francisco noted strength in used vehicle sales. Many auto dealers reported anxiety about future sales due to tighter household credit conditions.

Districts that commented on retail inventory levels generally described them as at or above desired levels. Several retailers reported that they planned to or had already heavily discounted merchandise to move inventory.

Most reports on tourism were positive, with the New York, Atlanta, Minneapolis, and Kansas City Districts reporting particularly solid growth in tourist spending. Minneapolis cited dry, warm weather for helping the tourism industry. Two Districts were less positive on tourism: San Francisco experienced slowing tourist activity and Chicago described a pessimistic outlook for the rest of the year despite a slight pickup in some parts of the District in August.

Services

Reports on the service industry were generally neutral to positive. Several Districts posted strong gains in financial services, health care, information technology, and technical and professional services. Demand for legal services was stable or showed modest increases. Demand for transportation services showed signs of softening--Atlanta and Dallas reported decreased activity while Cleveland and Chicago cited no change. Reports from Boston, Richmond, Minneapolis, and Dallas indicated that the recent volatility in financial markets may slow down the pace of business activity.

Manufacturing

Most Districts reported that manufacturing activity expanded during late July and early August. New York, Richmond, Minneapolis, and San Francisco indicated solid growth. Philadelphia, Chicago, and St. Louis stated that manufacturing expanded but at a slower pace. Manufacturing was stable to increasing slightly in Cleveland, Kansas City, and Dallas, but was described as mixed in Boston and Atlanta.

The automobile and building materials industries showed weakness across most reporting Districts. Cleveland, Atlanta, Chicago, and Dallas all indicated that the auto sector had softened, though one report suggested that some of the reduction in production was related to model changeovers. Six Districts said that industries related to housing experienced weakness, including building materials and construction equipment.

Industries showing improved conditions varied markedly across Districts. High-technology manufacturing was strong in the Kansas City and San Francisco regions and showed steady growth in the Dallas District. A number of Districts reported steady to solid growth in aircraft and electrical equipment production and strength in exports. Chicago noted that some steel producers have started exporting steel regularly for the first time. Most Districts indicated that input price pressures held steady or rose modestly compared to the previous report. Expenditures for plant and equipment remained close to plan in Boston and Cleveland. Contacts in San Francisco reported that productivity improvements continued on trend in 2007. Looking forward, contacts in New York, Philadelphia, Richmond, and Kansas City expressed near-term optimism about business conditions in their sectors; reports from Cleveland and Dallas were somewhat more cautious.

Real Estate and Construction

Residential real estate and construction weakened further in most Districts while the commercial market remained steady. Most Districts reported weak or declining residential sales and declining or stable prices. Markets in a few Districts did show some strength. Both sales and prices have been increasing in the Massachusetts housing market; the New York City apartment market remains tight as rents rise; and home sales rose in Louisville. Inventories of unsold homes are generally reported to be high. Moreover, contacts in Philadelphia, Cleveland, Richmond, Atlanta, Chicago, Kansas City, and Dallas believe softness in the market will continue in the near future, with potential for further declines.

Commercial real estate and construction markets were generally stable to expanding across the Districts. Philadelphia, Minneapolis, and San Francisco indicated continued expansion in nonresidential construction and commercial real estate. Dallas described the level of nonresidential activity as high, and St. Louis said commercial construction remained strong. New York, Cleveland, Richmond, Atlanta, Chicago, and Kansas City indicated commercial construction and real estate markets were steady or stable. Vacancy rates are reported to be low or declining in most Districts, and rents are rising modestly in many. Boston, New York, Richmond, Chicago, Kansas City, and Dallas noted some tightening of credit in the commercial real estate market.

Banking and Finance

The demand for residential mortgages continued a downward trend in most Districts. Consumer lending softened in New York, Cleveland, Chicago, and Dallas, while St. Louis reported stable activity. In Philadelphia, personal loans increased on credit card lending. Looking forward, lenders in Dallas do not expect any further deterioration in consumer lending after the softening that was reported earlier in the year. Bankers in Philadelphia continue to see growth in personal lending over the next few quarters, albeit at a slower rate than in the first half of the year.

More than half of the Districts reported a tightening in credit standards. Boston, New York, Richmond, Chicago, Kansas City and Dallas mentioned tightening for both residential mortgages and business loans, while financial institutions in Atlanta and San Francisco said tighter standards were aimed primarily at home mortgage products. Delinquencies in consumer loans and mortgages rose slightly in Cleveland, Atlanta, Chicago, and St. Louis, while New York reported no change in delinquencies across all loan categories.

Demand for business loans was steady or weakening in New York, Cleveland, Chicago, and St. Louis, while Philadelphia reported an increase in demand. Commercial real estate lending increased in Kansas City and was quite strong in San Francisco, where "some banks reportedly are approaching regulatory limits on loan concentrations for this segment."

Agriculture

Agricultural conditions varied across Districts. High temperatures and drought conditions resulted in damage to crops and pastures in the Richmond, Atlanta, Chicago, and St. Louis Districts. According to some estimates, the drought could cost Georgia and Florida farmers over \$2 billion in lost production. Nevertheless, a report from Chicago indicated that even with unfavorable weather, the District was poised for a record corn harvest because farmers had planted more corn at the expense of soybeans. In the Dallas and San Francisco Districts, favorable summer rains boosted pasture growth and livestock conditions. Rains in the Kansas City District resulted in above-average wheat yields and improved growing conditions for corn and soybeans, which placed some downward pressure on crop prices. Further, livestock prices remained solid, although rising production costs trimmed margins for hog producers and cattle feedlot operators. In the San Francisco District, demand for agricultural products continued to grow, and supply conditions were largely favorable. Some agricultural contacts reported that pressures on input costs eased overall, but others noted that prices of feed grain increased further.

Natural Resources

Activity in the energy and mining sectors remained positive as increases were observed in all Districts reporting on these developments. In Dallas, energy activity remained robust-- domestic drilling has flattened out, while international drilling is growing and remained the primary source of strength for service companies. Kansas City reported stable drilling activity and expected increased activity heading forward. Cleveland's oil and gas producers reported production levels were flat to increasing slightly since mid-July. Both Cleveland and Kansas City cite the lack of qualified labor as a continuing strain on expansion. In the Minneapolis District, activity increased since the previous report, with mining production remaining at near capacity. The Atlanta District reported that Hurricane Dean did not have a significant impact on energy production along the Louisiana coast.

Labor Markets, Wages, and Prices

Nearly every District reported at least modest increases in employment during the recent survey period. The lone exception was Chicago, which, instead, characterized employment conditions as mixed. Philadelphia and San Francisco made no statement characterizing overall changes in District employment. New York, Richmond, Atlanta, Minneapolis, and Dallas described their labor markets as tight. Nine of the twelve Districts reported that there were shortages of some skilled workers, including those in the information technology, accountancy, legal, and health care professions. In addition, Kansas City noted shortages for workers with lower skills, such as housekeepers and waiters, while San Francisco reported that agricultural workers were in increasingly short supply. Staffing services firms reported more demand for temporary workers in several Districts (Boston, Richmond, and Dallas), but less demand in Cleveland. Several Districts reported declines in construction employment, though the San Francisco District reported that, in some areas, rising commercial construction has helped keep overall construction employment stable.

Though some Districts described employment condition as tight, most reported that wage increases were moderate or steady. Wage pressures were intense only in isolated professions in short supply. Several Districts also noted that costs of health care benefits continued to post large increases, although they were not accelerating.

Most Districts reported little change in overall price pressures. There was downward pressure on residential real estate prices across nearly all Districts. Three Districts--Boston, Philadelphia, and Dallas--reported lower lumber prices, while Atlanta reported that these prices stabilized. Three Districts noted discounting among retailers during the back-to-school selling season (New York, Philadelphia, and Dallas), while two others reported overall

declines in retailers' prices (Richmond and Kansas City). However, higher food costs continued to be widely reported and were said to be putting upward pressure on grocery and restaurant prices.

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