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Summary of Commentary on \_\_\_\_\_

# Current Economic Conditions

By Federal Reserve District

August 2008

SUMMARY OF COMMENTARY ON CURRENT ECONOMIC CONDITIONS  
BY FEDERAL RESERVE DISTRICTS

AUGUST 2008

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**SUMMARY\***

Reports from the twelve Federal Reserve Districts indicate that the pace of economic activity has been slow in most Districts. Many described business conditions as “weak,” “soft,” or “subdued.” Cleveland and St. Louis reported some weakening since their last reports while Boston and New York noted signs of stabilization. Kansas City reported a slight improvement.

Consumer spending was reported to be slow in most Districts, with purchasing concentrated on necessary items and retrenchment in discretionary spending. Districts reporting on auto sales described them as falling or steady at low levels. Tourism activity was mixed but received support from international visitors in several Districts, and the demand for services eased in most Districts. The transportation industry was also adversely affected by rising fuel costs. Manufacturing activity declined in most Districts but improved somewhat in Minneapolis and Kansas City. Most Districts reported that residential real estate markets remained soft. Commercial real estate activity was slow in most Districts, and some reported further slackening in demand for office and retail space. Most Districts reported easing loan demand, especially for residential mortgages and consumer loans; lending to businesses was mixed. Districts reporting on the agricultural sector noted some relief from drought conditions. Districts reporting on energy and mining activity recorded increased activity.

Almost all Districts continued to report price pressures from elevated costs of energy, food, and other commodities, although some noted that there have been declines

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or slower increases in prices for several industrial commodities and energy products. Business contacts in a number of Districts indicated that they had increased selling prices in response to the high costs for their inputs. Wage pressures were characterized as moderate by most Districts amid a general pullback in hiring, although several Districts noted continued strong demand for workers in the energy sector.

### **Consumer Spending and Tourism**

Consumer spending was slow in most Districts. Retail sales and other consumer spending was reported as mixed or little changed in Boston, Chicago, St. Louis, and Dallas and weak or declining in Philadelphia, Richmond, Minneapolis, and San Francisco. Sales were described as below expectations in Atlanta but on or close to plan in New York. Cleveland and Kansas City noted some improvement in retail sales since the last report. Several Districts reported that consumers were concentrating on food, staples, and other necessary items while reducing spending on discretionary items. Chicago, Dallas, and San Francisco reported noticeable declines in spending on apparel, electronics, and jewelry. Sales of furniture and household appliances were weak in most Districts. San Francisco described sales of this merchandise as exceptionally poor. A shift of consumer shopping patterns toward discount stores and lower-price brands and away from traditional department and specialty stores was observed in Philadelphia, Chicago, Dallas, and San Francisco. Sales of motor vehicles were reported to be weak or falling in all Districts, especially for larger, less fuel-efficient cars, SUVs, and trucks.

Tourism activity varied across Districts. Atlanta, Minneapolis, and Kansas City reported mixed or steady conditions since the last report. Boston, New York, and Richmond reported improvement since the last report. San Francisco reported that

tourism was flat to down in most major destinations in that District, significantly so in Hawaii. International visitors boosted tourism in Boston, New York, and Minneapolis. In contrast, several Districts noted that domestic vacationers appeared to be reducing miles traveled and amounts spent on trips. Boston reported that business travel has been better than expected.

### **Nonfinancial Services**

Districts reporting on nonfinancial services generally indicated some slowing in activity since the last report, although New York reported stabilization after several months of decline. Boston, Cleveland, Atlanta, and Dallas noted falling demand for freight and transportation services, and firms in those industries reported higher fuel costs negatively affecting their margins. Dallas reported that airlines were reducing capacity. Demand for information technology services was reported to be flat in Boston and down in St. Louis. St. Louis and San Francisco noted less strength in the health care sector since the last report. Business and professional services activity was weakening in St. Louis and San Francisco. Dallas reported that business was steady at accounting firms but down at legal firms. Temporary staffing activity was reported to be mixed in Boston and Richmond and stable in Dallas.

### **Manufacturing**

Manufacturing activity was weak or declining in most Districts but improved in others. New York reported some stabilization after months of decline, Kansas City reported a rebound after a weakening in June, and Minneapolis and San Francisco have made gains since the last report. A number of Districts reported that export orders were bolstering manufacturing activity, but manufacturers in several of those Districts have

noted some recent slowing in growth from this source. Boston, Philadelphia, Cleveland, Richmond, Chicago, and Dallas reported continuing declines in demand for housing-related products and construction materials. Boston reported declining output of aircraft and other transportation parts and equipment, but San Francisco reported a high rate of aircraft production. Output of motor vehicles and related products was falling in Boston, Cleveland, Atlanta, Chicago, and Dallas. Boston and San Francisco reported rising demand for information technology equipment, but Dallas reported some weakening in demand for high-technology products. Manufacturers in Philadelphia, Cleveland, and Kansas City have increased capital spending or plan to do so, but Boston reported that manufacturers in that District were reexamining capital spending plans, and Chicago reported that several firms were postponing capital projects.

### **Real Estate and Construction**

Residential real estate conditions weakened or remained soft in all Districts, except Kansas City, which reported a modest increase in sales since the last report. Demand for housing was reported to be still moving down in Boston, New York, Chicago, St. Louis, and San Francisco. Residential real estate activity was sluggish in Philadelphia, Cleveland, Richmond, Atlanta, Minneapolis, and Dallas. New York reported low levels of single-family construction but a brisk pace of multi-family construction after an increase in permits in June occasioned by a change in the New York building code effective July 1. Chicago reported a faster rate of decline in residential construction since the last report as well as delays and cancellations in residential building projects. Richmond and Kansas City reported that lower and mid-price houses

were selling at a better rate than more expensive houses. Atlanta and Dallas reported that inventories of unsold new houses were edging down.

Commercial real estate activity moved down or remained weak in all Districts except Dallas. Boston, New York, Philadelphia, Atlanta, and Chicago reported signs of softening demand for commercial real estate, including declining leasing activity, rising vacancies, and decreasing construction. Cleveland, Richmond, St. Louis, Minneapolis, Kansas City, and San Francisco reported that commercial real estate market conditions varied across those Districts but in general were not strong. Dallas reported an increase in office leasing but at a slower pace than in the last report. Chicago and Minneapolis noted drops in demand for retail space. Dallas and San Francisco reported that public projects were buoying construction activity.

### **Banking and Finance**

District reports on bank lending generally indicated steady or slowing growth, with weakening demand for residential mortgages and consumer loans and near steady demand for commercial and industrial loans. Residential mortgage lending fell in New York and Richmond, remained slow in Chicago and Dallas, but gained slightly in Philadelphia. Consumer lending was flat to down in Cleveland, Atlanta, and St. Louis and showed little change in New York and Chicago. Commercial and industrial lending was near steady in New York, Philadelphia, and Cleveland and eased in Richmond, St. Louis, and Kansas City. Demand for commercial and industrial loans rose in Chicago—mostly from small and mid-size firms—and was described as solid in Dallas. San Francisco reported that overall loan demand has fallen since the previous report. All the Districts reporting on loan standards noted tightening. New York, Cleveland, Richmond,



and San Francisco reported deterioration in credit quality. Dallas indicated that credit quality was holding up, although bankers in that District expected it to decline. Districts reporting on bank funding noted that competition for deposits remained strong. In Dallas, bankers said they were pursuing nondeposit sources of liquidity.

### **Agriculture and Natural Resources**

The agricultural sector continued to struggle under drought conditions in the South, although there was some relief in July and August. In the Richmond District persistent dry conditions were expected to delay crop development and reduce yields; however, the fruit and vegetable harvests have been mostly completed. Atlanta reported some benefit from recent rains, although drought conditions persisted in Georgia. Chicago reported improved crop conditions, although corn and soybean development was behind schedule. Crop development was also behind schedule in the St. Louis District where conditions improved for grain but worsened for cotton. Minneapolis reported a better than expected harvest of winter wheat and expectations that corn production would exceed last year's harvest. Dallas reported dry conditions in much of the District and noted that Hurricane Dolly destroyed cotton and sorghum in the Rio Grande valley. Kansas City reported an increase in wheat yields. Although most Districts with significant agricultural sectors reported strong demand for their products, they also noted that fuel, feed, and fertilizer costs had risen, putting pressure on profit margins. High costs were reported for livestock operations, and Kansas City and Dallas reported that herds were being culled.

Energy and mining activity were strong and expanding in all of the Districts that reported on these sectors. Cleveland noted increases in oil, gas, and coal extraction since

the last report. Minneapolis also reported an increase in energy activity and indicated that almost all mines in the District were operating at full capacity. Drilling activity has increased in the Kansas City District since the last report and was well above the year-ago level. Dallas reported a continued rise in the rig count, to levels above last year, with much of the increase due to drilling for natural gas. San Francisco noted an increase in petroleum production.

### **Prices and Wages**

All Districts reported continuing upward price pressure from elevated input costs, although several noted recent retreats in some commodity and energy prices. Philadelphia reported rising prices for food products, industrial materials, and metals. Cleveland reported continuing increases in raw material costs, and business contacts in San Francisco said upward price pressure remained significant. Chicago, Minneapolis, and Dallas business contacts noted recent declines in commodity and energy prices but said price levels remained high. In Philadelphia, retailers reported rising wholesale costs. Retail price inflation edged up in Richmond. New York and Chicago reported little change in retail prices. Business contacts in Philadelphia, Atlanta, and Dallas indicated that high prices for their inputs were leading them to step up the pass-through of higher costs to their selling prices. Similar reports of the pass-through of costs to prices came from manufacturers in the Boston and New York Districts as well as from shippers in the Cleveland District. Chicago and San Francisco reported that the pass-through of costs to prices was more limited.

Labor market conditions were unchanged or somewhat softer in most Districts compared with the last report. Wage increases were typically characterized as moderate.

Boston reported mostly modest wage increases except for greater hikes in salaries at information technology companies. Philadelphia reported moderate wage gains and limited hiring. Cleveland noted wage pressures in the energy sector but not in manufacturing or construction. Atlanta received scattered reports of wage increases, mainly in the professional services and the energy sectors, and more generally in coastal areas undergoing rebuilding after storm damage. Chicago indicated that labor markets have weakened and there was little wage pressure other than for a few skilled trades. Kansas City reported steady wage pressure but noted that there were shortages of qualified workers in the energy sector. Dallas also noted shortages of workers in the energy sector but indicated that wage pressure was mild overall. San Francisco reported some easing in upward wage pressure as firms in that District have been reducing staff counts, although demand remained strong for skilled workers in the resource extraction and information technology industries.

## FIRST DISTRICT – BOSTON

Business contacts in the First District report little further deterioration in the pace of activity in the second quarter or recent months compared with the last report, although actual results are quite mixed. Retailers—partly because many respondents this time are discounters—say their sales are increasing, and so do software and information technology firms, but real estate markets in the region remain very slow and most responding manufacturers indicate unit sales or orders are down compared with last year. Manufacturers report ongoing hikes in their selling prices. According to most respondents, the near-term outlook is for “more of the same” or further slowing, with some signs of improvement expected in 2009.

**Retail and Tourism**

Retailers in the First District cite mixed sales results for the months of June and July, with the majority of respondents reporting year-over-year sales increases. Several contacts say consumers are cautious in their spending and are more focused on seeking value because of the economic downturn.

Inventory levels and headcounts continue to be tightly managed across the First District. Capital spending reports are mixed, with some retail contacts modestly pulling back spending and others continuing their capital spending as planned. Most respondents are still coping with the effects of high oil prices, but one notes that these cost pressures have abated somewhat.

Tourism in the Boston area has been “surprisingly good.” While room rates are softening, tourism is up year-over-year; museums and area attractions report significant growth in visitors. Business and international travel both remain strong.

Overall, most contacted First District retailers are cautiously optimistic in their outlook, even though they expect the next few months to be a continued challenge.

**Manufacturing and Related Services**

Two-thirds of First District manufacturers and related services providers contacted in August indicate that sales or orders were flat to down year-over-year in the second quarter or more recent months; for a couple of these firms, revenues were up but volumes were down. Two-thirds of the firms also anticipate further declines in the second half of 2008 and early 2009. They report that economic malaise is spreading as industrial customers turn cautious, postpone expansions, and undertake preemptive restructuring. Contacts serving the residential and, increasingly, the commercial construction industries, auto makers, commercial airlines, non-aviation transportation, semiconductor makers, and the healthcare industry report declines in orders or sales. By contrast, firms with customers in the alternative energy or information technology (IT) industries or producing labor-saving or sophisticated equipment say that sales continue to grow. While contacts generally report that foreign sales have been an important source of strength, many firms express concern that foreign demand growth is now slowing, especially in Western Europe and Japan, but also in emerging Asia.

Three-quarters of contacted manufacturers reportedly face rising input costs and point to fuel and energy, petrochemical, and rolled steel prices in particular. A few firms note with relief that oil prices have subsided and that natural gas prices are little changed from year-ago levels. In response to input cost pressures, two-thirds of the contacted firms say that they have raised their selling prices from 2007 levels by from 3 percent to

8 percent; a minority have posted two price increases in 2008 and are planning a third. Most firms find that “everyone” understands the need for these price hikes; thus, contacts are usually able to pass at least half of their increased material costs on to their customers. By exception, contacts in the IT industry report that selling prices are generally stable.

Two-thirds of manufacturing contacts have reduced their workforce—generally modestly—from year-ago levels. No firm expects to increase its head count; a minority plan further cuts or a hiring freeze, while a few await third and fourth quarter numbers to determine the need for further layoffs. Still, scientists, engineers, and other skilled labor reportedly remain hard to find. Wage increases for 2008 or planned for 2009 are generally 3 percent to 4 percent, but two firms have delayed or asked some workers to forego raises. Others are tightening their grip on merit increases or finding ways to cut benefits costs. While a few contacts note increased complaints from workers facing high gas and food prices, none has responded to these wage pressures; most of this group believes their staff understands that the firm cannot “make them whole.”

Manufacturers generally expect their capital spending to remain on budget at or above 2007 levels, but a few are taking a harder look at discretionary spending. None of these firms suggests that financial market distress is affecting its investment spending. Only one is seeking more credit than it has been able to negotiate to date.

Looking to 2009, half the manufacturers are “cautiously optimistic” or believe that the next 18 months could turn out “OK.” The other half are “anxious and concerned” and view the economic environment as “challenging” and “volatile.” They expect it will take several quarters to resolve problems emanating from the housing, energy, and financial markets.

#### **Software and Information Technology Services**

New England software and IT services firms report flat to favorable results in the second quarter of 2008, with nearly all firms showing year-over-year growth in revenues. At the extremes, one contact describes business activity as a “gentle ebb and flow,” while another reports a robust pipeline and a 29 percent year-over-year increase in revenues. No contacted firm is cutting its headcount, and some continue to expand slightly. One contact notes that the market for skilled labor remains tight and says his firm has raised average wages by 10 percent over the past year, with the largest increases for skilled engineers. Other contacts report pay increases in line with longer-term trends, around 3 percent to 4 percent. Software and IT firms in the First District are sustaining high profit margins, with a few contacts saying their sector is generally the last to be hit by a weakening economy. Through the end of the year, most responding firms are projecting continued growth, but at a somewhat slower pace than recently.

#### **Staffing Services**

Staffing respondents in the First District report varied outcomes during the second quarter of 2008, with comparable year-over-year revenue changes ranging from minus 10 percent to plus 19 percent. Demand is strong for workers in the biopharmaceutical, manufacturing, software, and web development industries, while demand from the financial and engineering sectors is down. Overall labor supply has improved, with one contact attributing the influx of candidates to the poor economic climate; nonetheless, filling upper-level positions remains a challenge for most staffing firms. Indeed, one contact says the skilled labor market is “still candidate-driven,” with applicants choosing

between multiple offers. For the remainder of the third quarter and going into the fourth, New England staffing firms are generally “cautiously optimistic.”

#### **Commercial Real Estate**

Commercial real estate contacts in New England report few major changes in market conditions since the last report, when sentiment leaned toward the negative. A Hartford contact describes rental rates and vacancies in the office sector as holding steady, despite very low leasing volume. He has not seen significant layoffs and space give-backs among downtown tenants, but he expects the employment picture to worsen in the coming months. A commercial broker in Boston describes the downtown office market as “still slow but not dead,” with very little new job creation to bolster demand, but no major tenant exodus as of yet; he estimates that rent growth in Boston is close to zero and vacancy may have edged up a point. The Rhode Island market is also described as slow but not dismal. In downtown Providence, office leasing demand has been adequate, but tenants are driving harder bargains. Several contacts say retail markets may be softer than office markets.

Building sales continue to be down sharply relative to last year, due to ongoing credit tightness and significant gaps between asking prices and bids. Capitalization rates are expected to continue to rise in response to increases in long-term interest rates, so downward price pressure will continue and default risks will continue to rise. Against these trends, a small banking contact in Boston states that his bank continues to enjoy a higher-than-usual deal volume, typically involving the refinancing of well-stabilized properties. To meet the above-normal demand for its loans, the bank has sought out new deposits by offering higher rates on CDs, with considerable success.

The outlook remains downbeat and some contacts say it has worsened. One commercial broker, for example, pushed back his forecast of when the market will begin to improve to the second half of 2009. Contacts expect overall leasing and sales activity to remain slow for a while, and express uncertainty as to whether fundamentals will deteriorate further, or simply stagnate, before recovering.

#### **Residential Real Estate**

Residential real estate markets in New England continue to show significant year-over-year declines in sales volume and median prices. Home sales in Maine declined 24 percent year-over-year in June, while Rhode Island and Massachusetts home sales decreased 15 percent, and Massachusetts condo sales declined 20 percent. New Hampshire home sales declined 6 percent year-over-year in July, and home sales year-to-date were down 25 percent through July in Connecticut compared to a year earlier.

Median home prices in Massachusetts, New Hampshire, and Connecticut declined 8 percent year-over-year in the most recent period, while median condo prices in Massachusetts stayed flat. Median home prices decreased year-over-year in June by 6 percent in Maine and by 14 percent in Rhode Island. Home price declines are said to partly reflect increases in foreclosure-related “distress” sales.

The number of months of supply is generally higher in New England markets than it was last summer, but it has decreased from its peak earlier this year. One exception is Massachusetts, where contacts report a decrease in listings of houses and condos in response to falling prices that has made the market more balanced, even though sales have declined since last year. Several contacts are optimistic that the housing bill recently passed in Congress will have positive effects on New England markets.

## SECOND DISTRICT--NEW YORK

The Second District's economy has shown signs of stabilizing since the last report, though not in all sectors. Manufacturers report that business activity has steadied in recent weeks, after weakening for a number of months, and factories continue to report fairly widespread increases in both input costs and selling prices. Contacts at non-manufacturing firms generally also report some stabilization in business conditions but continue to indicate modest declines in employment. Consumer confidence was reported to be at record lows in July. Still, retail sales remained on or close to plan in July and early August, and were up slightly from a year earlier; moreover, tourism activity in New York City has firmed. Housing markets have been mixed but generally softer, and office markets have slackened. Finally, bankers report weakening demand for both residential and commercial mortgages, widespread declines in refinancing activity, continued tightening in credit standards, and increasing delinquency rates on home mortgages.

**Consumer Spending**

Retail sales were said to be on or close to plan in July and early August and were up 1 to 3 percent from 2007 levels, once again led by strength in New York City. Inventories are reported to still be at desired levels generally, and prices are little changed. Consumer surveys indicate further declines in confidence: The Conference Board's survey of Middle Atlantic state residents (NY, NJ, PA) shows consumer confidence falling for the tenth straight month, to a record low, in July, and Siena College's survey of New York State residents shows confidence remaining at its lowest level in that survey's nearly ten-year history.

Tourism activity in New York City has strengthened in recent weeks. Manhattan's hotel occupancy rate remained near 90 percent in July, which is typically a relatively slow month; room rates were up roughly 10 percent from a year ago, compared with 8 percent in

June and 6 percent in May; preliminary indications for August suggest continued strength. An industry contact attributes the strength primarily to large numbers of overseas visitors. Broadway theaters report that business has improved moderately since the last report. Both attendance and revenues are reported to have risen by 1 to 2 percent from a year ago in July and by 3 percent in the first half of August. Average ticket prices have remained essentially flat.

### **Construction and Real Estate**

Housing markets in the District have been steady to weaker. Manhattan's rental market has slackened somewhat: average asking rents were reported to be running 2 to 4 percent lower in July and August than a year earlier, and the rental vacancy rate, though still below 2 percent, is reported to have climbed noticeably over the past year. A major appraisal firm reports some further softening in Manhattan's co-op and condo market: sales activity has been increasingly sluggish, with resale prices flat to weaker. A growing number of deals are said to be falling through, due to difficulty in getting financing—largely at the middle of the market. The sales market has weakened more noticeably in Brooklyn and Queens, as well as in eastern Long Island.

On a more positive note, a contact monitoring New Jersey's housing industry reports that the resale market has shown signs of stabilizing, though at a weak level, especially for single-family homes. Inventories of unsold existing homes have declined in northern New Jersey, as many discretionary sellers have taken their homes off the market and other sellers have become more negotiable. Both prices and sales volume have leveled off, though they remain lower than a year ago. Concerns over foreclosures are noted, though their absolute number is described as relatively low.

While single-family construction remains at low levels, multi-family activity has remained fairly brisk. In New York City, multi-family building permits ballooned in June, in



advance of a change in building codes that took effect July 1. The number of multi-family units authorized increased more than four-fold in June from a year earlier—surging from just under 4,000 to slightly over 17,000. Overall, multi-family permits were 63 percent higher for the first half of 2008 than in the first half of 2007. In urban areas of northern New Jersey proximate to New York City, multi-family re-development is reported to be persistently robust and above comparable 2007 levels

Commercial real estate markets in the New York City area have shown signs of weakening. In Manhattan, office vacancy rates were little changed from June to July, but were up nearly 2 percentage points from a year earlier; moreover, leasing activity is reported to be running well below comparable 2007 levels. An industry contact maintains that firms with upcoming lease expirations are increasingly inclined to hold off on leasing, reflecting some anticipation that rents could move down from current levels. Asking rents in Manhattan have leveled off, though they are still up by roughly 6 to 8 percent from a year ago; however, a major brokerage firm estimates that actual (effective) rents are lower than a year ago, by roughly 5 percent. Suburban office markets are mixed: Northern New Jersey's market is reported to be increasingly slack, while markets are described as stable in Westchester and Fairfield Counties, and slightly softer in Long Island. Finally, a contact in Manhattan's hospitality industry notes some pickup in interest, among developers, in new hotel projects.

### **Other Business Activity**

New York State manufacturers report some stabilization in business activity in early August, following a number of months of weakening, based on our Empire State Manufacturing Survey. A growing number of firms report declining employment. Contacts continue to note fairly widespread escalation in their selling prices (prices received) and expect increasingly widespread increases in the next six months. Moreover, survey

participants now view the cost of resources (energy and other commodities) to be the most widespread problem; a year ago, it was finding qualified workers.

In general, non-manufacturing firms in the District generally report that business activity has stabilized, after deteriorating for a number of months. Respondents continue to report flat to declining employment levels at their firms, but expect them to remain steady over the next three to six months. Among these contacts, finding qualified workers remains a major concern. Non-manufacturing firms report continued price pressures, but a somewhat smaller proportion than last month expect to raise their selling prices in the months ahead. A trucking-industry contact reports little change in conditions since the last report—truckers continue to be hampered by high diesel fuel costs and weaker demand.

### **Financial Developments**

Contacts at small to medium-sized banks in the District report weakening demand for both residential and commercial mortgages but little change in demand for consumer or commercial and industrial loans. Bankers also indicate a widespread decrease in refinancing activity: 42 percent of bankers report a decrease and just 3 percent report an increase. For all loan categories, respondents again indicate a tightening of credit standards. The percentage of bankers reporting higher standards ranged from 26 percent in the commercial and industrial loan category to 36 percent in the commercial mortgage category; no respondents indicate eased standards for any type of loan. Respondents note an upturn in the spreads of loan rates over cost of funds in the consumer loan and commercial mortgage categories, though little or no change in spreads is reported for residential mortgages and commercial and industrial loans. Contacts report an increase in the average deposit rate. Finally, bankers report an increase in the delinquency rate for residential mortgages, with one in four respondents indicating a rising delinquency rate and just 4 percent a lower rate. Little change in delinquencies is noted in other loan categories.

## THIRD DISTRICT – PHILADELPHIA

Business conditions in the Third District remained soft in August. Manufacturers, on balance, reported nearly steady shipments but a drop in new orders. Retailers posted mixed sales results, with year-over-year increases at some discount stores but decreases at most other types of stores. Motor vehicle sales were about flat during the month but well below the level of a year ago. Bank lending continued to grow slowly. Residential real estate sales and construction activity continued to be sluggish. Commercial real estate leasing and construction activity remained slow. Reports of increases in input costs and output prices were about as prevalent in August as they were in July.

The outlook among Third District businesses is mixed. Manufacturers forecast increases in shipments and orders during the next six months. Retailers generally expect consumer demand to be restrained for the balance of the year, and auto dealers expect slow sales to persist into next year. Bankers anticipate slow growth in overall lending. Residential real estate agents and home builders have varying opinions on how much further home sales will fall, although most agree that a rebound is not likely until next year. Contacts in commercial real estate expect leasing and construction activity to remain soft until financial conditions improve.

**Manufacturing**

Third District manufacturers reported nearly level shipments but declines in new orders from July to August. Around one-half of the surveyed manufacturers noted steady shipments, and the number reporting declines was just slightly greater than the number reporting increases. However, the pace of new orders slipped, on balance, as around one-third of the manufacturers reported declines from July to August, and around one-fourth reported increases. The weakness in new orders was apparent in most of the region's major manufacturing sectors. Firms supplying the construction industry have seen large drops in orders, and that market "continues to be under a lot of stress," according to producers of residential building products. In contrast, some makers of industrial

materials, metal products, and electrical machinery reported increased demand for their products.

The outlook in the Third District manufacturing sector appears to have become more positive since the last Beige Book. Nearly one-half of the manufacturers contacted for this report expect new orders and shipments to rise during the next six months, and only one-tenth expect declines. However, capital spending plans of District manufacturers remain only modestly positive, on balance.

### **Retail**

Retailers in the Third District generally posted year-over-year declines in sales in July and early August. Although several discount stores and some specialty stores achieved modest increases, most department stores and many apparel retailers had decreases. In the words of one retail contact, consumers are “sticking to the basics” in their back-to-school shopping. Sales of school supplies were near normal levels, but sales of clothes and other merchandise have been weak. Retailers said consumers have trimmed discretionary spending in response to rising food and gasoline prices, and that consumer confidence has fallen further as employment has weakened. The decline in consumer spending in the region has led to a number of closings of stores and restaurants. Store executives expect the rest of the year to be difficult, and many indicated that they are keeping tight control on inventories and reducing plans for capital spending.

Auto dealers in the region reported a near steady pace of sales in August but at a level far below sales in August of last year. Many dealerships were being closed or consolidated. Supplies of small cars continued to fall short of demand, according to dealers, but they said overall demand for vehicles was weak and total sales were unlikely to rise much even if the more popular small cars were available. Dealers expect sales to remain slow into next year, and they anticipate more dealerships will close as well.

### **Finance**

Total outstanding loan volume at Third District banks has continued to advance slowly in recent weeks. On balance, bankers contacted in August reported slight gains in consumer lending and in real estate lending, mainly for conventional home-purchase

mortgages. Commercial and industrial loan volume has been nearly flat. Some banks noted a drop in demand for business loans, and others reported they were limiting lending in some industries, notably retailing and construction. Several banks indicated they were tightening credit standards. However, other banks said they were maintaining existing standards, but loan approvals have declined because fewer prospective borrowers now meet those standards. As one banker explained, “the standards haven’t changed, but if you have less income and less collateral value, you don’t get the money.” Looking ahead, bankers expect loan growth to remain slow while economic conditions remain uncertain.

### **Real Estate and Construction**

Residential real estate activity in the District continued to be sluggish in August. Residential real estate agents and home builders reported that sales of existing homes remained well below the level of a year ago. One builder said he had the “lowest number of contracts in the pipeline in twenty-five years.” However, another builder noted that the number of sales that were being cancelled has diminished somewhat recently. Most of the residential real estate contacts surveyed for this report said inventories of existing homes for sale were still high and that homes were still taking longer to sell than at this time last year. One agent said “our boards are full of listings, but the sales aren’t matching up.” Many agents said potential buyers are taking much longer to make purchase decisions than they did a year ago. Several agents noted that demand for houses that are located farther from employment centers in the region has fallen more than demand for houses that are closer. Real estate agents have mixed views on how much further demand will decline before it turns up, but most are in agreement that a convincing rebound is not likely until sometime next year.

Commercial real estate firms indicated that construction and leasing activity continued to be very slow in August. Office markets have softened as tenants have reduced their space needs by vacating buildings as leases have expired or by offering currently leased space for subleasing. Commercial agents noted that demand for industrial and retail space has declined recently; however, they indicated that the pace of new development has slowed, helping to limit the increase in vacancies. Although several new construction projects have been announced in the region, no start dates have been

set, and as one contact noted, “with tight financing conditions it is likely these projects will not commence construction in the immediate future.”

### **Prices and Wages**

Reports of increases in input costs and output prices were about as prevalent in August as they were in July. Firms in the region noted increases in the prices of food products, chemicals, industrial materials, and metals. Several retailers noted recent large increases in price quotes from suppliers of many types of merchandise. Although many firms said their customers have been resistant to price increases, a significant number of firms said they have raised their prices in response to rising costs. Most of the firms reporting on employment costs in August said wage increases remained moderate. Firms also indicated that hiring is currently limited to the “most critical positions.”

**FOURTH DISTRICT – CLEVELAND**

Economic activity in the Fourth District has weakened somewhat since mid-July. Factory output was largely stable, though auto production declined. Residential construction remains weak, with no improvement expected going into 2009. Most commercial builders told us that business is steady; however, a growing number of them reported a decline in inquiries. Sales by District retailers showed a small improvement during July. Demand for business loans was relatively stable, while lending to households was flat to declining. Energy production was steady to increasing. And the market for freight transport services has softened.

Employment levels were largely unchanged and wage pressures were limited to energy producers. Staffing firms saw a small increase in the number of job openings and job seekers. Job vacancies were greatest in health care and high-skilled manufacturing. Accounts of rising input prices, especially for metals and petroleum-based products, were widespread. However, we heard a few reports that the rate of increase in commodity prices is moderating.

**Manufacturing.** Output by District factories was largely stable during the past six weeks. Reports of shifting production levels were attributed to seasonal factors or shrinking demand by the housing and auto industries. On a year-over-year basis, reports were evenly split between production slowdowns and increases. Manufacturers anticipate that orders will be relatively steady during the upcoming months. For a majority of our respondents, capacity utilization was near normal levels. Steel producers and service centers reported shipping volume was at or below seasonal expectations, which they attributed to a downturn in the auto and construction industries. The strongest end users for steel include energy and agriculture. In general, our contacts believe market conditions for steel will soften in the upcoming months. District auto production showed a sharp decline in July on a month-over-month basis due primarily to retooling for model changeovers. In terms of year-over-year comparisons, District auto production was down slightly, with most of the decline reported by domestic makers.

Capital spending remains on plan, with almost half of our respondents saying that they plan to raise spending in the upcoming months. Although credit remains available, we heard several accounts of borrowers seeing more stringent terms and higher interest

payments. Most manufacturers reported continuing price increases for raw materials, especially steel, petroleum-based products, and processed food ingredients. In response, half of them raised their product prices recently. Looking forward, expectations call for inflationary pressures to continue. However, only a third of our respondents said that they would consider additional price increases in the near future. On net, employment levels and wages at District factories have been stable, with little hiring anticipated in the near future.

**Real Estate.** Residential builders reported little change in market conditions. However, a few noted a slight up-tick in sales on a year-over-year basis. Looking forward, builders are not expecting any turnaround in the industry for the next several months. Further, several anticipate that banks will continue tightening credit standards. List prices on homes held steady since our last report, while discounting remains widespread. Accounts of price increases for concrete, shingles, metal products, and fuel were common. In contrast, lumber prices were stable to declining. Subcontractors are readily available at very competitive rates. General contractors reported employment levels were unchanged and no wage pressures.

Most commercial contractors told us that business conditions have been holding steady during the past six weeks. Although backlogs remain relatively strong, inquiries have declined. Nearly all of our contacts expect a small downturn in business in 2009. Several contractors commented that banks continue to tighten credit standards, nonetheless, financing is available. Contract pricing remains fairly stable, and the rapid rise in steel and fuel prices is beginning to abate. Workforce levels were largely unchanged, and little wage pressure was reported.

**Consumer Spending.** In general, District retailers reported that July sales showed a small improvement on a month-over-month basis across all industry segments. However, our respondents were mixed in their assessment when asked about fourth quarter sales. Reports from auto dealers indicate that purchases of new cars were flat to down, while used vehicle sales were mixed. Purchases of SUVs and trucks were characterized as poor. Dealers anticipate sales in the coming weeks to remain stable or decline slightly. With the exception of clothing, retailers told us that vendors raised their prices. In response, store owners passed some of the increases through to their



customers. Capital spending remains on target, with no revisions planned in the upcoming months. Employment levels and wages were relatively stable.

**Banking.** Demand for business lending has been steady to slightly down. Segments showing strength include commercial real estate and mid-market companies. On the consumer side, loan demand, including home mortgages, was flat to declining. Reports on home equity lines of credit were mixed. Many bankers told us that the availability of business and consumer credit continues to tighten. Reports showed that the number of delinquencies on business and consumer loans increased slightly, while credit quality was steady to declining. A majority of our contacts said that they are experiencing core deposit growth in a highly competitive market. Although lending rates are slowly increasing, it is insufficient to offset the rise in deposit prices. As a result, reports of compressing interest margins were widespread. A small decrease in employment levels across District banks was reported. However, personnel activity was firm-specific and not reflective of an industry trend. Wage pressures are not a major issue at this time.

**Energy.** Oil, gas, and coal production has been steady to increasing during the past six weeks. Looking forward, our contacts expect the demand for coal to increase, while oil and gas demand remains largely stable. Reports indicate that the price received for coal increased, while oil fell and natural gas was unchanged. Materials and equipment costs continue to rise, especially for steel and fuel. Capital expenditures were on plan or slightly higher than projected. A third of our respondents told us they expect to increase capital spending in the upcoming months. We heard a few reports of tightening credit; however, our contacts do not see it as a serious issue at this time. Half of our respondents told us that they hired additional employees during the past six weeks, while most plan further hiring in the near future. Wage pressures are an issue in the oil and gas segment due to competition for skilled workers.

**Transportation.** The market for freight transport services has been relatively soft since our last report. Freight executives told us that the auto, consumer products, and housing industries are primarily responsible for declining demand. Several executives commented that the transport market has hit bottom; however, they do not expect a turnaround until sometime after the first of the year. Rising fuel prices remain the biggest

cost increase confronting our contacts. Most shippers continue to pass it through to their customers via a surcharge. Capital expenditures remain on target, but are below 2007 levels for most companies. Little change in capital spending is expected during the coming months. For the most part, hiring was limited to driver turnover, and any wage increases fell within industry norms.

**FIFTH DISTRICT–RICHMOND**

**Overview.** Economic activity in the Fifth District remained weak in late July and August. Retail sales were soft despite recent tax holidays and rebates; a few auto dealers reported low but nearly steady sales. Similarly, service sector firms reported mostly sluggish demand with little or no revenue growth, while temporary employment agencies noted mixed conditions. Residential real estate sales remained weak across most markets, resulting in low home mortgage demand. Commercial real estate activity was generally softer. Manufacturing activity declined further amid feeble domestic sales that were not fully offset by increased exports. Tourism was a bright spot, with contacts in both coastal and mountain resort areas noting increased bookings since our last report.

**Retail.** Retail sales remained weak since our last report, despite the early August "tax holiday" on back-to-school purchases in Washington, D.C., North Carolina, South Carolina, and Virginia. A spokesperson for retailers in central Virginia said the effect of that state's sales tax holiday was "mediocre at best." Several retailers also reported slower sales since the federal stimulus check distributions dropped off. A department store manager in an upscale area near the Washington, D.C., Beltway told us sales were generally slower and customers were not buying home goods. In Virginia Beach, Va., a discount chain store manager said, "People are just not buying." Contacts noted that sales of 2008 automobiles and light trucks remained stable in recent weeks, albeit at low levels, as dealers tried to make room on their lots for 2009 models. A West Virginia dealer said that banks in his area had raised interest rates on car loans, adding downward pressure on sales. Retail price growth edged up since our last report. Retailers continued to cut jobs, though at a slower pace in recent weeks; average retail wages grew a bit more quickly.

**Services.** District services firms reported generally soft demand since mid-July. Contacts at professional, scientific, and technical firms told us revenues were mostly flat. Executives at financial services firms in Richmond, Va., and Baltimore, Md., said the general sentiment of their clients is concern over the slower economy. Price growth was nearly flat at services-providing firms in recent weeks. Services firms reduced their payrolls slightly, while average wage growth remained stable since our last report. However, a Maryland telecommunications contact said finding and keeping technical talent had been extremely difficult.

**Manufacturing.** District manufacturers reported that shipments, new orders, and employment continued to contract since our last report. A manufacturer at a North Carolina apparel factory reported that export orders were up dramatically while domestic orders remained

weak. A furniture maker in North Carolina told us that residential furniture sales had reached record lows and raw material prices had continued to rise. Similarly, a manufacturer of housing products in North Carolina indicated that orders had slowed further, noting that “customers are only purchasing what they need for in-house business and nothing more.” Price pressures eased somewhat but respondents remained concerned about elevated energy and transportation costs. A producer of gas turbines in South Carolina reported higher prices of raw materials and higher shipping costs.

Exports at Fifth District ports remained substantially above year-ago levels in recent weeks. Port officials noted particularly strong outbound activity for grains and paper products, although one contact reported a slowdown in automobile exports. Import levels generally remained steady, although several respondents noted a “big drop” in inbound furniture shipments. Fuel surcharges stabilized somewhat in late July and August, and one port contact anticipated that “they’ll hold for awhile.”

**Finance.** Demand for home mortgages across the Fifth District continued to weaken in late July and August. A Richmond, Va., lender noted that her firm was “feeling a pinch for the first time,” while a Charleston, S.C., contact said that loan initiations were down forty percent from the previous month. However, several contacts attributed a portion of the slowdown to seasonal factors. Contacts in Richmond, Va., and the Carolinas reported further tightening of credit standards, but a Washington D.C., lender said his institution had generally held standards unchanged, though loan-to-values had been increased “ever so slightly.” Reports on credit quality were mixed.

Commercial loan activity softened a bit in recent weeks as somewhat weaker demand combined with tighter loan standards. A lender in Charlotte, N.C., described activity as generally “healthy, although moderating in growth,” while a Washington, D.C., contact said that activity in his market was “continuing to slow.” Lenders tightened credit standards further and several noted more “laborious” underwriting and stricter adherence to policies and guidelines. Respondents also reported some deterioration in borrowers’ credit quality. In addition, several contacts said that long-standing customers of some banks were being turned down and were shopping around at other institutions.

**Real Estate.** Residential real estate agents across the District reported continued weakness in home sales. In Asheville, N.C., a contact told us that his housing market was very sluggish overall, noting that a lot of people were “on the fence” waiting to see if prices fall any further. Likewise, a Richmond, Va., agent told us he noticed only a seasonal change in August but was optimistic that September would be a better month for sales with vacations ending. In

Washington, D.C., a contact told us that buyers were looking for specific properties and when they can't find them they wait. In contrast, a contact in Greensboro, N.C., reported moderate sales activity and was hopeful that business would pick up when a large trucking firm moves its headquarters to the area in the coming months. Sales held steady in Fairfax, Va., where an agent said that prospective buyers feel the worst is over and prices are as low as they are going to go. Low-to-middle price houses remained the best sellers across much of the District, with little movement in the upper price range, particularly in parts of the Washington, D.C., market.

Commercial real estate conditions varied across the District. Leasing activity slowed in Richmond, Va., Columbia, S.C., and the outlying areas of Washington, D.C., picked up slightly in Charleston, W.Va., and Greensboro, N.C., and remained flat in Raleigh, N.C., and Baltimore, Md. Office vacancy rates were "creeping up" in northern Virginia and Richmond, Va., but were generally unchanged elsewhere. Agents in Baltimore, Md., Washington, D.C., Richmond, Va., and Raleigh, N.C., reported steady rental rates, but an increase in concessions. Only a handful of new construction projects were announced in recent weeks, and all were small and/or entirely pre-leased. While respondents continued to report that obtaining financing from larger banks was challenging, several noted that community banks remained more active in lending.

**Tourism.** Assessments of tourist activity were somewhat more positive in recent weeks. Contacts in both coastal and mountainous areas told us that bookings were generally stronger when compared to our last report, which brought business back to year-ago levels. Along the coast, contacts in Virginia Beach, Va., Myrtle Beach, S.C., and the Outer Banks of North Carolina reported an increase in last minute reservations, shorter stays and fewer group conventions. On the western edge of the District, however, managers at mountain resorts in Virginia and West Virginia reported numerous calls for regional group conventions. They also indicated a notable increase in business from neighboring urban areas, which they attributed to their establishments being within a "tank of gas."

**Temporary Employment.** Temporary employment agencies in the District gave generally mixed accounts since our last report. Demand was somewhat strong in Raleigh, N.C., average in Cary, N.C., and weak in Hagerstown, Md. Some contacts expected demand to strengthen over the next few months due to a general strengthening in the local economy. Preparations for the upcoming holiday season were also expected to increase demand. High-level IT, biotech services, life sciences, sales, and administrative support were among those skills most highly sought after.

**Agriculture.** Since our last report, most of the District continued to suffer from dry conditions, despite spotty rainfall in a few places. In Maryland and North Carolina, analysts

reported that the lack of rain had heightened farmers' concerns about inadequate soil moisture and crop development. Similarly, scattered rainfall brought some relief to parts of Virginia but most of the Commonwealth continued to suffer from dry conditions, reducing potential crop yields. Accordingly, corn silage yields were down and producers also expected corn for grain yield to be below normal. On the other hand, the peach harvest in South Carolina was on schedule, the tomato harvest was completed, and the harvest was near completion for cantaloupes and watermelons.

**SIXTH DISTRICT – ATLANTA**

**Summary.** Reports from contacts for July and August continued to describe weak levels of economic activity throughout the Sixth District. Retailers reported that sales were below expectations while inventories were higher than a year earlier. Both commercial and residential construction activity was weak. Most manufacturers reported lower production levels along with higher input prices. District banks continued to note tighter lending standards. Food, energy, and raw materials prices were elevated, but wage costs were not rising in most parts of the District.

**Consumer Spending and Tourism.** District merchants reported that sales were below expectations for July and August. Inventories were described as higher than a year earlier. Most contacts expect sales to remain flat or decline in the near term as the stimulus from the tax rebate wanes. District vehicle sales continued to worsen with contacts reporting lower sales across most sub-compact vehicle types. Tourism related activity was mixed with reports noting lower hotel occupancy in some parts of the District. Tourism contacts also reported concerns regarding reduced Labor Day weekend travel, and most anticipate some weakening in business travel during the fall.

**Real Estate and Construction.** Reports from homebuilders and Realtors indicated that new and existing home sales remained below year-earlier levels for July and August. Contacts reported that sales activity was mixed; some District contacts noted further weakening while others reported modest strengthening. Weakness was most pronounced among Georgia builders. Modest improvements in new and existing home sales activity were noted by some Florida contacts. The majority of builders reported that construction was significantly lower than a year earlier. Overall, new home inventories continued to fall while existing home inventories rose slightly. Home prices continued to decline across much of the District. The outlook for residential sales and construction over the next several months remained subdued; however, most contacts did not anticipate further significant weakening.

The majority of reports from commercial contractors noted declines in construction activity on a year-over-year basis. Weakness remained most pronounced in Florida. Vacancy rates among all commercial property types continued to rise in most

parts of the District. Overall, commercial contractors anticipate development activity will remain restrained at least through the first quarter of 2009.

**Manufacturing and Transportation.** Most manufacturing contacts reported slight declines in production for July and August compared with a year earlier. Many reported cutbacks in employment and hours. Construction-related firms reported very weak conditions. A larger proportion of contacts said that higher prices for raw materials and energy were being passed through to customers than in previous reports. Activity six months from now was expected to be similar to current levels with manufacturers anticipating the price increases for both raw materials and finished goods to moderate. Vehicle production at District plants weakened in July and August in response to lower consumer demand.

Freight demand was weaker than a year earlier, according to contacts. Regional rail activity was down from year-earlier levels as shipments of automotive and construction materials continued to drop, offsetting some gains in coal, minerals, and farm product shipments. Inter-modal shipments were also lower than year-earlier levels.

**Banking and Finance.** Most banking contacts in the District reported that credit standards remained tight during July and August. Many District banks adjusted rates upward according to risk, required larger down payments and higher credit scores, lowered loan-to-value requirements, and stipulated that new loan customers open deposit accounts. Consumer loan demand ranged from being steady to down across the District. Banks reported that funding remains an issue and retail deposit competition remains strong. Pricing for CDs is characterized as remaining high.

**Employment and Prices.** The majority of business contacts continued to report reductions in hours and workforce in July and August. Overall, firms were holding wage bills in check. There were only scattered reports of wage increases, mainly in high-demand professional positions, in markets along the Gulf Coast tied to rebuilding efforts, and in energy-extraction industries.

District businesses continued to note higher input prices mostly tied to higher energy costs, although increases in the prices of metals, food and fertilizers were also noted. Higher fuel prices continued to have a negative effect on the profitability of regional freight and passenger transportation firms. There were increased instances of



businesses passing on higher costs to consumers. However, there was skepticism about the ability to sustain the rate of pass through in the future because of weakening demand conditions.

**Agriculture.** Most District growers affected by poor soil moisture levels benefited from increased precipitation in July and August. Drought conditions still persisted in many northwestern Georgia counties. Many District growers continued to report higher costs of fuel and fertilizers.

**SEVENTH DISTRICT—CHICAGO**

**Summary.** Economic activity in the Seventh District remained sluggish in July and August. Consumer spending was flat and labor market conditions weakened. Residential construction declined and nonresidential construction showed further signs of slowing. Manufacturing activity was steady. Consumer lending was little changed, while there was some growth in business lending. Cost pressures from material and energy prices remained elevated, while wage pressures continued to be low. The condition of corn and soybean crops improved.

**Consumer spending.** Consumer spending was little changed since the previous reporting period. Although the boost from federal tax rebates subsided, the back-to-school season and increased discounting and promotions sustained retail sales. Spending on automobiles remained slow. Consumers continued to tighten their budgets and bargain shop, trading down to lower priced brands and fast-food restaurants and reducing spending on discretionary items such as furniture and apparel. Gasoline consumption rose as gas prices fell. Contacts indicated, however, that travel remained local, to the detriment of tourist destinations far removed from metropolitan areas. Light vehicle sales remained low, although demand for smaller cars stayed strong. Several contacts noted a slight positive impact on sales from General Motor's employee discount pricing program.

**Business spending.** The pace of business spending slowed from the previous reporting period. Several contacts reported delaying or postponing capital spending projects given reduced levels of activity in their industry or uncertainty over near-term prospects. For instance, a manufacturing contact put off plans to replace capacity from older plants they had shut down with newer facilities. In contrast, another contact noted that investment in emerging technologies, especially "green" energy, had increased. Labor market conditions in the District weakened further in July and August. The District rate of unemployment rose substantially in July. Contacts reported additional lay-offs in the automotive and financial services industries, and job growth continued to be weak in construction, retail trade, and business services. In addition, a staffing firm reported that billable hours for professional services such as IT, engineering, finance, and accounting declined from the previous reporting period. The demand for skilled labor in

manufacturing, however, remained strong and shortages of such workers continued to be reported. A pharmaceutical manufacturer reported strong growth in new hires.

**Construction/real estate.** The pace of construction slowed from the previous reporting period. Residential construction declined at a faster rate in July and August. A contact noted that activity was now so low that some residential builders had shifted toward small-scale commercial projects. The lack of demand for new construction was attributed to both the inability of potential buyers to secure credit or sell their existing home and substitution into the existing home market due to the continued decline in their relative price. Project delays and cancellations persisted, and credit remained tight for new developments. However, absorption rates of residential housing improved. Residential rents declined in some areas of the District. Nonresidential development and construction showed further signs of slowing during the reporting period. Construction of retail outlets, in particular, was mentioned as being very weak, and several contacts expressed concern about overbuilding in the sector. The availability of financing for commercial projects also continued to be of concern. Contacts cited fewer equity investors and tighter lending standards by banks as factors delaying existing projects and limiting new developments.

**Manufacturing.** Manufacturing activity in the District was steady this reporting period. Business conditions, in general, were solid for energy and commodity manufacturers. Demand for heavy machinery used in sectors such as oil and gas extraction, mining, and agriculture remained strong. Export-oriented industries also continued to do well despite a recent slowing in demand from Europe, rising transportation costs, and the recent appreciation of the dollar. Activity remained robust in the domestic steel and specialty metals-related industries. There were also reports of strength in demand from contacts in the food and pharmaceutical manufacturing industries. However, the demand for residential construction equipment remained weak, and there was additional softening in sales of commercial construction equipment. Demand also remained soft for manufacturers with close ties to housing, such as the home appliance industry. Automakers reported that the domestic vehicle market remained weak in July and August, especially for larger vehicles, and additional production cuts were planned for slow-selling larger products.

**Banking/finance.** Credit market conditions in the District tightened from the previous reporting period. The volume of consumer credit was little changed, despite a decline in approval rates due to continued tightening in lending standards. Mortgage originations remained low and foreclosures continued to rise in some areas of the District. However, a contact in this industry expressed the opinion that the recent federal housing stimulus bill had aided FHA lending. Refinancings and home equity loans were little changed in July and August. Nonetheless, a contact reported eliminating nearly all home equity products due to secondary market tightening. Some growth was reported in business loan demand, particularly for commercial and industrial loans to small and middle market businesses. Still, several banks noted they were closely monitoring the creditworthiness of business customers. Concerns about the residential and commercial real estate markets persisted and greatly limited the availability of credit for construction loans from banks.

**Prices/costs.** Despite some recent declines, commodity, food, and energy prices were again cited by contacts in various industries as contributing to elevated input costs. Shortages and tight supplies were also noted for certain metals and energy products. Input costs were also reported to be boosted by the imposition of fuel surcharges, credit card transaction fees, and higher wholesale prices for retailers. There were also several reports of pass-through of these higher costs to downstream prices, albeit to a very limited extent for industries such as residential construction and retail trade. In the financial sector, several contacts in the mortgage industry reported pressure on margins for residential mortgages from recent pricing increases in the secondary market. Wage pressures remained limited outside of skilled labor positions that continue to experience shortages.

**Agriculture.** Crop conditions improved in the District as sufficient moisture remained from earlier rains to offset dry weather in August. Replanted fields may boost soybean production above current published estimates. Contacts reported that corn and soybean fields were at least two weeks behind the typical stages of development, making crop yields more vulnerable than usual to an early frost. Concerns about risks for 2009 grew as farmers faced higher planting costs while having fewer options to lock in prices for their crops. These circumstances have led parties in transactions to more fully investigate the financial health of their counterparties. Hay supplies improved with new

cuttings, and pastures were in good shape. Corn and soybean prices fell during the reporting period. However, livestock producers still struggled with high feed costs. Hog producers benefited from higher hog prices. Lower corn prices eased margins for several ethanol producers reducing delays and allowing some new plants to start production.

**Eighth District - St. Louis**

**Summary**

Overall economic conditions in the Eighth District have softened since our previous report. Contacts noted declining activity in services and manufacturing. Compared with a year ago, retail sales were flat in July and the first half of August, while auto sales declined. Home sales and construction continued to decline throughout the District, while commercial real estate reports were mixed. Overall lending activity at a sample of District banks declined during the three-month period ending in July.

**Consumer Spending**

On average, contacts reported that retail sales in July and the first half of August were flat over year-earlier levels. Half of the retailers saw increases in sales, while 39 percent saw decreases. About 26 percent of the contacts reported that sales levels met their expectations, 39 percent reported sales above expectations, and 35 percent reported sales below expectations. Essentials and staple food items were strong sellers, while non-essential items and luxury goods moved more slowly. About 54 percent of the contacts noted that inventories were at desired levels, 35 percent reported that inventories were too high, and 11 percent reported that inventories were too low. About 54 percent of the retailers expect sales to increase in September and October over 2007 levels, while 23 percent expect sales to decrease; the remaining contacts expect sales to be the same.

On average, car dealers in the District reported that sales in July and the first half of August were down compared with last year. About 80 percent of the car dealers surveyed reported a decrease in sales, while 8 percent reported an increase. About 64 percent of contacts reported more rejections of finance applications. About 39 percent of the car dealers surveyed reported that inventories were too high (mostly trucks, sports cars, and less-fuel-efficient cars), while 17 percent reported that inventories were too low (mostly used cars and fuel-efficient cars).

About 71 percent of the car dealers expect sales to decrease over 2007 levels in September and October, 17 percent expect sales to increase, and 12 percent expect sales to be the same.

### **Manufacturing and Other Business Activity**

Manufacturing activity has declined since our previous survey. Several manufacturers reported plans to open plants and expand operations in the near future, but a larger number reported plans to close plants and reduce operations. Firms in the plastic goods and sporting goods industries reported plans to open new facilities in the District. Contacts in the plastic bottle, animal slaughtering and processing, furniture, and auto parts manufacturing industries reported plans to expand existing facilities and operations. Many firms in these industries also reported plans to hire additional workers. Several firms in the auto parts and auto manufacturing industries announced plans to retain workers and shifts, despite a slowdown in demand and production. In contrast, citing slow demand for product and/or rising input costs, other firms in the animal slaughtering and processing, auto parts, and electrical equipment component manufacturing industries reported plans to lay off workers and decrease operations. Firms in the appliance, structural metals, iron/steel pipe, apparel, plastic products, auto parts, animal slaughtering and processing, and building supplies manufacturing industries each announced that they will close a plant in the District and plan to cut jobs or move jobs out of the District.

Activity in the District's service sector has softened in most areas since our previous report. Contacts in the transportation and warehousing industries reported plans to expand operations, build new distribution centers, and hire additional workers in the District. Firms in the business support services also announced plans to hire additional workers. In contrast, and to a greater extent, firms in the information, health care and social assistance, warehousing and storage, education, architectural, and business support services industries announced plans to lay off workers. Firms in the information and health care services sectors announced plans to consolidate operations within the District.

**Real Estate and Construction**

Home sales continued to decline throughout the Eighth District. Compared with the same period in 2007, July 2008 year-to-date home sales were down 16 percent in St. Louis, 20 percent in Memphis, 21 percent in Little Rock, and 22 percent in Louisville. Residential construction also continued to decline throughout the District. June 2008 year-to-date single-family housing permits fell in nearly all District metro areas compared with the same period in 2007. Permits declined 34 percent in Little Rock, 42 percent in St. Louis, 43 percent in Louisville, and 57 percent in Memphis.

Commercial real estate market conditions varied across the District. The 2008 second-quarter industrial vacancy rate decreased compared with the first quarter rate in St. Louis, Louisville, Little Rock, and Memphis. During the same period, the suburban office vacancy rate decreased in St. Louis and Little Rock but increased in Louisville and Memphis. The downtown office vacancy rate decreased in Louisville and Memphis and increased in St. Louis and Little Rock. A contact in northeast Arkansas reported that commercial building was slow. Commercial contracting contacts in Louisville reported that a satisfactory number of projects are in the pipeline.

**Banking and Finance**

A survey of senior loan officers at a sample of District banks showed a modest decline in overall lending activity during the three months ending in July. Credit standards for commercial and industrial loans tightened somewhat for both large and small firms, while demand for these loans was moderately weaker. Credit standards for commercial real estate loans were tightened somewhat, while demand for these loans ranged from unchanged to weaker. Credit standards for consumer loans were also tightened somewhat, while demand for these loans was moderately weaker. Demand for both prime and nontraditional residential mortgage loans remained unchanged, while credit standards for both types of loans ranged from basically unchanged to slightly tighter.



**Agriculture and Natural Resources**

Development of the District's major crops remains behind its 5-year average. The overall condition of corn, soybeans, rice, and sorghum has improved slightly or acquired roughly the same percentage of poor ratings as in our previous report; however, a higher percentage of cotton was rated in poor condition. As of August 1, yields for the major crops in each District state were expected to be at least 88 percent of last year's yields.

## **NINTH DISTRICT--MINNEAPOLIS**

Ninth District economic activity was stagnant since the last report. Decreased activity was noted in consumer spending and services, while residential construction and real estate remained slow. Tourism and commercial real estate and construction were mixed. Increases in activity were noted in manufacturing, energy, mining and agriculture. Labor markets loosened somewhat since the last report. Wages increased moderately, while prices for many commodities and energy have decreased since mid July, but remain at relatively high levels.

### **Consumer Spending and Tourism**

Consumer spending decreased slightly in some areas. A major Minneapolis-based retailer reported that same-store sales in July were down 1.2 percent compared with a year earlier. A Minnesota-based leather goods retailer recently announced that it plans to liquidate its remaining stores and go out of business. A beauty salon company and franchiser and a woman's clothing retailer, both also based in Minnesota, announced plans to close 160 stores and 36 upscale boutiques, respectively. A North Dakota mall manager reported that August sales levels were on a par with a year ago. In contrast, a Montana mall manager reported strong traffic for back-to-school sales.

Tourism activity was mixed. Tourism activity in the Upper Peninsula of Michigan was soft in July, but August was fairly strong, according to an official. A tourism official in Montana noted that summer activity is on a par with last year; however, tourists are spending less on souvenirs and retail. The number of visitors stopping at tourism information centers was down during July in South Dakota compared with a year ago, but there was a substantial increase in the number of Canadians and other international travelers. A number of contacts observed that people were vacationing, but staying closer to home to save on fuel costs.

### **Services**

Activity in the services sector was down slightly. A large consulting firm noted a decrease in the length of outstanding contracts and reduced entertainment expenses as a result. Contacts from the health care sector reported softness in demand. Contacts from engineering firms reported stable to decreased activity due to the higher input costs their customers are facing.

**Construction and Real Estate**

Commercial construction activity was mixed. July nonresidential permits in Sioux Falls, S.D., were down 11 percent in value from a year earlier. However, permits increased dramatically in Fargo, N.D. Several energy-related construction projects are planned in the western portion of the District. Residential construction remained slow, but showed signs of bottoming out. July residential permits in Minneapolis-St. Paul were down 42 percent from a year earlier. However, multifamily construction increased in Minneapolis-St. Paul and Sioux Falls. The number of vacant new homes decreased in Minneapolis-St. Paul and other parts of the District.

Commercial real estate activity was mixed. A Minneapolis-St. Paul commercial real estate firm reported that so far this year, the industrial market has been strong, while the office market has been mainly flat and retail has worsened. Contacts in other District cities also reported slow demand for retail space. Residential real estate remained slow. Second-quarter home sales in central Minnesota were down 14 percent from a year earlier. The western Montana home market has cooled slightly from last year, but is performing well relative to most other areas. July pending sales in Minneapolis-St. Paul increased 6 percent from a year ago.

**Manufacturing**

Overall manufacturing activity was up since the last report. A July survey of purchasing managers by Creighton University (Omaha, Neb.) indicated increased activity in the Dakotas and flat activity in Minnesota. Exports of manufactured goods have increased across the District. "Business is booming due to exports," commented a Minnesota metal fabricator. However, a western Wisconsin hardwood product producer reported that sales were off 30 percent from a year ago and production is running at 60 percent of capacity.

**Energy and Mining**

Activity in the energy and mining sectors increased since the last report. Oil and gas exploration expanded to regions in western Montana. Several alternative biofuel plants are in the planning stages. Expansion of wind farms continued. Growth in the mining industry continued since the last report; almost all District mines are operating at full capacity.

**Agriculture**

Agricultural conditions improved since the last report. Results of the Minneapolis Fed's second-quarter (July) survey of agricultural credit conditions indicated that lenders expect

overall agricultural income and spending to be up in the third quarter. “Crops are looking good,” commented a respondent from Minnesota. The winter wheat harvest in Montana is showing better-than-average yields. District corn production is expected to increase over last year’s bumper crop. However, many District crop prices softened since the last report.

### **Employment, Wages and Prices**

Labor markets loosened somewhat since the last report. Minnesota’s unemployment rate reached 5.8 percent in July, the highest level since 1986. A major Minnesota-based manufacturing company announced plans to eliminate several hundred jobs companywide over the next few months, and a major Minnesota-based airline announced plans to cut 2,500 jobs companywide. Also in Minnesota, an insurance company announced plans to lay off 100 employees and a software firm recently announced plans to lay off 80 employees. Almost 170 employees were laid off by the City of Duluth (Minn.) in response to a budget shortfall. A North Dakota hospital recently announced plans to lay off up to 100 workers. In South Dakota 100 jobs were cut at a computer plant, and in Montana an aluminum producer laid off 125 workers in response to high energy prices. A motorcycle manufacturer in southwestern Wisconsin cut 60 jobs during August. The number of college graduates applying to volunteer in service organizations posted substantial increases in 2008 compared with a year ago. In contrast, labor markets in west-central North Dakota are expected to continue to tighten.

Wage increases were moderate. Miners and support staff at a Montana mine approved a four-year contract that includes pay raises of 4 percent annually, similar to the previous contract. However, a Montana bank director noted that in the northwestern part of the state, wage increases for management positions were accelerating.

Prices for many commodities and energy have decreased since mid July, but remain at relatively high levels. Several metal and grain prices, including aluminum, copper, lead, corn and soybeans, decreased significantly. Minnesota gasoline prices were 38 cents per gallon lower in mid-August than in mid-July; however, they were 68 cents higher than a year ago. Some school districts have moved to a four-day week in order to reduce fuel and energy costs. A bank director noted that medical insurance prices increased 7 percent this year, while health care costs to businesses increased only 5 percent due to benefit reductions and product shifts.

## **TENTH DISTRICT- KANSAS CITY**

Economic growth in the Tenth District improved slightly in late July and early August. Retail and restaurant sales rose, although auto sales remained weak. Manufacturing activity rebounded after weakening in early summer, and expectations for the next six months were positive. Residential real estate sales experienced a modest improvement, but sales volume and home prices remained well below year-ago levels. Commercial real estate activity held steady despite many contacts reporting an additional tightening of credit, but bankers reported a slight reduction in overall loan demand. Energy activity remained robust, and agricultural conditions were favorable. Labor markets softened, but some firms continued to report labor shortages. Wage pressures were largely unchanged, and most firms did not expect future wage increases. Additional gains in raw materials prices resulted in higher prices for finished products.

**Consumer Spending.** Consumer spending was mixed in late July and early August, with retail and restaurant sales up while auto sales remained down. Although traffic and spending at malls weakened, other store managers reported that retail sales strengthened compared with the previous survey period and were in line with year-ago levels. Restaurant sales climbed while menu prices stabilized. Auto dealers continued to report sluggish sales, with large truck and SUV sales particularly lethargic. Auto industry respondents indicated that tightened credit conditions persisted. Tourism activity was flat since the last survey. Several contacts reported that consumers were traveling less and staying closer to home for vacations. Air travel remained slightly higher than year-ago levels, and hotel occupancy rates were stable but below expectations. Room prices continued to increase.

**Manufacturing.** Manufacturing activity rebounded after weakening in June. Production levels and new orders increased considerably, especially for non-durable goods. Expectations for the next six months were also much stronger than in previous

surveys. Export demand continued to be strong. Capital spending remained well above year-ago levels, and manufacturers anticipated high capital spending levels to persist. Manufacturers expressed concern over soaring raw material prices driven by elevated fuel and energy prices. Respondents reported that higher input prices were increasingly being passed through to final product prices.

**Real Estate and Construction.** The Tenth District residential real estate market was mixed in late July and early August with sales strengthening slightly and prices continuing to fall. Residential sales improved modestly since the last survey period, but still remained well below year-ago levels. While sales of lower-priced homes and foreclosures increased, respondents commented that demand for higher-priced homes was weak. Home prices decreased in the current survey period and were anticipated to decline further in the next three months. Inventories of residential homes stabilized during the current survey period. Commercial real estate activity was unchanged since the last survey, and remained slow. Vacancy and absorption rates held steady, but sales were down slightly. Contacts reported modest increases in rental rates and prices. Survey respondents indicated that credit had tightened further and was a major constraint to current and future activity.

**Banking.** Bankers reported tighter credit standards and weaker loan demand than in the previous survey. Demand for commercial and industrial loans and commercial real estate loans fell appreciably, and demand for consumer installment loans and residential real estate loans declined modestly. As in the previous survey, half of respondents reported tighter credit standards for commercial real estate loans, while a quarter reported tighter standards for commercial and industrial loans. A few banks reported tighter standards for residential real estate and consumer installment loans. Assessments of current loan quality were little changed from the previous survey, but banks were somewhat more pessimistic about future loan quality. Bank deposits increased, and a

couple of respondents noted that depositors were paying more attention to the financial soundness of banks in deciding where to place their funds.

**Energy.** District energy activity remained robust in the current survey period. Drilling activity accelerated compared to the previous survey and was well above year-ago levels. Expectations for drilling activity remained strong, even as oil and gas prices fell from record levels to lower but still profitable levels. The number of active drilling rigs in the District was flat. Respondents continued to report easy access to credit, but the availability of qualified workers and equipment constrained drilling activity for some firms. Profit margins at bio-fuel firms improved with lower crop prices.

**Agriculture.** Agricultural conditions remained favorable in late July and August. Wheat yields were reported larger than normal in Kansas, Nebraska, and Oklahoma, though dry weather limited production and yields in Colorado. Despite lagging crop development due to delayed planting, rising expectations for bumper corn and soybean harvests contributed to lower prices in recent weeks. Dry pasture conditions in parts of Colorado, Kansas, and Oklahoma prompted supplemental feeding for cattle with a few reports of herd liquidations. Farm credit conditions showed some sign of deterioration as the number of loan renewals and extensions increased and the rate of loan repayments slowed. High input costs trimmed farm income expectations, boosted loan demand, curbed capital spending plans, and limited farmland value gains.

**Wages and Prices.** Price pressures continued to increase in late July and early August, but wage pressures remained steady. Prices of final manufactured products rose further as District factories faced surging raw material prices and fuel surcharges. Some retailers reported higher prices in the current survey period, but most expected prices to stabilize over the next three months. Restaurant contacts indicated that menu prices were flat despite increased food costs. Some contacts continued to report labor shortages, but wage pressures remained largely unchanged. Most respondents did not expect to raise wages in the next three months. However, a number of firms were instituting more

flexible work schedules or shorter work weeks to alleviate employee concerns with high gasoline prices. District layoff announcements exceeded hiring announcements in July, but hiring announcements rebounded in August with net hiring gains erasing July's losses.



## ELEVENTH DISTRICT—DALLAS

The Eleventh District economy expanded modestly in late July and August. Economic conditions were slightly softer than reported in the last survey. Despite weakness in some sectors, businesses with national sales say demand remains better in Texas than elsewhere in the country. Most contacts said higher costs continue to impact profitability. Many expressed concern about the health of the national economy and current financial conditions.

**Prices.** Elevated energy and commodity prices continue to significantly impact most industries in the District. Many contacts said higher costs were being passed through to selling prices. Several contacts were instituting or raising surcharges to cover transportation costs. There were reports of softer prices for some commodities including steel, aluminum and grain, but contacts did not expect much relief in the near-term.

After peaking at an all-time high in mid-July, oil prices retreated in recent weeks but remain elevated compared to a year ago. Oil product prices, such as gasoline, diesel and heating oil, fell in tandem with crude oil. The price of natural gas also declined to its lowest level since February. Natural gas inventories are near their 5-year average but are below the high levels seen last year. Prices for some petrochemicals, including ethylene and propylene fell along with energy prices, but plastics prices held steady and industry contacts noted they remain behind the curve in passing through previous energy increases.

**Labor Market.** The labor market remained relatively tight and most contacts reported flat to moderate hiring. Shortages remain prevalent for skilled workers in oil and gas related professions. Wage pressures were mild overall, but there were reports that companies were fielding more requests for higher wages. Some firms were eliminating overtime or reducing hours to help manage payroll costs.

**Manufacturing.** Demand for materials to supply residential construction remained weak, and bookings were lackluster. Inventory levels have fallen in response to a ramp down in production. Fabricated metal producers that supply commercial construction said demand was down considerably, driven by continued trouble in credit markets. One contact noted the falloff was “like the faucet shut off”. Primary metals producers noted slower to flat demand, and some contacts said their customers were reducing inventory. Outlooks were somewhat more cautious. Costs of construction continue to rise, and lending conditions have become much stricter. Despite the more difficult environment, contacts said the Texas construction market remains in better shape than most other areas of the country.

Respondents in high-tech manufacturing report flat to slightly lower sales since the last survey, with most describing the pace of growth as weak to moderate. One contact noted a recent softening of demand in Asia which had previously maintained a strong pace. Inventory levels were mixed. Expectations have diminished. Contacts said they had expected demand to improve in the third quarter but now expect weakness through year-end.

Food product sales remain near year-ago levels and the outlook is positive, despite higher costs for input prices such as corn and milk. Contacts are optimistic about the back-to-school season and expect new snack products to generate demand through the rest of the year. Activity remained steady for specialized transportation equipment, such as ambulances and aircraft parts. Automotive manufacturers said demand continued to fall—particularly for vehicles with low fuel economy—and there are reports of temporary plant shutdowns. Sales of corrugated packaging remained sluggish.

Demand for gasoline, diesel, and other oil products weakened and refiners cut production. Contacts said refining margins fell sharply as the decline in product prices was faster than the decline in crude prices. Contacts reported softer demand for petrochemical products as domestic sales remained weak and exports slowed, partly due to Olympics-related production cutbacks in China and the August vacation period in Europe.

**Retail Sales.** Retail demand was largely unchanged from the last survey, with mixed reports from contacts. Discount retailers noted strength in sales, although the pace of growth was less robust than a year earlier. Traditional department store sales remained tepid at below year-ago levels. Sales of discretionary items, such as electronics, jewelry and housewares weakened. Retailer outlooks remained pessimistic overall, even though Texas sales appear to be holding up better than in many other areas of the country. Respondents that extend credit expect conditions to worsen in the near-term.

Automobile sales remained weak, and most contacts expect no improvement until early next year. Inventory levels improved as manufacturers reduced production and dealers cut prices.

**Services.** Growth in orders for temporary staffing services leveled off following a slight uptick in the previous survey. Contacts noted clients were cautious to hire because of a slower national economy, rising costs and upcoming elections. Still, demand for skilled professional and technical workers remained strong, especially in the oil and gas industry. Outlooks were generally positive, but many noted concern about the health of the overall economy.

Legal firms said bankruptcy and litigation work continued to shore up activity. Transactional work was down overall, although demand from the oil and gas industry remained

strong. Real estate-related demand was weak. Contacts in accounting services reported steady, moderate demand.

Elevated fuel costs continue to hamper the transportation services industry. Intermodal cargo volume remained steady, but was well below year-ago levels. Respondents noted international demand has shifted the client composition to favor exporting. Railroad industry contacts said volumes were up slightly for metals, coal and chemicals, although the transportation cost of such materials was of great concern. Airlines continue to be negatively impacted by high jet fuel costs. Despite the recent reprieve in energy prices, airline contacts are maintaining their business models and will go ahead with announced capacity cuts.

**Construction and Real Estate.** Sales of new and existing homes remain slow and buyers are extremely cautious, according to contacts. Homebuilders continue to cut back on starts, and new home inventories are edging down. Sales incentives are prevalent on completed homes, but overall, prices are holding up relatively well in both the new and existing markets. The lending environment is a major concern. Several respondents said lending standards had over-corrected, making it difficult for some credit-worthy buyers to obtain mortgages. Contacts in the multifamily sector noted increased concern about apartment overbuilding across the District.

Office leasing activity remained positive but the pace was slower. Contacts noted that even as vacancies tick up, an expected decline in office construction should keep market fundamentals balanced. Overall, commercial construction activity remains relatively strong due to projects currently in the pipeline and elevated public sector construction, although many contacts expect a slowdown next year. Commercial real estate sales activity was subdued as investment capital remained scarce.

**Financial Services.** Eleventh District financial services contacts report relatively satisfactory conditions despite the uncertain national financial environment. Credit quality continues to hold up, although contacts still expect to see some deterioration in the near term. Lending standards remain tight and lenders are reportedly evaluating each borrower and deal with heightened scrutiny. Several contacts noted stiffer guidelines from regulators.

Competition for deposits remains high, and contacts continue to pursue other sources of liquidity. Elevated capital costs continue to pressure lenders to increase interest rate spreads. Loan demand remained soft for automobiles and single-family mortgages but commercial lending was fairly solid. Lending was reportedly strong for new multifamily development.

Automotive industry contacts reported that several lenders had exited the auto lending business and the ones that remained had become more stringent.

**Energy.** Despite a recent fallback, oil and natural gas prices remain at elevated levels compared to a year ago. The decline in prices over the past several weeks is attributed, in part, to weaker U.S. and global economies. The domestic rig count continued to rise, adding 79 rigs over the past six weeks. Much of the additional drilling activity is land-based natural gas activity in the Barnett and Haynesville shale. According to contacts, current prices remain profitable, and there are no indications of cuts in production.

**Agriculture.** Rain improved soil moisture conditions in a few areas, but drought continues to stress crops across much of the District. Hurricane Dolly wiped out cotton and sorghum acreage in the Rio Grande Valley adding to crop losses. Livestock operators culled their herds at a higher-than-normal rate due to elevated feed costs and poor pasture conditions. Dairy farmers said high demand for products and a recent reprieve in grain prices had led to better conditions.

**TWELFTH DISTRICT–SAN FRANCISCO****Summary**

Economic activity in the Twelfth District remained subdued during the survey period of late July through late August. Upward price pressures eased for food and energy-intensive items, but price inflation remained significant overall, while wage pressures fell further. Most retailers saw sluggish sales, and demand for services weakened. Manufacturing activity was mixed across sectors but appeared to expand on net, while demand remained strong for agricultural products and natural resources. The prolonged slump in District housing markets continued, and demand for commercial real estate remained somewhat weak. Contacts from financial institutions indicated that loan demand and credit quality slipped a bit further.

**Wages and Prices**

Upward price pressures remained significant. Despite slower price increases or lower levels for some foods and especially energy products, their prices remained elevated and continued to exert upward pressure on prices for related final products. Upward price pressures have eased for various raw materials but price levels remained high for some, notably steel and copper. Prices for many retail items were held down by extensive discounting, although a few contacts reported that they raised prices in response to earlier increases in input prices.

Upward wage pressures eased further. Firms in most sectors have been reducing staff counts through layoffs or attrition, with particularly pronounced drops continuing in the construction, finance, and real estate sectors. The resulting labor market slack has reduced upward wage pressures in general, with the exception of workers with

specialized skills in a few sectors such as resource extraction and information technology. Several contacts reported upward pressure on overall labor costs due to substantial increases in the costs of health benefits.

### **Retail Trade and Services**

Retail sales remained sluggish. Respondents pointed to high prices for food and fuel as a primary factor underlying the generally weak sales performance of discretionary items such as clothing and jewelry. For department stores and many smaller retail outlets, sales were weak and inventories rose. Demand remained stronger for discount chains than traditional department stores, as consumers offset price increases on food and fuel by switching to lower-priced items in other retail categories. Consumer electronic products continued to sell well in general. Retailers of furniture and household appliances reported exceptionally poor sales, and unit sales of gasoline remained weak. Demand dropped further for new automobiles, especially domestic models with low fuel efficiency.

Demand for services appeared to decline slightly compared with the previous survey period. Health-care providers reported a drop in demand, with some medical centers reducing staff counts in part by leaving vacant positions unfilled. Demand remained soft for providers of professional and legal services and fell further for providers of advertising services. Conditions remained “dismal” for providers of real estate services such as title insurance, with cumulative employment reductions reportedly in the range of 40 to 50 percent over the course of the ongoing real estate slump. Tourist activity was flat to down in major tourist destinations such as Southern California and Las Vegas and down significantly in Hawaii, and airlines continued to struggle with

reduced travel demand and elevated fuel costs.

### **Manufacturing**

District manufacturing activity was mixed across sectors but appeared to expand overall during the survey period. Production activity was at high levels for makers of commercial aircraft and parts as they continued to work through extensive order backlogs. Makers of semiconductors and other information technology products saw moderate sales gains and high rates of capacity utilization; semiconductor inventories reportedly rose slightly. Manufacturers of wood products made further cuts in production activity and employment. Capacity utilization at petroleum refineries remained well below its five-year average, and inventories have been above average. Sales reportedly grew at a moderate pace for food manufacturers, although some faced challenges to their bottom lines due to high input prices.

### **Agriculture and Resource-related Industries**

Strong demand and sales continued for agricultural items and natural resources. Sales continued at a brisk pace for most crops, especially those with extensive overseas markets such as grains and cotton, and sales of livestock products were reported to be at record levels. However, the high prices of fuel, feed, and fertilizer continued to crimp profit margins and reportedly caused some farmers and ranchers to scale back or shut down. Overall demand remained high for petroleum products, with further expansion in extraction activity noted.

### **Real Estate and Construction**

The slump in District home demand and construction activity continued, while demand for commercial real estate remained somewhat weak. Demand for new and existing homes continued to languish, resulting in further price declines. These effects

have been especially pronounced in areas that have experienced high levels of home foreclosures, such as parts of Arizona, California, and Nevada, although lower prices reportedly stimulated sales increases in some areas. Demand for nonresidential real estate was reported to be little changed from the previous survey period but was down relative to twelve months earlier. A few contacts noted that construction activity for public projects such as highways has been maintained or increased of late.

### **Financial Institutions**

District banking contacts reported that loan demand fell on net relative to the previous survey period. Scattered reports indicated that some businesses have sidelined expansion projects, resulting in a pullback in the demand for commercial and industrial loans. Demand for new residential mortgages continued to be very weak, and lending standards remained quite restrictive for residential mortgages and construction loans. Asset quality deteriorated a bit further on net, with scattered reports of more severe deterioration and concerns about additional bank failures, especially among community banks that have been stressed by poorly performing construction loans.