Fifth District Economic Report

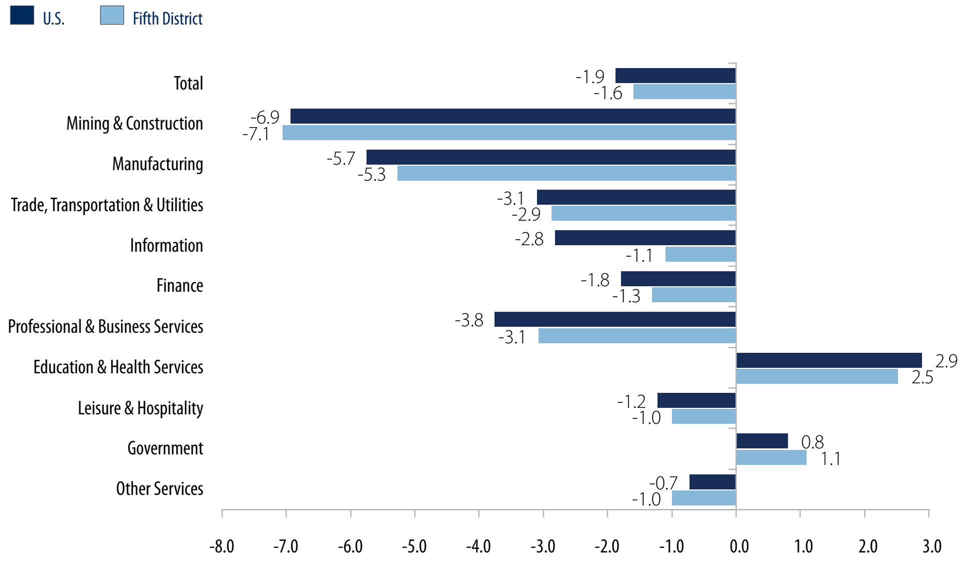
The Fifth District economy weakened in 2008 as the housing market malaise deepened and infected all sectors and jurisdictions of the District. The economic uncertainty that gripped the nation in 2008 did not spare the Fifth District. Credit conditions tightened, hiring activity declined steadily, and the increased cost of energy and food in the first half of the year hurt the bottom lines of District households and firms. Furthermore, the deterioration in housing conditions that had been concentrated in the northern regions of our District (District of Columbia, Maryland, and Virginia) spread to the Carolinas. Nonetheless, the Fifth District continued to outperform the nation on a number of key measures.

Labor Market Conditions

The Fifth District economy shed 287,600 jobs (2.1 percent) in 2008 after five years of payroll expansion. The District job market fared slightly better than the national market, where employment declined 2.2 percent in 2008.

Hiring activity in the District's goods-producing sector was particularly downbeat as those industries shed 161,600 jobs over the year, more than three times the losses in 2007. Builders alone cut over 81,000 jobs as employment in the construction industry contracted 9.6 percent — its worst performance in more than 10 years. Employment reports from the service sector were also grim as firms shed 125,600 jobs in 2008, with the trade, transportation, and utilities industry alone cutting 102,600 workers.

Payroll Employment
Year-over-Year Percent Change, December 2007–December 2008



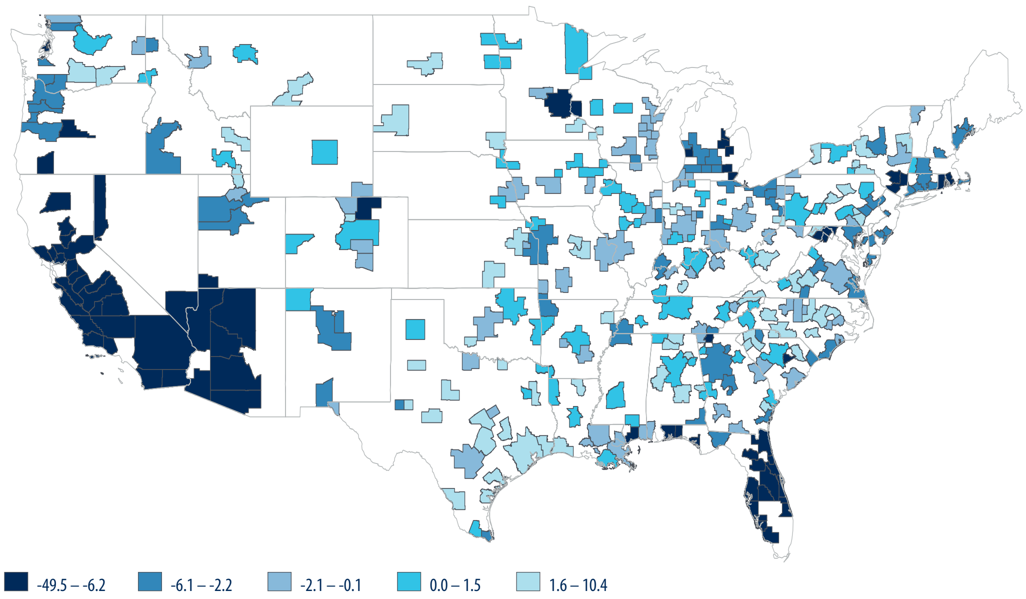
Sources: Bureau of Labor Statistics, Haver Analytics

All service-sector industries outside of education and health services, and government posted employment declines over the year.

Employment also contracted across District jurisdictions in 2008. North Carolina and South Carolina shed 3.0 percent and 3.3 percent of their workforces, respectively, as firms cut workers in each month of the last two quarters. Employment in Maryland and Virginia contracted 1.7 percent and 1.5 percent, respectively, for the first annual contraction in either state since 2001. Only the District of Columbia added jobs (6,400) over the year. The deeper losses in the Carolinas were due partly to the larger drops in goods-producing and trade-oriented employment in those states. In North Carolina, the construction industry, the manufacturing industry and the trade, transportation, and utilities industry accounted for 71.9 percent of total job losses. In South Carolina, the three industries accounted for 58.4 percent of job losses. In addition, North Carolina's professional and business services industry struggled as firms cut 29,500 jobs (5.8 percent) in 2008.

Metro-level labor markets weakened considerably as employers in the Fifth District's major metropolitan areas shed 154,700 jobs in 2008. Only three metro areas in the District posted payroll gains over the year — Durham, N.C.; Charleston, W.Va; and Morgantown, W.Va. Meanwhile, six metro areas lost over 10,000 jobs in 2008: Charlotte, N.C. (31,900); Baltimore, Md. (24,900); Richmond, Va. (16,500); Greensboro-High Point, N.C. (15,900); Raleigh, N.C. (11,100); and Virginia Beach, Va. (10, 400).

Change in U.S. Home Prices by MSA
Percent Change 4Q:07 - 4Q:08



Source: Federal Housing Finance Agency

Housing Market Conditions

The slowdown in national and Fifth District housing markets that began in 2007 worsened in 2008. Mortgage delinquency and home foreclosure rates continued to rise across Fifth District jurisdictions as existing home sales, house prices, and new residential construction levels fell. In particular, housing conditions in North Carolina and South Carolina — where markets had posted sales and price gains well after the northern parts of the District began to soften — started weakening in the spring and early summer.

One of the big stories of 2008 was the rise in delinquency and foreclosure rates across the nation, particularly in the subprime mortgage market. Although the percentage of total mortgage loans to subprime borrowers remained lower in the Fifth District than in the nation, and the foreclosure rate in the District was below the national mark throughout 2008, delinquency rates rose across District jurisdictions.

Fifth District house prices fell 3.7 percent in 2008, as measured by the Federal Housing Finance Agency's House Price Index. The District house price depreciation was less severe than the national depreciation of 4.5 percent, reflecting the 1.1 percent and 0.3 percent average house price growth in North Carolina and South Carolina, respectively. Although house prices in the Carolinas began to fall in the third quarter of 2008 (for the first time since the early 1980s), prices grew over the year. Without the appreciation in the Carolinas and the roughly stagnant prices in West Virginia, the Fifth District house price decline would have been steeper than that of the nation, with 6.0 percent depreciation in the District of Columbia, 7.7 percent depreciation in Maryland, and 4.6 percent depreciation in Virginia.

Much of the housing downturn in Maryland and Virginia was fueled by the softening of the Washington, D.C., metro area market, where house prices fell 12.1 percent in 2008. Other metro areas in Maryland and Virginia also saw falling house prices, although none dropped as sharply as those in the D.C. metro area.

In certain housing measures, the Fifth District began to look a bit weaker than the nation in 2008. Residential permit levels fell 51.4 percent in the Fifth District compared to 46.5 percent in the nation as a whole. Furthermore, existing home sales in the Fifth District fell 21.9 percent over the year, while sales in the United States fell 5.9 percent.

Household Conditions

Considering labor and housing market conditions, it is not surprising that the economic circumstances of District households deteriorated in 2008. At 6.6 percent, the District unemployment rate ended 2008 below the national 7.2 percent mark, although joblessness grew on par with the national year-over-year increase of 2.3 percentage points.

Joblessness soared in Fifth District jurisdictions in 2008. The largest increase was in North Carolina, where unemployment jumped 3.1 percentage points to end the year at 8.1 percent. The highest unemployment rate was 8.8 percent in South Carolina — 3.0 percentage points above the mark at the end of 2007. Meanwhile, the District of Columbia rate climbed to 8.2 percent from 5.8 percent, Maryland unemployment rose to 5.4 percent from 3.6 percent, and Virginia jumped to 5.0 percent from 3.3 percent.

On a more positive note, households were buoyed by growth in real personal income that spread across Fifth District jurisdictions.

Personal income growth surpassed the national rate of 0.5 percent in every jurisdiction over the year, leaving the District with a combined real personal income growth of 1.0 percent.

Business Conditions

District businesses struggled in 2008 with declining demand, tightening credit conditions, and general economic uncertainty. In addition, the rising cost of energy in the first part of the year strained firms' profit margins.

The general decline in the manufacturing industry was buoyed a bit in the beginning of 2008 by growing export activity fueled by a weak dollar and strong overseas demand. Over the year, however, the globalization of the economic malaise and the weakening of the dollar reduced international demand for U.S. goods, and exports began to decline. The Federal Reserve Bank of Richmond's survey readings on manufacturing activity fell to record lows in the second half of the year.

Another big story of 2008 was the tightening of credit conditions that was evident across the nation and the Fifth District. More stringent mortgage loan requirements continued — and deepened — in 2008, but the problems in the banking sector translated into increased difficulty obtaining credit for non-mortgage loans as well. Therefore, in addition to weaker demand and general economic uncertainty, the difficulty obtaining credit and the increased cost of borrowing curtailed activity and negatively impacted capital expenditures in 2008 and planned expenditures for 2009. This has been particularly true for manufacturing and construction firms. Even when credit has been extended, uncertainty about the future has made firms more reluctant to incur debt; in other words, evidence suggests that the supply of and demand for credit has fallen. Throughout 2008, commercial developers noted delays and cancellations of construction projects.

The service sector also contracted over the year. The Richmond Fed survey index of retail revenues was in negative territory throughout 2008, as sales of big-ticket items — such as automobiles and furniture — declined steadily. Shopper traffic also dwindled as consumers suffered from rising food and energy costs in the beginning of 2008, and heightened economic uncertainty in the second half of the year. District retailers reported lackluster holiday sales. Meanwhile, although services firms generally outperformed retailers, even services firms' revenues deteriorated steadily over 2008, with the index hitting a near-record low in the last month of the year.

Looking Ahead

The Fifth District's economy softened along with the nation's in 2008, and remained weak as it headed into 2009. It seems likely that housing markets in the northern parts of the District will begin to stabilize toward the middle-to-end of 2009, which should relieve households, strengthen firms, and bolster labor market conditions. The slowdown in lending and planned capital expenditures could affect firms for years to come, but some positive economic developments are expected in the Fifth District — led by the more service-oriented urban areas — toward the end of 2009.

The data presented and discussed are accurate as of March 24, 2009.