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**Summary of Commentary on** ______________________

# Current Economic Conditions

**By Federal Reserve District**

**July 2009**

SUMMARY OF COMMENTARY ON CURRENT ECONOMIC CONDITIONS
BY FEDERAL RESERVE DISTRICTS

JULY 2009

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# SUMMARY[1]

Reports from the 12 Federal Reserve Districts suggest that economic activity continued to be weak going into the summer, but most Districts indicated that the pace of decline has moderated since the last report or that activity has begun to stabilize, albeit at a low level. Five Districts used the words "slow", "subdued", or "weak" to describe activity levels; Chicago and St. Louis reported that the pace of decline appeared to be moderating; and New York, Cleveland, Kansas City, and San Francisco pointed to signs of stabilization. Minneapolis said the District economy had contracted since the last report.

Most Districts reported sluggish retail activity. Cleveland, Richmond, and Minneapolis noted further declines in sales, although results were somewhat mixed or positive according to retailers in the Boston, Philadelphia, St. Louis, Kansas City, and San Francisco Districts. Manufacturing activity showed some improvement in the Richmond, Chicago, and Kansas City Districts; while St. Louis and Dallas reported some moderation of declines; Philadelphia and Minneapolis saw activity decrease; and most other Districts indicated that manufacturing activity continued at low levels. Boston, Richmond, St. Louis, Minneapolis, and San Francisco reported contractions in services industries. Banking sectors in the New York, Cleveland, Richmond, St. Louis, Kansas City, and San Francisco Districts experienced weaker demand for some categories of loans. Residential real estate markets stayed soft in most Districts, although many noted some signs of improvement. By contrast, commercial real estate markets weakened further in recent months in two-thirds of the Districts and remained slow in the others.

Districts reported varied—but generally modest—price changes across sectors and products, with competitive pressures damping increases; however, Boston, Cleveland, Chicago, Minneapolis, and Dallas noted that some metals prices have increased in recent months. Most Districts indicated that labor markets were extremely soft, with minimal wage pressures, and cited the use of various methods of reducing compensation in addition to, or instead of, freezing or cutting wages.

[1] Prepared at the Federal Reserve Bank of Boston and based on information collected on or before July 20, 2009. This document summarizes comments received from business and other contacts outside the Federal Reserve and is not a commentary on the views of Federal Reserve officials.

**Consumer Spending and Tourism**

Consumer spending in the early summer remained below previous-year levels in most Districts, as households continued to be price conscious. Boston, Kansas City, and San Francisco experienced either modest sales increases or less negative sales results than in recent reporting periods. Philadelphia, Atlanta, St. Louis, New York, and Dallas cited flat or mixed sales, while sales in the remaining Districts remained soft. Several Districts noted that consumers focused on purchasing less expensive necessities, while sales of big ticket items languished. Retailers in Boston, Philadelphia, and Dallas characterized their outlook as cautious.

Auto sales were mixed across the country. Chicago, Minneapolis, and Kansas City saw modest increases in car sales, while New York, Philadelphia, Cleveland, and Atlanta continued to experience subdued sales. The exception was sales of used vehicles, which continued to be strong or were strengthening, according to Philadelphia, Cleveland, Atlanta, Kansas City, and San Francisco.

Travel and tourism declined in the majority of Districts. The San Francisco District observed a sharp drop in luxury and business travel, while tourism activity in New York City was weak but stable since the last Beige Book report. Tourism contacts along the Atlantic coast reported that with the exception of July $4^{th}$ holiday bookings, business was generally weaker than a year ago. Hotel room rates have declined in several Districts.

**Nonfinancial Services**

District reports regarding nonfinancial services industries were largely negative, although they included a few bright spots. The Minneapolis, St. Louis, and Dallas Districts indicated that demand for professional services such as business support, architecture, and legal services continued to decline or remained soft. By contrast, reports from the healthcare sector were largely positive, with the San Francisco, Minneapolis, and Richmond Districts citing steady to increased demand for medical services, and the Atlanta, Cleveland, Chicago, and Dallas Districts reporting hiring activity in health care. Technology-related firms in the Kansas City District also reported heightened activity, especially in the clean technology and defense-driven aerospace markets. Richmond and Minneapolis noted increased demand for information technology workers, and Atlanta saw hiring activity in the defense and aerospace industry. Staffing industry contacts in numerous Districts suggested a higher demand for temporary or part-time workers over permanent hires, and Atlanta noted that employers were taking advantage of a higher supply of skilled labor to improve the quality of their workforces.

Nearly all Districts reporting on transportation services observed continued weakness. Freight transport respondents from the Atlanta, Dallas, and Cleveland Districts noted that cargo volumes remain below year-earlier levels. While Cleveland contacts reported that competitive shipping rates are being maintained, trucking contacts from the Atlanta District noted that an oversupply of trucks relative to demand has exerted downward pressure on rates. A few Districts also reported reduced airline traffic, especially amongst business travelers.

**Manufacturing**

Reports on the manufacturing sector remained subdued but were slightly more positive than in the previous Beige Book. Many Districts characterized manufacturing activity as remaining depressed but with selected signs of modest improvement. Philadelphia, Minneapolis, Atlanta, and St. Louis reported decreased manufacturing activity; however, the latter two Districts noted that the overall rate of decline abated in the latest reporting period. Richmond and Kansas City reported rising manufacturing activity, albeit chiefly in nondurables industries. Districts attributed some of the recent increases in production to replenishment of finished-goods or customer inventories.

Chicago indicated that the quick resolutions of the Chrysler and GM bankruptcies have boosted business confidence, and that automakers were scheduling a pickup in production for July. However, ongoing shutdowns of domestic auto plants have led to precariously low business volumes for parts suppliers, according to Chicago and St. Louis. Steel production remained depressed but has leveled off or increased somewhat, according to Cleveland, Chicago, and St. Louis. Similarly, Dallas observed that refineries increased their capacity utilization slightly over the past six weeks, but that overall industry conditions remain weak because of low demand for fuels. Various District reports noted cancellations of orders for commercial aircraft and continued weak demand for most types of equipment and machinery. Among the positive developments in manufacturing, several Districts mentioned pickups in technology sectors, or cited strong or rising sales of military products or pharmaceuticals.

Comments on the near-term outlook varied across Districts, but on the whole they appear consistent with a forecast of modest and uneven recovery in manufacturing output beginning during roughly the coming six to twelve months. New York, Philadelphia, and Atlanta indicated that manufacturers have a generally positive or improved near-term outlook. Dallas reported that high-tech manufacturers “are seeing some upside potential in their forecasts instead of just down-side risks,” but that construction-related manufacturers “expect no improvement in the near term.” Boston indicated that many respondents expect continued sub-par revenue numbers for the remainder of the year, but “look forward to slowly improving business in 2010,” while Cleveland and Kansas City reported that manufacturing contacts expect little or no change in demand through the end of 2009.

**Real Estate and Construction**

Commercial real estate leasing markets were described as either “weak” or “slow” in all 12 Districts, although the severity of the downturn varied somewhat across Districts. While the office vacancy rate was up and rents were down in the Dallas District, market fundamentals there remained stronger than the national average. Market conditions in the New York District are significantly worse than one year ago, on average, but have been relatively stable in recent weeks and some parts of the District report improving fundamentals. Office vacancy rates continued to climb in the Atlanta, Boston, Kansas City, Minneapolis, Philadelphia, Richmond, and San Francisco Districts, as well as in Manhattan, resulting in sizable leasing concessions and/or declines in asking rents. Significant weakness in the retail leasing sector was reported for the Boston, Minneapolis, and New York Districts, and industrial vacancy increased in the Atlanta, Dallas, Minneapolis, and St. Louis Districts. Commercial real estate sales volume remained low, even “non-existent” in some Districts, reportedly due to a combination of tight credit and weak demand. Construction activity was limited and/or declining in most Districts, although exceptions were noted for health and institutional construction in the St. Louis District, public sector construction in the Chicago District, and the reconstruction of the World Trade Center in Manhattan. Tight credit was cited as an ongoing factor in the dearth of new construction activity. The commercial real estate outlook was mixed, both within and across Districts. Some contacts expect commercial real estate markets to improve within two quarters and others predict further market deterioration for the remainder of 2009 and possibly through late 2010.

Residential real estate markets in most Districts remained weak, but many reported signs of improvement. The Minneapolis and San Francisco Districts cited large increases in home sales compared with 2008 levels, and other Districts reported rising sales in some submarkets. Of the areas that continued to experience year-over-year sales declines, all except St Louis—where sales were down steeply— also reported that the pace of decline was moderating. In general, the low end of the market, especially entry-level homes, continued to perform relatively well; contacts in the New York, Kansas City, and Dallas Districts attributed this relative strength, at least in part, to the first-time homebuyer tax credit. Condo sales were still far below year-before levels according to the Boston and New York reports. In general, home prices continued to decline in most markets, although a number of Districts saw possible signs of stabilization. The Boston, Atlanta, and Chicago Districts mentioned that the increasing number of foreclosure sales was exerting downward pressure on home prices. Residential construction reportedly remains quite slow, with the Chicago, Cleveland, and Kansas City Districts noting that financing is difficult.

**Agriculture and Natural Resources**

The farm sector reported better weather in much of the country in June and early July. As a result, the supply and condition of many crops have improved, and prices have fallen. In the Richmond and Atlanta Districts, generally favorable weather has facilitated the vegetable, small grain or fruit harvest-- much of which is in good condition. Similarly, contacts in several Districts including Chicago, St. Louis, and Kansas City indicated that the size and condition of the corn, soybean and/or rice crops have improved and that farmers are now planning to harvest more acres than previously expected; thus, prices and profits are−and for the short term are expected to remain−down. By contrast, the production of wheat or barley is expected to fall well below strong 2008 levels in the St. Louis and Minneapolis Districts. In the Dallas District, where a drought continues, much of the corn, cotton, and other crops were described as "not worth harvesting," and producers are collecting insurance.

Livestock contacts in the Chicago, Kansas City, and Dallas Districts report that prices for dairy, hogs, and cattle have fallen by more than operating costs and some ranchers are liquidating herds. In the Chicago District, livestock operations have reportedly lost their cash cushion and have been unable to get financing; contacts in Dallas, where the ongoing drought has destroyed forage, also note concerns about ranchers' cash flow.

With oil prices up to $70 per barrel in the first half of 2009 but recently trending down, oil production was reportedly flat in June and early July in the Cleveland, Minneapolis, and Kansas City Districts and up slightly in Dallas and San Francisco. Contacts in Atlanta indicate that the number of rigs operating in the Gulf of Mexico had fallen by half year over year while in Dallas the number of working rigs was up slightly. Natural gas prices continue to fall, discouraging drilling in the Kansas City, Dallas, and San Francisco Districts. Kansas City energy producers report financial strains and are cutting headcounts selectively, while contacts in Dallas observe much excess capacity and weak demand for energy services. In response to weak demand from the utilities, coal prices in the Cleveland District have fallen 50 percent since early 2009, and coal production, jobs and hours are down; capital spending has fallen to minimum maintenance levels. In Minneapolis, by contrast, new wind projects have been announced.

**Banking and Financial Services**

In most reporting Districts, overall lending activity was stable or weakened further for most loan categories. In contrast, Philadelphia reported a slight increase in business, consumer, and residential real estate lending. As businesses remained pessimistic and reluctant to borrow, demand for commercial and industrial loans continued to fall or stay weak in the New York, Richmond, St. Louis, Kansas City, Dallas, and San Francisco Districts. Consumer loan demand decreased in New York, St. Louis, Kansas City, and San Francisco, stabilized at a low level in Chicago and Dallas, and was steady to up in Cleveland.

Residential real estate lending decreased in New York, Richmond, and St. Louis. Dallas reported steady but low outstanding mortgage volumes, while Kansas City noted that the rise in mortgage loans slowed. Refinancing activity fell dramatically in Richmond, decreased in New York and Cleveland, and maintained its pace in Dallas. Bankers in the New York District indicated no change in delinquency rates in all loan categories except residential mortgages, while Cleveland, Atlanta, and San Francisco reported rising delinquencies on loans linked to real estate.

Banks continued to tighten credit standards in the New York, Philadelphia, Richmond, Chicago, Kansas City, Dallas, and San Francisco Districts; and some have stepped up the requirements for the commercial real estate category, in particular, due to concern over declining loan quality. Meanwhile, Cleveland and Atlanta reported that higher credit standards remained in place, with no change expected in the near term. Credit quality deteriorated in Philadelphia, Cleveland, Kansas City, and San Francisco, while loan quality exceeded expectations in Chicago and remained steady in Richmond.

**Employment, Wages, and Prices**

All Districts indicated that labor markets remain slack, with most sectors either reducing jobs or holding them steady and aggregate employment continuing to decline, on net. However, Boston, Cleveland, Richmond, Atlanta, Chicago, St. Louis, and Minneapolis noted selective hiring, including attempts by some firms to take advantage of layoffs elsewhere to pick up experienced talent. Richmond, Chicago, St. Louis, and Dallas cited moderation in the pace of manufacturing employment decline since the last report, and New York noted some signs of labor market stabilization. But Atlanta reported further deterioration in labor market conditions and additional job cuts already planned for coming months.

The weakness of labor markets has virtually eliminated upward wage pressure, and wages and compensation are steady or falling in most Districts; however, Boston cited some manufacturing and business services firms raising pay selectively, and Minneapolis said wage increases were moderate. Boston, Cleveland, Richmond, Chicago, Dallas, and San Francisco cited a range of methods firms are using to limit compensation, including cutting or freezing wages or benefit contributions, deferral of future salary increases, trimming bonuses and travel allowances, reducing hours, temporary shutdowns, periodic furloughs, and unpaid vacations.

Most Districts reported that upward price pressures were minimal. Manufacturers in the Boston, Philadelphia, Atlanta, Minneapolis, Kansas City, and Dallas Districts indicated that most materials costs were flat or down; however, several Districts mentioned price increases for some metals, petrochemicals, and building materials. While the Boston, New York, and Kansas City reports say a few firms are making modest price increases stick, selling prices of most manufacturers and retailers were reportedly held down by competitive pressures. Services firms have increased discounting and/or cut fees, according to contacts in Boston, Philadelphia, Atlanta, Dallas, and San Francisco, while Richmond indicated price increases for services were mild.

FIRST DISTRICT – BOSTON

Business activity in the First District continues to be slow. Most retail contacts are optimistic that they are past the bottom, while manufacturers consider business to be bouncing along it, at best. While activity at consulting and advertising firms seems to be leveling out, commercial real estate has weakened further, reflecting continuing cuts in office employment, among other factors; residential real estate markets remain weak. Many respondents continue to reduce headcount and cut benefits, if not pay. Price changes are varied. Few contacts expect business to pick up before 2010.

**Retail**

Contacted retailers in the First District report mixed sales results for the early summer months, although the majority of respondents report less negative or more positive year-over-year sales changes than in recent reports. Family restaurants are said to be an exception, with some deterioration in sales.

Retailers continue to manage inventory levels carefully. Capital spending is varied, with some contacts looking for or taking advantage of expansion opportunities. The majority of contacted retailers say their headcounts are currently stable, although several mention picking up talent when possible, as other firms shed workers. Selling prices are mostly stable, but a few retailers report that they are starting to observe some vendor price increases. Overall, most First District retailers expect sales growth to remain modest, but many say they are cautiously optimistic about being "past the bottom."

**Manufacturing and Related Services**

Almost all manufacturing and related services contacts headquartered in the First District report that business remained weak in the second quarter. Many customers were said to be delaying or even canceling their orders for equipment and instruments, causing sales of nondefense capital goods to fall at double-digit rates from year-earlier. A few contacts had rising equipment sales to the military or to parts of the residential construction market year-over-year. Biopharmaceutical and other selected healthcare niches were the only additional bright spots mentioned. Respondents indicate that foreign sales varied by geography but were mostly weak or down, and that currency movements depressed dollar-denominated revenues. Some contacts detected order or sales upticks for selected products in the second quarter, but the consensus appears to be that volumes remain low, business is merely "bouncing along the bottom," and "no sustainable green shoots" have emerged. Still, a few express relief that the economy is no longer in a "free fall" and customers are "getting their bearings."

Manufacturers say that materials costs are flat to down compared to a year ago. However, costs for petroleum derivatives and some steel products are beginning to creep up. With the exception of biopharmaceuticals, most contacts cite downward pressure on selling prices, but the extent to which this is translating into actual reductions varies. For example, some companies that increased prices 2 percent to 3 percent in early 2009 indicate that the higher prices are sticking. Others are giving concessions to their major customers or are dropping prices for non-specialty products.

About one-quarter of the contacted manufacturers and related services providers are holding their domestic headcounts steady. Most of the remaining firms continue to cut U.S. employment, either selectively or through layoffs and facility closures. Nonetheless, several respondents mention that they are actively hiring specialized scientific and engineering personnel. About two-thirds of the firms have raised employee pay this year, usually in the range of 2.5 percent to 3.5 percent. In some cases, however, these firms have also reduced benefits, frozen pay for selected business units, or announced that they will be deferring future pay increases. The remaining one-third or so have reduced and/or frozen employee pay, and/or have enacted temporary shutdowns or unpaid vacations.

The majority of responding firms have cut capital spending from last year's levels, in some cases dramatically. Some companies are holding expenditures steady because of commitments to restructuring- or technology-related projects. Relatively few respondents are increasing production capacity. Capital spending plans generally center on new product development, technology upgrades, or cost reduction. Some contacts add that while bank credit remains expensive, financial market conditions have improved.

Most manufacturers and related services providers appear resigned to slower growth or outright declines in revenues year-over-year through late 2009. While many respondents look forward to slowly improving business in 2010, some mention that factors such as structural shifts in the automotive and financial services industries are likely to delay a full recovery in business until sometime after next year.

**Selected Business Services**

Most First District advertising and consulting contacts report stable or slightly higher demand in the second quarter of 2009 compared to the first quarter but year-over-year declines from 8 percent to 42 percent. Losses associated with mergers or acquisitions of large clients seen in the beginning of the year have not been offset with new demand. Demand from the healthcare sector is weakening, chiefly due to uncertainty about the upcoming healthcare reform.

All contacted advertising and consulting firms report price pressure and some are facing "extremely aggressive" price-cutting strategies from competitors. Some firms have offered 15 percent to 20 percent discounts to core clients. Several respondents have reduced personnel costs, cutting bonuses up to 50 percent, deferring compensation, or laying off workers. By contrast, a few companies increased compensation by 2 percent to 3 percent in April 2009. Although wages and salaries will be held stable, a couple of respondents expect to increase total compensation somewhat in the second half of the year. Headcounts in most contacted firms were stable in the second quarter, although a few companies laid off from 10 percent to 25 percent of their workforce. Several contacted firms will reduce employment in the second half of the year either through layoffs or attrition.

Most respondents expect the third quarter to be similar to the second. Demand in 2009 is projected to decline about 4 percent to 10 percent, and sales should start to increase in 2010. Major risks to this outlook are healthcare reform, the state of the regional economy, and higher jobless rates.

**Commercial Real Estate**

Sentiment is mostly negative among commercial real estate contacts this period. Throughout the region, vacancy rates rose again across all commercial property types as sublease supply continues to expand. In Boston, office vacancy downtown is estimated at roughly 15 percent. While this figure is the same as that reported last time, the perception is that the number is on the rise. The suburban vacancy rate is reportedly higher, but estimates range from the upper teens to as high as 24 percent (the figure reported last time). In downtown Providence, office vacancy stands at roughly 18 percent, and suburban office vacancy climbed from 19 percent in December to close to 22 percent currently. The industrial market in

Rhode Island continued to perform relatively well, with vacancy rates still below 10 percent. Office vacancy also rose in Hartford. Rents are said to be falling dramatically in Greater Boston. One Boston contact estimates that asking rents for office space in June 2009 fell 30 percent to 40 percent on a year-over-year basis. Retail rents in Greater Boston were also "clobbered," with exact figures not cited. Year-over-year rent declines have been less steep in Rhode Island, about 6 percent, with all of the declines occurring in the past six months. In Greater Hartford, rents are reportedly holding steady, but landlords are offering significant leasing concessions. Across the board, leasing volume remains very low, as tenants refrain from making commitments beyond a one-month horizon.

Sales transaction volume remained very light across all markets, as large gaps persisted between bid and ask prices and credit remains tight. While underwriting standards are still quite stringent, commercial real estate financing continues to be available from small and medium-sized banks with healthy balance sheets, and through the public equity (REIT) market, which has seen increased activity in recent months. Two contacts noted the rising tide of loan delinquencies and maturities on properties that are "underwater." One contact reports that special servicers for securitized commercial loans are overwhelmed by the volume of problem loans, the result being that *de facto* loan extensions are being granted. Across all types of lenders, including commercial banks, loan extensions of one to three years have become increasingly common, as lenders hope that equity positions will improve over that horizon. Other lenders are restructuring debt at deep discounts, forestalling steeper losses. Ideally, lenders would prefer that borrowers put in additional equity, but most are short on cash.

Contacts expect fundamentals to continue to deteriorate for at least one more quarter, but expectations for the timing of the recovery vary from three to twelve months. Consistent with recent developments, future declines in rents and property values are expected to be greatest for Boston and less severe in other markets that saw smaller run-ups in prices during the boom. The pace of write-downs by commercial lenders is expected to accelerate over the next twelve months.

**Residential Real Estate**

Residential real estate markets in New England remained sluggish in May and into June, although contacts cite some positive signs. Massachusetts and Connecticut saw May home sales drops of 15 percent and 19 percent, respectively, from May 2008. Rhode Island and Maine had more moderate single-digit year-over-year home sales declines in May. In June, Boston area home sales declined only 5 percent year-over-year. In New Hampshire, home sales were flat in June compared to the year before. Condo sales were still far below 2008 levels in Massachusetts, Rhode Island, and Connecticut.

The median home price fell about 12 percent year-over-year for most states in the region, but dropped 25 percent in Rhode Island in May from a year earlier. Another exception was the Greater Boston area, where the median home price decreased only 2 percent year-over-year in June.

Distressed properties make up a much larger share of the homes being sold this year than last, especially in Rhode Island, with negative effects on median prices. However, inventory continues to decline in some areas, reducing excess supply. Several contacts complained about the Home Valuation Code of Conduct, which they argue is leading to under-appraisals by appraisal management companies lacking sufficient experience in local housing markets.

SECOND DISTRICT--NEW YORK

The Second District's economy has shown more signs of stabilizing in recent weeks, though, on balance, economic activity may still be contracting. The labor market remains exceptionally weak but with some signs of leveling off. Manufacturing sector contacts report stable conditions and are generally optimistic about the near-term outlook. Retailers indicate that sales were steady in June and early July while continuing to run well below 2008 levels. Consumer confidence was mixed but generally steady at a low level in June. Tourism activity in New York City has also been sluggish but little changed since the last report, as have been commercial real estate markets. Housing markets have shown some signs of stabilizing in northern New Jersey and upstate New York but continued to deteriorate in New York City and especially in Manhattan. Finally, bankers report a downturn in loan demand—particularly from the household sector—as well as ongoing tightening in credit standards and steady to higher delinquency rates.

**Consumer Spending**

Retail sales were reported to be on or somewhat below plan in June but still down considerably from a year earlier, with selling prices holding fairly steady. Retail sales in New York City, which had been lagging the rest of the region, reportedly picked up in June and early July but remain 8-10 percent below comparable 2008 levels. Contacts in western New York State note that Canadian customer traffic has remained weak and that sales have been stable but below plan and still down from 5 percent to 15 percent from a year earlier. One major chain indicates that, in general, moderate price line merchandise has been selling better than either premium lines or lower-priced lines. Overall, inventories are said to be at favorable levels, and selling prices remain stable, though a number of contacts indicate that low inventory levels have enabled them to be a bit less promotional than in recent months. Auto dealers in upstate New York report that sales continue to run 20-30 percent lower than a year ago—less steeply than in other parts of the country—though the pace of decline has moderated since the last report. Tight credit continues to be a major issue, particularly for dealers who rely on floor plan loans to finance their inventories.

Consumer confidence was mixed in June but at low levels. The Conference Board reports that confidence among residents of the Middle Atlantic states (NY, NJ, Pa), rose modestly in June, reaching its highest level in over a year, though still quite low by historical standards. Siena College reports that consumer confidence among New York State residents retreated in June, after rising in April and May. Tourism activity in New York City has been weak but stable since the last report. Manhattan hotels report that revenues continued to run 35-40 percent below a year ago in June; occupancy rates remained in the mid-80s in June—down just 4-5 percentage points from a year earlier—but room rates were down roughly 30 percent. Broadway theaters report that attendance weakened further since the last report and was down more than 10 percent from a year earlier; however, a 15 percent jump in average ticket prices starting in late May has boosted total revenue moderately ahead of year-ago levels.

**Construction and Real Estate**

Commercial real estate markets in the District were, on balance, steady since the last report. Manhattan's office vacancy rate was steady in June but rose modestly during the second quarter; asking rents on Class A properties continued to slip and remained more than 15 percent lower than a year earlier. There are reported to be more than 13 million square feet of space (2½ percent of the overall market) currently under construction, partly related to the rebuilding of the World Trade Center. Around the District, office vacancy rates have also risen in Northern New Jersey, as well as in the Rochester metro area; however, vacancy rates are reported to be lower than a year ago in the Long Island, Buffalo, Syracuse and Albany areas, and steady in Westchester and southwestern Connecticut. The office-building sales market is reported to remain exceptionally weak throughout the District.

Retail real estate markets are mixed: in Manhattan, the rental vacancy rate fell below 3 percent at mid-year, though asking rents are down roughly 6 percent from a year ago; in northern New Jersey, however, vacancy rates have risen by a full percentage point over the past year, and rents are down marginally. Retail real estate markets in upstate New York have been steady, on balance. Industrial markets have been mixed: vacancy rates have climbed in northern New Jersey and metropolitan Rochester but have eased in the Buffalo and Westchester markets.

Housing markets remained soft throughout most of the District, though there were signs of stabilization in a number of areas. Contacts in northern New Jersey indicate that the market has a somewhat more positive tone than in recent months: prices, though still down about 15 percent over the year, appear to have stabilized somewhat and volume has picked up moderately. There is still reported to be a moderate degree of new development of multi-family buildings along the Hudson waterfront, but otherwise new construction activity is described as moribund. New construction in the Buffalo-Niagara Falls area was reported to be exceptionally slow in April and May but picked up in June; while the high end of the market has weakened somewhat, sales activity at the low end ($150,000 and under) has reportedly been fairly brisk, with multiple bids, sometimes above the asking price. This strength was largely attributed to the $8,000 tax credit for first-time homebuyers. Overall, home prices have held relatively steady in western New York State.

New York City's market, however, has shown further signs of deteriorating, in both the sales and rental markets. In the second quarter, the median sales price for existing co-ops and condos in Manhattan reportedly fell 26 percent from a year earlier, while the number of sales transactions fell 50 percent; the inventory (number of units listed) was up 9%, though there is reported to be a substantial "shadow" inventory of new apartments—condo units that are unsold but not yet listed. Brooklyn's and Queens' markets have also slackened in the second quarter, with median prices of existing apartments reported to be down 15 to 17 percent from a year earlier, and the number of transactions down roughly 30 percent. The city's rental market has also slackened further, with asking rents reported to be down 8-12 percent over the past year, and actual rents off more than 17 percent, on a per square foot basis. Also, landlords are increasingly offering concessions—free rent for one or more months—in slack neighborhoods.

**Other Business Activity**

A leading New York City employment agency notes that the labor market, though still exceptionally slack, has shown some signs of stabilizing since the last report—there continues to be very little hiring activity from the financial sector, but hiring has reportedly picked up somewhat in the legal industry. Still, there is reported to be a huge pool of candidates and few opportunities overall. More broadly, both manufacturers and firms in other sectors generally report that they are still reducing employment, on net. Manufacturing contacts in the District report that business activity has leveled off since the last report, but non-manufacturing contacts overall indicate that conditions have weakened. Still, a large proportion of both groups say they are optimistic about the business outlook. Firms across most sectors report moderate increases in prices paid but modest declines in prices received.

**Financial Developments**

Small to medium-sized banks report weakening loan demand across all categories, but most notably in the residential mortgage and consumer loan categories, where 56 percent of those surveyed report a decrease in demand. A pullback is also reported in refinancing activity. For all loan categories, respondents indicate continued tightening of credit standards, with no banker reporting an easing of standards. Bankers report an increase in the spreads of loan rates over costs of funds for all loan categories—most widely in the commercial mortgage loan category. There were also widespread increases noted in deposit rates. Finally, bankers indicate no change in delinquency rates for all loan categories except residential mortgages, where 26 percent of bankers report increases in delinquency rates and 15 percent report decreases.

THIRD DISTRICT – PHILADELPHIA

Economic conditions in the Third District remained subdued in July. Manufacturers, on balance, reported declines in shipments and new orders. Retailers gave mixed reports, although sales were not strong overall. Motor vehicle dealers indicated that sales of new vehicles were slow. Bank loan volume has increased slightly. Credit quality has continued to deteriorate. Residential real estate sales increased in June and July as pent-up demand and seasonal factors boosted sales, according to local real estate agents, but the sales rate remained below the year-ago pace. Nonresidential real estate investment, leasing, and construction activity continued to be slow. Business firms in the region reported level or falling input costs and output prices in July.

The outlook in the Third District business community was slightly more positive in July than at the time of the previous Beige Book, although most contacts see little prospect of strong improvement in the immediate future. Manufacturers forecast a rise in shipments and orders during the next six months. Retailers expect sales to gain strength slowly, but auto dealers expect sales to remain slow for the rest of the year. Bankers anticipate demand for credit to remain limited until overall economic conditions improve, and they expect further weakening in credit quality as well. Residential real estate contacts believe housing demand is stabilizing, although they say a substantial increase in sales is not imminent. Contacts in nonresidential real estate expect leasing and purchase activity to remain weak during the rest of this year and perhaps move up early next year.

**Manufacturing**

Third District manufacturers reported declines in shipments and new orders, on balance, from June to July. A bit more than one-fourth of the manufacturers surveyed noted decreases in both measures, and slightly less than one-fourth reported increases. Demand remains weak for the products of most of the District's major manufacturing sectors, although producers of some industrial materials and products noted slight increases in orders from June to July.

The outlook among Third District manufacturers is positive. Among firms polled in July, around one-half expect new orders and shipments to increase during the next six months; less than one-tenth expect decreases. However, several of the manufacturers surveyed in July said they expect the pickup in business to be uneven. Typical comments were that that markets are mixed with “areas of strength and areas of weakness,” and that improvement is likely to be “slight” or “spotty.”

**Consumer Spending**

Third District retailers gave mixed reports on sales in June and July, but on balance sales were not strong. Discount stores continued to have better results than other stores. Business at restaurants, hotels, and other leisure and hospitality establishments remained slow. Retailers said consumer confidence continues to be fragile, limiting consumers’ willingness to spend. The remark of one retailer, that “Customers are keeping a more watchful eye on how they spend their money,” was seconded by many other merchants. More positively, home improvement contractors reported fairly good increases in demand for weatherization and energy-efficiency products and home alterations as consumers take advantage of federal tax credits for these items. Looking ahead, retailers are apprehensive that consumer caution will extend into the back-to-school shopping period, although some believe a slow trend toward strengthening sales could begin when there is evidence that the recession is bottoming out.

Third District auto dealers reported that sales of new vehicles remained slow in July but sales of used vehicles have increased recently. Dealers continue to cope with closings and consolidations, and several are emphasizing vehicle servicing in order to maintain income. Looking ahead, dealers said a return of consumer confidence is a prerequisite for a solid increase in demand for new vehicles.

**Finance**

Total outstanding loan volume at Third District banks has been moving up very slowly in recent weeks, according to bankers contacted for this report. There have been slight gains in consumer, business, and residential real estate lending. Most of the bankers contacted for this report said the slowness in loan growth was a result of restrained loan demand, although some noted that they were limiting business lending, especially in the retail, hospitality, and multi-family residential sectors. Nevertheless, banks in the District do not appear to have imposed overall lending restrictions, and—as one banker said—“good credits are still getting money.” Most of the banks contacted in July said that credit quality continued to deteriorate for all categories of lending. Some lending institutions noted increased losses on defaulted mortgages as a result of declines in house prices. Bankers generally expect demand for credit to remain slack in the near term, and some said a significant upturn in lending will not occur until there are solid indications of overall improvement in economic conditions.

Non-depository lenders in the District said financing remains tight, especially for commercial real estate. They noted that many borrowers facing loan rollovers are having difficulty replacing loans. Contacts in secondary debt markets are generally of the opinion that large-scale financial restructuring over an extended period will be required to counter the decline in securitization the has occurred since the onset of the current recession.

**Real Estate and Construction**

Residential real estate activity in the Third District in June and July remained well below the level of a year ago, although residential real estate contacts reported a noticeable pickup from earlier months of the year. According to real estate agents the increase is partly seasonal and partly the effect of “pent-up demand” rebounding from the very low pace of sales over the past winter. Real estate agents generally indicated that the improvement in sales has been mainly for relatively lower-priced houses. They say a wider upturn in sales will depend on significant improvement in consumer confidence and employment. Real estate agents said price declines appear to be easing, although in some parts of the District prices continued to drop substantially compared with a year ago.

Nonresidential real estate firms indicated that leasing and purchase activity has remained slow. Vacancy rates have risen in office, industrial, and retail buildings. Rents have moved down and landlord concessions have increased. Several contacts echoed the comment of one who said, “The balance of power has moved back toward the tenant.” Contacts also indicated that financing for commercial construction and investment remained very difficult. Contacts expect nonresidential real estate leasing and construction activity to remain weak for the next two quarters, at least, but several noted that the lack of new buildings coming on line this year could move markets closer to balance in early 2010.

**Prices**

Reports on input costs and output prices indicate mostly steady or falling prices since the last Beige Book. Manufacturing firms noted decreases for most of the materials they use as well as the products they make. Retailers indicated that their cost of goods has been about steady, and they have kept selling prices nearly level. Several contacts in service industries, especially those related to real estate and construction, said they have reduced fees recently.

## FOURTH DISTRICT – CLEVELAND

The economy in the Fourth District has shown signs of stabilizing since our last report, though activity remains sluggish. Reports from factories indicated that production stabilized at low levels, with manufacturers expecting little change in demand during the upcoming months. New home construction remains weak, while non-residential building activity was mixed. Credit availability continues to be an issue for residential and commercial contractors. Sales by District retailers were flat to slightly down. New motor vehicle sales remained weak, whereas purchases of used vehicles were relatively strong. Coal production fell, with little change noted in oil and gas output. Freight transport volume remains at low levels. Commercial and industrial loan activity was mixed. Refinancing applications for residential mortgages have slowed, though other types of consumer lending were generally characterized as stable. Core deposits increased across the District.

Employment declines were reported in manufacturing, regional banking, and coal mining. Staffing firms noted a fall-off in job openings, with the exception of healthcare and call centers. Given the weak labor market, wage pressures are contained. We heard widespread reports of increased prices for metals and residential construction materials. Capital spending was frozen or trimmed back to mainly critical maintenance projects.

**Manufacturing.** Reports from District factories showed that production stabilized at low levels in June and early July. Any increases cited were attributed to a slight improvement in market demand or seasonal factors. On a year-over-year basis, factory output was sharply lower. Manufacturers expect little change in demand during the upcoming months. Steel producers and service centers reported that the sharp decline in shipping volume has leveled off, but volume remains at depressed levels. The only end market showing growth was defense. Half of our steel respondents anticipate a slight pickup through the third quarter; nevertheless, the industry is not expecting a substantial turnaround through year’s end. District auto production rose modestly during June on a month-over-month basis due to an increase in foreign nameplate output. On a year-over-year basis, both domestic makers and foreign nameplates experienced a sharp drop in production.

Capacity utilization has changed little since our last report, with most contacts saying that it is well below historic norms. Capital budgets remain frozen or have been severely curtailed. Capital expenditures are expected to stay at depressed levels through the remainder of 2009. We heard widespread reports of an uptick in metals prices, which is putting some upward pressure on product pricing. A majority of our respondents made further reductions in payroll costs through layoffs, wage cuts, and reductions in production hours. Predictably, wage pressures are contained.

**Real Estate.** The residential construction industry remains weak. Although most builders continued to experience a slight increase in sales, their outlook is less optimistic than in the second quarter. Foot and Internet traffic was characterized as stable or declining, and sales trends are expected to remain at current levels or fall off slightly through year's end. Builders reported that a recovery in the housing industry is being impeded by financing difficulties (contractors and home buyers), low appraisal values, and limiting of tax credits to first-time buyers. Discounting has been reduced significantly. We heard widespread reports of increased prices for lumber, shingles, and concrete; these were attributed to seasonal factors. General contractors continue to operate with skeleton crews, and subcontractors are readily available at very competitive prices.

Reports on nonresidential construction activity were mixed, with some improvement seen by contractors participating in public works and education projects. We heard several reports of a slight pickup in backlogs and inquiries. All of our respondents said that business has dropped below its level a year ago. Looking forward to 2010, half of our contacts expect construction activity will be very weak. Although a few contractors anticipate some growth next year, they do not expect a return to 2008 levels. We continued to hear numerous accounts of difficulties in obtaining financing for private-sector projects. Any increases cited in construction materials prices were attributed to seasonal factors and the recent run-up in oil prices. Apart from seasonal help, only two general contractors noted that they have hired a few workers due to increased project work. Subcontractors are readily available at very competitive rates.

**Consumer Spending.** June sales for District retailers were flat to slightly down on a month-over-month basis. Further, consumers continued to focus on purchasing less expensive necessities. Most retailers expect little change during the third quarter, with some pick-up toward year's end. On balance, vendor and retail pricing has been stable. Accounts from auto dealers indicated that new vehicle sales remained weak for the most part during June and were down sharply on a year-over-year basis. However, reports showed considerable differences across brands in sales and dealer inventories. Purchases of used vehicles remain relatively strong, which is putting some upward pressure on prices at auctions and dealer lots. Most dealers are uncertain about future sales due to weak economic activity, stringent credit conditions (floor plan and buyer), and the fallout from the Chrysler and GM bankruptcies. On balance, there has been little change in staffing levels at retailers. Capital expenditures by retailers remain on plan but have been trimmed back from 2008 levels.

**Banking.** Commercial and industrial (C&I) loan demand is decidedly mixed. Regional banks reported declining loan demand and balances, while community bankers commented that their C&I pipelines are filling up, in part because they are attracting business from large regional banks. Spreads on business loans are steady to increasing. On the consumer side, loan demand was characterized as stable to up slightly, with steady interest rates. A few community bankers told us that indirect lending is doing very well. Applications for refinancing residential mortgages have slowed. Core deposits increased across the District. Credit quality deteriorated somewhat on the consumer and business sides. Delinquencies at many banks continued to rise, particularly for commercial and residential real estate loans. Higher lending standards remain firmly in place, with no easing expected. Several bankers expect credit to tighten further going forward. Staffing levels at a few regional banks are being reduced due to mergers and a contraction of specific business lines. In contrast, some community banks are hiring ahead of foreseeable growth.

**Energy.** Coal executives reported continuing production declines, which they attributed to weakening demand from electric utilities. One executive noted that contract prices for coal have dropped 50 percent since the beginning of the year. Little change in oil and gas production was reported, though drilling activity has fallen off substantially in some regions. Spot prices for natural gas and oil are trending downward. For the most part, the costs of production equipment and materials have fallen. Capital spending by coal producers has been cut back and is restricted to some critical maintenance projects, while expenditures by oil and gas producers remain as projected. Employment levels in the oil and gas industry were largely stable, although coal executives reported workforce reductions and cuts in overtime.

**Transportation.** Freight transport executives reported that shipping volume remains at low levels and is down substantially on a year-over-year basis across all market segments. Any pickup cited was attributed to seasonal factors or competitors exiting the market. A majority of our contacts expect activity to stay at current levels through year’s end. Nevertheless, a few executives anticipate that volume will begin to gradually pickup during the third quarter but remain well below 2008 levels. Shipping rates remain very competitive, and capital spending is restricted to replacement only. On the labor front, we heard a few reports of wage cuts or freezes and minimal hiring for spot shortages.

FIFTH DISTRICT–RICHMOND

**Overview.** On balance, economic conditions in the Fifth District remained weak in June and early July. Retail and services firm revenues continued to shrink, and contacts reported falling wages and steady or declining employment levels. Price growth in the service sector was slow. Commercial real estate activity softened further, with declining rents, increased concessions, and rising vacancy rates in some markets. Commercial lending activity continued to decline as loan demand remained subdued and some institutions reported tightened credit standards. Meanwhile, residential real estate contacts gave mixed reports about housing activity. Residential lending slowed as the slight increase in purchase loans was offset by a drop in demand for refinances. On a brighter note, manufacturing activity continued to strengthen in recent weeks as contacts reported increased shipments, new orders, and capacity utilization, and a moderation in the employment decline.

**Retail.** Retail sales generally contracted in recent weeks as retailers reduced their inventories and shopper traffic remained down. The manager at a chain department store located outside the Washington, D.C., beltway observed retailers "fighting for a little piece of what money is out there." On the other hand, a grocer in southwest Virginia reported increased foot traffic, although "customers are not buying as much per transaction either in items or in dollar terms." Big-ticket sales languished, according to most contacts. Sales of domestically produced vehicles generally remained in the doldrums, although dealers of automobiles and light trucks told us that sales of foreign nameplates were soft to "pretty good," and a few building supply establishments in coastal South Carolina reported an uptick in sales. Many retail merchants cut payrolls, although some filled permanent or temporary vacancies. Growth in retail prices slowed somewhat in recent weeks, while average retail wages fell.

**Services.** Contacts at services firms reported that revenues declined since our last report, albeit at a slower pace. A financial services executive noted that people were more cautious and holding more cash than usual. According to a Virginia web-based business owner, "Projects either aren't starting or are running out of money."  Consumers also cut back. The business manager at a fitness organization in central North Carolina said membership and class revenues fell in recent weeks. In contrast, executives at hospitals and healthcare systems reported steady demand for their services. An executive at a hospital in central North Carolina said the hospital was starting to see more unemployed patients, though most were covered by COBRA. Contacts generally noted either steady or declining employment. Average wages at services firms continued to shrink while price growth at services businesses was mild.

**Manufacturing.** District manufacturing activity continued to strengthen in June and the first half of July. Contacts reported increases in shipments, new orders, capacity utilization and the average workweek, while noting that the decline in employment had moderated considerably. Demand was notably stronger for apparel, chemicals, food, printing and publishing, rubber and plastics, and textile manufacturers. A spark plug producer in West Virginia observed a jump in orders and noted that, “customer forecasts going out 3 to 4 months are showing a steady increase.” A contact at a chemical plant in South Carolina reported considerable growth in orders from China, India, and other East Asian markets, while a textile manufacturer in North Carolina observed that, “We passed the eye of the storm about four weeks ago.” Contacts indicated that both raw materials and finished goods prices grew more slowly.

**Finance.** Residential lending activity slowed a bit in June and early July across the Fifth District. Contacts reported a slight increase in purchase loans; however, the uptick was not enough to offset a “dramatic” fall in demand for refinances. First-time purchases and conventional mortgages reportedly composed the bulk of activity, while contacts noted little demand for jumbo loans. Credit standards tightened a bit to adhere to changes in Freddie, Fannie, and FHA guidelines, but lenders reported no internal changes.

On the commercial side, lending activity continued to decline, with demand for loans “unseasonably low.” Contacts reported an uptick in loan prices, especially for mid-grade borrowers. Credit standards were unchanged at some institutions, while others reported further tightening. Changes included requiring pre-existing depository relationships with the borrower, stricter adherence to policies on loan-to-value ratios and risk grade requirements, and increased scrutiny of paper work—especially for commercial mortgages. However, contacts stressed that despite more stringent credit standards over the last year, they were still lending. In addition, credit quality of existing portfolios was little changed since our last report.

**Real Estate.** Residential real estate agents gave mixed reports about recent housing activity. In Fairfax, Va., a Realtor reported that the heart of the market was “hot” as houses in the $400K to $1.2 million price range sold the fastest. Similarly, contacts in the Washington, D.C., area reported sales increases over last year, fueled by sales of properties under $1 million. A Realtor in Greenville, S.C., said June had been his "best month" and that houses in the low- to middle-price range remained the best sellers. On a less positive note, Realtors in Richmond, Va., Greensboro, N.C., and Asheville, N.C., reported more sluggish house sales. The Richmond Realtor called sales "way off the mark" while the contact in Asheville observed his area "buckling down and weathering the storm." House prices either held steady or declined across much of the District.

Commercial real estate activity remained weak since our last report as contacts reported fewer prospects and smaller transaction sizes. Contacts cited multiple reasons for recent transactions that did occur, including firms cutting back on space, moving to a less expensive building, or extending existing contracts early in order to negotiate lower rental rates. Relatedly, rents softened across most District markets, while agents observed that concessions—especially free rent—remained widespread. Vacancy rates were fairly stable in Charleston, W.Va., and Greenville, but edged up in other markets. Contacts reported no new large development projects, which they believed would help limit increases in vacancy rates. Commercial sales were "practically nonexistent" in recent weeks. There were, however, a few sales for owner-occupied buildings, and a Charleston contact reported normal sales of office buildings, churches, and land. Additionally, owners not needing to sell immediately were reportedly pulling their properties off markets. Sales prices trended down in most District markets.

**Tourism.** Assessments of tourist activity varied since our last report. Along the coast, contacts reported that although the July 4$^{th}$ holiday weekend bookings matched or exceeded year-ago levels, summer business was generally weaker than a year ago. Analysts from Myrtle Beach, S.C., and Virginia Beach, Va., noted a considerably shortened booking cycle and double-digit discounts at many hotels. Moreover, a contact on the Outer Banks of North Carolina said that rental agencies were discounting heavily. A respondent at a mountain resort in West Virginia described holiday bookings as somewhat weaker than a year ago. In contrast, a manager at a mountain lodge in Virginia indicated that occupancy rates over the holiday were in line with last year, restaurants were busy, and retail numbers looked good.

**Temporary Employment.** Temporary employment agents gave mixed reports on demand for workers in recent weeks. While a contact in Richmond, Va., reported a slight pickup in demand for workers in the medical industry, and a Hagerstown, Md., contact reported some increase in the government and education sectors, both saw generally reduced demand. In contrast, a contact reported “somewhat strong” demand in the Raleigh, N.C., area, especially for manufacturing labor, and another Raleigh contact noted a “reemergence” of several clients who had lately been “dormant.” Some of the skills in greatest demand included workers proficient in IT and Microsoft Office, in addition to specialized managers and minimum wage workers.

**Agriculture.** Although there were scattered reports of rainfall, dry conditions persisted in most areas since our last report. In North Carolina, South Carolina, and Virginia, analysts reported heightened concerns about inadequate soil moisture and crop development. In some places, however, the dry weather improved the progress of various crops. In Maryland, the harvest of most vegetable crops was in full swing and apple and peach crops in both Maryland and West Virginia were reported to be in generally good condition. Likewise, producers in Virginia completed the small grain harvest and the planting of double-crop soybeans.

## SIXTH DISTRICT – ATLANTA

**Summary.** Sixth District business contacts reported that economic activity remained generally weak through mid-July. Retail sales and traffic continued to be soft, but were largely in line with retailer's modest expectations. Tourism-related spending was also sluggish, and auto industry contacts reported further declines in new-vehicle sales. Reports from real estate contacts indicated that home sales, especially in the starter home market, had shown some signs of stabilizing. Encouragingly, most Florida contacts reported that home sales were above their year-ago readings. Also, indicators point to a moderating in the pace of decline in manufacturing activity. However, commercial real estate activity continued to slow, with more projects put on hold or cancelled. Banking contacts remarked that tight credit conditions remained in place and that demand for new loans continued to be soft in the current environment. Labor market conditions deteriorated further in June and early July, with unemployment rising in most areas. Price pressures continued to be relatively subdued throughout the District.

**Consumer Spending and Tourism.** Retail contacts noted that sales and traffic remained below year-ago levels and were largely in line with their expectations. Most merchants had adjusted their inventories as a result of the weak sales performance and indicated that they were not anticipating adding to stocks in the short-term. Several auto dealers reported lower new-vehicle sales, and most industry contacts noted a pickup in the used-car business that was helping to offset poor sales of new vehicles.

According to most hospitality industry contacts, travel and tourism spending decreased across most of the region. Several reports mentioned lower profit margins as a consequence of heavy price discounting and modest spending by vacationers. As a result, most contacts reported continuing to trim staffing levels. A significant decline in business-related travel and convention attendance was also noted in some areas.

**Real Estate and Construction.** Reports from most District homebuilders and Realtors indicated that the pace of decline in home sales continued to moderate. Most Florida contacts experienced improvements in sales, particularly for existing homes, although partly because of increased foreclosure sales. Most contacts continued to note downward pressure on home prices from foreclosures and short-sales. Both builders and Realtors noted some increased demand at the low-end of the housing market. The majority of homebuilders and contractors reported that new home construction remained at very low levels. The outlook among builders and Realtors had improved in recent months, but in June expectations for sales over the next several months moderated following the end of the peak spring selling season.

Commercial real estate activity continued to trend lower in June and through mid-July. Vacancy rates rose in many parts of the District, which has put additional downward pressure on rents. Contacts reported that some tenants were requesting lower lease rates on existing contracts. Commercial construction continued to slow as well. Contractors continued to report an increasing number of projects being delayed or cancelled, especially in the retail sector. Several contacts noted that some delayed projects were being re-bid to take advantage of the willingness of contractors to lower their bids, thus raising the possibility that some postponed projects could get underway in coming months.

**Manufacturing and Transportation.** Regional manufacturing contacts indicated that the rate of decline in production and new orders moderated further in June and early July. Most reports also noted an improved outlook for the coming months. However, providers of transportation services continued to indicate a reduction in container volume from both retailers and manufacturers. Trucking contacts noted that an oversupply of trucks relative to demand was putting downward pressure on freight rates and squeezing profit margins. Rail shipments for lumber, gravel, autos, and chemicals were down from a year earlier.

**Banking and Finance.** Credit conditions remained relatively unchanged since the last report. Banking contacts continued to indicate that access to credit remained tight, with loans only being given to consumers with very good credit scores and to business customers with stable cash flows. Lenders reported that they continued to focus on building reserves in June and early July as loan defaults continued to rise.

**Employment and Prices.** District business contacts continued to report weak labor market conditions and rising unemployment in June and early July. Although most reported that the worst of the layoffs are behind them, some auto and oil and gas companies noted that they were planning additional job cuts in the coming months. Reports of hiring were limited to healthcare and the defense and aerospace industry, with most other business contacts noting that they do not plan to increase hours or workforce in the near term. There were a few reports of employers taking advantage of the increased supply of skilled labor to increase the quality of their workforce.

Construction and manufacturing firms reported that raw material prices generally had moderated by mid-July after having increased in late spring. However, most prices received for finished manufactured products remained down from a year earlier. Some contacts noted that they were unsuccessful in attempts to pass on higher input costs to their customers. Most retailers reported that prices remained relatively stable.

**Natural Resources and Agriculture.** As of mid-July, only half as many rigs were operating in the Gulf of Mexico compared with the same period a year earlier. Despite the gain in energy prices since the beginning of the year, energy industry contacts indicated that District producers have been gradually scaling back operations in response to increasing inventory levels and weaker domestic demand.

District farm crops, particularly citrus, benefitted from favorable weather in June through mid-July. Moisture conditions were adequate in all areas, with the exception of southern Louisiana. Lower domestic and global textile mill demand continued to trouble the near-term outlook for the District's cotton producers.

## SEVENTH DISTRICT—CHICAGO

**Summary**. Economic activity in the Seventh District remained weak in June and early July, but the pace of decline slowed from the previous reporting period. Consumer and business spending were sluggish. Manufacturing and construction activity remained at low levels, although both sectors showed some signs of improvement. Labor market conditions deteriorated, but the pace of job loss slowed. Credit conditions, although moderately improved, remained tight. Price and wage pressures were minimal. The outlook for crop production improved; crop and livestock prices fell as did costs for livestock operations.

**Consumer spending**. Consumer spending continued to be sluggish in June and early July. Households remained price conscious, focusing on necessities and holding back on purchases of most big-ticket and luxury items. Retailers expected a poor back-to-school season and planned to maintain low levels of inventory until the uncertainty surrounding the state of the economy recedes. Contacts noted that tourism activity was down over the July 4th holiday weekend, even more so than last year's poor showing. In contrast, auto dealers reported higher sales, which helped to bring inventories more in line with typical levels. New incentives and interest in brands expected to be discontinued after this model year were both cited as contributors to increases in showroom traffic and sales. However, the closing of dealerships as a result of the GM and Chrysler bankruptcies was indicated to be negatively affecting local communities.

**Business spending.** The pace of business spending was also sluggish. Contacts again indicated that they were delaying capital expenditures until the general decline in economic activity abates. Labor market conditions in the District continued to deteriorate, due in large part to weakness in the manufacturing sector. However, while some additional layoffs and reductions in hours through mandatory furloughs were reported, the pace of job loss slowed from the previous reporting period. Hiring activity remained limited outside of healthcare and education, although a few contacts reported increasing hiring plans. Several auto assembly plants reopened in late June and early July, but a contact noted that many of these plants will be coming back on-line with fewer employees. Similar cuts were also expected for auto suppliers. In contrast, one supplier reported rehiring workers let go earlier in the year due to improving sales trends and expectations of greater auto production for the remainder of the year.

**Construction/real estate**. Construction activity in the District remained weak. Residential construction was low, especially for apartments and condominiums. However, several contacts noted either a bottoming out or small increase in sales of new single-family homes. The number of signed contracts declined at a slower pace with showroom traffic remaining slow but steady and cancellations declining. Many more foreclosed homes reached the stage of repossession and sale, putting downward pressure on home prices. Contacts in the mortgage industry reported a small increase in purchase applications. Nonresidential construction declined, led by the commercial and industrial sectors where high vacancy rates remained a concern. In contrast, public sector construction increased. Furthermore, a contact noted that several large nonresidential projects which recently broke ground and additional projects in the pipeline suggest a small increase in activity in the coming months. Credit continued to be tight for residential and commercial developers.

**Manufacturing**. Manufacturing activity remained weak, but conditions improved from the previous reporting period. Manufacturers of medium and heavy trucks and heavy machinery continued to report weak activity. The shutdown of several auto plants was reported to have had negative impacts, but contacts also noted that the quick resolution of the Chrysler and GM bankruptcies had been beneficial for business confidence. Conditions remained weak for auto suppliers, and contacts indicated that financial support from the automakers may be necessary at some point to prevent a loss in production capacity. Automakers reported some signs of firming in prices and a return to comfortable levels of inventories, and have scheduled a pickup in production in July. In addition, demand from overseas was noted to have picked up, and pharmaceutical production remained strong. Steel production increased as service centers looked to replenish their inventories. One contact in the steel industry said that orders had filled the reduced capacity levels through the summer and that consideration was being given to bringing some idle capacity back on-line later in the year. Other metals-related industries noted soft conditions.

**Banking/finance**. Credit conditions in the District remained tight, but improved moderately from the previous reporting period. Consumer credit demand stabilized at a low level as standards remained tight. Banking contacts indicated that loan quality had been better than expected, reflecting smaller increases in unemployment and increases in transfer payments from the recent economic stimulus package. Business loan demand remained weak with standards still tight and most firms reluctant to borrow. Terms continued to tighten in commercial real estate, as contacts indicated that loan quality was likely to continue to deteriorate. However, contacts noted that, in general, bankruptcies had slowed and that financing costs for a number of area corporations had improved along with the rise in equity prices. A number of financial sector contacts expressed concern that the uncertainty surrounding the regulatory environment was potentially having harmful consequences for credit creation. In addition, some were concerned about the limited time frame being discussed to implement new rules and regulations.

**Prices/costs**. Price pressures were mixed, with energy prices falling and some material prices rising. A number of contacts noted declining gasoline prices in July. In contrast, contacts reported higher steel prices, with further increases expected by summer's end due to lean supplier inventories. The closing of several lumber mills contributed to increasing plywood prices. Prices of other industrial metals like copper and aluminum were little changed. Wage pressures were limited, although some contacts noted continued cuts to benefits. In the retail sector, recent increases in the minimum wage reportedly led to cutbacks in hours. Pass-through of wage and price pressures to downstream prices was minimal as contacts indicated that pricing power remained limited.

**Agriculture**. Corn and soybean prices declined during the reporting period. Crop conditions remained better than last year, and markets were surprised by an increase in corn acres planted. Moreover, District farmers planted more acres of both corn and soybeans than a year ago. Although crop maturation was behind the typical pace due to planting delays, favorable weather in June and early July improved the outlook for both corn and soybeans. Lower demand for livestock feed also contributed to the decline in crop prices. Reduced costs for feed were not enough, however, to offset continued low prices for dairy, hogs, and cattle. One contact expressed the view that agriculture has lost the financial cushion that was built up in previous years. Many farmers forward contracted only a relatively small portion of their production and were not well prepared for the quick decline in crop prices. In addition, some livestock herds have been liquidated, as producers were unable to secure financing for operations.

## Eighth District - St. Louis

### Summary

The pace of decline of economic activity in the Eighth District has moderated since our previous report. Activity in the manufacturing and services sectors contracted at a slower pace. Reports from retailers and auto dealers were mixed. Residential and commercial real estate markets conditions continued to be weak. Total loans at a sample of small and midsized District banks declined slightly from early April to mid-June.

### Manufacturing and Other Business Activity

Manufacturing activity declined since our previous report but at a slower pace, as reported job losses slightly outpaced new job announcements. Several manufacturers reported plans to close plants or reduce operations, but a similar number of contacts reported plans to open plants and expand operations in the near future. Contacts in aerospace product manufacturing, electrical equipment manufacturing, and frozen food manufacturing reported plans to lay off workers and decrease operations. A firm in the paint/adhesive manufacturing industry announced that it will close a plant in the District, and several auto parts and auto manufacturing firms furloughed a large number of workers and reduced production as a result of the industry's restructuring plans. In contrast, firms in the furniture manufacturing, fabricated metal product manufacturing, plastic product manufacturing, paper manufacturing, and rail technology manufacturing industries reported plans to expand facilities in the District and hire additional workers. A major firm in steel manufacturing resumed production and recalled several shifts of idled workers.

The District's services sector continued to decline in most areas but a slower pace. A large number of contacts in education services, information services, business support services, and medical services announced job cuts. In contrast, contacts in the government services and health/social services industries announced plans to hire additional workers. Also, several cities in the District continued to report that they will be hiring temporary and part-time summer workers in a range of service industries using funds allocated through the American Recovery and Reinvestment Act of 2009. Contacts in the retail sector reported a mixed outlook. Smaller retailers responded to a slowdown in store traffic with a mixture of promotions and discounted merchandise. In contrast, a major big-box retailer in the District continued to experience growth, particularly by targeting higher-income consumers. Auto dealers' reports were mixed; several franchise owners are going out of business, converting to used-car dealerships, or transitioning into service/repair centers. Contacts reported that smaller cars continue to sell well with a limited market for large trucks and sport utility vehicles.

**Real Estate and Construction**

Home sales continued to decline throughout the Eighth District. Compared with the same period in 2008, May 2009 year-to-date home sales were down 13 percent in St. Louis, 22 percent in Memphis, 32 percent in Little Rock, and 35 percent in Louisville. Residential construction also continued to decline. May 2009 year-to-date single-family housing permits fell in nearly all District metro areas compared with the same period in 2008. Permits declined 30 percent in Little Rock, 37 percent in St. Louis, 44 percent in Louisville, and 56 percent in Memphis.

Commercial real estate and construction markets continued to struggle throughout the District. A contact in Memphis noted that commercial real estate foreclosures are likely to increase as a result of current credit conditions. A contact in St. Louis noted that, with the exception of institutional and health care–related projects, little construction is taking place. Industrial real estate and construction contacts throughout the District also continued to report a difficult environment. Contacts in the Louisville area expressed disappointment regarding the slow impact of the stimulus bill and the size of projects it has funded to date.

**Banking and Finance**

Total loans outstanding at a sample of small and midsized District banks decreased 1.3 percent from early April to mid-June. Real estate lending, which accounts for 73.0 percent of total loans, decreased 0.9 percent. Commercial and industrial loans, accounting for 16.7 percent of total loans, decreased 3.4 percent. Loans to individuals, accounting for 5.3 percent of total loans, decreased 3.0 percent. All other loans, roughly 5.0 percent of total loans, rose 0.7 percent. During this period, total deposits at these banks decreased 0.6 percent.

**Agriculture and Natural Resources**

For the most part, development of the District's major crops remained behind its 5-year average pace. In mid-July, the overall condition of soybeans was slightly better than last year, while the condition of sorghum, rice, and cotton was slightly worse than last year, and corn was similar to last year. Farmers in the District states planned to harvest more acres of corn for grain, soybeans, and rice than in 2008 but fewer acres of sorghum for grain. The winter wheat harvest was nearly complete in all District states except Illinois and Indiana, where it was slightly behind its normal pace. Based on July estimates, total winter wheat production in the District states was expected to be down 41 percent from last year's bumper crop, but only 5 percent below the 2007 level.

## NINTH DISTRICT--MINNEAPOLIS

The Ninth District economy contracted since the last report. Decreases in activity occurred in the retail spending, tourism, services, residential construction, agriculture, mining and manufacturing sectors. The commercial construction sector was stable at low levels, while the energy and residential real estate sectors saw moderate increases. Labor markets slackened since the last report, and wage increases were moderate. While a number of prices were lower than a year ago, prices have generally remained stable since the last report.

**Consumer Spending and Tourism**

Retail spending remained constrained. A major Minneapolis-based retailer reported that same-store sales in June were down 6 percent compared with a year earlier. Recent same-store sales at a Minnesota-based hair care company dropped 4 percent, and sales at a Montana mall were flat to down slightly from a year ago, according the mall manager. Meanwhile, sales at a North Dakota mall were down about 3 percent in June compared with a year earlier. A representative of a Minnesota-based food retailer noted that consumers were value-focused and cautious with their spending. A Minnesota-based high-end seafood restaurant chain recently filed for bankruptcy.

Auto sales picked up slightly since the last report. Auto repair and auto parts businesses reported an increase in activity. Three domestic auto dealers, two in Minnesota and one in northwestern Wisconsin, noted increases in sales during June and early July. However, a western Montana auto dealer noted that sales were down more than 50 percent compared with the past couple of years.

Tourism activity was down from a year ago. Summer tourism activity in the Upper Peninsula of Michigan dropped about 15 percent, according to a tourism official. Occupancy at hotels and resorts in northeastern Minnesota was down 5 percent to 20 percent. Hotels in western Montana noted occupancy down 4 percent to 10 percent; hotels were discounting prices to draw people to their facilities. The number of tourists in northwestern Wisconsin was equal to or greater than last summer, but overall sales activity was slow.

**Services**

Services sector activity fell since the last report. Several law firms reported reduced demand. A software development company based in Minnesota cut back on development.

Architects reported continued slow demand for their services. However, demand for health services picked up, and accountants who deal with business workouts reported increased activity.

**Construction and Real Estate**

Commercial construction was stable at low levels. A Bank director noted that bidding activity was up in the Helena, Mont., area but that large contractors were mostly bidding on smaller jobs. A number of civic projects were under construction around the District. However, commercial permits in Sioux Falls, S.D., decreased 40 percent in value in June from a year earlier. Residential construction was slower. June housing permits were down 25 percent in value from a year earlier in Minneapolis-St. Paul and decreased 30 percent in Fargo, N.D.

Commercial real estate markets were slow. A representative of a state bankers' association said the number of troubled commercial property loans has increased. Vacancies were particularly pronounced in retail and industrial markets throughout the District. Several contacts reported that tenants were asking for rent decreases. Residential real estate activity increased. Closed home sales in Minneapolis-St. Paul increased 20 percent in June from a year earlier, but the dollar volume of sales was flat, as median sale prices were down more than 15 percent. Realtors in western Montana said sales were steady there for lower-priced homes, but slow for high-end properties.

**Manufacturing**

Manufacturing activity decreased since the last report. A June survey of purchasing managers by Creighton University (Omaha, Neb.) indicated that activity declined in Minnesota and the Dakotas. A Minnesota specialized-equipment company reduced production. A South Dakota producer of skid-steer and front-end loaders cut production in response to weak demand. However, a Minnesota diversified manufacturer reported that sales have stabilized after its customers drew down inventory earlier in the year.

**Energy and Mining**

Activity in the energy sector increased slightly, while the mining sector continued to fall. Early July oil and gas exploration edged up from early June. New wind energy projects were announced since the last report. As iron ore inventories have accumulated at the shipping ports, a mine in northern Minnesota plans to shut production for about a year.

**Agriculture**

Agricultural conditions weakened since the last report. Potato growers in the Red River Valley could lose 20 percent of their crop due to heavy rains, while drought conditions persist in northern Wisconsin. Corn, soybean and wheat prices are expected to fall, according to the U.S. Department of Agriculture. District production of wheat and barley is expected to drop significantly in 2009 from strong 2008 levels. In addition, progress for the District corn and soybean crops was behind its five-year average pace.

**Employment, Wages and Prices**

Labor markets slackened since the last report. The University of Minnesota recently announced plans to reduce the school's workforce by 1,200 positions over the next year, mostly through attrition, but 370 employees are expected to be laid off. Also in Minnesota, a trucking company with 200 employees recently announced it will close by the end of August, a Minnesota-based regional airline plans to furlough up to 110 pilots and a health insurance company will lay off 100 workers. A Montana sawmill recently closed, resulting in 85 lay-offs. A work platform lifts plant in North Dakota will shut down this fall, resulting in 61 lost jobs. A temporary staffing agency survey of Minneapolis-St. Paul businesses showed that 13 percent of respondents expect to hire workers during the third quarter, while 19 percent expect to reduce staff. A Minnesota staffing services company noted that the pace of business in early July was much slower than usual. However, another placement company noted an increase in demand for experienced information technology workers.

Wage increases were moderate. According to respondents to a recent St. Cloud (Minn.) Area Business Outlook Survey, 24 percent expect to increase employee compensation over the next six months, down from 35 percent in last year's survey. A Minnesota bank branch cut pay by 5 percent for all salaried staff.

While a number of prices were lower than a year ago, prices have generally remained stable since the last report. Metal prices held relatively stable since the last report, although recent increases in some copper and steel products were noted. Minnesota gasoline prices in early July were 17 cents per gallon lower than a month ago.

## TENTH DISTRICT - KANSAS CITY

The Tenth District economy showed further signs of stabilization in June. Consumer spending was generally sluggish but improvements were noted in auto sales and tourism spending. Manufacturing activity expanded modestly, primarily in nondurable goods production. Residential real estate activity held steady; however, commercial real estate firms reported weakening market conditions. Employment in the energy sector continued to contract in response to low natural gas prices. Bankers reported weaker loan demand, stable deposits, and a continued negative outlook for loan quality. While growing conditions improved, agricultural profit opportunities softened, especially for livestock producers. Despite higher input prices, retail price pressures eased and little evidence of wage pressures was reported in District labor markets.

**Consumer Spending.** District retailers reported a weaker than expected uptick in consumer activity since the last survey. General retailers reported a slight improvement in overall sales activity, highlighted by stronger sales for home furnishings, appliances, and other household items. Auto dealers reported an increase in sales volume in June, with the greatest unit gains in small new cars and all types of used cars. Dealers reported offering only a modest level of incentives to buyers and were largely satisfied with existing inventories; however, dealer access to credit remained tight. Demand for all types of apparel remained soft heading into the critical back-to-school season. Restaurant operators reported weaker overall sales and a continued decline in average check size. Tourism spending rebounded in June but remained below expectations, especially at mountain resorts. Casino revenues remained strong in Oklahoma and Missouri, but declined in other District states.

**Manufacturing and Other Business Activity.** The Tenth District's manufacturing, transportation, and high-tech sectors showed tentative signs of increased business activity. The manufacturing sector reported a slight improvement in production, shipment volumes, and new orders in June – a marked improvement from the sharp contractions reported in the early spring. The strongest manufacturing production increases were reported in nondurable sectors. Durable goods production was flat and showed little sign of expansion, with sharp contractions in aviation and oil and gas-driven machinery sectors. District manufacturing firms reported an increase in weekly hours worked but did not expect to hire new workers for many months. New export orders returned to a near neutral position after showing weakness since last summer. Factory managers expected conditions to remain unchanged over the next six months. Technology-related firms reported increased business activity, with strength noted in clean technology and defense-driven aerospace. Like manufacturing, transportation firms reported a similar improvement in overall business activity.

**Real Estate and Construction.** Residential real estate firms reported stronger sales volumes in June but commercial real estate activity weakened further. Home inventory levels improved further in all District states, with strong sales in the lower and middle price tiers of the market. Starter home sales remained strong due to first-time homebuyer tax credits and sales volumes improved for bank owned and investor properties. Housing prices remained firm in Kansas and Oklahoma, while foreclosures weighed most heavily on the Colorado and New Mexico housing markets. Home builders cited unfavorable borrowing terms, mounting foreclosures, and a slower than expected inventory adjustment as the major reasons limiting a construction rebound. Commercial real estate weakened further with declines in completions and construction underway. Vacancy rates in the District rose further and absorption rates declined. Few commercial real estate firms expected a recovery by the end of 2010, although some commercial builders noted increased competitive pressures from firms outside the region seeking opportunities in District markets. Further declines in commercial real estate prices and rents were expected. Commercial real estate firms said the market favored buyers and tenants, leaving them little negotiating leverage.

**Banking.** Bankers reported weaker loan demand, stable deposits, and a continued negative outlook for loan quality. Overall loan demand declined moderately after showing signs of stabilizing in the previous survey. Demand for residential real estate loans rose more slowly, while demand for commercial and industrial loans resumed declining following a brief pause in the last survey. Demand for commercial real estate loans and consumer installment loans also fell somewhat. Some banks continued to report tighter credit standards on commercial and industrial loans and commercial real estate loans, and a few banks reported tighter standards on consumer installment loans. Loan quality remained substantially lower than a year ago, and about half the banks expected loan quality to decline further in the next six months. Deposits were little changed, following a substantial increase in the previous survey.

**Energy.** The energy sector remained a drag on overall District economic activity in June. Nearly all contacts reported no change in drilling activity and did not expect any improvement in the months ahead. Although national crude oil prices were above $60 per barrel, low natural gas prices limited drilling activity and encouraged well shut-ins. Low natural gas prices created a particular financial strain on Wyoming, Colorado, and New Mexico producers where the spread between regional and national prices remained large. Producers generally expected prices for both crude oil and natural gas to remain at or above current levels over the next three months. Several contacts reported considerable reductions in their workforce and have no plans to increase hiring in the near future. Many firms noted selectivity in their workforce reductions in order to retain critical high skill workers and the ability to respond quickly when pricing conditions improve.

**Agriculture.** While growing conditions improved, profit opportunities softened for agricultural producers since the last survey period. Ample rainfall in June and early July aided growing conditions but declining commodity prices dampened farm income expectations. Though corn and soybean development was lagging due to cooler temperatures, crops were still reported in good condition. Due to weather damage, wheat producers in the southern portions of the District harvested fewer acres and reported below average yields; however, growers located further north anticipated above average wheat yields. Soft demand for meat continued to put downward pressure on livestock prices, and producers responded with further herd liquidations. Farmland values held firm, supported by the limited supply of farms for sale coupled with solid demand from farm operators and renewed interest from non-farm investors.

**Wages and Prices.** District contacts reported limited pass through of higher input prices and little evidence of wage pressures across District labor markets. Rising fuel costs pushed up producer prices, although few producers planned to raise output prices in the future. Builders reported higher prices for supplies, especially roofing products and asphalt. Manufacturers reported that raw materials and finished goods prices were largely unchanged. Retail prices edged down and were expected to soften further; however, restaurant menu prices increased. Only a small number of firms reported labor shortages, resulting in little to no wage pressures.

## ELEVENTH DISTRICT – DALLAS

Economic activity in the Eleventh District remained mostly steady at subdued levels in June and early July. Contacts in many industries noted some stabilization in demand, but few expected any real turnaround in the near-term. Outlooks remain very uncertain and businesses continue to cut costs and reduce payrolls. Price and wage pressures remain minimal.

**Prices** Most firms continued to report downward price pressures. Fee reductions were noted in several industries, including temporary staffing, accounting and legal services and construction. Auto dealers said prices had firmed slightly, but remain low due to anemic demand and high inventories. Eleventh District-based airlines continued to reduce fares, although at a slower pace.

Manufacturers said selling prices were flat to down. Petrochemicals remained an exception, as some product prices were driven higher by the uptick in oil prices. Raw materials prices were mostly stable, but some contacts said higher fuel costs had squeezed margins. There were scattered reports of increases for some types of steel products among nonresidential construction contacts.

Prices for light sweet crude oil stayed near $70 per barrel throughout June, but fell back to $60 in early July. According to contacts the rise to $70 per barrel seemed to defy market fundamentals of weak demand and high inventories. Natural gas prices remained relatively weak, moving briefly over $4 per Mcf in June before falling back to $3.50 by early July. Natural gas prices are expected to remain low as inventories are 19 percent above the 5-year average. Pump prices for gasoline rose about 10 cents per gallon in June, but declined by 12 cents in early July.

**Labor Market** Labor markets remain weak and the pool of available workers continues to grow due to rising unemployment and relocations from other areas of the country, according to contacts. Layoffs continue at some firms and many are continuing hiring freezes initiated earlier in the year. Staffing firms said employers were “dragging their feet” as economic uncertainty remains elevated. There were no reports of wage increases, and many firms were reducing costs by cutting perks such as bonuses and travel allowances, or freezing 401(k) contributions. Salary freezes remain widespread.

**Manufacturing** Construction-related manufacturers said demand was flat at weak levels, although there were some reports that public works construction had improved due to school bond measures and hospital expansions. Both private residential and commercial construction activity remain depressed, and contacts expect no improvement in the near term. There were scattered reports of layoffs, though most firms said they had already “right sized” their staff levels. Fabricated metals respondents said inventories had come down. Primary metals contacts anticipate some bankruptcies that may help alleviate excess capacity in the industry. Brick producers continued to cut capacity and reported some upcoming plant closures.

Most respondents in high-tech manufacturing said production had increased since our last report, primarily because retailers and manufacturers pared back inventories less sharply than they had earlier in the year. Demand was reported to be increasing in China, flat in Europe, and flat to slightly up in the U.S. One respondent noted that orders from state and local governments had been delayed due to budget shortfalls. Most contacts said that they continue to reduce employment but at a slower pace. Improved outlooks suggested more confidence that the economy will recover by year-end, and contacts are seeing some upside potential in their forecasts instead of just down-side risks.

Contacts in the paper industry said demand continued to stabilize with orders holding relatively steady. Employment levels edged down slightly, although most cutbacks occurred earlier in the year. Outlooks were slightly more optimistic than in the last report, although most contacts don't expect much change in demand through year-end. Food producers noted demand was off slightly but they remained optimistic about their individual business conditions. Most expect stable sales over the next several months. Demand in the transportation manufacturing sector remains weak overall. Outlooks suggest continued uncertainty, although several contacts said they believe economic conditions are stabilizing.

Petrochemical producers said little had changed over the past six weeks. Export demand continued to increase due to the cost advantage of domestic natural gas-based products over oil-based products, but domestic demand remains generally weak and operating rates for most products are low. Prices for a variety of chemicals rose with the June uptick in oil prices.

Refiners operated at a slightly higher percent of capacity utilization over the past six weeks, but most producers said conditions remained weak overall—gasoline demand remains slightly below year-earlier levels and both distillates and jet fuel are down 15 percent. Weak demand made it difficult for refineries to pass through the uptick in crude oil prices, thus profit margins remained low.

**Retail Sales** Retail activity was mixed. Department stores saw continued improvement in sales, while value-based retailers reported slightly weaker activity. According to contacts, inventories have been pared down to appropriate levels relative to sales. Consumers remain cost conscious and continue to substitute less-expensive store brands for name brands. Merchants' outlooks for future sales remain cautious.

Auto dealers said demand was fairly steady at low levels, and most were hopeful the worst was behind them. Inventories remain high and are exerting downward pressure on prices. Outlooks continue to be pessimistic, with sales expected to remain low this year. Some are hoping for a turnaround by next spring, but most expect a long, slow recovery.

**Services** Staffing firms report that orders are trickling in and layoffs have slowed, but overall activity remains sluggish and erratic. Contract work continues to be more active than direct hires, and weakness is still widespread with only orders from the healthcare industry showing some stability.

Demand for legal services has stabilized at low levels according to contacts. Litigation and bankruptcy work is solid, while demand for real estate and corporate transactions remains soft. Law firms say that they have pushed out starting dates of new associates by several months and some are also offering lower starting salaries. Accounting services firms said demand for tax and audit services is holding up, while that for discretionary services has declined. Both legal and accounting firms expect business to be weak through year-end.

Airlines report that demand remains feeble especially for business travel. Capacity reductions and job cuts are underway and future bookings suggest continued weakness over the next three months. Transportation service contacts in small parcel shipping and intermodal trade noted an uptick in demand. Still volumes remain well below year-ago levels, and the outlook is for continued weakness in the near-term. Container trade fell further in June, but contacts expect a pickup in the fourth quarter. Railroads reported growth in June, although cargo volumes remain below year-earlier levels. Shipments of construction-related materials such as nonmetallic minerals, stone, clay and glass posted the largest monthly increases.

**Construction and Real Estate** Home sales continue to improve in the lower-priced, entry-level market as buyers take advantage of the first-time homebuyer tax credit which expires at the end of November. Despite the pickup, overall sales are well below year-ago levels and contacts say sales continue to decline in higher-priced segments of the market. While sales prices are slightly below year-earlier levels they have held up comparatively well to most other areas of the country. Residential construction activity remains at very low levels, but some contacts expect to see a pickup in entry-level housing starts in the near term.

Commercial leasing activity continues to soften as businesses cut costs. Landlords are reportedly becoming more aggressive in lease negotiations by offering additional concessions. Vacancy rates are edging up for office and industrial space, but contacts say the retail market remains the most difficult. Still, supply and demand fundaments are better in the Eleventh District than in many other areas of the country, according to respondents.

Sales transactions of commercial real estate properties remain almost nonexistent, but there continue to be reports of interested investors for very good deals. Private nonresidential construction activity continues to decline, although there were reports of some pickup in public sector activity due to hospital and school projects. Several contacts noted stimulus money had not led to any additional work. Outlooks remain uncertain, and many expect no significant pickup in nonresidential activity until late 2010 or 2011.

**Financial Services** Eleventh District loan demand did not change significantly over the past six weeks, according to financial industry contacts. Business lending was subdued and commercial real estate lending was anemic. Home loans remained at low levels and refinancing activity held steady. Contacts said credit standards remain tight and banks are being more conservative going forward due to uncertainty over future regulation. Contacts noted concern about commercial real estate loans and expect losses to become much worse as loans come due in the next several years. So far lenders have deferred the necessary de-leveraging as property values have declined, waiting to see where values settle before taking decisive action. Community banks saw strong deposit growth as customers moved funds from larger institutions to smaller ones as a safe haven, according to contacts. Although respondents say economic conditions have improved from earlier in the year, outlooks for the financial services sector remain very uncertain.

**Energy** The number of working rigs in the Eleventh District rose slightly in late June and early July. The improvement was driven solely by rising oil prices--which hit $70 per barrel in June—as some producers switched to oil-directed activity. More recently oil prices slipped, and contacts expect projects to fall back. Natural gas activity continued to fall, and contacts were pessimistic about any near-term improvement. Despite the small improvement in the rig count, demand for oil services remained quite weak relative to the large overhang of capacity in the industry.

**Agriculture** Drought continues to stress crops and forage across much of the District. Dry conditions are most severe in south and central Texas where many fields of cotton, corn and other dryland crops are not worth harvesting—leading producers to collect insurance. Ranchers in the driest parts of the District continue to liquidate their cow and cattle herds at a loss. Contacts expressed concern about the cash flow position of producers because of drought and high feed and input costs.

# TWELFTH DISTRICT–SAN FRANCISCO

## Summary

Economic activity in the Twelfth District appeared to hold largely steady on net during the reporting period of June through mid-July, with continued signs of stabilization or improvement in some sectors. Upward price pressures remained very modest on net, and upward wage pressures generally were absent. Retail sales remained sluggish, while demand for services weakened further. Manufacturing activity in the District stayed mired at very low levels on balance, although demand and activity improved further for manufacturers of information technology products. Sales continued at a solid pace for agricultural producers, while demand fell further for providers of natural resource products. Housing sales and construction picked up in some areas but were weak on net, and demand for commercial real estate continued to fall. Banking contacts reported very weak loan demand and ongoing declines in credit quality.

## Wages and Prices

Upward price pressures continued to be very limited on balance during the reporting period. Oil prices fell from recent highs, and the prices of other commodities remained largely stable. Final prices on various retail goods were held down by continued discounting, and weak demand led to further price reductions for assorted services, such as transportation, hotel rooms, and professional services. With few exceptions, contacts reported that they anticipate prices in their respective industries to stay mostly stable during the second half of 2009.

Upward wage pressures remained virtually nonexistent. Contacts continued to report the use of wage freezes or cuts, reductions in benefits, and mandatory furloughs as cost-saving measures in various industries. Hiring remained quite limited, and reports pointed to rising reliance on temporary workers in some sectors, putting additional downward pressure on wages.

## Retail Trade and Services

While retail sales remained sluggish overall, reports suggested that they were stable or improved slightly compared with the previous reporting period. With consumers staying focused on necessities such as food and sundries, discount chains and grocers continued to see sales growth. By contrast, demand remained quite soft for department stores and many smaller retail outlets, and sales of furniture and household appliances remained anemic. Sales of new automobiles and light trucks continued at exceptionally low levels. Demand for used automobiles stayed comparatively strong, but contacts noted that a lack of suitable inventory has held down sales somewhat. Contacts pointed to ongoing job losses and rising unemployment as the primary factors constraining consumer spending.

Demand for services continued to soften on net since the last reporting period. Conditions remained challenging for restaurants throughout the District, with contacts noting significant revenue declines and further closures. Likewise, demand for professional and media services continued to be very weak, resulting in additional layoffs. Demand for transportation services dropped, with reports pointing to further declines in container traffic at ports. Travel and tourism activity in the District fell further; the sharpest declines were evident in the business and luxury segments of the market, which reduced airline traffic. By contrast, providers of health-care services saw a slight increase in patient volumes, reversing the trend of prior reporting periods.

**Manufacturing**

Manufacturing activity in the District remained feeble on net during the reporting period of June through mid-July. Metal fabricators continued to experience very weak demand, which held their capacity utilization rates at extremely low levels. Following the seasonal peak in gasoline demand, activity at petroleum refineries declined. Production activity by commercial aircraft manufacturers continued to slow, and their order backlog declined as new aircraft orders were outnumbered by cancellations of existing orders. By contrast, conditions improved further for manufacturers of semiconductors and other information technology products, as sales increased and capacity utilization rates rose significantly. New orders and sales remained strong for food manufacturers.

**Agriculture and Resource-related Industries**

Demand remained solid for agricultural products but stayed somewhat weak for producers of natural resources. Sales mostly held steady for a variety of crop and livestock products, and contacts noted largely stable input costs, with transportation costs reported to be at the lowest levels recorded at any time during the last three years. Oil extraction activity has expanded in response to earlier increases in the price of oil, but contacts noted that recent declines in oil prices may reverse this trend. Extraction of natural gas has been held down by weak demand and falling prices, with activity reportedly near the lowest levels seen since 2002.

**Real Estate and Construction**

Conditions in District housing markets remained very weak but showed further signs of improvement, while demand for commercial real estate continued to erode. Sales prices for new and existing homes fell further in most parts of the District, and home construction activity remained at very low levels. Combined with low mortgage rates, however, price declines have propelled a sustained pickup in the pace of home sales in many areas. Demand for commercial real estate fell further, and with rising vacancy rates, tenants have successfully been requesting rent concessions and other new terms on existing leases. Construction activity for commercial properties also continued to fall, and contacts noted that a lack of available credit remained a constraint for construction activity and investment transactions in some areas.

**Financial Institutions**

District lending activity fell further, and credit conditions remained tight during the reporting period. Demand for commercial and industrial loans continued to fall, as business owners remained pessimistic about near-term prospects and continued to restrain their capital spending. Demand for consumer loans also was characterized as weak on net. Banking contacts reported further deterioration in credit quality for business and consumer loans, with bankruptcies and foreclosures staying on an upward trend.