

DISTRICT ECONOMIC OVERVIEW

BY MATTHEW MARTIN

Fifth District economic activity advanced at a moderate pace in the second quarter as continued declines in housing market activity constrained growth. In contrast, labor market conditions remained strong as District services firms maintained a brisk pace of hiring and posted healthy revenue gains. Also, District households experienced solid income growth during the second quarter.

Housing Markets Retreat

Overall, Fifth District housing market activity declined further in the second quarter. The pullback in residential construction activity deepened a bit, with building permit issuance down 16.2 percent compared to last year. Existing home sales were lower as well. Sales in the District fell 11.1 percent since the second quarter of 2006.

Slower home construction and sales were accompanied by slower home price growth during the period. While the pace of growth lessened in the second quarter, appreciation in every District jurisdiction — with the exception of West Virginia — remained in positive territory. After peaking at 14.3 percent in the second quarter of 2005, overall, year-over-year price growth in the District has drifted lower since, settling at 4.0 percent

in the second quarter of this year. Considerable variation in home price performance remains, however. Rates of appreciation have pulled back sharply along the coast and in the Washington, D.C., metro area, while

Fifth District economic activity advanced at a moderate pace in the second quarter.

holding steady or even accelerating modestly in many markets across the Carolinas.

Labor Markets and Services Sector Activity Steady

District labor market conditions remained generally healthy in the second quarter. Employment growth was steady at 1.5 percent compared to a year earlier — matching the first-quarter mark — with payroll expansions recorded in all District jurisdictions. Reports from the household survey also indicated solid labor market fundamentals. The Fifth District's unemployment rate held steady at 4.2 percent, keeping the region's rate lower than the national rate by 0.3 percentage point.

The majority of the employment growth during the quarter occurred in the District's services sector. Job gains were particularly strong in education and health services and business services with year-over-year increases of 3.3 percent and 2.5 percent, respectively. Other assessments of the services sector were also upbeat. The revenue index from the Richmond Fed's survey of service-providing firms rose two points in the second quarter to finish at 9. Additionally, the retail revenues index rebounded in the second quarter, climbing into positive territory at 5, up from -9 in the first quarter. Survey readings on services employment in the District were positive as well.

Goods-producing industries did not fare as well in the second quarter, however. Our survey of manufacturers indicated generally lower levels of new orders and shipments since the end of March, though the index for overall activity rebounded into positive territory in the June survey. On the employment front, District factories continued to shed workers during the second quarter. Our manufacturing employment index finished the quarter at -6. By contrast, employment in the District's construction industry continued to increase despite the pullback in home building activity, buoyed by solid nonresidential activity.

Households Faring Well

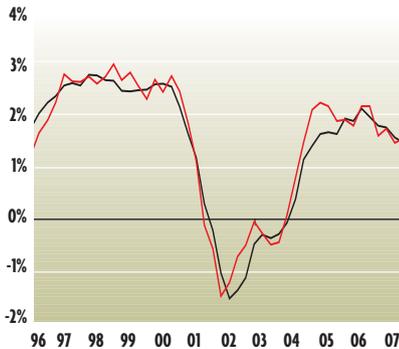
Steady job and income growth helped strengthen household financial conditions in the second quarter. Overall, real personal income in the District was up 3.9 percent compared to last year, with solid growth in most District jurisdictions. Other measures of household financial conditions were mixed. Mortgage delinquency and foreclosure rates were moderately higher in the second quarter, though in many parts of the District they were below recent peaks. **RF**

Economic Indicators

	2nd Qtr. 2007	1st Qtr. 2007	Percent Change (Year Ago)
Nonfarm Employment (000)			
Fifth District	13,872	13,816	1.5
U.S.	137,864	137,447	1.4
Real Personal Income (\$bil)			
Fifth District	942.7	940.0	3.9
U.S.	9,882.0	9,867.3	3.9
Building Permits (000)			
Fifth District	53.9	50.5	-16.2
U.S.	404.4	361.5	-23.6
Unemployment Rate (%)			
Fifth District	4.2%	4.2%	
U.S.	4.5%	4.5%	

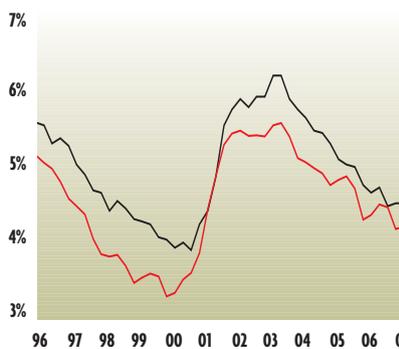
Nonfarm Employment

Change From Prior Year
First Quarter 1996 - Second Quarter 2007



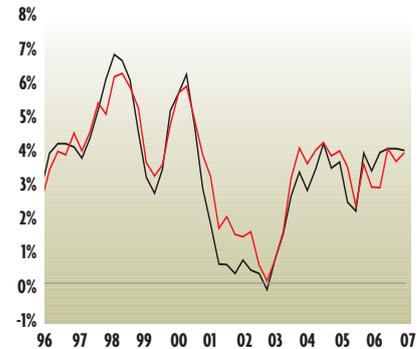
Unemployment Rate

First Quarter 1996 - Second Quarter 2007



Real Personal Income

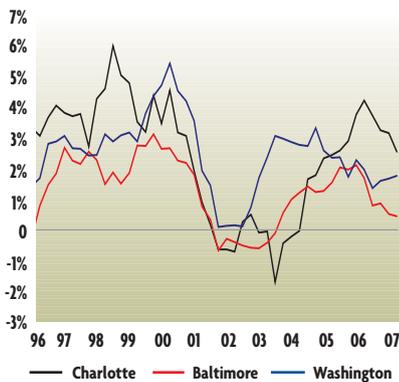
Change From Prior Year
First Quarter 1996 - Second Quarter 2007



— Fifth District — United States

Nonfarm Employment Metropolitan Areas

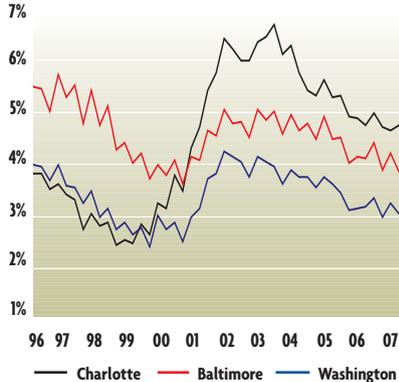
Change From Prior Year
First Quarter 1996 - Second Quarter 2007



— Charlotte — Baltimore — Washington

Unemployment Rate Metropolitan Areas

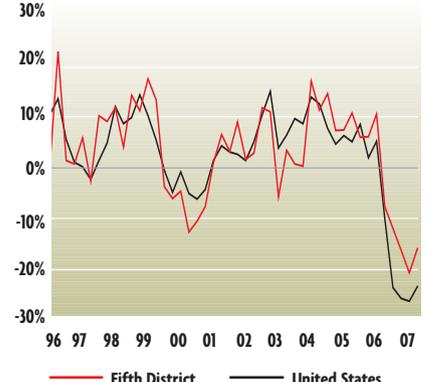
Change From Prior Year
First Quarter 1996 - Second Quarter 2007



— Charlotte — Baltimore — Washington

Building Permits

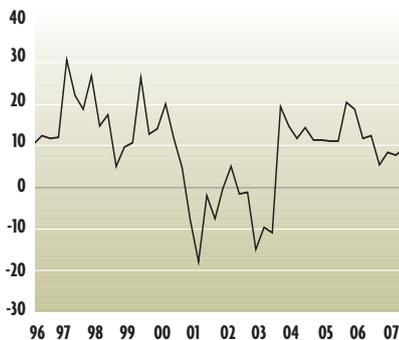
Change From Prior Year
First Quarter 1996 - Second Quarter 2007



— Fifth District — United States

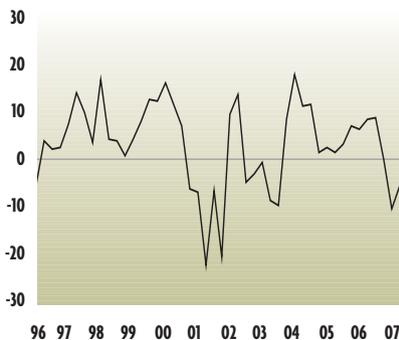
FRB—Richmond Services Revenues Index

First Quarter 1996 - Second Quarter 2007



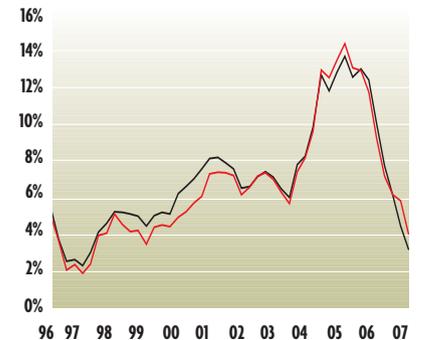
FRB—Richmond Manufacturing Composite Index

First Quarter 1996 - Second Quarter 2007



House Prices

Change From Prior Year
First Quarter 1996 - Second Quarter 2007



— Fifth District — United States

NOTES:

1) FRB-Richmond survey indexes are diffusion indexes representing the percentage of responding firms reporting increase minus the percentage reporting decrease. The manufacturing composite index is a weighted average of the shipments, new orders, and employment indexes.
2) Metropolitan area data, building permits, and house prices are not seasonally adjusted (nsa); all other series are seasonally adjusted.

SOURCES:

Real Personal Income: Bureau of Economic Analysis/Haver Analytics.
Unemployment rate: LAUS Program, Bureau of Labor Statistics, U.S. Department of Labor, <http://stats.bls.gov>.
Employment: CES Survey, Bureau of Labor Statistics, U.S. Department of Labor, <http://stats.bls.gov>.
Building permits: U.S. Census Bureau, <http://www.census.gov>.
House prices: Office of Federal Housing Enterprise Oversight, <http://www.ofheo.gov>.

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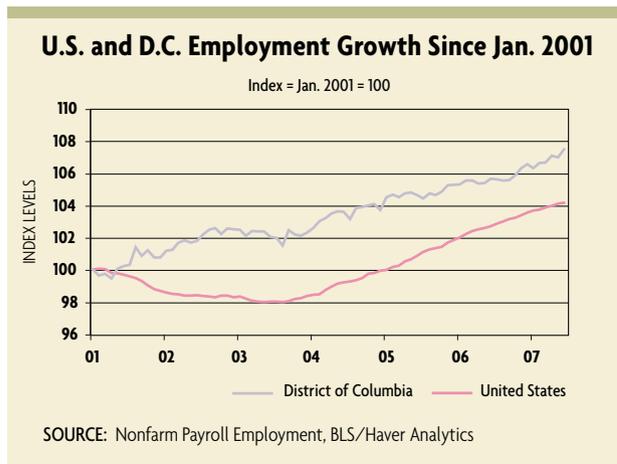
STATE ECONOMIC CONDITIONS

BY MATTHEW MARTIN

◆ District of Columbia

Economic conditions in the District of Columbia remained generally healthy in the second quarter as strong payroll growth outweighed softening residential real estate activity. Employment growth accelerated during the period, advancing at a 2.4 percent annual rate compared to last quarter's 1.1 percent mark. The region's housing market pullback deepened, however, as both existing home sales and new construction declined, while delinquency rates edged higher.

Overall, labor market conditions improved in the second quarter, propelled by a 7.1 percent increase in professional and business services employment. Government payrolls



also posted solid gains during the period. Employment in the sector was up 3.4 percent at an annual rate, on the heels of two consecutive quarters of decline. Turning to household conditions, the District of Columbia's unemployment rate dipped 0.2 percentage point to finish at 5.6 percent — its lowest point in nearly seven years. However, even with the improvement, the unemployment rate remained the Fifth District's highest mark.

On the residential real estate front, housing market conditions deteriorated further since the end of March. After a slight uptick to begin the year, existing home sales reversed course in the second quarter, falling 10.3 percent. Home sales were also lower compared to the previous year, with sales activity down 7.1 percent since the second quarter of 2006. The decline in sales contributed to continued softness in home prices. The District of Columbia's House Price Index (HPI) — published by the Office of Federal Housing Enterprise Oversight (OFHEO) — was unchanged in the second quarter. On the other hand, the region experienced mild appreciation over the past year as its HPI was up 4.6 percent compared to a year earlier.

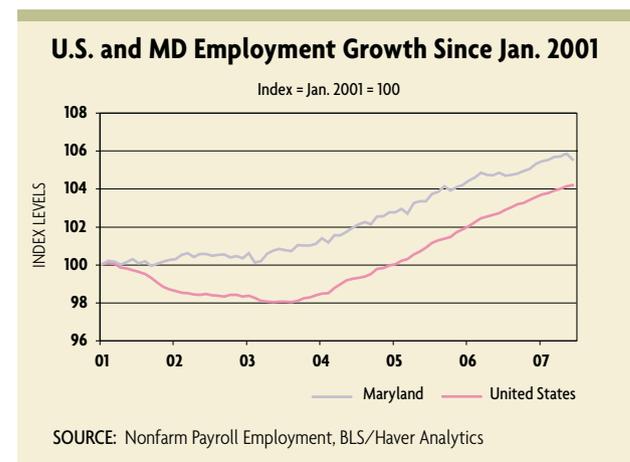
Slowing residential real estate activity during the period coincided with slightly higher mortgage delinquency and foreclosure rates. The District of Columbia's delinquency rate increased 0.5 percentage point during the second quarter to finish at 3.7 percent, though it remained well below its recent peak of 6.0 percent. The region's foreclosure rate edged up 0.1 percentage point to settle at 0.6 percent.

◆ Maryland

Maryland's economy slowed a bit in the second quarter as mild employment growth and continued weakness in residential real estate markets tempered growth prospects. Payroll employment growth moved lower during the quarter, advancing at a 0.6 percent annual rate versus 1.7 percent last quarter. Job gains were limited due to further declines in manufacturing payrolls and a slight dip in professional and business services employment. Employment performance in the state was also sluggish compared to a year earlier; payrolls expanded by less than 1.0 percent since the second quarter of 2006.

The report on household economic conditions was a bit more upbeat, however. Maryland's unemployment rate was unchanged during the second quarter at 3.7 percent and 0.2 percentage point lower than a year ago, though a portion of the stability in unemployment can be attributed to a slight reduction in the state's labor force. The readings on income growth were mixed. Although real-income growth remained positive in the second quarter, the rate slowed to just 0.6 percent at an annual rate down from 4.8 percent in the first quarter. However, real income in the state increased 3.5 percent over the past year, up from last quarter's mark of 3.2 percent.

In housing markets, activity in the state declined in the second quarter spurred by a drop-off in sales and



construction activity. Existing home sales declined by a wide margin during the second quarter, falling 19.7 percent compared to the first quarter and 21.1 percent compared to a year earlier. Additionally, building permit issuance fell 27.8 percent over the past 12 months. Both declines were the largest among District jurisdictions.

Despite a weaker housing market, home prices continued to move higher in the second quarter. Maryland's HPI rose at a 3.2 percent annual rate, a full percentage point higher than the first-quarter mark. In addition, its HPI was 4.7 percent higher than a year ago, though the increase was the state's smallest since 1999. On a less rosy note, Maryland's mortgage delinquency rate moved higher in the second quarter. The state's overall delinquency rate rose to 4.2 percent, but remained well below the recent peak of 6.4 percent registered in the third quarter of 2001. The delinquency rate for subprime mortgages set a new high watermark, however, climbing to 13.8 percent, up from 11.2 percent in the first quarter.

North Carolina

The North Carolina economy remained on generally solid footing during the second quarter, though labor market growth was less robust. Compared to a year earlier, total employment was up 2.2 percent versus 2.4 percent in the first quarter. Job gains were centered in the state's services industries, but an increase in the rate of

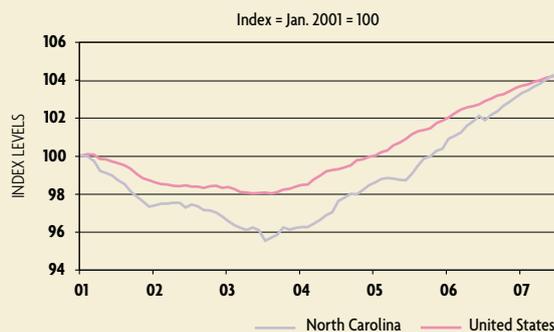
rate rose 0.3 percentage point to finish at 4.8 percent. Additionally, labor force growth in the state slowed to 1.6 percent over the past year, down from 2.4 percent in the first quarter.

On a brighter note, household financial conditions improved in the second quarter as North Carolina posted solid income growth. In fact, the state experienced the strongest income growth among District jurisdictions during both the second quarter and the past 12 months. Furthermore, the state's 4.8 percent increase in personal income was nearly a full percentage point above the national mark over the same period.

As in most other jurisdictions, North Carolina's housing sector continued to slump. Building permit issuance across the state declined 16.7 percent compared to the same quarter last year, while existing home sales declined 4.5 percent over the same period. Soft construction and sales activity in the second quarter accompanied a slowdown in home appreciation. North Carolina's HPI increased 0.8 percent during the three-month span compared to a 1.7 percent increase last quarter. Nonetheless, the state saw housing prices increase 7.1 percent since the second quarter of last year — the largest year-over-year gain in the Fifth District.

In other housing news, North Carolina's overall mortgage delinquency rate edged higher in the second quarter to 5.5 percent compared to 5.3 percent a year earlier. The subprime delinquency rate also rose during the quarter, increasing 2.1 percentage points to 15.5 percent.

U.S. and NC Employment Growth Since Jan. 2001



manufacturing job losses constrained overall growth. Professional and business services employment increased by 3.7 percent over the past 12 months, while manufacturing payrolls contracted 1.3 percent.

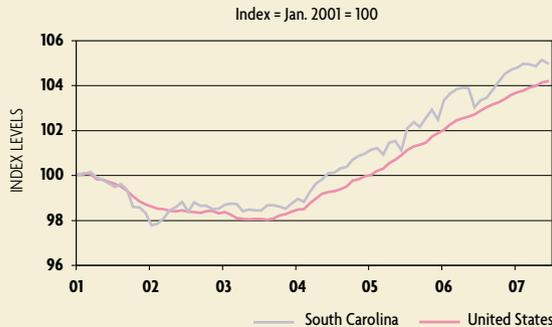
The household survey provided a less optimistic view of labor market conditions as North Carolina's employment

South Carolina

Economic conditions in South Carolina deteriorated a bit in the second quarter amid softening labor markets and continued housing woes. Employment growth moderated during the period as payrolls expanded just 0.1 percent since the end of March. The weak employment performance was due, in part, to the state's first decline in construction payrolls in two years in concert with an intensification of manufacturing job losses. On a brighter note, education and health services employment was up 7.1 percent compared to the previous year. State professional and business services firms also posted solid payroll gains — employment in the sector expanded 1.9 percent during the quarter, the largest increase in the District over the period.

On the household side, South Carolina's unemployment rate fell 0.5 percentage point to finish at 5.6 percent — a mark which, despite the drop, tied the District of Columbia for the highest rate in the Fifth District. Household financial conditions were boosted by solid income growth over the

U.S. and SC Employment Growth Since Jan. 2001



SOURCE: Nonfarm Payroll Employment, BLS/Haver Analytics

second quarter. Real personal income increased 3.7 percent compared to the same quarter last year. Nonetheless, solid income growth coincided with increased mortgage delinquencies. Delinquency rates among both conventional and subprime borrowers moved higher since the end of March, finishing at 3.3 percent and 15.7 percent, respectively.

Like the rest of the District, South Carolina's recent housing woes persisted in the second quarter. Cumulative building permits through the second quarter were 19.8 percent lower than 2006 levels. Additionally, existing home sales were down 9.3 percent from a year ago with especially large declines in coastal markets. Soft housing market activity contributed to lower rates of home price appreciation. South Carolina's HPI was up 6.3 percent over the last 12 months versus last quarter's mark of 7.6 percent. As was the case with sales, home price growth was slower near the coast due in part to sharp reductions in demand for second homes. The HPI for the Charleston metro area, for example, was down slightly in the second quarter.



Virginia

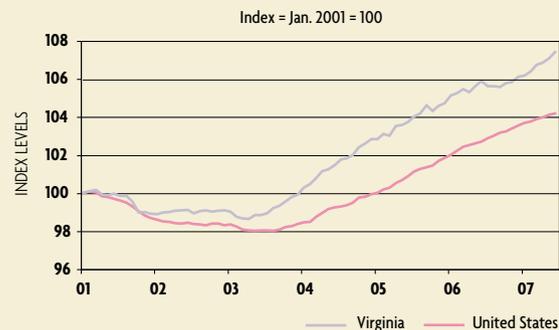
On balance, economic conditions in Virginia improved during the second quarter of 2007 as healthy labor market conditions more than offset growing weakness in the residential real estate markets.

Payroll employment growth was strong across Virginia. Nonfarm payroll employment increased at a 2.6 percent annualized rate in the second quarter and 1.4 percent since March of 2006. Most of the gains occurred in the services sector, led by a 5.5 percent jump in professional and business services employment. The state also experienced an increase in manufacturing employment during the second quarter. The expansion marked the second consecutive quarterly gain in factory payrolls following 10 quarters of losses.

The economic conditions of Virginia's households were also solid during the second quarter. The unemployment rate inched higher by 0.1 percentage point to finish at 3.0 percent, but remained the lowest rate in the Fifth District. The unemployment rate has hovered near the 3.0 percent mark over the past 12 months even amid a sizable 1.6 percent increase in the labor force. Solid job prospects in the period accompanied stronger personal income growth across the state. Virginia's real income growth over the past year accelerated to a 3.5 percent annual rate, up from 3.1 percent in the first quarter.

On the other side of the coin, Virginia's residential real estate market remained a weak spot in the state's economy during the second quarter. Existing home sales dropped

U.S. and VA Employment Growth Since Jan. 2001



SOURCE: Nonfarm Payroll Employment, BLS/Haver Analytics

sharply compared to the first quarter and a year earlier. Home sales fell 15.3 percent over the past year, while building permit levels dropped 17.6 percent over the same period. The decline in both sales and construction corresponded with a further deceleration in home price appreciation as year-over-year growth in the HPI slowed to 3.7 percent.

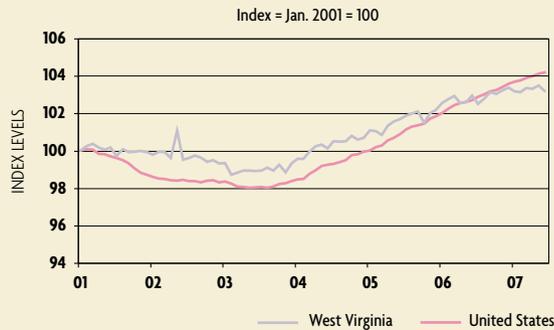
Adding to the less upbeat housing report, Virginia's overall mortgage delinquency rate increased to 3.7 percent compared to last quarter's 3.1 percent mark. Increased delinquencies among subprime borrowers accounted for much of the second-quarter jump as that rate moved higher from 11.0 percent to 13.4 percent. Nonetheless, both overall and subprime delinquency rates remained well below recent peak levels.



West Virginia

The pace of West Virginia economic activity waned a bit in the second quarter as weak employment performance and slower residential real estate activity weighed on growth.

U.S. and WV Employment Growth Since Jan. 2001



Labor market conditions in the state softened further in the second quarter. West Virginia's unemployment rate increased 0.2 percentage point during the period to settle at 4.4 percent, though the mark was below the state's 4.9 percent rate a year ago. Additionally, payroll growth in the state was weak. Total nonfarm employment expanded just 0.6 percent over the past year — the smallest percentage increase among Fifth District jurisdictions. Steep manufacturing job losses weighed on overall job gains, while employment growth in both the mining and construction sectors decelerated somewhat.

The weak job growth in West Virginia accompanied softer income growth in the second quarter. Real personal income increased at an annual rate of 0.4 percent during the period compared to last quarter's 3.5 percent increase. Over the past year personal income levels grew just 2.8 percent, the lowest mark among all Fifth District jurisdictions.

Residential real estate remained a soft spot in West Virginia's economy during the second quarter. Activity continued its retreat as the number of building permits issued during the period fell 7.3 percent short of year-earlier levels. Existing home sales were off more sharply, declining 17.4 percent for the quarter and 13.6 percent over the previous year. Moreover, West Virginia was the only state in the Fifth District whose HPI contracted during the second quarter. The state's HPI edged lower at a 0.9 percent annual rate, though the index remained 4.4 percent higher than a year earlier. Additionally, the overall mortgage delinquency rate increased to 6.8 percent — 0.6 percentage point above the second-quarter level. The increase in the overall rate was due in large part to a substantial jump in the number of subprime delinquencies. The state's subprime delinquency rate swelled 2.3 percentage points to finish at a District-high of 18.1 percent. **RF**

Behind the Numbers: Consumer Confidence

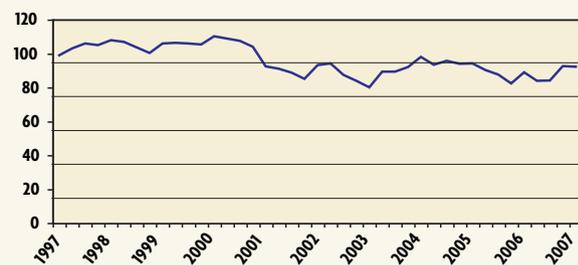
A leading consumer confidence index is released once a month by an independent research organization called the Conference Board. It is a survey of 5,000 households (returned by about 3,500), asking participants whether they are positive, neutral, or negative about a short list of economic conditions in the present and near future. Out of the responses the Conference Board builds indexes tied to the base year of 1985. The method is similar to that used by the other main consumer confidence index provider, Reuters/University of Michigan Surveys of Consumers.

These indexes may be useful in forecasting what consumers will spend in the future and perhaps provide insights into current economic conditions not captured in other data. In fact, studies have shown a strong correlation between consumer confidence and consumer spending.

But do consumer confidence indexes do more than confirm or support other data? That was the question posed by economist Dean Croushore with the University of Richmond.

Croushore noted that previous research has shown that forecasts are not improved with adding consumer confidence

Index of Consumer Sentiment



indexes. To double-check, Croushore tapped into a real-time data set developed by the Federal Reserve Bank of Philadelphia. This allowed him to take the view of a forecaster operating at the time those forecasts were made. Even then, consumer confidence indexes don't seem to add much: "The bottom line: If you are forecasting consumer spending for the next quarter, you should use data on past consumer spending and stock prices and ignore data on consumer confidence." **— DOUG CAMPBELL**

State Data, Q2:07

	DC	MD	NC	SC	VA	WV
Nonfarm Employment (000's)	698.0	2,609.6	4,101.2	1,924.4	3,779.4	759.4
Q/Q Percent Change	0.6	0.1	0.5	0.1	0.6	0.1
Y/Y Percent Change	1.6	0.9	2.2	1.3	1.4	0.6
Manufacturing Employment (000's)	1.6	134.3	546.8	244.8	286.8	59.5
Q/Q Percent Change	2.1	-0.3	-0.4	0.3	0.2	-0.2
Y/Y Percent Change	-9.3	-1.6	-1.3	-3.9	-1.3	-2.6
Professional/Business Services Employment (000's)	159.8	401.7	488.4	218.1	647.2	60.9
Q/Q Percent Change	1.7	-0.1	0.5	1.9	1.4	1.4
Y/Y Percent Change	4.4	2.0	3.7	0.0	3.4	1.4
Government Employment (000's)	233.9	471.1	686.9	333.0	680.8	144.6
Q/Q Percent Change	0.8	0.1	1.2	0.4	0.9	0.0
Y/Y Percent Change	0.5	0.0	1.1	0.5	1.0	0.3
Civilian Labor Force (000's)	319.9	2,998.6	4,529.3	2,148.8	4,051.0	814.0
Q/Q Percent Change	-0.3	-0.9	0.2	-0.5	0.0	0.2
Y/Y Percent Change	1.4	-0.2	1.6	1.3	1.6	1.1
Unemployment Rate (%)	5.6	3.7	4.8	5.6	3.0	4.4
Q1:07	5.8	3.7	4.5	6.1	2.9	4.2
Q2:06	5.9	3.9	4.7	6.4	3.0	4.9
Real Personal Income (\$Mil)	30,053.1	220,350.4	259,680.9	115,348.7	271,749.4	45,529.6
Q/Q Percent Change	0.3	0.2	0.4	0.3	0.3	0.1
Y/Y Percent Change	4.0	3.5	4.8	3.7	3.5	2.8
Building Permits	501	6,280	23,103	12,015	10,804	1,157
Q/Q Percent Change	-39.9	15.1	-0.2	14.3	12.0	31.3
Y/Y Percent Change	136.3	-27.8	-16.7	-9.2	-17.6	-7.3
House Price Index (1980=100)	665.3	547.4	339.4	322.3	477.6	232.5
Q/Q Percent Change	0.0	0.8	0.8	0.2	0.7	-0.2
Y/Y Percent Change	4.6	4.7	7.1	6.3	3.7	4.4
Sales of Existing Housing Units (000's)	10.4	92.8	231.2	113.6	124.0	30.4
Q/Q Percent Change	-10.3	-19.7	-5.2	-2.7	-12.9	-17.4
Y/Y Percent Change	-7.1	-21.1	-4.5	-9.3	-15.3	-13.6

NOTES:

Nonfarm Payroll Employment, thousands of jobs, seasonally adjusted (SA) except in MSA's; Bureau of Labor Statistics (BLS)/Haver Analytics, Manufacturing Employment, thousands of jobs, SA in all but DC and SC; BLS/Haver Analytics, Professional/Business Services Employment, thousands of jobs, SA in all but SC; BLS/Haver Analytics, Government Employment, thousands of jobs, SA; BLS/Haver Analytics, Civilian Labor Force, thousands of persons, SA; BLS/Haver Analytics, Unemployment Rate, percent, SA except in MSA's; BLS/Haver Analytics, Building Permits, number of permits, NSA; U.S. Census Bureau/Haver Analytics, Sales of Existing Housing Units, thousands of units, SA; National Association of Realtors®

Metropolitan Area Data, Q2:07

	Washington, DC MSA	Baltimore, MD MSA	Charlotte, NC MSA
Nonfarm Employment (000's)	2,437.6	1,314.2	843.7
Q/Q Percent Change	1.7	2.0	1.4
Y/Y Percent Change	1.8	0.4	2.6
Unemployment Rate (%)	3.0	3.8	4.7
Q1:07	3.2	4.2	4.6
Q2:06	3.1	4.1	4.7
Building Permits	7,311	1,644	6,312
Q/Q Percent Change	14.4	-5.6	12.0
Y/Y Percent Change	-5.5	-27.5	-6.6

	Raleigh, NC MSA	Charleston, SC MSA	Columbia, SC MSA
Nonfarm Employment (000's)	498.9	294.9	365.8
Q/Q Percent Change	2.1	1.1	0.6
Y/Y Percent Change	2.5	2.9	1.3
Unemployment Rate (%)	3.7	4.2	4.7
Q1:07	3.6	4.9	5.5
Q2:06	3.7	5.0	5.4
Building Permits	4,214	2,197	2,313
Q/Q Percent Change	3.7	-54.3	38.2
Y/Y Percent Change	21.3	-3.0	14.0

	Norfolk, VA MSA	Richmond, VA MSA	Charleston, WV MSA
Nonfarm Employment (000)	783.6	638.3	151.9
Q/Q Percent Change	2.8	1.5	2.2
Y/Y Percent Change	1.2	1.7	1.0
Unemployment Rate (%)	3.1	3.0	4.1
Q1:07	3.3	3.2	4.5
Q2:06	3.2	3.1	4.6
Building Permits	1,574	2,136	70
Q/Q Percent Change	-25.5	18.1	-6.7
Y/Y Percent Change	-19.3	-12.7	-19.5

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