

# DISTRICT ECONOMIC OVERVIEW

BY ANDREA HOLMES

**F**ifth District economic activity grew more slowly in the second quarter with a continued deceleration in housing activity combined with some downshifting in the manufacturing and retail sectors. Labor markets remained generally on track though, with solid job growth and a large influx of job seekers.

## Housing Market Slows

Activity in District housing markets slowed further from April to June of this year. The National Association of Realtors reported that home sales during the quarter declined 1.4 percent. The slowdown was most pronounced in Washington, D.C., where real estate agents noted a deceleration in buyer traffic and resale volume and added that market inventory had tripled from year-earlier levels. The downshift in demand appears to have weighed on the pace of home price appreciation in many areas: Second-quarter District home prices rose only 6.8 percent in the period, the lowest quarterly growth rate in three years.

## Manufacturing Output Dwindles

Momentum in the Fifth District's manufacturing sector wound down somewhat in the second quarter, after expanding briskly in the first

**Both service-producing and retail businesses noted that price pressures eased slightly from April to June.**

three months of the year. Slower activity occurred in factory shipments, new orders, and capacity utilization. District manufacturers cut back on hours, though not employee numbers during the period. The length of the average workweek contracted sharply, but factory employment was little changed and wage growth maintained its solid pace of recent months.

Manufacturers reported that the prices of raw materials and finished goods grew more moderately from April to June, but contacts remained alert to increasing price pressures. Some respondents, such as a North Carolina plastics producer, planned to raise prices in coming months.

## Services Revenues Robust

Activity at Fifth District services firms expanded at a healthy clip in the second quarter, with revenue growth

picking up the pace and employment and wage growth rising steadily over the period. Also positive, financial services establishments in Richmond, Va., and Baltimore, Md., reported that business remained fundamentally strong, though they said that clients were exercising more caution as interest rates rose.

The latest news from District retailers was less upbeat, however, with contacts reporting a deceleration in sales activity following strong growth early in the year. Big-ticket sales, in particular, declined sharply by midyear, with contacts at two large building supply stores attributing the drop-off to lower construction activity and higher energy prices. Fifth District contacts from both service-producing and retail businesses noted that price pressures eased slightly from April to June.

## Labor Markets Steady

District labor markets remained generally strong outside of slower retail hiring. Compared to the first quarter, districtwide payrolls advanced at a 1.7 percent annual rate in the second quarter, outpacing the 1.2 percent rate nationwide. Demand for employees in the professional and business services sector was especially strong, as evidenced by a Raleigh, N.C., temporary employment contact who noted a shortage of workers with administrative and technical skills.

The District's unemployment rate inched up to 4.3 percent in the second quarter, as solid growth in jobs was more than matched by a sizeable increase in job seekers. Despite this imbalance, the District unemployment rate remained well below the 4.8 percent rate posted a year earlier. By state, the second-quarter jobless rate moved higher in all District jurisdictions except North Carolina, where the unemployment rate was unchanged. **RF**

## Economic Indicators

	2nd Qtr. 2006	1st Qtr. 2006	Percent Change (Year Ago)
<b>Nonfarm Employment (000)</b>			
Fifth District	13,636	13,579	1.9
U.S.	135,128	134,722	1.4
<b>Real Personal Income (\$bil)</b>			
Fifth District	911.1	906.2	3.2
U.S.	9,496.9	9,434.3	3.8
<b>Building Permits (000)</b>			
Fifth District	64.2	63.9	-7.9
U.S.	529.5	492.3	-10.3
<b>Unemployment Rate (%)</b>			
Fifth District	4.3%	4.1%	
U.S.	4.6%	4.7%	

### Nonfarm Employment

Change From Prior Year  
First Quarter 1993 - Second Quarter 2006



### Unemployment Rate

First Quarter 1993 - Second Quarter 2006

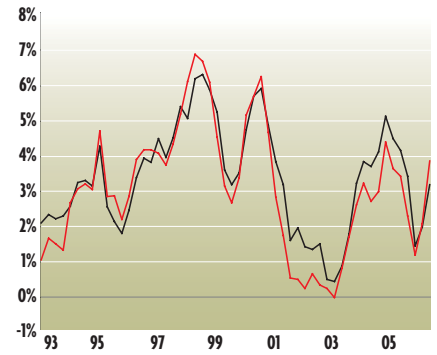


— Fifth District

— United States

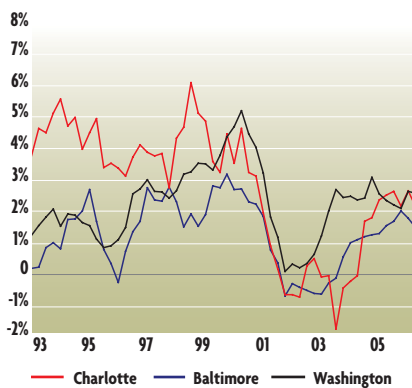
### Real Personal Income

Change From Prior Year  
First Quarter 1993 - Second Quarter 2006



### Nonfarm Employment Metropolitan Areas

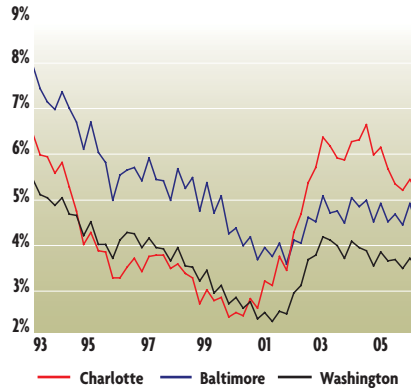
Change From Prior Year  
First Quarter 1993 - Second Quarter 2006



— Charlotte — Baltimore — Washington

### Unemployment Rate Metropolitan Areas

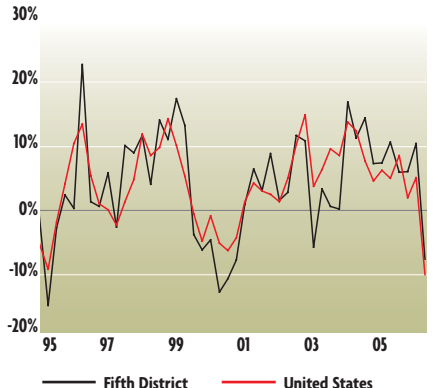
First Quarter 1993 - Second Quarter 2006



— Charlotte — Baltimore — Washington

### Building Permits

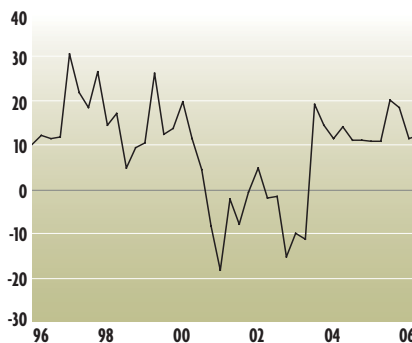
Change From Prior Year  
First Quarter 1995 - Second Quarter 2006



— Fifth District — United States

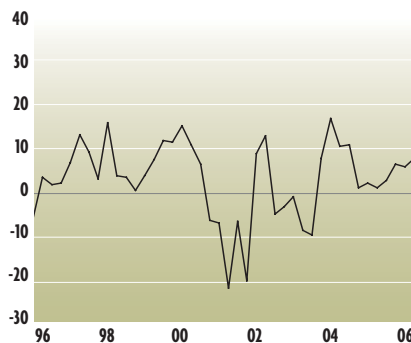
### FRB—Richmond Services Revenues Index

First Quarter 1996 - Second Quarter 2006



### FRB—Richmond Manufacturing Composite Index

First Quarter 1996 - Second Quarter 2006



### House Prices

Change From Prior Year  
First Quarter 2001 - Second Quarter 2006



— Fifth District — United States

#### 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, building permits, and house prices are not seasonally adjusted (nsa); all other series are seasonally adjusted.

#### SOURCES:

Real Personal Income: Bureau of Economic Analysis/Haver Analytics.

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>.

House prices: Office of Federal Housing Enterprise Oversight, <http://www.ofheo.gov>.

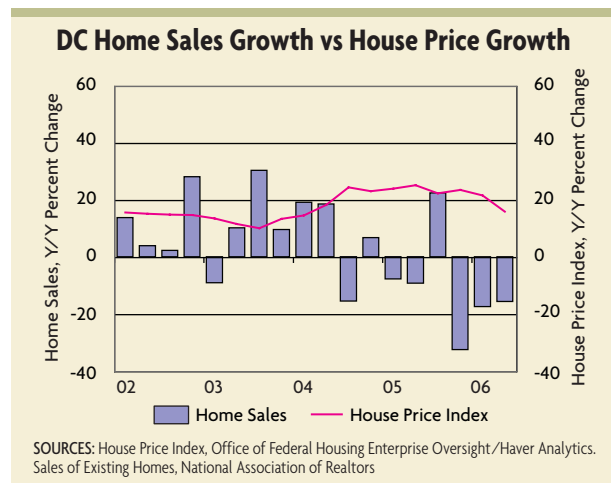
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# STATE ECONOMIC CONDITIONS

BY MATTHEW MARTIN

## District of Columbia

Growth in the District of Columbia slowed in the second quarter, as employment growth was marginal and housing market activity slowed further. Payroll employment expanded less quickly, though growth over the past year was on par with the national pace. Real estate markets slowed as well, with declines in housing permit issuance, home sales, and the rate of price appreciation.



Labor market growth slowed in the second quarter with an anemic payroll growth rate of 0.2 percent. Job losses were posted in the District of Columbia's outsized professional and business services sector. However, both total and professional services employment growth remained healthy, with growth rates of 1.6 percent and 2.8 percent, respectively, compared to a year ago. Also notable was the decline in labor force growth compared to both the previous quarter and a year earlier. The 1.6 percent decline in the labor force in the second quarter was accompanied by an increase in the unemployment rate to 5.5 percent — 0.2 percent higher than the first quarter.

The investment environment brightened in the District of Columbia. Venture capital investment into D.C. continued to post solid growth in the second quarter, following strong growth in the first quarter. Second-quarter inflows totaled \$31.8 million, with nearly 16 percent of the funding slated for Internet-related companies. Expansion-stage firms were responsible for much of the midyear investment.

The District of Columbia's real estate market displayed a sharp deceleration in the second quarter. This was especially true of new residential permits, which had easily outpaced year-ago levels in the first quarter. More than 1,300 permits were issued in the first quarter, more than double the number a year earlier. By contrast, just 212 permits were issued in the second quarter, leaving cumulative permit levels in 2006

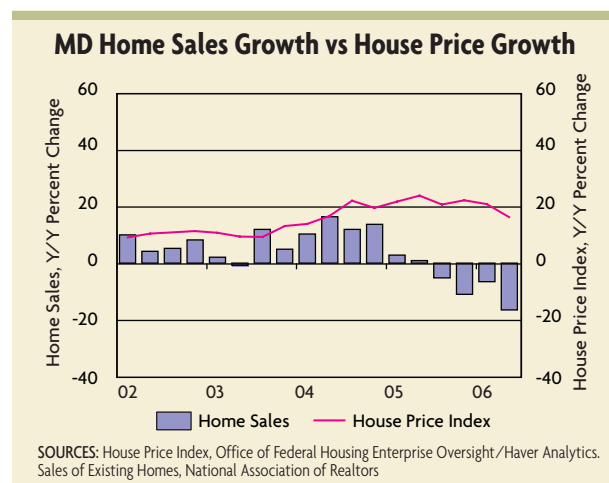
roughly on par with last year. Warmer weather early in the year likely played a role, leading to more construction activity early in the year. However, just nine permits were issued in July, suggesting that new housing starts got off to a weak start in the third quarter.

Activity in the existing housing market also weakened in the second quarter, with sales off 0.9 percent in the first quarter and 15.6 percent over the past year. In addition, the rate of home price appreciation dropped to just a 5.2 percent annual rate in the second quarter compared to 9.1 percent in the first quarter and 26.1 percent in the final quarter of 2005. Over the past year home prices have increased 15.9 percent, a solid pace, though less than the rate of the previous two years.

## Maryland

By most measures, the Maryland economy continues to expand, with the state's housing market the only segment that is clearly contracting. After the rapid acceleration in the state's housing activity in recent years, the current slowdown appears to be a return to more typical levels of new home building and sales activity. Furthermore, cooling housing market activity has yet to have a perceptible impact on the rest of the economy. Employment growth in the state was solid into the second quarter, including an increase in construction employment.

Overall payroll employment was constrained by job losses in the manufacturing and trade, transportation and utilities sectors. Even so, overall employment grew 1.0 percent, led by solid gains in professional and business and education and health services. Meanwhile, the unemployment rate rose by 0.3 percent to 3.8 percent, though it remains well below the national figure. The increase in the unemployment rate is mostly due to the largest quarterly increase in the state's labor force since 1986.



Most measures of business investment continue to suggest underlying strength in the Maryland economy. Venture capital inflows rebounded strongly in the second quarter. Investment totaled \$334 million, more than three times the amount recorded in the first quarter. Firms in the expansion stage received the most funding (49.6 percent), while start-up firms received the bulk of the remainder (22.9 percent).

The housing market is one segment of the state economy that is clearly slowing. New home construction has decreased from the elevated pace of last year, and year-to-date permits issued fell 14.0 percent through the end of the second quarter. Price growth slowed to 9.6 percent in the second quarter, and though still robust by historical standards, is well below the 20.6 percent rate seen in the last quarter of 2005. Because of strong price appreciation in recent quarters, the increase over the past year is still elevated at 16.2 percent, though the 16.5 percent decline in home sales over the same period may weigh on home prices in the future.



## North Carolina

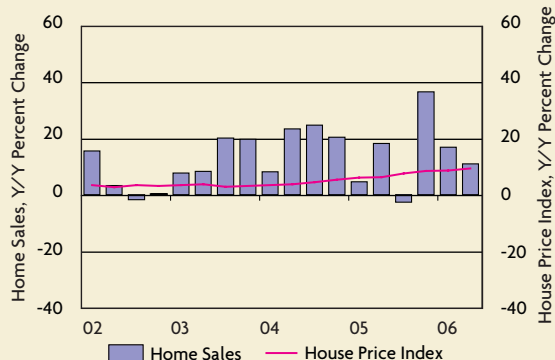
Momentum has been maintained in both the overall North Carolina economy and in the state's housing market. Payroll employment growth in the state moderated somewhat in the second quarter compared to the first, but the rate still ranked among the highest in the District. Most measures of real estate activity increased in the second quarter, including existing home sales and the growth rate of home prices.

Labor market indicators were generally positive in the second quarter. Although the pace of job growth slowed half a percentage point to 1.9 percent, it was the second-fastest rate of increase among the District's six jurisdictions. Job growth accelerated among professional service establishments, remained steady for financial services, and declined among retailers. Manufacturing jobs declined at a 1.1 percent annual rate, nearly matching the first quarter's pace. Results from the household survey were more upbeat, with stronger growth in employment offset by equally stronger labor force growth, leaving the quarterly average unemployment rate unchanged compared to the first quarter.

Venture capital investment activity was also positive in the second quarter. Nineteen North Carolina firms received venture capital inflows in the second quarter, with investment totaling \$150.5 million, up \$32.3 million from a quarter earlier. Of this total, more than half went to Internet-related companies, with expansion- and later-stage firms garnering the bulk of the funding.

The state's housing market showed few indications of slowing in the second quarter. Existing home sales were up 11 percent compared to a year earlier, though they were slightly

### NC Home Sales Growth vs House Price Growth



SOURCES: House Price Index, Office of Federal Housing Enterprise Oversight/Haver Analytics. Sales of Existing Homes, National Association of Realtors

lower than in the first quarter. However, second-quarter home prices were 9.3 percent ahead of a year ago and exhibited growth above that of the first quarter. The number of permits issued in the second quarter was the only housing measure that fell short of last year's. However, warmer weather early in the year boosted the first-quarter figure; the total number of permits issued so far this year is 6.4 percent higher than the same period in 2005, providing little evidence of a general slowing of housing markets in the state.



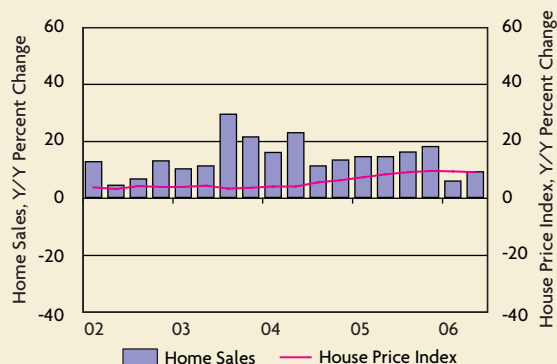
## South Carolina

Economic conditions in South Carolina improved in the second quarter, due in part to improvement in the state's manufacturing employment picture. Unemployment in South Carolina is more than a full percentage point higher than the national rate, however, the state is still recovering from manufacturing's retrenchment over the last few years and the recent upticks are encouraging. Although signs of a modest cooling in parts of the state remain, existing home sales were higher in the second quarter than a year earlier and annual home price growth was nearly on par with recent quarters.

Total payroll employment in the state increased at a 3.4 percent annual rate in the second quarter, a bit below the first-quarter pace. The 3.2 percent gain in manufacturing employment was the first quarterly increase for that sector in two years and reflected better overall conditions in the state's manufacturing sector. The state's labor force also expanded at a 3.4 percent rate in the second quarter, driving the state's unemployment rate up 0.2 percent to 6.6 percent.

The investment environment improved in the second quarter. Venture capital inflows to South Carolina firms were flat in the second quarter, but this followed a solid \$9.7 million gain in the first quarter. The first-quarter gain marked the largest quarterly investment recorded since late 2004

### SC Home Sales Growth vs House Price Growth



SOURCES: House Price Index, Office of Federal Housing Enterprise Oversight/Haver Analytics. Sales of Existing Homes, National Association of Realtors

and was more than triple the investment in 2005.

The housing market shows some signs of slowing across the state, though the deceleration was not as prominent as seen elsewhere across the District and the nation. Permit issuance fell in the second quarter compared to a year earlier, though cumulative permits through July remained 2.9 percent higher than last year. Home price growth eased slightly in the second quarter. However, South Carolina was one of just two jurisdictions in the District where sales of existing homes increased in the second quarter compared to a year earlier. Sales were up 8.9 percent in the second quarter compared to a year earlier, matching the year-over-year change in prices for the same.



### Virginia

Steady job growth and a decrease in housing activity were the hallmarks of Virginia's economy in the second quarter. Persistent job creation, aided by significant construction and government hiring, kept the Virginia economy on track during the period though softness in housing markets became more apparent. Despite the dip in housing construction, strong construction payroll growth in commercial construction activity more than offset slowing residential construction employment.

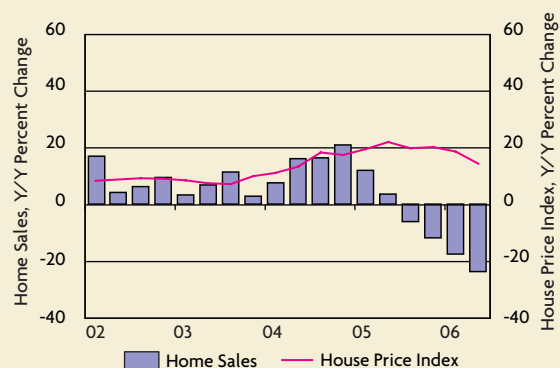
Payroll employment increased at a modestly faster rate in the second quarter, rising 0.4 percent to 1.5 percent. About one-third of the jobs created were in the government sector, while growth in the construction sector continued as a pickup in commercial construction outweighed a slowdown in housing construction. By contrast, job growth in professional and business services remained well below 1 percent. Manufacturing employment expanded for the second quarter in a row and at a rate of a full percentage point higher than the overall rate of increase for payrolls. The unemployment rate inched 0.1 percent higher

in the second quarter despite an additional 19,000 jobs reported in the household survey. The labor force expanded by 24,000, however, surpassing 4 million for the first time in the history of the survey.

Venture capital investment at Virginia firms totaled \$88.4 million in the second quarter, outpacing the \$56.2 million inflow recorded in the first quarter. Of this, more than half was slated for Internet-related companies, with expansion-stage firms capturing the most funding and companies in the startup and later stages receiving most of the remainder.

Most measures of housing activity continued to show declines in the second quarter. Year-to-date housing permit issuance fell 15.9 percent in the second quarter, the largest decline among District states and considerably faster than the 1.0 percent decline in the first quarter. Not surprisingly, home price growth is slowing across the state, from last year's better than 25 percent pace at an annual rate to 8.3 percent in the second quarter. Home sales fell 23.9 percent over the period – the fastest rate of decline in the District – and the slower pace of sales will likely weigh on future home price appreciation.

### VA Home Sales Growth vs House Price Growth



SOURCES: House Price Index, Office of Federal Housing Enterprise Oversight/Haver Analytics. Sales of Existing Homes, National Association of Realtors

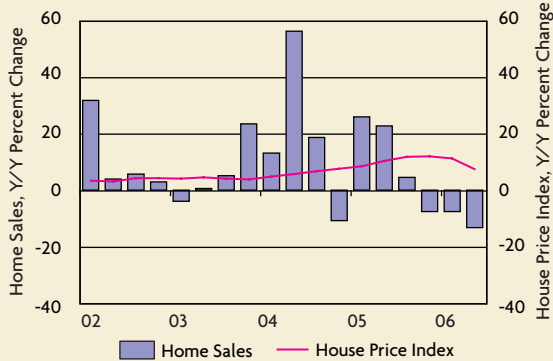


### West Virginia

Recent data indicate that the West Virginia economy grew at a healthy pace during the first half of 2006. Payroll employment in the state expanded at roughly the same rate as the national economy, with mining and construction job gains providing the bulk of the growth. A sizeable increase in the state's unemployment rate relative to the first quarter was less troubling than it may appear, given that it occurred on the heels of an outsized decline in the unemployment rate in the first quarter. The state's housing market slowed in the second quarter, though by less than in other District states.



### WV Home Sales Growth vs House Price Growth



SOURCES: House Price Index, Office of Federal Housing Enterprise Oversight/Haver Analytics. Sales of Existing Homes, National Association of Realtors

Payroll employment growth in West Virginia accelerated from a standstill in the first quarter to 1.4 percent in the second quarter, despite job losses in the manufacturing, professional and business services and government sectors. Mining, construction and leisure and hospitality employment accounted for the majority of the quarterly job gains. The state's unemployment rate rose 0.7 percent to 4.6 percent, though the increase reflected an unusually large jump in first quarter household employment that was offset in the second quarter. At 4.6 percent, the unemployment rate remains below the 4.9 percent level recorded at the beginning of 2006, suggesting general improvement in the labor markets.

Business conditions in the state remain upbeat for the most part, though venture capital funding remains elusive. One West Virginia expansion-stage company in the e-commerce goods, services, and content industry received an investment in the second quarter, totaling \$0.5 million. The midyear inflow followed flat investment in the first quarter of 2006 and outpaced year-ago activity when investment was flat.

Housing markets showed signs of slowing, despite a modest rise in existing home sales in the second quarter. However, comparisons to a year earlier were less favorable, with sales down 13.3 percent. Softer sales over the past year have contributed to a stall in existing home prices, which rose just 0.6 percent at an annual rate in the second quarter, limiting the pace of growth over the last year to 7.4 percent. While this rate is higher than long-term averages for the state, it remains substantially lower than the peak rate of nearly 12 percent seen last year.

Andrea Holmes contributed to this article.

**Correction:** In the Summer 2006 issue, we stated that Baltimore City posted a 3.9 percent jobless rate during the first quarter of 2006. That figure described Baltimore County's unemployment rate instead. Baltimore City's unemployment rate was 6.4 percent.

### Behind the Numbers: Seasonally Adjusted

Much of the employment data that appear every quarter in this magazine are seasonally adjusted. That means the figures have been fine-tuned to account for events that follow a predictable pattern year after year. Economists rely on seasonally adjusted data to explain underlying strength or weakness in the economy that might not otherwise be apparent.

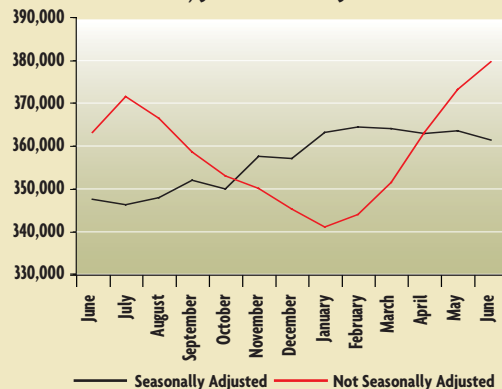
Seasonal patterns are a major factor in influencing short-term swings in the data. Seasonality is particularly important when looking at certain employment sectors. For example: Employment in leisure and hospitality tends to increase sharply in the summer months, then drops as we move into September. In North Carolina, unadjusted figures show leisure and hospitality employment growing from about 341,000 workers in January to almost 380,000 in June. But a month-to-month comparison of these unadjusted numbers isn't particularly useful because they don't tell us anything about the fundamental strength of the activity, or at what point a particular industry might be in the business cycle.

The Bureau of Labor Statistics takes the unadjusted numbers and plugs them into a model that aims to account for the longer-term trend and expected seasonal fluctuations. In the case of the leisure and hospitality sector, the seasonal adjustment model predicts that employment rises in the summer months. Then, it compares the expected change to the actual change. The resulting seasonally adjusted data will show an increase if the *unadjusted* numbers exceed the expected ones. So while the April, May, and June 2006 trend in unadjusted leisure and hospitality employment in North Carolina looks sharply positive, the *seasonally adjusted* trend looks much flatter — an insight that the unadjusted figures wouldn't provide.

Statistical agencies don't adjust every dataset. This is why they are not published for metropolitan area data, building permits, and house prices. In viewing adjusted data, analysts hope to gain a clearer picture of the business cycle and not get fooled by annual events that won't play a long-term role.

— DOUG CAMPBELL

### Leisure and Hospitality Employment in North Carolina, June 2005 – June 2006



SOURCE: Bureau of Labor Statistics

## State Data, Q2:06

	DC	MD	NC	SC	VA	WV
<b>Nonfarm Employment (000)</b>	691.1	2,582.1	3,980.0	1,905.1	3,724.2	753.8
Q/Q Percent Change	0.2	1.0	1.9	3.4	1.5	1.4
Y/Y Percent Change	1.6	1.2	2.1	2.7	1.8	1.0
<b>Manufacturing Employment (000)</b>	2.1	138.2	561.2	260.2	298.1	61.4
Q/Q Percent Change	13.5	-1.3	-1.2	3.2	3.3	-0.6
Y/Y Percent Change	-3.0	-1.9	-1.0	-1.4	0.3	-1.3
<b>Professional/Business Services Employment (000)</b>	151.5	390.6	452.5	208.6	620.5	58.8
Q/Q Percent Change	-1.6	2.1	2.0	14.8	0.5	-4.4
Y/Y Percent Change	2.8	1.9	2.8	2.9	3.1	0.2
<b>Government Employment (000)</b>	231.8	468.5	680.9	333.9	669.6	143.3
Q/Q Percent Change	0.6	0.7	4.0	0.4	3.0	-2.1
Y/Y Percent Change	-0.8	1.1	2.7	2.3	1.1	-0.1
<b>Civilian Labor Force (000)</b>	292.3	2,992.3	4,397.9	2,121.2	4,001.1	815.0
Q/Q Percent Change	-1.6	2.8	2.4	3.4	2.5	3.1
Y/Y Percent Change	-1.3	2.1	1.9	2.5	1.8	2.1
<b>Unemployment Rate (%)</b>	5.5	3.8	4.5	6.6	3.1	4.6
Q1:06	5.3	3.5	4.5	6.4	3.0	3.9
Q2:05	6.6	4.2	5.3	6.6	3.5	4.9
<b>Personal Income (\$bil)</b>	28.6	217.4	248.2	111.3	261.9	43.7
Q/Q Percent Change	2.1	2.5	1.7	2.2	2.3	2.7
Y/Y Percent Change	3.0	3.5	3.0	3.5	2.9	3.0
<b>Building Permits</b>	212	8,695	27,736	13,234	13,119	1,248
Q/Q Percent Change	-99.9	264.9	19.7	-30.1	-18.5	-48.3
Y/Y Percent Change	-76.7	-3.3	3.7	-5.8	-24.9	-19.2
<b>House Price Index (1980=100)</b>	634.9	522.1	321.5	305.0	460.3	227.0
Q/Q Percent Change	5.2	9.6	7.9	6.9	8.3	0.6
Y/Y Percent Change	15.9	16.2	9.3	8.9	14.2	7.4
<b>Sales of Existing Housing Units (000)</b>	10.8	116.2	230.4	122.5	144.0	35.7
Q/Q Percent Change	-0.9	-8.0	-0.5	11.0	-6.8	1.7
Y/Y Percent Change	-15.6	-16.5	11.0	9.0	-23.9	-13.3

### NOTES:

Nonfarm Payroll Employment, thousands of jobs, seasonally adjusted (SA) except in MSA's; Bureau of Labor Statistics (BLS)/Haver Analytics, Manufacturing Employment, thousands of jobs, SA in all but DC and SC; BLS/Haver Analytics, Professional/Business Services Employment, thousands of jobs, SA in all but SC; BLS/Haver Analytics, Government Employment, thousands of jobs, SA; BLS/Haver Analytics, Civilian Labor Force, thousands of persons, SA; BLS/Haver Analytics, Unemployment Rate, percent, SA except in MSA's; BLS/Haver Analytics, Building Permits, number of permits, NSA; U.S. Census Bureau/Haver Analytics, Sales of Existing Housing Units, thousands of units, SA; National Association of Realtors®

## Metropolitan Area Data, Q2:06

	Washington, DC MSA	Baltimore, MD MSA	Charlotte, NC MSA
<b>Nonfarm Employment (000)</b>	2,993.5	1,305.5	808.7
Q/Q Percent Change	7.9	9.0	4.4
Y/Y Percent Change	2.5	1.5	2.1
<b>Unemployment Rate (%)</b>	3.0	4.0	4.5
Q1:06	3.0	4.0	4.7
Q2:05	3.5	4.4	5.2
<b>Building Permits</b>	7,739	2,268	6,760
Q/Q Percent Change	-37.1	-17.1	46.2
Y/Y Percent Change	-33.9	-13.9	16.5

	Raleigh, NC MSA	Charleston, SC MSA	Columbia, SC MSA
<b>Nonfarm Employment (000)</b>	277.4	292.8	361.8
Q/Q Percent Change	4.7	10.4	3.0
Y/Y Percent Change	2.9	4.3	3.3
<b>Unemployment Rate (%)</b>	3.7	5.1	5.6
Q1:06	3.8	5.2	5.6
Q2:05	4.3	5.1	5.5
<b>Building Permits</b>	1,125	2,264	2,029
Q/Q Percent Change	-17.1	-39.4	-5.3
Y/Y Percent Change	-8.3	-11.5	-2.8

	Norfolk, VA MSA	Richmond, VA MSA	Charleston, WV MSA
<b>Nonfarm Employment (000)</b>	779.9	626.0	151.1
Q/Q Percent Change	12.1	5.1	9.5
Y/Y Percent Change	1.7	1.2	1.3
<b>Unemployment Rate (%)</b>	3.5	3.2	4.4
Q1:06	3.7	3.4	4.6
Q2:05	4.1	3.7	5.0
<b>Building Permits</b>	1,951	2,447	87
Q/Q Percent Change	-49.1	24.0	15.1
Y/Y Percent Change	-23.8	0.4	-28.7

For more information, contact Matthew Martin at 704-358-2116 or e-mail [Matthew.Martin@rich.frb.org](mailto:Matthew.Martin@rich.frb.org).