Fifth District Economic Report

The Fifth District economy continued to expand in 2007, albeit at a slower pace than in 2006. The District economy opened the year on generally solid footing, but lost traction in the second half of 2007 as the ongoing downturn in the region's housing market intensified and began to spread to other sectors. Overall, however, the District economy generally outperformed the nation in 2007, according to a number of key measures. Growth in the region continued to be propelled by the strength of its major metropolitan areas.

Labor Market Conditions

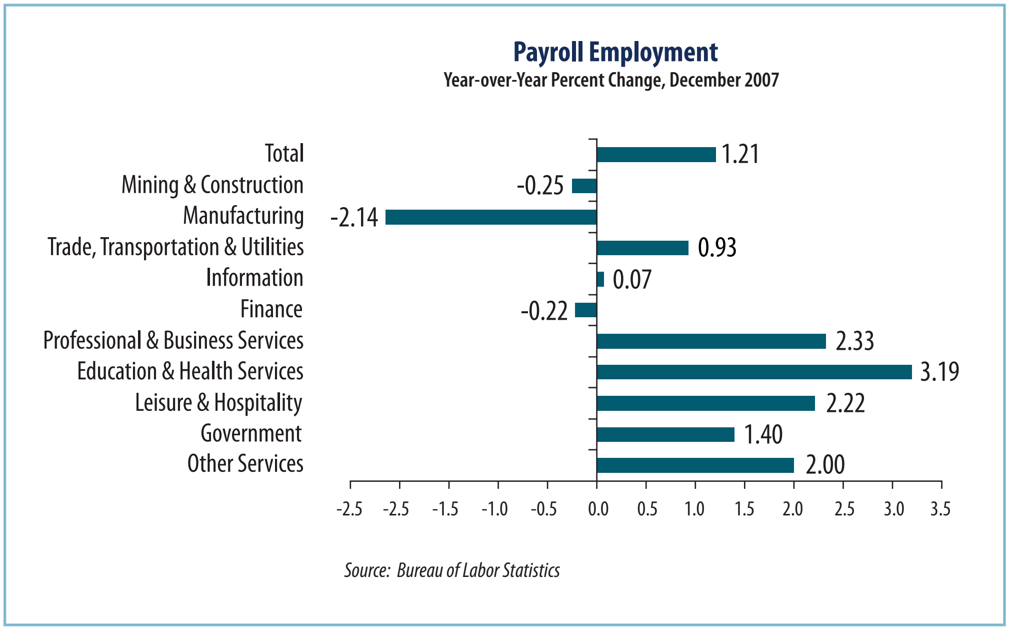
Fifth District businesses continued to add jobs at a healthy clip in 2007, though the pace of hiring cooled a bit from recent years. District payrolls expanded by 1.2 percent (166,800 jobs) in 2007, compared to a 2.2 percent (304,600 jobs) increase the previous year. Despite the moderation, job growth in the region outpaced the nation, with U.S. payrolls up just 0.8 percent (1.1 million jobs).

Job growth in the District, as well as the nation, continued to be centered in the services side of the economy. However, jobs data show that gains in that sector were concentrated in just three industries—leisure and hospitality, professional and business services, and educational and health services. These industries comprise less than a quarter of the region's total workforce, but accounted for 77 percent of the new jobs in 2007.

In contrast, the goods-producing side of the region's economy experienced sharp employment declines during the year. District factories trimmed payrolls for the ninth consecutive year, cutting 27,400 jobs since the end of 2006. Employment numbers from the District's construction sector were also weak as the housing slump intensified over the course of the year. Builders cut over 2,000 jobs in 2007, compared to the previous year's gain of 27,900 jobs.

Employment gains in the District were somewhat uneven across jurisdictions. Job growth maintained its momentum in Maryland, Virginia, and Washington, D.C., some of the region's most service-dominated economies. On the flip side, South Carolina and West Virginia—states more reliant on goods-producing industries—saw a notable softening in payroll growth in 2007. North Carolina—with the District's largest manufacturing presence—was somewhat of an exception. Job growth in the Tarheel state fell short of its 2006 pace, but was still the strongest in the District. North Carolina payrolls were up 1.9 percent in 2007, accounting for nearly half of the region's employment growth for the year.

Drilling down, the data show that employment growth is becoming increasingly concentrated in the District's major metropolitan areas. Over 63 percent of the region's total job gains in 2007 occurred in the District's ten largest metro areas—Baltimore, Md.; Charleston, S.C.; Charlotte,



N.C.; Columbia, S.C.; Greensboro, N.C.; Greenville, S.C.; Raleigh, N.C.; Richmond, Va.; Virginia Beach, Va.; and Washington, D.C. The D.C. metro area alone was home to over 13 percent of District payroll growth in 2007. Despite Washington D.C.'s impressive performance, it was the Charlotte and Raleigh areas that posted the strongest job growth last year. Those areas saw payrolls expand 2.5 and 4.3 percent, respectively, over their 2006 totals, while employment in the D.C. metro area was up only 0.8 percent.

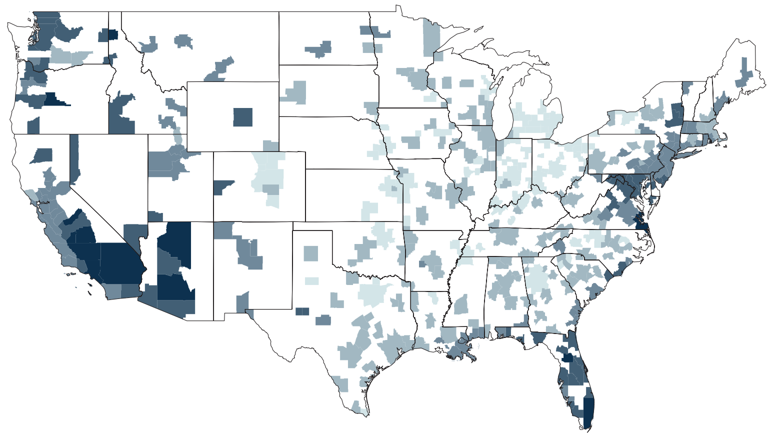
Household Conditions

Reports on the economic condition of District households were generally in line with the overall assessment of the region's economy: not quite as strong as 2006, but still solid and generally on par with the United States. Although the District's unemployment rate fluctuated throughout 2007, it finished the year with an increase of just one-tenth of a percentage point at 4.3 percent. Despite the increase, the District's rate continued to track below the national average, which climbed six-tenths of a percentage point in 2007 to finish at 5.0 percent. By jurisdiction, the numbers were mixed. Rates edged up slightly in South Carolina, Virginia, and West Virginia, moved lower in Washington, D.C., and Maryland, and remained unchanged in North Carolina. Conditions at the metro area level were more uniform. Unemployment rates inched higher in seven of the region's ten largest metropolitan statistical areas, while rates in the other three either edged lower or remained unchanged. Nonetheless, the District's major metro areas still tended to fare better than the nation. Only the Columbia and Greenville areas posted unemployment rates above the U.S. mark in 2007.

Data on household balance sheets indicated that income growth softened in 2007. District incomes were up 2.1 percent for the year, compared to a 4.0 percent increase a year earlier. Income growth at the state level was generally in line with the District with the exception of West Virginia, where household incomes increased by only 1.4 percent.

In other news, non-business bankruptcies in the District were up 26.4 percent during the first nine months of 2007—a sizable jump but not quite as sharp as the national increase of 27.7 percent. Maryland posted the District's highest gain with bankruptcies surging 45.1 percent, while North Carolina reported a District-low increase of 9.4 percent.

Change in U.S. Home Prices by MSA
Percent Change 1Q:03 – 4Q:07



Source: Office of Federal Housing Enterprise Oversight

Housing Market Conditions

The leading economic development of 2007 was the correction in the nation's housing markets, which was deeper than anticipated. Although the Fifth District experienced a housing slump, the drag, on average, was less than in the U.S. economy. Strong demand for housing—fueled by solid job growth and in-migration—helped curb the housing slide in the District. The District's housing market also benefited from the fact that price growth across most of the region has been more moderate in recent years. Nationwide, markets exhibiting the most pronounced declines in housing activity—areas like the Northeast corridor and portions of the West Coast—tended to experience sharp increases in home prices over the last several years.

The pace of home price appreciation in the District—as measured by the Office of Federal Housing Enterprise Oversight's House Price Index—cooled throughout 2007. The average home price in the region was up 1.0 percent during the year—compared to a 5.9 percent increase in 2006—while U.S. prices inched up only 0.8 percent. In some localities housing market conditions were even stronger. Home price appreciation rates were double the U.S. average in eight out of the District's ten largest metro areas, including four markets—Columbia, Greenville, Raleigh, and Charlotte—which actually saw price growth accelerate in 2007.

On the construction front, residential permit activity in the District was down 20.2 percent for the year, while U.S. totals fell 24.9 percent. Fifth District declines in home sales, on the other hand, were a bit more pronounced. Existing home sales in the region fell 16.8 percent from their year-ago pace, compared to a drop of only 13.7 percent nationally. District sales were pushed lower by sharp declines in Maryland and Virginia, both of which saw sales activity slip to a ten-year low.

Another important story in 2007 was subprime loans. However, the data suggest that subprime mortgages have been somewhat less of a factor in the Fifth District than in the nation. As of the fourth quarter of 2007, subprime loans made up only 10.5 percent of the region's total mortgage pool compared to the U.S. share of 12.7 percent. In addition, delinquency rates on subprime mortgages were generally below the U.S. average in most District jurisdictions.

Business Conditions

For most of last year, the U.S. housing sector malaise was largely contained. However, as the pullback in activity intensified over the course of the year, spillovers into other sectors became more apparent. The Fifth District economy was no exception.

The effects of the housing slide were especially apparent at District factories. Our survey readings on manufacturing were persistently weak in 2007. Activity was particularly soft in housing-related businesses, such as furniture and building material producers. On a brighter note, production activity was buoyed a bit during the year by stronger overseas demand for U.S. goods due to a weakening dollar. The retail sector saw District sales activity drift lower throughout the year, dragged down by weak housing-related spending and softness in big-ticket categories. In addition, District merchants reported generally lackluster holiday sales.

Not surprisingly, given the strong employment growth in the sector, reports from service providers were more upbeat. District service providers—particularly business consulting and healthcare firms—continued to post strong revenue growth in 2007, though the pace of growth tapered off somewhat in the year's final months.

Looking Ahead

National and local economic conditions softened a bit in 2007 and most major, national economic forecasts are anticipating rather sluggish growth. Nevertheless, the data indicate that solid economic fundamentals remain in place throughout the Fifth District—particularly in its growing urban centers—which suggest the potential for the region's economy to continue to outperform the United States as we enter 2008.

The data presented and discussed are accurate as of March 27, 2008.