Fifth District Economic Report

After three years of robust growth, the Fifth District economy moderated in 2006, much like the national economy that it closely tracks. The well-documented slowdown in housing contributed to this deceleration. But the housing market's retreat was not enough to significantly dampen regional activity. Moreover, residential investment accounts for only a small portion of total U.S. output—just 6 percent. It would take a much larger contraction than we saw in 2006 to weaken consumer spending.

Total Payroll Employment

	December 2006 (thousands of jobs)	% Change from December 2005
Fifth District	13,729	1.5
United States	137,147	1.7
District of Columbia	695	1.2
Maryland	2,612	1.7
North Carolina	4,000	1.4
South Carolina	1,907	1.7
Virginia	3,755	1.5
West Virginia	760	1.0

Sources: Bureau of Economic Analysis/Haver Analytics
Note: All data are seasonally adjusted.

Most economic measures during 2006 pointed upward in the District, just not as sharply as in recent years. Persistent growth in services-related businesses—such as health care and financial services—and solid employment gains across most of the District indicate underlying strength that so far has counterbalanced softer portions of the economy, including the long-struggling manufacturing sectors.

Employment

It was an up-and-down year in the Fifth District labor market. The region added about 203,000 jobs during 2006, a 1.5 percent increase. Unemployment dropped 0.3 percentage points compared with the close of 2005 to 4.4 percent, beating the national average of 4.5 percent. Though the overall story was of a strong performance, it really was one of a fast start followed by a loss of steam. January 2006 began with joblessness at 4.1 percent, and the rate crept up over the course of the year as the market cooled.

Job prospects differed across the region, with manufacturing-heavy South Carolina posting the highest unemployment rate at 6.6 percent, and Virginia, abundant in stable government and growing services jobs, reporting the lowest at 2.9 percent. West Virginia and Washington, D.C., were alone among District jurisdictions in seeing their jobless rates worsen compared with the previous year. Across the District, the healthiest advances were seen in services-oriented urban areas, with rural parts weaker.

The overall expansion of employment in the District masked considerable variation among specific industries. Manufacturing employment declined by 1.8 percent over the course of the year, as the sector shed 23,300 jobs. This hit was felt strongest in North Carolina, which accounted for more than half that loss with 13,600 jobs eliminated. Yet North Carolina ended up gaining more than 56,000 jobs on the year, with a large share of those in its thriving health and professional services sectors. Likewise, Maryland's addition of roughly 44,000 jobs came despite losses in manufacturing and a sluggish financial sector. The state's gains were powered mostly by the education and health care, leisure and hospitality, and professional and business services sectors. Competition for skilled workers was strong, especially in large metropolitan areas like Washington, D.C., and Charlotte, and there were some reports of employers having difficulty with recruiting.

Households

The District's fair performance in the labor market can be seen in household financial conditions. While national real personal income climbed 3.6 percent in 2006, our region's rate of income growth trailed slightly at 3.5 percent. Three of the Fifth District's jurisdictions topped the national average: North Carolina at 4 percent; West Virginia at 3.8 percent; and Washington, D.C., at 3.7 percent. In 2005, all of the District's jurisdictions except North Carolina beat the national pace.

Real Personal Income

	Fourth Quarter 2006 (billions of chained 2000 dollars)	% Change from Fourth Quarter 2005
Fifth District	922	3.5
United States	9,604	3.6
District of Columbia	29	3.7
Maryland	219	3.1
North Carolina	253	4.0
South Carolina	113	3.6
Virginia	264	3.4
West Virginia	45	3.8

Sources: Bureau of Economic Analysis/Haver Analytics
Note: All data are seasonally adjusted.

The number of personal bankruptcies plunged across the District and nation in 2006 with sweeping reforms to federal bankruptcy laws. But after the initial dip, filings began to grow, with each jurisdiction in the District reporting personal bankruptcies at least 25 percent higher in the fourth quarter than in the first. The ability of households to keep up with mortgage payments worsened nationwide and in the District. At the end of the year, 3.3 percent of U.S. mortgages were past due 30 days or more, with 49 out of 51 states seeing overall rates increase. By comparison, 3.4 percent of mortgages were late in the Fifth District, up 0.3 percentage points from 2005. West Virginia reported the toughest conditions on this front, with a 0.6 percentage point increase in delinquencies to 4.8 percent.

Business

The financial health of Fifth District businesses was mixed in 2006. Our monthly surveys of business conditions pointed to contraction in retail establishments. Sales were brisk at the start but as the year drew to a close, retailers generally reported weakening revenues as well as declines in employment. Managers with non-retail service establishments, however, indicated decent growth in both revenue and employment throughout the year.

As reflected in labor market measures, manufacturers in the District saw continued pullback, with new orders trending downward over the course of the year. Our composite index of manufacturing activity says it all: 2006 began with gains, followed by pointed retreats. This pattern repeated itself throughout the year, but with each gain smaller than the last.

This trend of moderation as 2006 progressed was also reflected in business bankruptcy filings. Though, as with personal filings, business bankruptcies dropped off significantly from the year before because of stricter new filing rules, they inched up steadily through the seasons. The number of firms seeking protection from creditors rose 7.7 percent from the first quarter to the second; 13.3 percent from the second to the third; and 7.8 percent from the third quarter to the last. From the first quarter to the last, Fifth District business filings grew a sizable 31.6 percent. Still, this was lower than the national pace of 36.7 percent.

Venture capital—money typically provided to new businesses with strong growth prospects—flowed into the District. The 2006 total was $1.6 billion, a 10 percent increase over 2005. As would be expected, more than 90 percent of those funds were invested into firms in three states: Maryland, North Carolina, and Virginia, in that order.

Housing and Commercial Real Estate

No report on annual economic activity in 2006 would be complete without mention of the housing market. What's important to note is that, at least for our region, the run-up in housing prices over the past five years appears to have been based by and large on fundamentals, not speculation. But the slowdown is affecting District conditions. Existing home sales in our region fell 14.6 percent over the year. The biggest drop was the 26.2 percent decline registered in Virginia, followed by the District of Columbia, and Maryland. North Carolina's decrease of 1.5 percent was by far the smallest.

Yet home prices were resilient: Fifth District home prices were actually 7.8 percent higher than the year before, though the increase was well off the 17 percent annual increases that were the norm in the early part of 2005. Housing starts were down toward the end of the year. The biggest declines, however, were mostly confined to large metro areas. And the decline in housing permits was still less pronounced than the national trend. In the world of commercial real estate, office vacancy rates fell across the largest metro areas in the District. The most significant tightening occurred in Baltimore, where office vacancies dropped from 15 percent to 11.4 percent.

Outlook

2007 is shaping up much like the latter months of 2006. Economic performance more than ever is tied to location and industry. Growth is centered in the services sector, particularly health care, tourism, and professional services. Demand for skilled workers in those industries is fierce and some labor shortages have been reported. Still, through the first few months of 2007, the District is adding jobs at a slower pace than the national economy. Both retail and manufacturing activity have been softer. Not surprisingly, manufacturing-dependent states like West Virginia and South Carolina continue to experience weaker employment than Maryland and Virginia. Metro areas are seeing the strongest job markets, but their housing markets are also seeing some of the biggest retreats. The weakness in housing has been generally persistent throughout the first half of 2007, but many analysts expect the market to strengthen toward the end of the year. How the rest of the story of the Fifth District economy unfolds remains to be seen.

Note: The data presented and discussed above are accurate as of April 25, 2007, but subject to later revision.

Richmond Fed Economic Resources

5E Indicators
Published monthly by the regional economics section of the Federal Reserve Bank of Richmond, after the release of the monthly state employment and unemployment data.
www.richmondfed.org/research/regional_conditions/5e_indicators

Manufacturing Survey
Monthly survey of manufacturing managers in the Fifth District on economic conditions.
www.richmondfed.org/research/regional_conditions/manufacturing_conditions

Services Sector Survey
Monthly survey of managers at retail and services firms in the Fifth District on economic conditions.
www.richmondfed.org/research/regional_conditions/service_sector

Beige Book
Summary of commentary on current economic conditions by Federal Reserve District.
www.federalreserve.gov/FOMC/BeigeBook/2007

Region Focus
Quarterly magazine of the Richmond Fed providing information and analysis about the economy of the Fifth Federal Reserve District.
www.richmondfed.org/publications/economic_research/region_focus