

DISTRICT ECONOMIC OVERVIEW

BY ROBERT LACY

The Fifth District economy expanded at a fairly strong pace in the first quarter of 2005. Services businesses generally reported solid gains in revenues, manufacturers said that shipments and new orders were up (albeit modestly in some cases), and employment and personal income rose in District states. Although growth in output and employment in the services sector slowed toward the end of the quarter, the District economy retained considerable momentum heading into the spring.

Growth Continues

Services businesses generally reported higher sales and expanded payrolls in the first quarter. Home sales and residential building activity were particularly brisk, and commercial real estate activity picked up in a number of areas. Financial institutions reported higher lending activity as well.

Retail sales, however, were a little softer in the first quarter. Shopper traffic and sales growth began to slow in February, and by March an increasing number of retailers were reporting stagnant sales. Retailers said rainy weather and substantially

The Fifth District economy expanded at a relatively strong pace in the first quarter of 2005, but momentum slowed by the end of the quarter.

higher gasoline prices contributed to March's malaise.

Manufacturing output rose in the first quarter, but the pace of expansion remained generally modest. New orders and shipments were somewhat higher while capacity utilization was flat. Manufacturing employment, on the other hand, edged lower; 16,000 jobs were trimmed from payrolls in the first quarter. The textiles and apparel sectors, which employ one in seven of the District's manufacturing workers, will likely contract further in 2005 as imports are expected to gain even greater shares of the U.S. market.

District Gains Jobs

Despite the loss in manufacturing jobs, first-quarter payroll employment in the Fifth District was 1.4 percent higher than a year ago. This was slightly off the pace of the second half of 2004 and somewhat short of the rate of expansion nationwide. Slow employment growth in South Carolina accounted for some of the difference between the U.S. and the District's growth rates. South Carolina payroll employment rose by a meager 2,200 jobs year over year, and jobs in the health services and education sector fell compared to a year ago.

The unemployment rate in the District edged lower — from 4.9 percent to 4.8 percent in the first quarter. Virginia's unemployment rate dipped to 3.3 percent, among the lowest rates in the nation. Rates of unemployment in Maryland, North Carolina, and West Virginia were relatively low as well, and below the U.S. average of 5.3 percent for the quarter.

Energy Prices Jump

Higher energy prices filtered through the Fifth District economy in the first quarter. Manufacturers, public utilities, and transportation firms in particular endured substantially higher energy costs during the period. Businesses with little pricing power, especially textiles and apparel firms, saw their profit margins squeezed as higher petroleum prices raised raw materials costs.

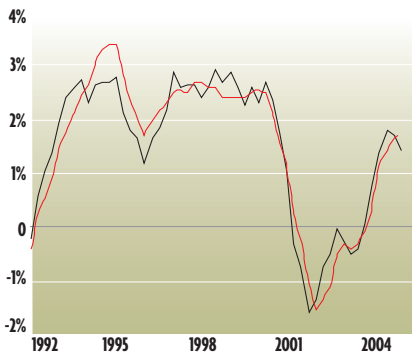
Other firms were able to pass at least some of their higher energy costs on to their customers. Consumers throughout the District grumbled as gasoline prices rose above \$2.00 per gallon at the pump in the first quarter. According to the consumer price index for the Washington, D.C.-Baltimore metropolitan area, energy prices in March 2005 were 14 percent higher than a year earlier.

Economic Indicators

	1st Qtr. 2005	1st Qtr. 2004	Percent Change (Year Ago)
Nonfarm Employment (000)			
Fifth District	13,262	13,074	1.4
U.S.	132,822	130,541	1.7
Real Personal Income (\$bil)			
Fifth District	885.4	844.6	4.8
U.S.	9,232.7	8,838.9	4.5
Building Permits (000)			
Fifth District	57.9	54.0	7.2
U.S.	469.2	442.4	6.0
Unemployment Rate (%)			
Fifth District	4.8%	5.1%	
U.S.	5.3%	5.7%	

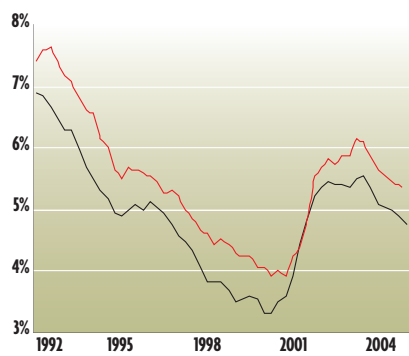
Nonfarm Employment

Change From Prior Year
First Quarter 1992 - First Quarter 2005



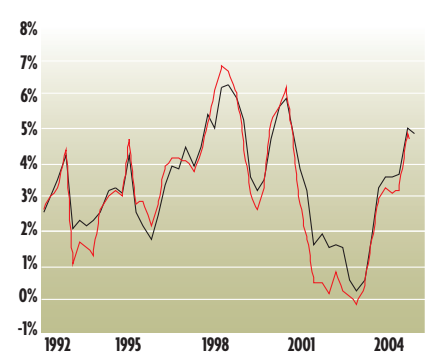
Unemployment Rate

First Quarter 1992 - First Quarter 2005



Real Personal Income

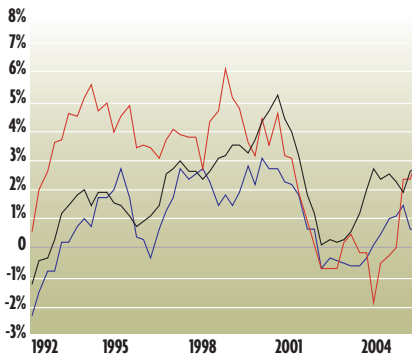
Change From Prior Year
First Quarter 1992 - First Quarter 2005



— Fifth District — United States

Nonfarm Employment Metropolitan Areas

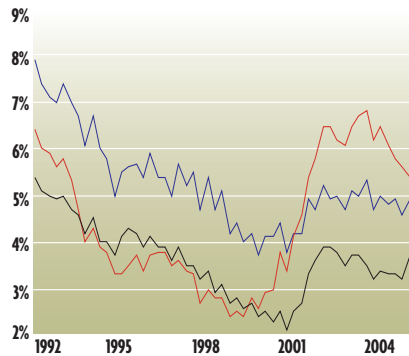
Change From Prior Year
First Quarter 1992 - First Quarter 2005



— Charlotte — Baltimore — Washington

Unemployment Rate Metropolitan Areas

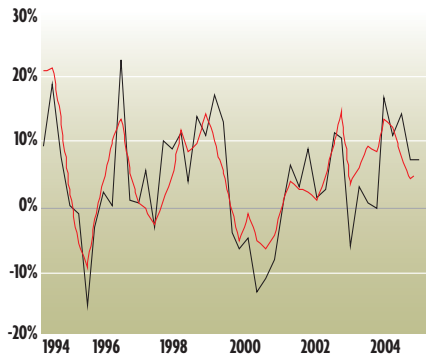
First Quarter 1992 - First Quarter 2005



— Charlotte — Baltimore — Washington

Building Permits

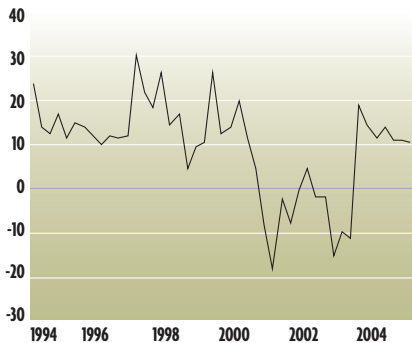
Change From Prior Year
First Quarter 1994 - First Quarter 2005



— Fifth District — United States

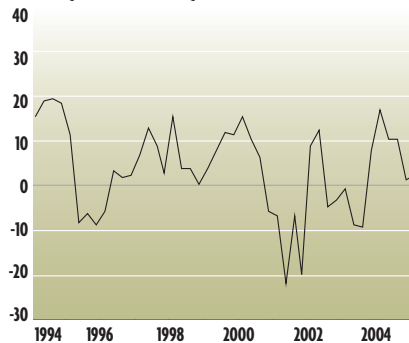
FRB—Richmond Services Revenues Index

First Quarter 1994 - First Quarter 2005



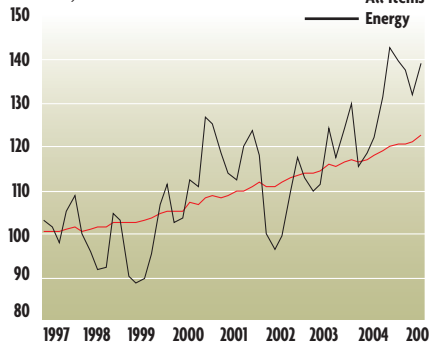
FRB—Richmond Manufacturing Composite Index

First Quarter 1994 - First Quarter 2005



Washington DC—Baltimore Metro Area Consumer Price Index

January 1997 - March 2005



— All Items — Energy

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 and building permits are not seasonally adjusted (nsa); all other series are seasonally adjusted.

SOURCES:

- Income: Bureau of Economic Analysis, U.S. Department of Commerce, <http://www.bea.doc.gov>.
- 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>.
- Consumer price index: Bureau of Labor Statistics, <http://stats.bls.gov>.

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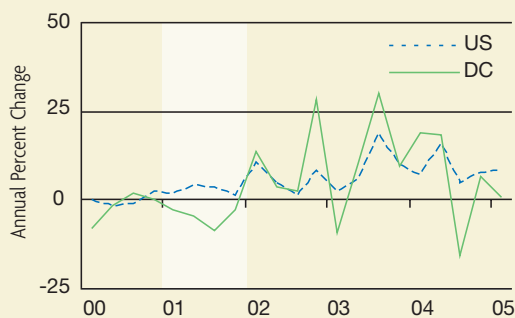
STATE ECONOMIC CONDITIONS

BY ANDREA HOLLAND

◆ District of Columbia

Economic conditions in the District of Columbia continued to gain momentum in early 2005. The first quarter saw a pickup in payrolls as well as a decline in the jobless rate and number of initial unemployment insurance claims. On the business front, venture capital investment followed the national trend and waned somewhat, but the residential and commercial real estate markets forged ahead.

DC Home Sales, Q1:00-Q1:05



NOTE: Shaded Area Represents Recessionary Period
SOURCE: Sales of Existing Housing Units, National Association of Realtors®

District of Columbia payrolls expanded 1.1 percent in the first quarter of 2005. Strong gains in the leisure and hospitality sector — boosted in part by National Cherry Blossom Festival-related tourism — offset modest job losses in other industry sectors. According to the Richmond Fed's most recent Beige Book, more than 1 million tourists attended the 93rd annual Cherry Blossom parade, a record for the event.

Indicators of household labor market conditions, such as initial unemployment insurance claims and the jobless rate, also showed improvement in the first quarter. Initial claims dropped 4.4 percent, a steeper decline than in most other Fifth District jurisdictions. The jobless rate also posted a significant drop — 0.7 percentage point — though much of the downward adjustment stemmed from the annual benchmark revision.

Venture capital investment was flat — the most recent data showed no venture investment activity in the District of Columbia between January and March of this year. The District of Columbia was not alone, though — 15 states nationwide also reported flat activity in the first quarter.

In real estate, the District of Columbia's residential market continued to gain ground in the first quarter. New building permit authorizations advanced strongly over the year as did sales of existing homes, which outpaced last year's level by 0.7 percent. Compared to other Fifth District jurisdictions, however, home sales in the District of Columbia advanced more slowly, possibly due in part to escalating home prices. In the

first quarter alone, prices shot up by 11.3 percent, bringing the four-quarter growth rate to 22.2 percent. As such, the District of Columbia ranked fourth nationwide in terms of price gains.

◆ Maryland

Maryland's economy grew on pace in the first quarter. The latest economic reports showed a rebound in job numbers and continued strength in the residential real estate market. Private investment into state businesses, however, expanded at a slower clip.

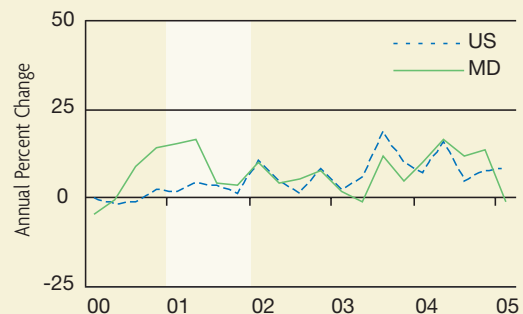
According to the Bureau of Labor Statistics, business hiring in Maryland continued to accelerate in the first quarter. Payrolls in the state expanded by 1.8 percent — or 11,067 jobs — accounting for nearly half of the Fifth District's total job growth. By sector, the bulk of the job creation came from the services side of the economy, with only the information sector reporting losses. In contrast, payrolls were trimmed across the board at goods-related establishments in the first quarter.

Tracking the pickup in hiring, initial unemployment insurance claims filed by Maryland residents fell 0.6 percent in early 2005 — encouraging, but less than the 5.4 percent decline recorded nationwide. Also little changed was unemployment. Maryland's jobless rate came in at 4.2 percent in the first quarter, matching the measures of both the prior quarter and a year earlier.

Compared to the state, employment activity in the Baltimore metropolitan statistical area was less bright. Metro area firms trimmed jobs by 7.6 percent in the first quarter, and the jobless rate inched 0.3 percentage point higher to 4.9 percent.

Venture capital activity declined in the first quarter — inflows were barely one-fifth of the level recorded in late 2004. Attracting more venture funds is a high priority in the state, with legislators recently pushing for the establishment of an Entrepreneurial Investment Technology Tax Credit,

MD Home Sales, Q1:00-Q1:05



NOTE: Shaded Area Represents Recessionary Period
SOURCE: Sales of Existing Housing Units, National Association of Realtors®

which early-stage investors could then apply toward their state income or insurance premium tax bill.

Maryland's residential real estate market advanced at a moderate pace in early 2005. New permit growth was robust, but sales of existing housing units backed off 10.1 percent in the first quarter. Even so, demand for housing remained strong enough to boost prices by 15.9 percent in the first quarter, the largest quarterly jump recorded districtwide.



North Carolina

Economic conditions in North Carolina blew hot and cold in the first quarter. Sluggishness persisted in state labor markets into early 2005, though indicators of business investment and real estate conditions continued to firm.

First-quarter employment activity was generally flat in North Carolina, with job losses outnumbering gains by only 200. Manufacturing and natural resources and mining establishments trimmed payrolls, as they had the previous quarter. Services companies also cut payrolls, with losses recorded in most industry sectors.

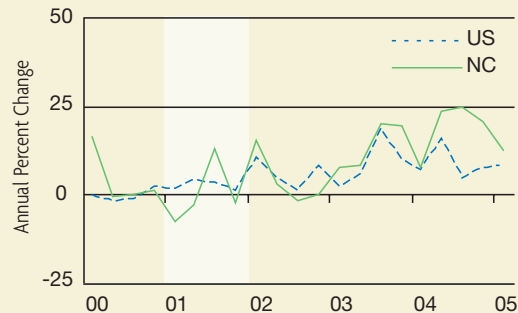
Reflecting lackluster payroll activity, North Carolina's jobless rate was little changed in the first quarter. The share of unemployed persons inched down 0.1 percentage point to 5.2 percent. Other measures of the labor market were less encouraging. Initial unemployment insurance claims, which are often viewed as a signal of future labor market activity, rose 7.1 percent in the first quarter — designating North Carolina as the only District state to record an increase in this measure. News from the job front was similar in some of North Carolina's largest metro areas, with first-quarter payrolls in Charlotte and Raleigh contracting 4 percent and 3.8 percent, respectively.

North Carolina has launched a number of programs in recent years to attract more high-salary jobs, one of the more recent of which is the proposed Defense Technology Innovation Center near Fort Bragg. The business incubator would assist North Carolina companies targeting government defense contracts.

The latest indicators of business activity in North Carolina were more encouraging, with venture capital investment coming in just shy of \$100 million in the first quarter. Although the first-quarter reading fell slightly short of late 2004 measures, North Carolina attracted the bulk of funding districtwide — accounting for more than 40 percent of total inflows.

Looking next at the residential real estate market, the most recent data suggest that the sector continued to firm. The number of first-quarter building permits issued in

NC Home Sales, Q1:00-Q1:05



NOTE: Shaded Area Represents Recessionary Period
SOURCE: Sales of Existing Housing Units, National Association of Realtors®

North Carolina exceeded the number authorized a quarter earlier by 39.8 percent.

Existing home sales also forged ahead, expanding 21.8 percent in the first quarter — the strongest increase districtwide. Continued demand has boosted the price of the state's housing stock, but at a more tempered pace than seen in other areas. Home prices rose by 7.4 percent in the first quarter, far less than the districtwide rate increase of 11 percent.



South Carolina

The economic upturn has advanced more slowly in South Carolina than in other District states, with improvement in the state's labor markets slow to take hold. The latest data suggest that employment and venture capital investment remain below their historical highs, though South Carolina's residential real estate market — buoyed by relatively moderate price increases — remained robust.

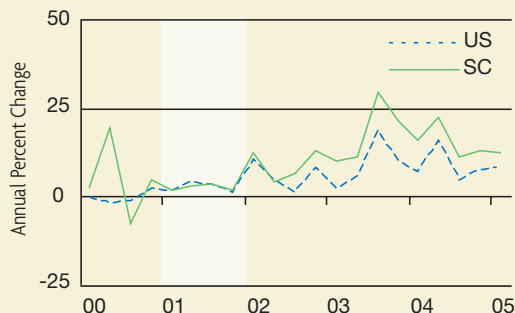
South Carolina payrolls declined an additional 0.2 percent in the first quarter, marking the third straight quarter of job losses. By sector, jobs were trimmed at all establishment types except trade, transportation, and utilities, leisure and hospitality, information, and construction. The weak job market was also reflected in South Carolina's unemployment rate, which edged up slightly to 7 percent in the first quarter.

Employment data from South Carolina's major metro areas told a similar story. Payrolls edged lower in Charleston and Columbia in the first quarter, falling 2.8 percent and 3.6 percent, respectively. The jobless rate also kicked up sharply in both areas — jumping from 4.6 percent to 6 percent in Charleston and 5 percent to 6.6 percent in Columbia.

News was also lackluster on the state's business front. Venture capital funding was generally flat in the first quarter,

Economic conditions in North Carolina blew hot and cold in the first quarter.

SC Home Sales, Q1:00-Q1:05



NOTE: Shaded Area Represents Recessionary Period
SOURCE: Sales of Existing Housing Units, National Association of Realtors®

totaling a modest \$200,000, a significant decrease from the \$13.3 million attracted a quarter earlier. Enhancing the skills of South Carolina's workforce would make the state more attractive to outside investors. Moving in this direction, Claflin University in Orangeburg was one of 12 colleges nationwide selected to receive \$750,000 in federal funding earmarked to prepare students for biotechnology jobs. Further, the U.S. Labor Department reported that surrounding high schools would eventually have biotech lessons incorporated into their curriculum as part of a long-term training program.

For now, though, the best news continued to come from South Carolina's residential real estate market. First-quarter permit authorizations expanded briskly compared to early 2004, with South Carolina posting the second strongest pick-up districtwide. Likewise, existing home sales came in above year-ago levels, although they moderated somewhat from the fourth-quarter level. The slight abatement in sales, however, was less pronounced than in most other District jurisdictions. Home prices in South Carolina moved up only 7 percent in the first quarter — the second slowest growth districtwide.

Virginia

The most recent measures of Virginia's economy were generally upbeat. Employment and investment activity continued to firm, while residential real estate activity remained steady, despite rising home prices.

Virginia firms boosted payrolls by 1 percent the first three months of 2005, and unemployment insurance claims retreated 0.6 percent. Jobs were added in all sectors except natural resources and mining, manufacturing, leisure and hospitality, and government. The jobless rate reflected the pickup in hiring at businesses, dropping 0.3 percentage point

Residential real estate activity in Virginia remained steady, despite rising home prices.

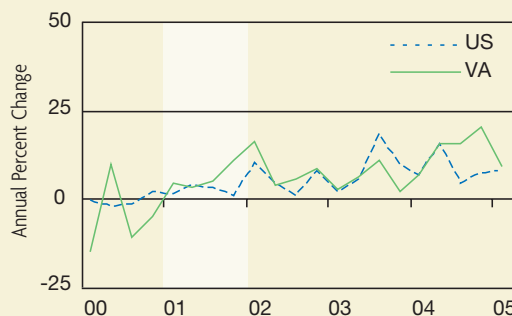
to 3.3 percent — the lowest unemployment rate districtwide.

The state's labor market is affected by military presence, ranking second only to California in defense employment and spending in 2003. As such, upcoming decisions from the Base Realignment and Closure Commission are of particular import — especially around the Norfolk metro area, which is home to nearly half of Virginia's military bases. In the first quarter, employment news from the Norfolk MSA wasn't as bright as reported statewide. Payrolls were trimmed 7.4 percent from late 2004, though they remained 1.7 percent higher over the year.

In state business conditions, recent reports were mostly favorable. According to first-quarter data, Virginia saw an increase in venture capital inflows — bucking a districtwide and national downturn. The first-quarter expansion in funding marked the second straight quarterly gain for the state, following three periods of decline.

Virginia's residential real estate market powered forward in early 2005. Compared to year-ago levels, new building permit authorizations rolled in at a slightly slower pace but first-quarter existing home sales were

VA Home Sales, Q1:00-Q1:05



NOTE: Shaded Area Represents Recessionary Period
SOURCE: Sales of Existing Housing Units, National Association of Realtors®

up 9.4 percent. Viewed against data from the fourth quarter of 2004, however, the pace of residential sales moderated — due partly perhaps to the sharp acceleration in Virginia home prices. In the first quarter alone, prices shot up by 15.2 percent, bringing the four-quarter growth rate to 18.6 percent — the 8th strongest increase nationwide.

West Virginia

First-quarter economic data suggest that West Virginia's economy continued to improve in early 2005. Although indicators of financial conditions at state businesses

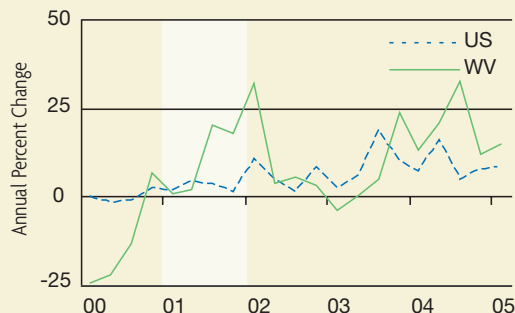
remained mixed, real estate and jobs activity were mostly positive across the board.

Payroll employment rose 1.5 percent in West Virginia during the first quarter of 2005, marking six quarters of positive job growth. Gains were reported in the majority of industry sectors — even manufacturers tacked on a few more jobs in early 2005 — but weakness persisted in natural resources and mining, information, financial activities, and education and health services. By comparison, news from the job front was not as bright in the Charleston metro area — first-quarter payrolls contracted 4.7 percent, and the jobless rate shot up 1.5 percentage points to 5.9 percent.

The pickup in hiring was not fully reflected in other first-quarter labor market indicators. West Virginia's jobless rate was unchanged in early 2005, holding fast at 5 percent. Further, initial unemployment insurance claims only retreated 0.1 percent in the first quarter, far less than the 5.4 percent decline seen nationally. Looking back over the year, however, improvement in these measures was more apparent — claims moved 12.8 percent lower and the jobless rate declined by 0.4 percentage point.

Recent employment and income gains have broadened home affordability in the state. According to recently released data by the Census Bureau, West Virginia had the lowest median home price nationwide in 2003 (\$78,201) just over half the national median price. Home prices in the state have risen steadily since then, but at a slower pace than

WV Home Sales, Q1:00-Q1:05



NOTE: Shaded Area Represents Recessionary Period
SOURCE: Sales of Existing Housing Units, National Association of Realtors®

recorded in other District states. For instance, first-quarter home prices kicked up only 4.3 percent in West Virginia, marking the slowest acceleration districtwide. West Virginians have taken advantage of the relative affordability of the state's housing stock, as reflected by the sustained volume in residential sales and building permits. Compared to a year ago, existing home sales in West Virginia stood 14.9 percent higher in the first quarter, and permit authorizations were up 6.5 percent.

Other recent indicators of business activity in West Virginia were less encouraging. First-quarter venture capital inflows were flat — following a surge of \$5.3 million in late 2004.

Behind the Numbers: Housing Bubble?

Economists disagree about both the definition of and the existence of a U.S. housing bubble. Deutsche Bank strategist Peter Garber says it's nearly impossible to identify a true bubble, while Yale economist Robert Shiller, author of *Irrational Exuberance*, offers this description: "a situation in which temporarily high prices are sustained largely by investors' enthusiasm rather than by consistent estimation of real value."

But how to gauge if prices are temporarily high? Among the traditional measures are the housing price index (HPI) and the price-to-rent ratio. In a recent study, the Federal Deposit Insurance Corporation (FDIC) looked at the HPI and said the number of "boom" markets grew by 72 percent last year, now encompassing 55 metropolitan areas, including five in the Fifth District. Nationally, the price-to-rent ratio grew by nearly 30 percent in the past five years. The FDIC notes that a housing boom seldom leads to a housing bust — which ought to give some reassurance to homeowners in the Washington, D.C., metro area, whose housing prices nearly doubled over the past five years.

— DOUG CAMPBELL

Top-Five Fifth District Markets in Home Price Appreciation Through Q1:05

Metro Area	Rank*	One-Year	Five-Year
Washington, DC	27	23.14	93.65
Baltimore, MD	45	20.96	76.04
Hagerstown, MD	58	20.19	68.20
Va. Beach-Norfolk, VA	59	22.12	67.56
Charlottesville, VA	63	17.23	64.51
Others			
Yuba City, CA	1	26.03	121.96
Los Angeles, CA	16	25.55	105.52
New York, NY	44	15.57	76.55
San Francisco, CA	66	17.50	62.88
Chicago, IL	95	10.57	45.10
Atlanta, GA	145	4.86	29.07

*Ranked by five-year change among 265 metro areas
SOURCE: Office of Federal Housing Enterprise Oversight

State Data, Q1:05

	DC	MD	NC	SC	VA	WV
Nonfarm Employment (000)	674.9	2,546.3	3,850.0	1,820.0	3,629.8	740.7
Q/Q Percent Change	1.1	1.8	0.0	-0.2	1.0	1.5
Y/Y Percent Change	0.6	1.6	1.3	0.1	2.4	1.0
Manufacturing Employment (000)	2.4	140.4	575.6	265.2	298.4	62.7
Q/Q Percent Change	-10.4	-5.1	-2.8	-5.1	-2.0	0.2
Y/Y Percent Change	-2.7	-1.9	-0.3	-0.8	0.0	-1.1
Professional/Business Services Employment (000)	143.1	380.7	434.7	183.2	591.5	58.0
Q/Q Percent Change	0.1	3.7	-1.8	-14.7	2.0	0.5
Y/Y Percent Change	0.8	3.0	2.6	-2.6	4.9	-0.7
Government Employment (000)	230.7	462.0	650.7	329.7	654.4	143.1
Q/Q Percent Change	-0.6	0.7	0.5	-1.8	-0.4	0.7
Y/Y Percent Change	0.0	-0.8	0.7	1.8	1.3	0.3
Civilian Labor Force (000)	305.1	2,896.4	4,283.7	2,073.0	3,855.3	792.2
Q/Q Percent Change	5.1	1.5	1.9	2.5	2.5	3.3
Y/Y Percent Change	2.1	0.6	0.9	2.0	1.6	0.3
Unemployment Rate (%)	8.0	4.2	5.2	7.0	3.3	5.0
Q4:04	8.7	4.2	5.3	6.9	3.6	5.0
Q1:04	7.6	4.2	5.8	6.7	3.7	5.4
Personal Income (\$bil)	27.4	209.7	239.7	108.5	255.3	44.9
Q/Q Percent Change	0.8	0.7	0.6	0.2	0.7	1.1
Y/Y Percent Change	4.1	4.6	4.9	4.0	5.5	4.6
Building Permits	565	7,745	22,161	12,650	13,460	1,336
Q/Q Percent Change	602.9	33.1	39.8	97.0	-6.0	132.4
Y/Y Percent Change	269.3	31.8	-0.8	33.5	-9.9	6.5
House Price Index (1980=100)	511.5	421.2	294.2	275.8	385.2	216.8
Q/Q Percent Change	11.3	15.9	7.4	7.0	15.2	4.3
Y/Y Percent Change	22.2	21.0	6.0	6.9	18.6	7.8
Sales of Existing Housing Units (000)	14.4	130.2	213.5	102.5	183.5	34.7
Q/Q Percent Change	-10.0	-10.1	21.8	-1.6	-6.3	-29.8
Y/Y Percent Change	0.7	-1.1	12.7	12.3	9.4	14.9

NOTES:

Nonfarm Employment, thousands of jobs, seasonally adjusted (SA); Bureau of Labor Statistics (BLS)/Haver Analytics, Manufacturing, thousands of jobs, SA; BLS/Haver Analytics, Professional/Business Services, thousands of jobs, SA; BLS/Haver Analytics Government, thousands of jobs, SA; BLS/Haver Analytics, Civilian Labor Force, thousands of persons, SA; BLS/Haver Analytics, Unemployment Rate, percent, SA; BLS/Haver Analytics, Personal Income, billions of chained 2000\$, Bureau of Economic Analysis/Haver Analytics, Building Permits, number of permits, NSA; U.S. Census Bureau/Haver Analytics, House Price Index, 1980=100, NSA; Office of Federal Housing Enterprise Oversight/Haver Analytics, Sales of Existing Housing Units, thousands of units, SA; National Association of Realtors®

Metropolitan Area Data, Q1:05

	Washington, DC MSA	Baltimore, MD MSA	Charlotte, NC MSA
Nonfarm Employment (000)	2,869.4	1,249.4	783.2
Q/Q Percent Change	-2.9	-7.6	-4.0
Y/Y Percent Change	2.8	0.7	3.2
Unemployment Rate (%)	3.7	4.9	5.4
Q4:04	3.2	4.6	5.6
Q1:04	3.4	5.0	6.5
Building Permits	8,304	2,100	4,734
Q/Q Percent Change	24.2	-71.9	8.2
Y/Y Percent Change	0.5	8.2	-5.1

	Raleigh, NC MSA	Charleston, SC MSA	Columbia, SC MSA
Nonfarm Employment (000)	266.1	274.1	343.5
Q/Q Percent Change	-3.8	-2.8	-3.6
Y/Y Percent Change	1.3	3.2	1.5
Unemployment Rate (%)	4.1	6.0	6.6
Q4:04	3.5	4.6	5.0
Q1:04	4.0	4.5	4.8
Building Permits	3,139	2,522	1,810
Q/Q Percent Change	5.3	125.1	45.2
Y/Y Percent Change	-16.9	51.8	10.0

	Norfolk, VA MSA	Richmond, VA MSA	Charleston, WV MSA
Nonfarm Employment (000)	744.0	606.6	147.2
Q/Q Percent Change	-7.4	-2.1	-4.7
Y/Y Percent Change	1.7	2.2	0.6
Unemployment Rate (%)	4.1	3.8	5.9
Q4:04	4.4	4.0	4.4
Q2:04	4.6	4.3	5.2
Building Permits	2,427	2,820	68
Q/Q Percent Change	-26.5	209.0	0.0
Y/Y Percent Change	-1.5	30.0	-18.1

For more information, contact Andrea Holland at 804-697-8273 or e-mail Andrea.Holland@rich.frb.org.