



October 17, 2007

## Summary

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### Summary

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Prepared at the Federal Reserve Bank of Dallas and based on information collected on or before October 5, 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.

Anecdotal reports from the Federal Reserve Banks suggest economic activity continued to expand in all Districts in September and early October but the pace of growth decelerated since August. Growth was similar to that observed in the last Beige Book in seven Districts--Atlanta, Boston, Chicago, Minneapolis, New York, Philadelphia and St. Louis. The economy grew at a slower rate in five Districts--Cleveland, Dallas, Kansas City, Richmond and San Francisco. The expansion was variously characterized as "moderate," "modest" and "mixed."

Consumer spending expanded, but reports were uneven and suggest growth was slower in September and early October than in August. The manufacturing and service sectors continued to expand, but growth weakened--mostly for products and services related to home construction and real estate transactions. Several manufacturing and service firms reported that weaker domestic demand was offset by strong sales to global markets.

Residential real estate markets continued to weaken, and most Districts reported additional declines in home sales, prices and construction. Financial institutions reported an increase in delinquencies and slight deterioration in credit quality. Lenders in many Districts tightened credit standards, particularly for real estate. The majority of reports indicated an increase in business lending but a decline or slower growth in consumer lending.

Activity in the energy industry is still robust but growth has slowed. Favorable agricultural conditions are contributing to a bumper crop throughout much of the country, but drought continues to hamper production in the southeast.

Contacts in a number of industries indicated a higher-than-usual degree of uncertainty about the outlook for economic activity. Many real estate contacts expect housing markets to remain subdued for several months. At firms without direct ties to real estate and construction, contacts are still wary that credit tightening and slowing construction might slow activity in their industry, but there is cautious optimism because few see much evidence of such spillovers at this time.

Job growth eased in some regions, but labor shortages were reported for many occupations in most Districts and are said to be restraining economic activity in some instances. Wages rose moderately except for workers in short supply, where sharp increases were reported for some positions. Upward pressure on input costs are reported in most Districts, but competitive pressures are restraining the ability to pass higher input costs to selling prices in many instances.

### **Consumer Spending and Tourism**

Retail sales increased, but reports were uneven and suggest growth has softened. Sales were weak at department and discount stores and for furniture and other home durables. Purchases of electronics and luxury items remained solid. Unseasonably mild weather dampened apparel sales in some regions.

There appeared to be a high level of uncertainty about the outlook for retail sales, and a few Districts report that retailers have reduced inventories. Vehicle sales were weaker, but reports indicated that sales of fuel-efficient and used cars remained strong. Tourist activity was generally solid.

### **Manufacturing**

Factory activity continued to expand, but reports suggested that growth has been dampened by declining output of products used in home construction. A few Districts noted that export demand for other products helped sustain growth. District reports indicated strong growth of sales for paper, steel, machine tools, agricultural machinery, energy equipment, electrical equipment, defense and aerospace, chemicals and health-related equipment.

The outlook for factory activity is uneven. Boston District contacts noted continued weakness in housing and possible negative spillovers from tight credit but point to export growth and new product development as sources of strength. Manufacturers in the Cleveland District anticipate production remaining at current levels or decreasing slightly. Factories in the Kansas City District cut inventory levels and expect further reductions. Automakers in the Chicago District anticipate weakness in auto sales, but the St. Louis District reports major hiring to support the opening of new facilities for motor vehicle parts manufacturing.

### **Services**

Districts reporting on business services indicated the sector is in expansion but the strength varied. Temporary staffing firms reported increased hiring, with the exception of activity to support financial services and real estate. Shipping activity was mixed and suggests some softening. Container shipments and regional freight activity were softer in the Atlanta and New York Districts, but freight hauling and shipping firms in the Dallas District reported increases in volume. Dallas District airlines say traffic is steady and bookings are solid.

### **Construction and Real Estate**

Home sales continued to fall or increased more slowly in most Districts. In some instances, buyers could no longer secure financing or were unable to sell their current homes. New home inventories remained elevated, and builders continued to curb new home construction. Rising inventories of existing homes added to uncertainty about the overall health of the housing market.

Commercial market fundamentals remained solid. Most Districts reported steady absorption of commercial space. Rental rates were firm to rising across Districts, with sizable increases for Manhattan office space. Construction activity continued at a steady pace overall. Some softness in commercial investment activity was noted, however, and several Districts reported a move to more conservative financing. Reports suggested developers are becoming more cautious--in some cases shelving or canceling projects.

### **Banking and Finance**

District reports indicated increased delinquencies and a slight deterioration in credit quality. Lenders in many Districts tightened credit standards, including for consumers and all types of real estate. Consumer lending grew more slowly in most Districts. Lending for home mortgages, equity lines and refinancing continued to soften or decline in most Districts,

which some reports attributed to tighter lending standards. Overall business lending was up, but tightening lending standards were applied, particularly for real estate.

### **Agriculture and Natural Resources**

Favorable agricultural conditions in much of the country have allowed harvests to run ahead of normal schedules and contributed to above-average crop yields throughout much of the country. A near-record corn crop and above-average soybean yields are expected. Livestock producers reported strong demand and high prices.

Bumper crops have strained storage capacity and caused transportation problems. The Chicago District notes that transportation and storage problems emerged because of the size and speed of the harvest and because cash prices are enough lower than futures prices that farmers have an incentive to store crops until 2008.

Crop production has been hampered by dry or drought conditions in Alabama, the Carolinas, Georgia, Kentucky, Tennessee and Virginia. Shortages of feed and low forage supplies have led some livestock producers in these areas to cull their herds. The Chicago District reports that crop yields in Indiana, Michigan, and Wisconsin were less affected by a summertime drought than had been anticipated by some observers.

Energy activity held at robust levels, and oil production was up slightly. While natural gas drilling activity is still vigorous, there were reports that high costs have or will lead to reductions in production. The Kansas City and Minneapolis Districts reported that overall mining activity was strong and expanding, with mines in the Minneapolis District producing near capacity.

### **Labor Markets**

Labor markets remain tight across much of the country, and there continues to be moderate upward pressure on wages and benefits. Job growth eased in some regions, however, and wage pressures softened.

Most Districts report worker shortages in a variety of occupations, with sizable wage increases for workers in short supply. Positions mentioned as difficult to fill include scientific, technical, accounting, finance, engineering, marketing, health-care, truckers, welders, ironworkers, crane operators, office workers and energy-service workers. Low-skilled and entry-level workers are in short supply in some areas, including those in the retail and hospitality industries.

### **Prices**

Upward pressure on input costs was reported by most Districts. Pushed up by strong domestic and international demand, energy and raw material costs are characterized as high by several Districts. Prices are up for a broad range of foods, including milk, corn, soybeans, wheat, beef, chicken and vegetables. Declines in the value of the dollar and high shipping costs have made imported goods more expensive. Insurance costs have increased in the Atlanta District.

The ability to pass higher input costs to selling prices was mixed. Some manufacturers raised selling prices as a result of higher costs, such as for food products, chemicals, machinery and oil and gas equipment. But there were also reports of lower prices, particularly for construction-related materials, such as lumber, wood, wallboard and some metals, pushing down construction costs. Competitive pressures are restraining retail price increases in many instances. Prices are higher for food products and at restaurants. Vehicle prices are lower, with dealers using incentive and discount programs or manufacturers adding features to

vehicles without raising prices. Reports from the service sector suggest there have been continued increases in fees and fuel surcharges, but the rate of increase has not changed.

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