Summary of Economic Activity

Economic activity in the Third District rebounded to a slight pace of growth from a modest decline during the prior period. Employment levels appeared to increase modestly following a slight decrease last period. Wage pressures have eased compared with 2021, but now some business contacts are concerned that household incomes are not sufficient for consumers to maintain their spending nor manage their debt. Price pressures remain elevated, and affordability problems are a growing concern for low- and middle-income households. Nonmanufacturing firms began to lean positive in their future expectations, while manufacturers remained broadly optimistic.

Labor Markets

Employment appeared to increase modestly following a slight decrease during the prior period; however, most firms continued to report no change. Staffing contacts operating in locations with overall job growth noted that the growth was present across most sectors of the local economy; however, employment levels were stagnant in some parts of the District.

Most contacts noted only incremental productivity gains, with a minor impact on employment levels either from AI use specifically or automation generally. Call center staff and coders were most frequently mentioned as at-risk jobs; however, contacts suggested these cuts will primarily impact offshore employment. Contacts from many sectors cited the “low-hiring, low-firing” environment as leading to lower turnover and lessened wage pressures.

Wage inflation remained steady at a modest pace—typical of its long-run average. One retail firm stated that it matched the market wage increase of 2.5 percent this year, which helps its profit margins but hurts its employees and, by extension, its customers. This contact said, “With medical and utility costs going up, we see a lot of headwinds for the consumer.”

On a quarterly basis, firms’ expectations of the one-year-ahead change in compensation cost per worker held steady at a trimmed mean of 3.3 percent in the fourth quarter of 2025—just a tick higher than the 3.2 percent pre-pandemic average (2016 through 2019). Expectations had averaged 3.5 percent through 2024 and the first half of 2025 after reaching a peak of 5.8 percent in the third quarter of 2022. There was no significant difference in expectations between manufacturing and nonmanufacturing firms.

Prices

On balance, firms’ prices rose at a moderate pace for the third consecutive quarter. Based on responses from all firms to our fourth quarter survey, the trimmed mean for reported price changes (received by firms for their own goods and services over the past year) edged up to 3.0 percent from 2.9 percent in the third quarter and 2.8 percent in the second quarter. The recent increases are sharply higher than the 1.4 percent increase reported in the first quarter of 2025.

In our monthly surveys, the diffusion indexes for prices paid and prices received remained well above their nonrecession averages for nonmanufacturers and manufacturers. A banker noted that prices are flattening but at a much higher level than four years ago. Contacts noted that consumers continued to face affordability problems with most of the household budget, including housing, cars, utilities, insurance, and health care.

Looking ahead one year, the increases that firms anticipate in the prices for their own goods fell. The trimmed mean for all firms dropped to 2.6 percent in the fourth quarter of 2025 from 3.3 percent in the third quarter. The expected rate of growth was 2.4 percent for nonmanufacturers and 2.9 percent for manufacturers. However, many contacts still expect tariffs to seep into general price levels. The trimmed mean for inflation expectations was 3.6 percent for all firms in the fourth quarter of 2025, down from 4.7 percent in the third quarter.

Manufacturing

Manufacturing activity edged up following a modest decline in the prior period. About one-fourth of the firms reported increases in shipments and new orders, and about one-fifth reported decreases; most reported no change. However, the index for general activity fell further into negative territory.

Firms most often cited uncertainty and labor supply as constraints on capacity utilization. In comments, firms also noted a drag on orders from “the sluggish housing market” and the “continuing rise in both material and labor inflation” making it “difficult to discount prices in an effort to drive demand.” One large firm noted that “tariffs are greatly impacting [its] profitability.”

Manufacturers remained optimistic about growth over the next six months. Just over half of the firms expect increases in new orders and shipments, although the percent expecting decreases did edge higher. Over one-fourth of the firms expect to increase future capital expenditures.

Trade and Services

On balance, firms across a broad spectrum of nonmanufacturing industries reported a modest increase in activity, reversing a modest decrease in the prior period. The new orders index was slightly positive, and the sales/revenues index was modestly so. Nonmanufacturers cited uncertainty and labor supply as constraints on capacity utilization and expected uncertainty to worsen.

Retailers (nonauto) continued to report stagnant sales—noting that consumers are still holding back. One contact attributed consumer hesitancy to a combination of general “price fatigue” and a belief that consumers were saving funds for holiday spending. A banker noted that sales dropped by one-third at a local restaurant chain.

Auto dealers continued to report a modest decline in new car sales. “Affordability is a huge challenge,” according to dealers—aggravated by tariffs and the loss of EV incentives but often accommodated by extending loan terms up to seven years.

Tourism activity continued to decline—slightly in the current period. However, the snowfall has been the best in 10 years for the District’s ski resorts. Moreover, contacts are generally optimistic for the first half of 2026, as Philadelphia hosts a strong season of conventions, sporting events, and the nation’s Semiquincentennial.

Expectations for own-firm growth in the next six months began to lean positive, with 42 percent of the firms expecting increases versus 31 percent expecting decreases. However, the resulting diffusion index of 11 is far below the norm of 42.

Real Estate and Construction

Existing home sales continued to decline slightly, with no significant improvement in inventory levels. New-home builders reported slight declines in sales and construction activity overall, although one builder noted a nice bounce back in December. Affordability issues remain, however. A builder noted that “resale prices are so high, it makes new home sales attractive.” A real estate agent commented that recently built townhomes “are being rented out instead of being put on the market for sale” and that “rental unaffordability is growing month over month.”

In nonresidential markets, contacts reported ongoing development for industrial, flex, and some retail space. Contacts were unsure whether the office market had hit bottom yet in Philadelphia. New plans for multifamily construction appear to have slowed, while current projects are being absorbed.

Credit Conditions

The volume of bank lending (excluding credit cards) essentially held steady during the period (not seasonally adjusted), as it did during the comparable period in 2024. Bank lending edged down in the prior period—running a bit lower than the prior year throughout the fourth quarter.

District banks reported moderate growth in home equity lines, modest growth in commercial and industrial loans, slight growth in mortgage volumes, and little change in auto loans. Most of this growth was offset by a slight decline in the volume of commercial real estate loans plus a modest decline in other loans. Credit card volumes surged following modest growth during the prior period—typical for the year-end holiday season, but 2025 volumes are barely above 2024 levels.

Two banking contacts characterized loan demand across general industrial sectors as tepid, except for aerospace, defense, and data centers. Another noted that mortgage delinquencies are starting to rise among lower-end borrowers. A consumer lender noted that adjustments to its lending tools and credit standards earlier in the year resulted in better credit performance now despite added economic pressure on borrowers. ■

For more information about District economic conditions, visit **www.philadelphiafed.org/regional-economy.**