Fifth District Continues to Experience Slow, Steady Economic Growth

The year 2013 marked the continuation of slow, steady growth in the Fifth District and throughout the nation. Private sector firms hired at a modest pace, while government employment and purchasing continued to be a drag on the economy. The housing recovery persisted, and there were increased, although still somewhat scattered, reports of new investment and construction in residential and commercial real estate. In general, businesses reported expanded activity and increased sales, but the environment continued to be somewhat volatile and unpredictable, particularly for retailers. In addition, the pace of the recovery varied considerably by region within the Fifth District. Urban areas generally outperformed rural areas, and certain parts of West Virginia continued to suffer from the contraction of coal mining.

Labor Markets

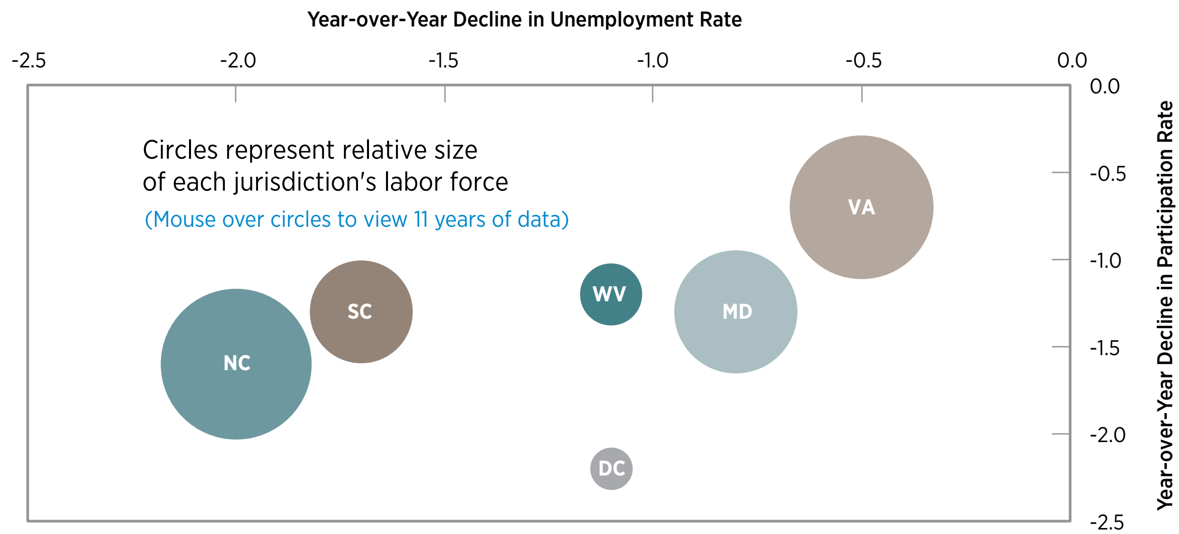
Much like the overall economy, labor markets in the Fifth District grew slowly and steadily. On net, firms in the Fifth District added 170,200 jobs (1.2 percent), which was slightly below the 205,800 jobs added in 2012 but above net job creation during the five previous years. The District also underperformed the United States, where payroll employment grew 1.7 percent. The biggest contributions to the District's net job gain came from education and health services (43,100 jobs), leisure and hospitality (41,900 jobs), trade, transportation, and utilities (35,600 jobs), and professional and business services (19,400 jobs). Other industries saw sizeable percentage growth in employment, such as natural resources/mining/construction (2.1 percent) and finance (1.5 percent). The only segments that posted job declines in 2013 were the information industry, which shed 2,100 jobs (0.9 percent) and the government sector, which cut 1,200 jobs (0.0 percent).

Year-over-year employment gains in the District were evident across all five states and the District of Columbia. North Carolina experienced the sharpest absolute gain—85,600 new jobs, while South Carolina saw the highest percentage increase—2.5 percent growth.

District-wide trends included the expansion of payrolls in education and health services, financial services, and the trade, transportation, and utilities segment. In addition, federal government payrolls contracted in every jurisdiction across the District. Other industries varied widely in different states. For example, professional and business services in North Carolina added 27,600 net new jobs (5.1 percent) while that industry lost 16,500 net jobs (2.4 percent) in Virginia.

In the household employment survey, however, there were more consistent trends across states. Notably, both the unemployment rate and the labor force participation rate fell during 2013 in every state in the District. The unemployment rate for the District fell from 7.4 percent in December 2012 to 6.2 percent in December 2013, remaining below the national rate of 6.7 percent at the end of the year. Again, the greatest improvement in unemployment rates occurred in the Carolinas, where the North Carolina rate dropped from 8.9 percent to 6.9 percent and the South Carolina rate fell from 8.3 percent to 6.6 percent. Unfortunately, labor force participation also dropped in the District—from 63.9 percent in December 2012 to 62.7 percent in December 2013, as every District state posted sharp declines. Participation also fell in the United States to 62.8 percent by the end of 2013. Still, the number of unemployed people in the District decreased over the year by more than the number of people in the labor force decreased, indicating (along with the results of the establishment survey) some real improvement in labor markets.

FIGURE 1: Declines in Unemployment Rates and Labor Force Participation Rates in 2013



Source: Bureau of Labor Statistics, Haver Analytics

Real Estate

Housing markets across the Fifth District continued along the recovery trend they established in 2012. According to the CoreLogic Information Solutions house price index, year-over-year house price growth has been consistently positive in the District since February 2012, with an acceleration in 2013 that resulted in 5.7 percent appreciation from December 2012 to December 2013. The house price rebound was evident across states, with almost every state posting consistent year-over-year appreciation since at least May 2012. (West Virginia had two months—July and August—with year-over-year house price declines, but West Virginia house price growth is generally more volatile than that of other states in the District.) Reports from real estate agents across the District also indicated stronger demand and pricing for homes than they had seen in a while. The share of mortgages in delinquency and foreclosure was also lower in District states at the end of 2013 than at the end of 2012.

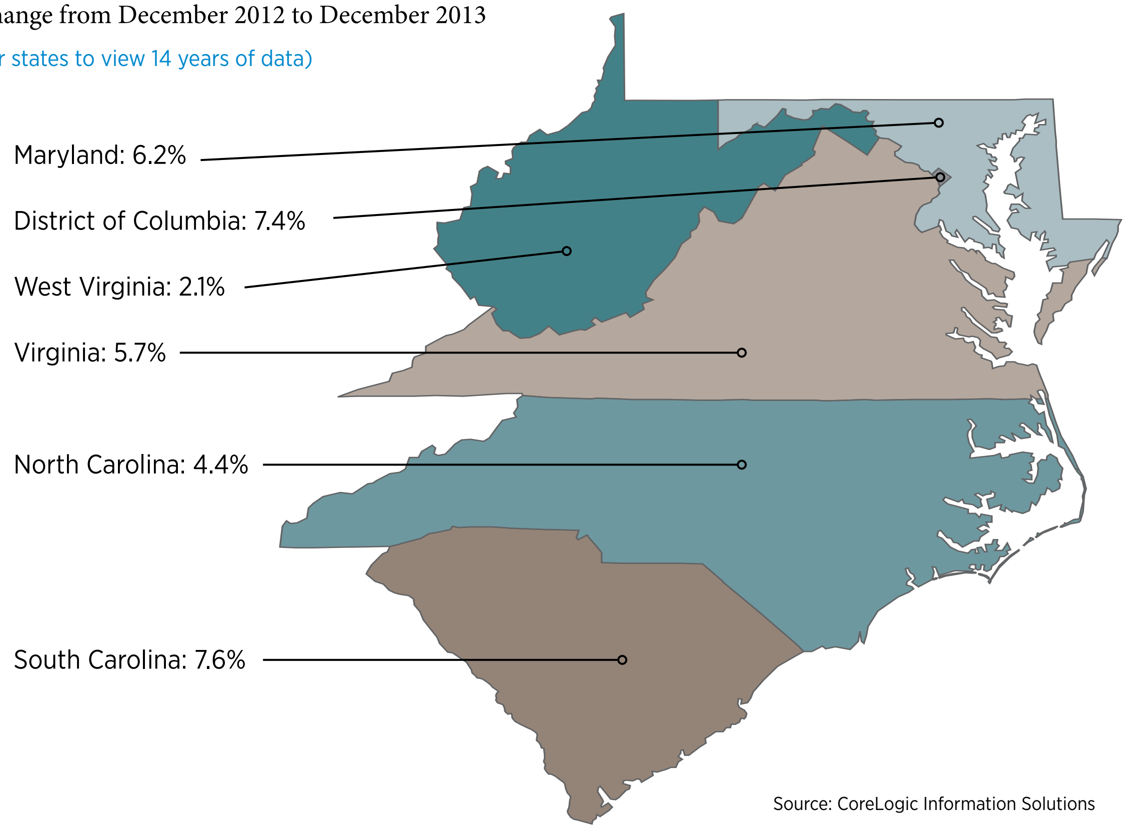
Early in 2013, reports of low inventories were limited to the Washington, D.C., area, although some contacts in other areas remarked on inventory declines. As 2013 progressed, however, more and more real estate agents across the District reported low inventories and multiple offers on homes. In addition, there were increasing numbers of reports on new construction for the first time in years, and builders in some markets bemoaned shortages in lots and in residential building materials. The issuance of residential building permits, although a volatile measure, continued to trend upward. For the whole year, real estate agents reported rising foot traffic, fewer days on the market, increased sales (except perhaps in the most expensive bracket), and higher selling-to-asking price ratios.

There were also more reports of construction in commercial real estate, particularly in multifamily and, toward the end of the year, in industrial real estate. Reports of construction in the office and retail

FIGURE 2: CHANGE IN FIFTH DISTRICT HOUSE PRICES

Percent Change from December 2012 to December 2013

(Mouse over states to view 14 years of data)



Source: CoreLogic Information Solutions

segments were more scattered, but even in those segments, contacts reported increased lending activity, declining vacancy rates, firming rental rates, and fewer concessions from landlords. In many markets, there were reports of particular tightening in the availability of class-A office space. Multifamily activity was the strongest, although it seemed to slow toward the end of the year, and more than a few contacts expressed concern regarding overbuilding in that segment.

Business Conditions

Manufacturing activity has been volatile, but it generally ended the year stronger. The Federal Reserve Bank of Richmond maintains a composite manufacturing index based on the Bank's Fifth District Survey of Manufacturing Activity. It is a diffusion index, meaning that a positive reading indicates that the share of firms reporting expansion exceeds the share of firms reporting contraction. This index was at or above zero for the last five months of the year and was well above zero for three of those five months. It was driven up by reports of increases in shipments and in the volume of new orders. (The manufacturing index is available at www.richmondfed.org/research/regional_economy/surveys_of_business_conditions/manufacturing.) Although reports indicated that growth continued to vary by industry, by region, and by manufacturer, there were some overall trends in 2013. Auto and auto parts manufacturing continued to be strong, as did lumber production, furniture and flooring manufacturing, and other manufacturing firms that stood to benefit from improvements in residential real estate markets. However, there were reports of an inability to raise prices, which squeezed margins for some manufacturers. Furthermore, there continued to be cuts in government spending and considerable uncertainty around government contracts

Regional Forums

Twice a year, several of the Bank's leaders and economists visit regions within the Fifth District to gain first-hand knowledge of local economies. In 2013, delegations from the Bank visited Baltimore, Maryland, and Charlotte, North Carolina. They gained insight about each metropolitan area by meeting with business executives, education officials, community leaders, students, workers, and government officials. More information about these regional forums is available at www.richmondfed.org/press_room/our_news/2013/baltimore_tour_20130705.cfm (for Baltimore) and at www.richmondfed.org/press_room/our_news/2013/char_reg_recap_20131212.cfm (for Charlotte).

PHOTO: LARRY CAIN

President Jeffrey Lacker (left) listens to Louisa Taylor, a student at Johnson C. Smith University in Charlotte. To view a brief video about the 2013 regional forums, please go to http://bcove.me/e7ueknfp.

that negatively impacted certain manufacturers, although some of those same firms noted strength in their non-government business.

A few manufacturers during the year reported that although domestic demand remained too weak to enable strong growth, exports to Europe, Latin America, and Asia helped boost their sales. Over the year, port contacts indicated that port activity in both exports and imports was generally strong, with export growth somewhat outpacing import growth. Anecdotes indicated that coal exports were not as strong as in 2012. In general, the southern part of West Virginia continued to suffer from a decline in coal mining, while the northern part of the state benefitted from expansion in natural gas drilling.

Retail activity continued to be volatile in 2013, according to both the retail revenues index generated from the Richmond Fed's Service Sector Survey and to comments and anecdotes from contacts across the District. (The service sector survey and the retail revenues index are available at www.richmondfed.org/research/regional_economy/surveys_of_business_conditions/service_sector/index.cfm.) However, there were some comments during the middle of the year that certain retailers faced "less of a roller coaster" in 2013 than in other recent years. Auto and truck sales continued to be strong, while furniture and home goods sales continued to benefit from the improvement in residential real estate. There was conjecture among some retailers that consumers were buying bigger-ticket items and not spending money on clothing, electronics, or other smaller items. The major concerns among smaller retailers in the District were the effect of the rise in online sales on brick-and-mortar stores, the increased inability to predict traffic and sales from week to week, and implementation of the Affordable Care Act. Reports on the nonretail service sector were more steadily positive than in the retail sector. The nonretail revenues diffusion index spent most of 2013 above zero, indicating that more firms reported increased revenues than reported decreased revenues.

Banking Markets

Throughout 2013, Fifth District banks experienced modest improvements in condition. The overall banking environment was tempered by ongoing slow growth, low overall interest rates, and slowing residential mortgage demand during the second half of 2013. In spite of these challenges, continued improvements to asset quality contributed to increased earnings and capital for the year.

Balance sheets of Fifth District banks reflected tepid but improving growth during 2013. Median commercial bank loan growth increased from 0.48 percent in 2012 to 2 percent in 2013, despite the negative effect that rising interest rates had on mortgage lending during the second half of the year. This growth was primarily driven by the commercial real estate and commercial-industrial categories. Of particular note is that year-over-year loan growth remained positive for five consecutive quarters, the longest period since 2009. While loan growth increased, median nonperforming loans and loan losses declined 37 percent and 42 percent, respectively. Continued improvement in asset quality allowed banks to further reduce loan-loss provisions, which contributed to an increase in the median return on average assets from 0.57 percent in 2012 to 0.66 percent in 2013. Overall, 89.7 percent of Fifth District banks were profitable in 2013, up from 83.2 percent in 2012. Although earnings showed some improvement in 2013, the low interest rate environment continued to hamper banks through compressed net interest margins, leading to earnings performance that remained considerably below pre-recession levels.

Capital levels remained strong in the District despite a full year of risk-weighted asset growth, a reversal of the trend from the previous three years. While risk-weighted assets increased, earnings improved, providing a boost to capital positions. Liquidity remained solid for Fifth District banks even though noncore funding increased slightly during the second half of the year, primarily due to an increase in short-term borrowing. Despite this increase, overall reliance on noncore funding remained low as banks continued to fund growth largely from core deposits. Although such deposits have been the primary funding source over the past several years, an eventual shift in the rate environment could result in changes to bank-funding strategies.

Summary

The Fifth District experienced another year of slow, steady economic growth in 2013. Business conditions were somewhat unpredictable and volatile during the year, but most industries reported improved sales and revenues, and employment grew at a modest pace. In addition, the gradual residential real estate recovery continued, and in some segments there were hints of recovery in commercial real estate as well. Although the rebound in growth following the 2007–09 recession has not been as strong as the nation or District might have hoped, the slow recovery continued in 2013. ■