

District Economic

BY ROBERT LACY

Our monthly surveys of District businesses indicate that manufacturing shipments and services firms' revenues were moderately higher during the second quarter. Payroll employment generally expanded as well, with growth particularly strong in Virginia. Retail trade remained a soft spot, however, and higher prices for gasoline, steel, and some building materials continued to boost raw materials costs for manufacturers and builders.

Did You Know . . .

Georgia may be the Peach State but neighboring South Carolina often produces more peaches. Growers in South Carolina expect to harvest 140 million pounds of peaches this year, about 30 million pounds above the harvest expected in Georgia. The two states vie for second-place honors in the nation each year; most peaches consumed in the United States are grown in California.

Fifth District economic activity expanded at a solid pace in the second quarter of 2004, as services sector output picked up and employment gains mounted. Manufacturing shipments and new orders continued to rise, and housing activity remained strong despite an increase in mortgage interest rates. And while prices for some raw materials used in manufacturing and construction moved higher, overall price inflation in the District was contained.

Manufacturing Expansion on Track

Growth in manufacturing activity slipped a notch in the second quarter but remained generally strong. Industry contacts said that shipments and new orders rose at a solid pace and told us they expected growth to continue for the remainder of the year. In the words of a plastics manufacturer in North Carolina, "We are clearly seeing signs of an expanding economy: longer lead time on raw materials; raw material price increases; and decent, though not great, new order activity."

Higher steel, oil, and building materials prices caused a spike in raw materials prices in April. According to our monthly manufacturing survey, total raw materials prices increased at the strongest pace in several years. By June, however, price increases had eased back to about 2 percent.

Housing Buoyant

District housing markets remained upbeat despite somewhat higher mortgage interest rates in the second quarter. According to the Federal Home Loan Mortgage Corporation,

average interest rates on 30-year fixed-rate conventional mortgages rose from 5.5 percent in March to 6.25 percent in June. With the exception of Maryland, the number of building permits issued in District states trended higher during the period.

Real estate agents in particularly hot markets such as in Northern Virginia told us that sales activity was so frenzied that some home buyers were waiving inspections and appraisals and offering to pay sellers' closing costs. On the construction side, home builders reported shortages of wallboard, plywood, and insulation in some areas.

Better Job Growth

Growth in payroll employment in the District picked up in the second quarter of 2004. While the pace slowed in May, when only 18,000 jobs were added, it surged again in June with the addition of 40,000 District jobs.

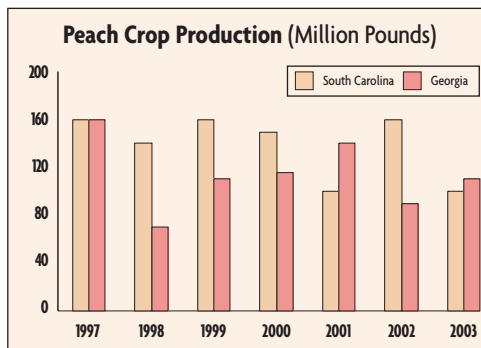
The services sector continued to lead the way in job growth. Professional, business, health, education, and financial services jobs were substantially higher in most District states.

The District's unemployment rate was 4.8 percent in the second quarter of 2004, down from 5.5 percent a year earlier. Both Maryland and Virginia had unemployment rates below 4.0 percent in June.

Gray Skies

It was a rainy summer in much of the region. Washington, D.C., Richmond and Norfolk, Va., and Charlotte, N.C., received over 16 inches of rain between June 1 and mid-August, about three times the normal rainfall.

While South Carolina received less than most areas farther north, the state received enough rain to end the drought that prevailed through the spring. The agricultural sector in South Carolina received a boost from improved soil conditions and, as of August, crops were developing at or ahead of schedule. But excessive rain damaged crops in other areas of the District. On the Eastern Shore of Virginia soybean fields were waterlogged, and corn stalks were in danger of falling into the mud.



Developments

Nonfarm Employment

Second Quarter 2004

	Employment (Thousands)	% Change (Year Ago)
DC	670	0.8
MD	2,519	1.5
NC	3,841	1.2
SC	1,836	1.5
VA	3,582	2.6
WV	727	-0.1
5th District	13,175	1.6
US	131,119	1.0

Unemployment Rate

(Percent)

	2nd Qtr. 2004	2nd Qtr. 2003
DC	7.3	7.1
MD	3.9	4.5
NC	5.4	6.5
SC	6.5	6.8
VA	3.5	4.1
WV	5.3	6.3
5th District	4.8	5.5
US	5.6	6.1

Personal Income

First Quarter 2004

	Income (\$ billions)	% Change (Year Ago)
DC	28.2	5.1
MD	213.5	5.8
NC	247.5	5.8
SC	112.2	4.8
VA	260.7	6.7
WV	45.4	4.1
5th District	907.6	5.8
US	9,510.1	5.2

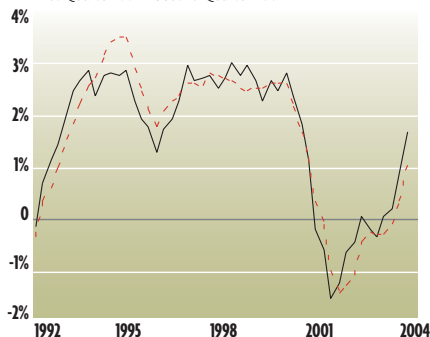
— Fifth District

- - - - - United States

Nonfarm Employment

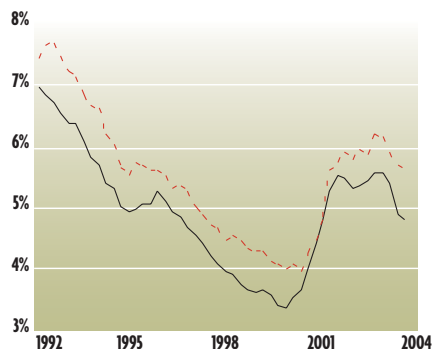
Change From Prior Year

First Quarter 1992 - Second Quarter 2004



Unemployment Rate

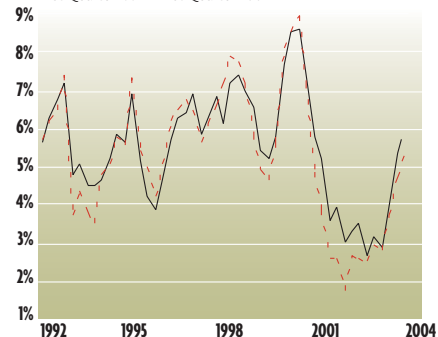
First Quarter 1992 - Second Quarter 2004



Personal Income

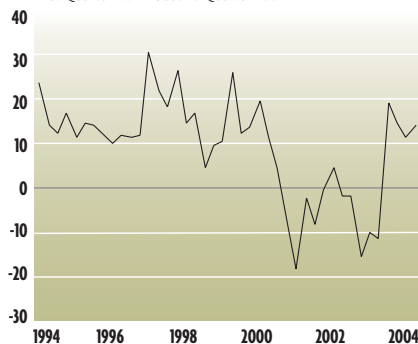
Change From Prior Year

First Quarter 1992 - First Quarter 2004



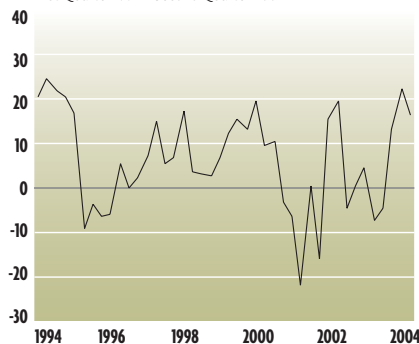
FRB—Richmond Services Revenues Index

First Quarter 1994 - Second Quarter 2004



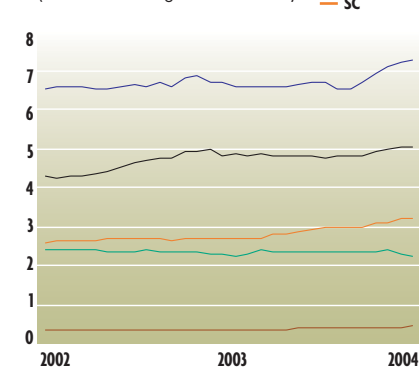
FRB—Richmond Manufacturing Shipments Index

First Quarter 1994 - Second Quarter 2004



Housing Units Authorized

(12-Month Average, in thousands)



NOTES:

- 1) All data series are seasonally adjusted.
- 2) FRB-Richmond survey indexes are diffusion indexes. Positive numbers represent expansion, negative numbers contraction.
- 3) State nonfarm employment estimates are based on surveys of establishments. These employment figures differ from those used to calculate state unemployment rates.

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>

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BY ANDREA HOLLAND

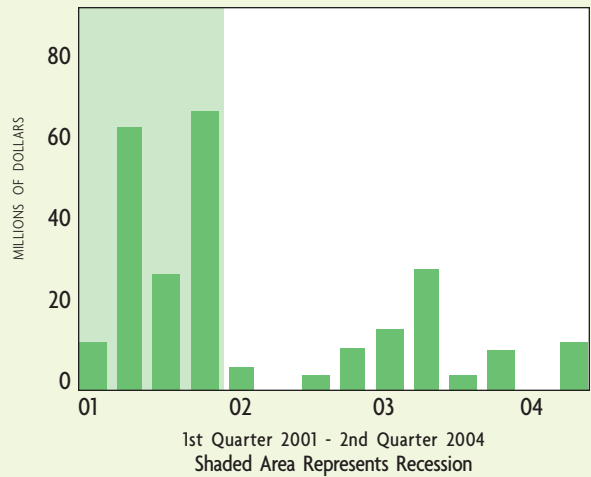
Venture capital is an alternative source of funding for fledgling companies that are oftentimes perceived as more risky and lack the capital to develop their own product. Investment of this type is important because, if successful, it could boost the number of cutting-edge companies, which in turn, stimulates employment and wage growth in the higher-paying knowledge sector. Furthermore, a recent joint study by DRI-WEFA and Venture Economics suggested that venture-backed companies may be more immune to economic downturns than are traditionally funded businesses.

Supporting this theory, 2000 revenues from venture-backed businesses in the District of Columbia contributed 2.4 percent toward gross state product, and the number of workers equaled 10,850, or 1.7 percent of the total work force. Three years later, revenues at these firms were up 33 percent (the fastest growth rate districtwide), and job numbers had expanded 16.5 percent in spite of the 2001 recession. In contrast, aggregate employment in the District of Columbia rose only 2.2 percent during the same time period.

In light of the above findings, recent investment activity has been discouraging. District of Columbia businesses have struggled to attract capital this year, and had raised only \$12 million at the end of the second quarter. By comparison, inflows had reached \$44.5 million by midyear 2003.

With only two investment deals recorded in the second quarter, the District of Columbia ranked 26th nationally by deal volume. The lion's share of the funding, \$11.5 million, was awarded to a telecommunications firm, and the remaining \$0.5 million was granted to a software firm. By stage of financing, 96 percent of the capital was expansion funding for an already up-and-running business, and the remaining 4 percent was listed as seed funding, which provides new firms with the backing necessary for their initial development. Geographically, the second-quarter funding originated in California, the District of Columbia, Illinois, and Maryland.

Venture Capital Investment



NOTE: No bar represents a zero or close to zero value. SOURCE: PricewaterhouseCoopers/Thompson Venture Economics/National Venture Capital Association MoneyTree™ Survey

	Percent Change at Annual Rate From		
	2nd Qtr 2004	1st Qtr 2004	2nd Qtr 2003
Nonfarm Employment	670.4	0.3	0.8
Manufacturing	2.5	5.5	-3.8
Professional/Business Services	144.5	1.9	3.0
Government	230.8	0.8	-0.5
Civilian Labor Force	300.7	-4.9	-0.8

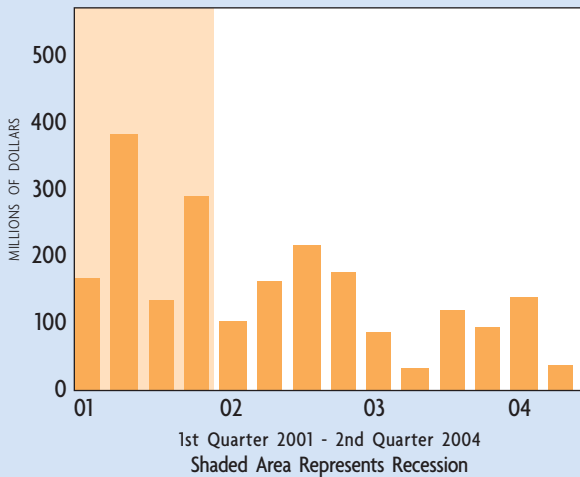
	2nd Qtr 2004	1st Qtr 2004	2nd Qtr 2003
Unemployment Rate	7.3	6.5	7.1
Building Permits, NSA	760	153	539
Home Sales	179	16.5	14.9

NOTES: Nonfarm Employment, thousands of jobs, seasonally adjusted (SA); Bureau of Labor Statistics (BLS)/Haver Analytics
Manufacturing, thousands of jobs, not seasonally adjusted (NSA); 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
Building Permits, number of permits, NSA; U.S. Census Bureau/Haver Analytics
Home Sales, thousands of units, SA; National Association of Realtors®



BY ANDREA HOLLAND

Venture Capital Investment



SOURCE: PricewaterhouseCoopers/Thompson Venture Economics/National Venture Capital Association MoneyTree™ Survey

Investment by venture capitalists is a means of turning a concept into a product for entrepreneurs without the needed startup capital. Venture funding accounts for a modest share of Maryland's financial market; its major importance lies in the nurturing of future businesses, which if viable, could translate into better employment opportunities. In addition, a recent study by DRI-WEFA and Venture Economics suggested that the presence of venture-backed firms could have a stabilizing effect on a state's economy because employment at venture-backed businesses appeared to be less susceptible to recessionary periods.

To illustrate this point, employment at venture-backed firms grew from 95,000 to 104,300 from 2000 to 2003 — an increase of nearly 10 percent. By comparison, total payroll growth in Maryland measured only 1.3 percent. Revenues also forged ahead; venture-backed firms recorded a 21.8 percent rise during the same time frame.

Realizing more fully the long-term benefits of venture capital investment, the most recent readings have been particularly heartening. According to data from the MoneyTree survey of venture capital spending, midyear capital inflows to Maryland firms in 2004 outpaced activity recorded in the first two quarters of last year.

Second-quarter disbursements into Maryland businesses totaled \$39.8 million, and with 20 deals on the books, the state ranked 8th nationally by deal volume. Within the state, Montgomery, Anne Arundel, and Baltimore City attracted the most capital. Montgomery County alone recorded eight deals, ranking 20th nationwide. By business type, software firms garnered the majority of the funding, with nine deals totaling \$25.8 million. Close behind was the biotechnology industry, which captured five deals in the amount of \$10.5 million.

By stage of investment, 60 percent of the businesses that received capital were classified as seed, startup, or early stage — firms which have not yet fully established operations. This is encouraging, as an increase in new deals could suggest increased investor confidence. The remaining 40 percent of the businesses were in the expansion and later stages — additional funding which is usually used to solidify a firm's current standing.

	Percent Change at Annual Rate From		
	2nd Qtr 2004	1st Qtr 2004	2nd Qtr 2003
Nonfarm Employment	2,518.8	4.4	1.5
Manufacturing	145.4	1.8	-2.2
Professional/Business Services	372.1	12.3	2.8
Government	461.5	1.0	-0.4
Civilian Labor Force	2,948.2	1.0	1.5
	2nd Qtr 2004	1st Qtr 2004	2nd Qtr 2003
Unemployment Rate	3.9	4.1	4.5
Building Permits, NSA	7,636	5,875	8,849
Home Sales	146.0	141.5	124.0

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
 Building Permits, number of permits, not seasonally adjusted (NSA); U.S. Census Bureau/Haver Analytics
 Home Sales, thousands of units, SA; National Association of Realtors®



NORTH CAROLINA

BY ANDREA HOLLAND

A private donation made to a promising business with many prospects but no capital is known as a venture capital investment. The aggregate level of investment injected into a state is critical, but just as important are the possible downstream effects on the economy such as the creation of higher-paying jobs. According to a recent study by DRI-WEFA and Venture Economics, a solid knowledge-skilled employment base in historically goods-producing states such as North Carolina could help soften payroll losses during periods such as the 2001 recession.

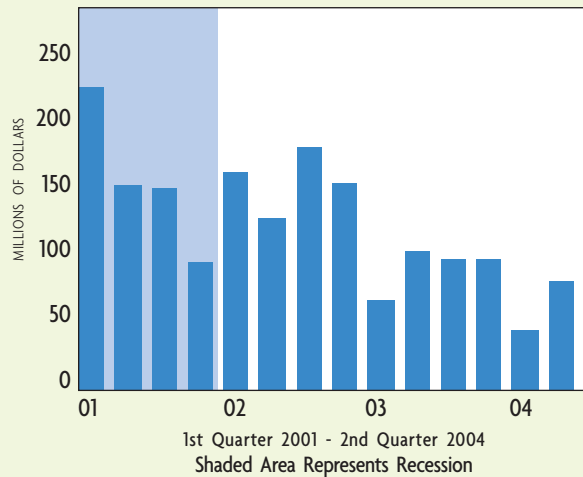
To highlight this point, venture-backed businesses in North Carolina employed 165,500 persons in 2000, or 4.2 percent of the total work force. Over the next three years, job numbers at these firms expanded 2.7 percent despite the 2001 recession. In contrast, aggregate employment in North Carolina contracted 3.3 percent during the same time period, marking the greatest loss districtwide.

Armed with this knowledge, the most recent reports from North Carolina's venture market have been somewhat uninspiring. Firms have had to look hard and long to secure available capital this year despite a recovering economy. Compared to total capital captured by midyear 2003, investors have injected substantially less into North Carolina businesses during the first two quarters of 2004.

Second-quarter capital inflows into North Carolina totaled \$81.8 million. By volume, deals totaled 11 in the second quarter, placing North Carolina 18th nationwide. The counties pulling in the largest number of deals were Durham (ranked 24th nationally), Wake, and Guilford. The health-care services industry courted the most cash, with one deal totaling \$55 million. Telecommunications firms came in second, with three deals garnering \$9.5 million.

By stage of funding, second-quarter investment into seed companies — businesses that have no viable product and are still working on concept development — was zero in North Carolina, suggesting that potential investors remain hesitant. The majority of the funding, 84 percent, instead went to firms in the expansion and later stages.

Venture Capital Investment



SOURCE: PricewaterhouseCoopers/Thompson Venture Economics/National Venture Capital Association MoneyTree™ Survey

	Percent Change at Annual Rate From		
	2nd Qtr 2004	1st Qtr 2004	2nd Qtr 2003
Nonfarm Employment	3,841.0	3.6	1.2
Manufacturing	583.4	-2.5	-4.5
Professional/Business Services	441.2	17.4	5.2
Government	654.8	3.4	2.4
Civilian Labor Force	4,199.9	0.2	-0.6

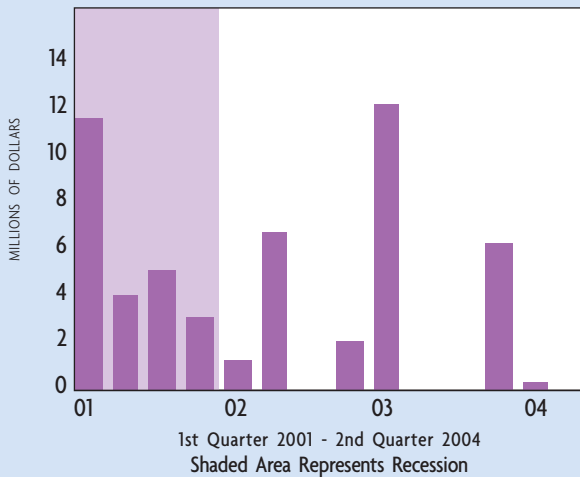
	2nd Qtr 2004	1st Qtr 2004	2nd Qtr 2003
Unemployment Rate	5.4	5.7	6.5
Building Permits, NSA	24,664	22,329	20,776
Home Sales	337.4	281.7	270.3

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
 Building Permits, number of permits, not seasonally adjusted (NSA); U.S. Census Bureau/Haver Analytics
 Home Sales, thousands of units, SA; National Association of Realtors®



BY ANDREA HOLLAND

Venture Capital Investment



NOTE: No bar represents a zero or close to zero value.
SOURCE: PricewaterhouseCoopers/Thompson Venture Economics/National Venture Capital Association MoneyTree™ Survey

In return for investing in higher-risk, private companies that lack the capital to develop and market their own product, venture capitalists typically expect greater-than-average returns in the future. Investors, however, aren't the only ones who could potentially win. The existence of a strong venture capital industry could result in significant benefits for the economy, particularly in light of South Carolina's historically strong ties to the goods-producing sector.

According to a recent, joint study released by DRI-WEFA and Venture Economics, successful venture-backed companies generally expand faster and create more jobs than businesses in other sectors. If this holds true, the maturation of venture-backed companies in South Carolina could help promote a higher-paid and higher-skilled work force.

In addition to accelerating job growth, the DRI-WEFA and Venture Economics report also suggested that the existence of venture-backed firms could result in fewer payroll losses during future recessionary periods as knowledge-based jobs were more recession proof than labor-intensive jobs. Employment data from South Carolina seem to back up these findings — venture-backed companies do appear hardier. Notwithstanding the 2001 recession, venture-backed employment in South Carolina contracted only 0.7 percent (the only decline districtwide) from 2000 to 2003. In contrast, aggregate employment in South Carolina fell 2.6 percent during the same time period.

In light of the above findings, the most recent reports rolling in from South Carolina's venture capital market were disappointing: The state continues to trail behind all other Fifth District jurisdictions when it comes to attracting capital. Further, inflows into South Carolina businesses have grown increasingly sporadic since the end of the 2001 recession. For example, investment deals were recorded in only three quarters out of the year in 2002. By 2003, that number had dropped to two quarters. The most recent data from 2004 have been no more encouraging: State businesses received zero funding in the second quarter, down from a modest \$0.3 million deal recorded in the first quarter of this year.

	Percent Change at Annual Rate From		
	2nd Qtr 2004	1st Qtr 2004	2nd Qtr 2003
Nonfarm Employment	1,836.0	2.7	1.5
Manufacturing, NSA	271.2	1.6	-2.6
Professional/Business Services, NSA	191.9	18.0	2.2
Government	330.4	-0.7	1.0
Civilian Labor Force	2,055.3	2.5	2.8
	2nd Qtr 2004	1st Qtr 2004	2nd Qtr 2003
Unemployment Rate	6.5	6.4	6.8
Building Permits, NSA	11,249	9,474	9,471
Home Sales	165.5	152.1	134.0

NOTES:
Nonfarm Employment, thousands of jobs, seasonally adjusted (SA); Bureau of Labor Statistics (BLS)/Haver Analytics
Manufacturing, thousands of jobs, not seasonally adjusted (NSA); BLS/Haver Analytics
Professional/Business Services, thousands of jobs, NSA; 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
Building Permits, number of permits, NSA; U.S. Census Bureau/Haver Analytics
Home Sales, thousands of units, SA; National Association of Realtors®



VIRGINIA

BY ANDREA HOLLAND

Venture capital investment is the private funding of early stage, high-risk businesses that are lacking their own capital. In addition to playing a vital role in the nurturing of new companies, the venture capital industry also promotes innovation, economic growth, and better employment opportunities. Also, a recent study DRI-WEFA and Venture Economics suggests that employment at venture-backed companies appears to be less susceptible to fluctuations in the business cycle, and as such, the existence of venture-backed firms in a state economy could have a stabilizing effect during recessionary periods.

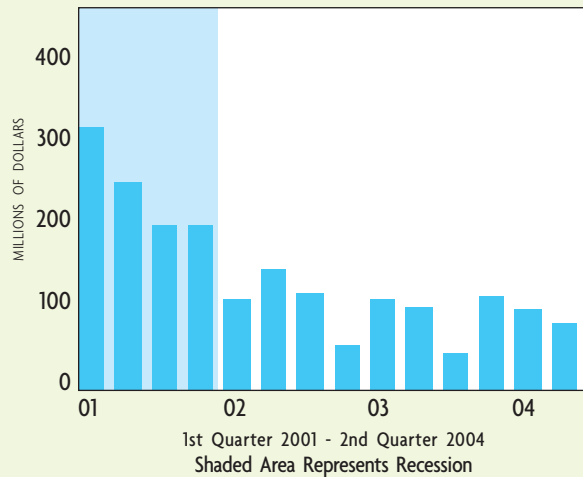
To illustrate this point, employment at venture-backed firms in Virginia grew from 310,200 to 333,200 from 2000 to 2003 — an increase of nearly 7.4 percent, even with the backdrop of a recession. By comparison, total payrolls in Virginia contracted 0.5 percent over the same time period.

Realizing more fully the long-term benefits of venture capital investment, recent reports on activity have been auspicious. Virginia has maintained a vibrant venture capital report in recent years, despite the fact that disbursements in the first and second quarters of 2004 came in a bit under those recorded during the same time frame last year.

Second-quarter capital inflows into Virginia businesses totaled \$80.1 million, and deal volume numbered 19, consigning the state to 9th place nationwide. Within Virginia, localities receiving the most money were Fairfax (ranked 19th nationally), Alexandria, and Arlington. By business sector, the software industry attracted the most deals and venture funds totaled \$26.4 million. Telecommunications businesses were the second most appealing to investors, capturing three deals and \$2.6 million in the second quarter.

By stage of investment, 58 percent of the businesses receiving capital were classified as seed, startup, or early stage — firms that have not yet fully established operations. The preference to support fledgling firms is encouraging, as an increase in deals on riskier projects could suggest a rise in investor confidence. The remaining 43 percent of the businesses were either expansion or later stage; in these cases funding is typically used to further develop the operations of an up-and-running enterprise.

Venture Capital Investment



SOURCE: PricewaterhouseCoopers/Thompson Venture Economics/National Venture Capital Association MoneyTree™ Survey

	Percent Change at Annual Rate From		
	2nd Qtr 2004	1st Qtr 2004	2nd Qtr 2003
Nonfarm Employment	3,582.1	2.9	2.6
Manufacturing	297.3	2.2	-3.3
Professional/Business Services	574.5	4.6	5.4
Government	647.7	2.3	1.7
Civilian Labor Force	3,844.3	1.1	2.0

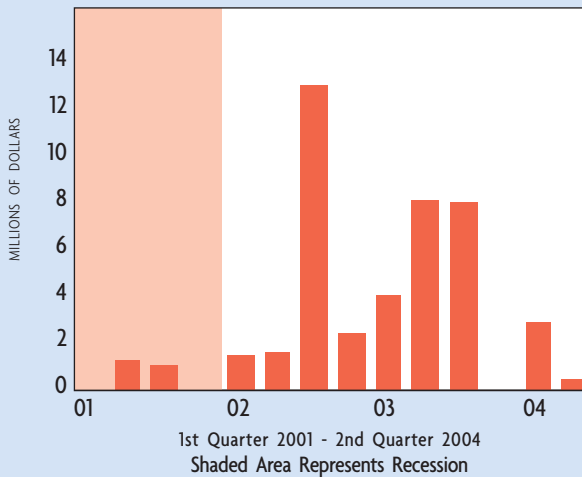
	2nd Qtr 2004	1st Qtr 2004	2nd Qtr 2003
Unemployment Rate	3.5	3.5	4.1
Building Permits, NSA	17,237	14,931	15,801
Home Sales	200.4	174.8	171.0

NOTES:
 Nonfarm Employment, thousands of jobs, seasonally adjusted (SA); Bureau of Labor Statistics (BLS)/Haver Analytics
 Manufacturing, thousands of jobs, SA; BLS/Haver Analytics
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 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
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 Home Sales, thousands of units, SA; National Association of Realtors®



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Venture Capital Investment



NOTE: No bar represents a zero or close to zero value.
SOURCE: PricewaterhouseCoopers/Thompson Venture Economics/National Venture Capital Association MoneyTree™ Survey

Venture capital is funding supplied by private investors to high-risk businesses that are unable to obtain financing through more conventional methods. The existence of a strong venture capital industry could result in significant benefits for a state economy, particularly those with historically strong ties to the goods-producing sector, such as West Virginia. According to a report released by DRI-WEFA and Venture Economics, successful venture-backed companies generally expand faster and create more jobs than traditionally funded businesses. If this holds true, the maturation of venture-backed companies could help foster a higher-paid, higher-skilled work force in West Virginia.

The DRI-WEFA and Venture Economics study also suggested that the presence of venture-backed firms could result in shallower employment losses in future business cycle downturns. Data show that knowledge-based jobs at venture-backed firms are more recession proof than West Virginia's more traditional labor-intensive jobs. Illustrating this, venture-backed employment in West Virginia grew 18.4 percent (the fastest growth rate districtwide) from 2000 to 2003, despite the 2001 recession. In contrast, aggregate employment in West Virginia contracted 1.4 percent during the same time period.

In light of these findings, recent reports on capital inflows have been generally upbeat. Though not traditionally thought of as a repository for venture capital, investments into West Virginia's capital market have, with the exception of the last three quarters, steadily risen since the end of the 2001 recession. In line with higher inflows, revenues from venture-backed companies grew 27.9 percent from 2000 to 2003, marking the third fastest growth rate districtwide.

West Virginia businesses raised \$0.5 million from April through June 2004. The second-quarter deal apportioned expansion funding into a software business in Berkeley County — expansion and later stage funding is usually used to solidify the current standing of an already operating business. With only one deal in the second quarter, West Virginia ranked 33rd in terms of deal volume nationwide.

	Percent Change at Annual Rate From		
	2nd Qtr 2004	1st Qtr 2004	2nd Qtr 2003
Nonfarm Employment	727.1	2.4	-0.1
Manufacturing	69.4	-2.9	-1.4
Professional/Business Services	56.9	0.7	1.4
Government	141.0	-3.2	-1.6
Civilian Labor Force	796.9	0.1	0.9
	2nd Qtr 2004	1st Qtr 2004	2nd Qtr 2003
Unemployment Rate	5.3	5.4	6.3
Building Permits, NSA	1,544	1,255	1,315
Home Sales	31.6	31.8	25.8

NOTES:
Nonfarm Employment, thousands of jobs, seasonally adjusted (SA); Bureau of Labor Statistics (BLS)/Haver Analytics
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Professional/Business Services, thousands of jobs, SA; BLS/Haver Analytics
Government, thousands of jobs, SA; BLS/Haver Analytics
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Home Sales, thousands of units, SA; National Association of Realtors®

For more information regarding state summaries, call 804-697-8273 or e-mail Andrea.Holland@rich.frb.org.