

DISTRICT ECONOMIC OVERVIEW

BY MATTHEW MARTIN

Economic activity in the Fifth District grew at a somewhat slower pace in the third quarter as weakness in housing and retail sales offset some firming in manufacturing and continued strength in much of the service sector. Employment and income growth remained robust, though signs of some strains on household balance sheets emerged due in part to the pullback in housing market activity.

Healthy Labor Markets

Labor market conditions remained generally solid in the third quarter, though reports from the household survey were a bit weaker. Payroll employment in the Fifth District was up 1.7 percent over the past year, considerably more than the 1.0 percent increase the national economy experienced over the same time period. Most services-producing industries added jobs as did the construction industry on the goods-producing side.

On the other hand, manufacturing payrolls declined again, though the rate of job loss in that sector slowed in the third quarter. In addition, healthy employment growth accompanied solid income growth in the third quarter. Fifth District incomes were up 3.8 percent at an annualized rate — a slight uptick from last quarter's pace,

but a touch below the national mark of 4.3 percent.

Data from the household employment survey was somewhat less positive, however. The Fifth District unemployment rate inched up to 4.3 percent, thanks to a concurrent rise in the number of unemployed persons

Economic activity in the Fifth District grew at a somewhat slower pace in the third quarter.

and a decline in the size of the labor force. Nonetheless, the Fifth District third-quarter unemployment rate was lower than the national rate by 0.4 percentage point.

Service Sector Steady

The Fifth District service sector remained the primary source of economic growth in the third quarter. Revenue growth at services firms remained healthy, though survey contacts indicated that the pace of expansion eased somewhat since our last report. On the employment front, the pace of hiring at services firms slowed — a result that was evident in spotty payroll employment growth in some key sectors. Professional and

business services employment contracted in Virginia and South Carolina, for example, while financial activities employment declined in Maryland and West Virginia. By comparison, the retail sector was hard hit in the third quarter. Sales of big-ticket items were especially weak, including a further drop-off in furniture and automobile sales. Retail hiring in the District also tapered off, though wage growth was steady.

Real Estate Weakens

Residential real estate activity weakened further in the third quarter, characterized by lower levels of home building and sales activity. Permit issuance declined 20.8 percent compared to the previous year, with double-digit declines reported in all jurisdictions except the District of Columbia. Additionally, existing home sales fell in all jurisdictions, with the steepest declines in the northernmost parts of the Fifth District.

Declining sales activity coincided with increased home inventories and a further cooling of home price growth, with a few regions experiencing outright price declines. For example, the house price index fell 0.3 percent in Maryland in the third quarter, though prices in the state remained 2.6 percent higher than the same quarter a year earlier. Nonetheless, house prices inched higher elsewhere in the District, with North Carolina seeing the most rapid appreciation — 6.6 percent — over the past year.

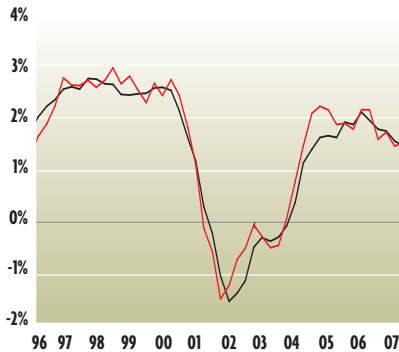
On the commercial side, conditions were relatively brighter. Leasing activity slowed somewhat in the second half of the third quarter, but office vacancy rates remained near cyclical lows. Retail and industrial leasing activity also remained generally healthy. Though financing for new projects still appeared to be available, reports indicated little new commercial construction activity across the Fifth District.

Economic Indicators

	3rd Qtr. 2007	2nd Qtr. 2007	Percent Change (Year Ago)
Nonfarm Employment (000)			
Fifth District	13,909	13,872	1.7
U.S.	137,758	137,500	1.0
Real Personal Income (\$bil)			
Fifth District	946.9	938.6	3.8
U.S.	9,952.4	9,854.0	4.3
Building Permits (000)			
Fifth District	42.8	53.9	-20.8
U.S.	340.1	404.4	-22.3
Unemployment Rate (%)			
Fifth District	4.3%	4.2%	
U.S.	4.7%	4.5%	

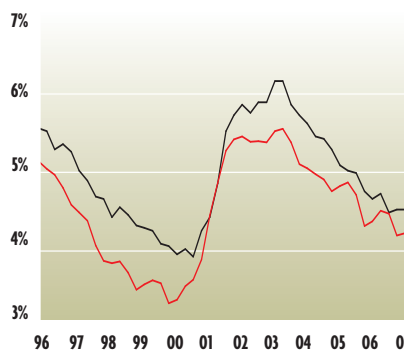
Nonfarm Employment

Change From Prior Year
First Quarter 1996 — Second Quarter 2007



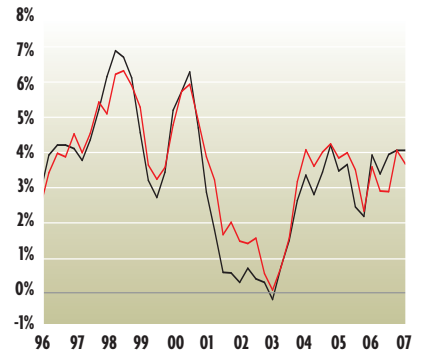
Unemployment Rate

First Quarter 1996 — Second Quarter 2007



Real Personal Income

Change From Prior Year
First Quarter 1996 — Second Quarter 2007

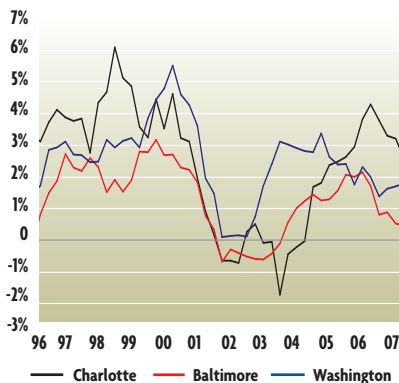


Fifth District

United States

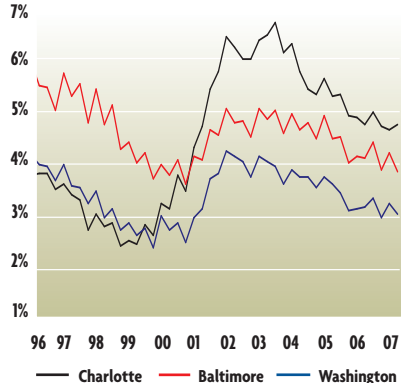
Nonfarm Employment Metropolitan Areas

Change From Prior Year
First Quarter 1996 — Second Quarter 2007



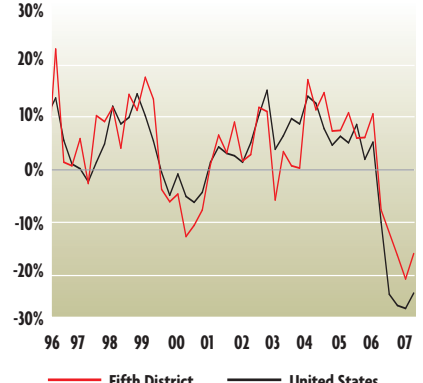
Unemployment Rate Metropolitan Areas

Change From Prior Year
First Quarter 1996 — Second Quarter 2007



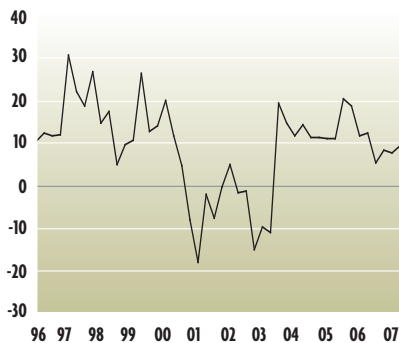
Building Permits

Change From Prior Year
First Quarter 1996 — Second Quarter 2007



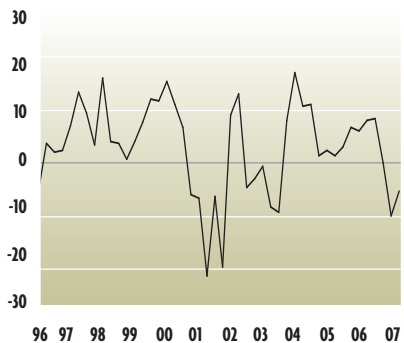
FRB—Richmond Services Revenues Index

First Quarter 1996 — Second Quarter 2007



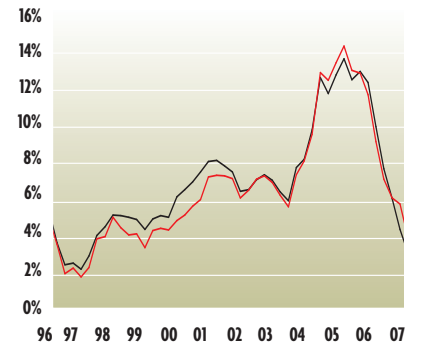
FRB—Richmond Manufacturing Composite Index

First Quarter 1996 — Second Quarter 2007



House Prices

Change From Prior Year
First Quarter 1996 — Second Quarter 2007



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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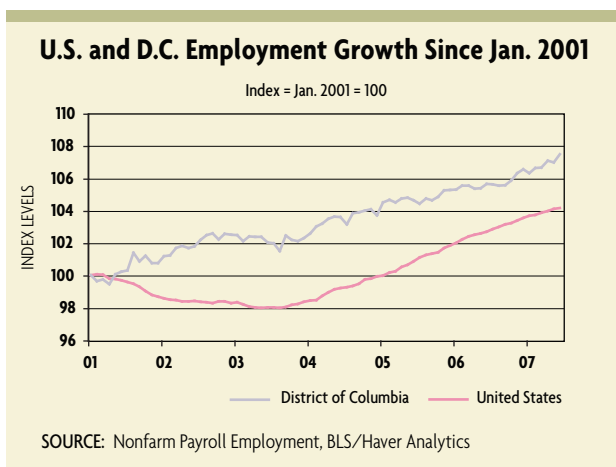
STATE ECONOMIC CONDITIONS

BY MATTHEW MARTIN

District of Columbia

The District of Columbia's economy remained on generally solid footing in the third quarter. Payroll employment growth and unemployment rates were steady, while the housing market — with a modest gain in residential permitting activity and an uptick in home prices — regained some stability. Steady income growth buttressed household balance sheets, though increases in mortgage delinquencies and foreclosures remained a concern.

Labor market conditions in the District of Columbia were generally healthy in the third quarter. Firms in the region added 2,000 jobs in the third quarter, a 1.9 percent increase over the previous quarter. Payroll growth in government employment and



many services-producing sectors fueled the increase, while job losses in the information and financial activities sectors dampened growth. At 5.7 percent, the unemployment rate remained unchanged since the beginning of 2007, and was 0.1 percentage point lower than the third quarter of 2006.

The District of Columbia's housing market showed some improvement. Its House Price Index rose 2.3 percent in the third quarter, following a decline of 0.3 percent in the second quarter. New residential construction also improved in the third quarter, with the District of Columbia posting the only quarterly gain in residential permit activity in the Fifth District. Still, other measures of real estate activity were less positive — the pace of existing home sales declined 11.5 percent in the third quarter.

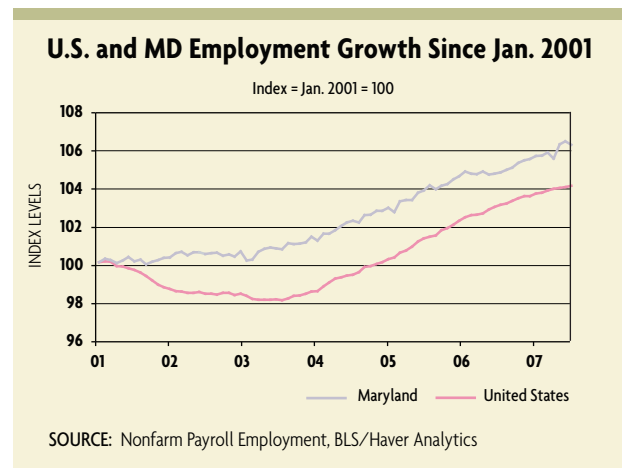
Modest housing market improvements were balanced by increased delinquencies among mortgage borrowers. The percentage of mortgages more than 90 days past due continued to creep up in the third quarter. The rate of foreclosures also increased, though it remained below the peak rate posted in 2001. Although mortgage data revealed some problems, households remained in generally good financial condition overall. Real income growth advanced at a 3.9 percent annualized rate in the third quarter.

Maryland

Economic conditions in Maryland were mixed in the third quarter. The payroll survey continued to show positive employment growth and household incomes grew at a healthy clip. Still, Maryland's unemployment rate edged up slightly and the state experienced its first quarterly decline in home prices in nearly a decade.

Conflicting reports from the two employment surveys provided a mixed picture for the state's labor market. On the positive side, the payroll survey reported that Maryland added 6,800 jobs to its economy in the third quarter, for a 0.3 percent increase over the quarter and a 0.9 percent increase over the past 12 months. Gains were reported across the state's services-producing sectors, with the exception of a 0.8 percent (1,300 jobs) decline in financial activities employment. Other than the financial activities, the only other sector to experience net job losses was manufacturing, which lost 700 jobs over the quarter. The household survey, however, indicated that the unemployment rate inched up 0.1 percentage point in the third quarter to end at 3.6 percent — still the second-lowest unemployment rate among District jurisdictions. Reports on Maryland's household incomes were more encouraging, however: Household incomes increased at a 2.7 percent annualized rate in the third quarter, up sharply from the second quarter's tepid 0.3 percent pace.

Residential real estate activity contracted further, compounded by falling house prices and rising mortgage delinquencies. Retreating housing market activity showed few signs of slowing in the third quarter, with residential permitting activity down 25.5 percent over the quarter and 27.1 percent over the year. Existing home sales were also sharply lower, raising the market inventory of homes for sale to unusually high levels in markets across the state. In addition, Maryland saw a decline in home prices for the first time in almost 10 years. Its House Price Index indicated that Maryland home prices edged lower 0.3 percent during the third



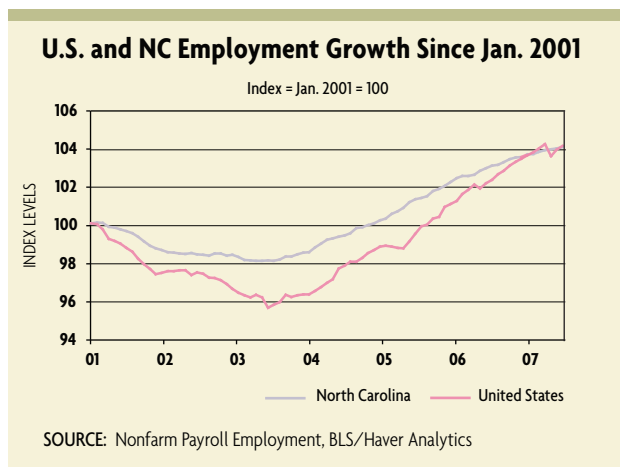
quarter, though home prices in the state remained slightly above year-ago levels.

The contraction of the housing market was also felt in mortgage delinquencies and foreclosure rates. The percentage of mortgages more than 90 days past due — which had been at cyclically low levels recently — increased sharply in the third quarter to an even 1.0 percent. The foreclosure rate also increased. Nonetheless, both rates remained below peak rates reached several years earlier.

North Carolina

Economic conditions were mixed across North Carolina in the third quarter. Residential home building and home sales were down, but income and payroll employment grew at a healthy pace and unemployment rates remained steady.

Payroll employment in North Carolina grew in the third quarter as the state added 15,500 jobs, a 0.4 percent increase over the second quarter and a 2.3 percent increase over the past 12 months. The gains were spread across sectors. The professional and business services sector accounted for the largest gain (3,900 jobs) during the quarter, while only three sectors — manufacturing, construction, and financial activities — saw net job losses in the third



quarter. Additionally, the state's unemployment rate remained steady at 4.7 percent in the third quarter — 0.2 percentage point higher than at the beginning of 2007, but 0.1 percentage point lower than the third quarter of 2006.

Household financial conditions remained generally healthy bolstered by solid real income growth. North Carolina household incomes rose at an annualized 3.8 percent in the third quarter and were up 4.5 percent over the past 12 months, the latter ranking as the fastest pace among Fifth District jurisdictions. On the other hand, higher levels of personal bankruptcy and mortgage delinquency indicated financial difficulties in some segments of the

state's population, although both measures remained below peak levels reached in the aftermath of the 2001 recession.

By any measure, residential real estate activity in North Carolina declined further in the third quarter. The number of permits issued was 16.7 percent lower than a year earlier as permit levels fell to their lowest mark since the second quarter of 2003. Previous declines in permit issuance had been concentrated in coastal areas and some of the smaller MSAs. However, that trend changed a bit in the third quarter as some of the larger MSAs, especially Charlotte, experienced substantial declines in permitting activity. In addition, existing home sales declined by 13.0 percent since the same quarter in 2006. House price growth across the state also slowed in the third quarter, though prices rose 6.6 percent over the past year.

South Carolina

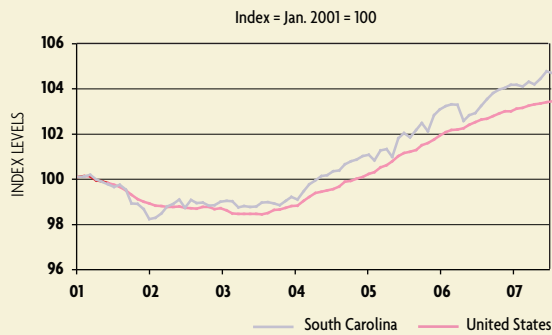
Recent readings on South Carolina's economy varied. Payroll employment expanded and incomes grew at a healthy clip, while the state's unemployment rate inched up and its housing markets weakened further.

South Carolina's labor markets produced some mixed signals in the third quarter. Payroll employment in the state grew 0.8 percent in the third quarter. The bulk of the gains came in the leisure and hospitality, and education and health services sectors, which accounted for nearly half of the 16,300 jobs added in the period. The government sector also posted solid employment gains, adding approximately 3,000 jobs in the quarter. The only sector to post net job losses was manufacturing — the sector lost an additional 400 jobs during the third quarter, marking its third consecutive quarterly decline. On the other hand, the state's unemployment rate edged higher 0.1 percentage point to finish the quarter at 5.8 percent — the highest jobless rate among Fifth District jurisdictions.

Reports on household financial conditions remained mostly positive. Real income growth accelerated in the third quarter, both in aggregate and per-capita terms. Annualized quarterly growth of 4.0 percent pushed the state's year-over-year growth rate back above 4.0 percent — the second-fastest growth rate among Fifth District jurisdictions. Personal bankruptcy filings also provided little evidence of financial strain on household balance sheets in the third quarter.

Modestly higher rates of mortgage delinquency and foreclosure reflected worsening conditions in the state's residential real estate markets. The share of all South Carolina-held mortgages that were at least 90 days delinquent moved higher in the third quarter. In fact, at 1.2 percent, the rate was near its recent peak from the second quarter of 2003, though it remained lower than the national rate of mortgage delinquency. In addition, home price growth in the state decelerated sharply in the third quarter to just 0.4 percent

U.S. and SC Employment Growth Since Jan. 2001



SOURCE: Nonfarm Payroll Employment, BLS/Haver Analytics

at an annual rate. Coastal areas bore the brunt of slower price growth, with the Charleston MSA posting home price growth of just 0.7 percent in the third quarter on the heels of a slight price decline in the second quarter. Many of the inland markets fared a bit better, posting more modest declines in home sales and home building.

Virginia

Another stretch of solid employment growth underpinned the healthy Virginia economy in the third quarter. The state retained the lowest unemployment rate in the Fifth District by a wide margin, and experienced payroll growth across most sectors of the economy, including construction. In contrast, Virginia's housing markets continued to languish with falling home sales and sluggish home building activity weighing on growth.

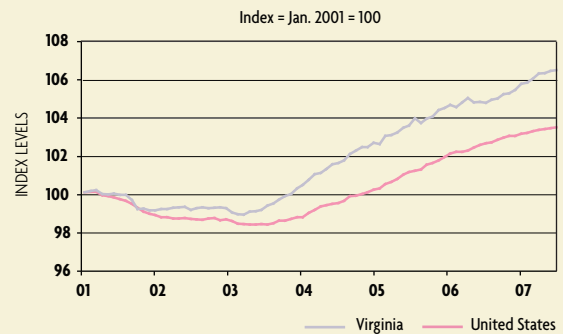
Both the payroll and household surveys underscored healthy labor market conditions in the state. Virginia added 5,300 jobs to its economy in the third quarter, for a quarterly growth of 0.1 percent and a year-over-year growth of 0.9 percent. On the other hand, Virginia's goods-producing sectors experienced declines in employment. Construction lost 2,900 jobs for its sixth consecutive quarter of payroll declines, while District factories cut 2,200 jobs for its 11th consecutive quarter of declines. Payroll performance on the services side was mixed. Job losses in financial services and information sectors were more than compensated for by gains in trade, professional and business services, education and health services, and leisure and hospitality. The government sector also posted employment growth in the third quarter. News from the household survey was also generally positive despite a small uptick in the state's jobless rate. Virginia's unemployment rate inched up 0.1 percentage point to 3.1 percent — a rate that matched the state's mark from a year-ago and was the lowest rate among Fifth District jurisdictions.

Turning to housing, Virginia's decline in residential real estate

activity continued in the third quarter. Residential permit issuance in the state declined sharply again, falling 22.7 percent since the second quarter. Additionally, existing home sales fell 12.6 percent in the third quarter, pushing the months' supply of homes above 10 months in some markets. The decline in homes sales contributed to a notable deceleration in home price appreciation in the third quarter. Existing home prices in Virginia rose just 0.3 percent at an annual rate, down from a peak annualized growth rate of 28.5 percent three years ago. Nonetheless, prices remained 2.9 percent higher than a year earlier, which is larger than the 2.2 percent increase experienced nationally over the same time period.

After a prolonged period of remaining relatively flat, mortgage delinquency and foreclosure rates began to rise across the state in the third quarter. The percentage of all mortgages past due by 90 days or more rose to 0.88 percent, which was low compared to the

U.S. and VA Employment Growth Since Jan. 2001



SOURCE: Nonfarm Payroll Employment, BLS/Haver Analytics

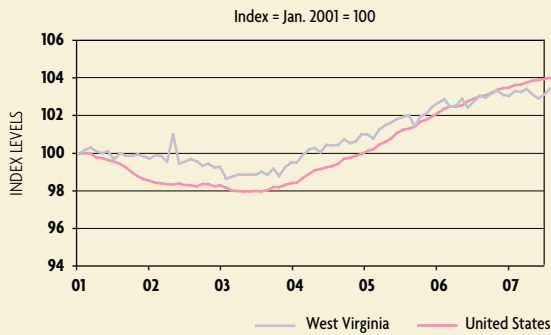
national rate, but double the figure posted a year earlier. The foreclosure rate also increased. Still, both marks were below recent peaks from earlier in the decade.

West Virginia

Economic conditions in West Virginia softened a bit in the third quarter, with little change in employment and further weakness in the state's housing markets. The state did see some encouraging indicators, however, including the resumption of positive income growth and relatively steady home price appreciation.

Labor market conditions deteriorated somewhat in the third quarter, characterized by weak job growth and higher unemployment. Employment gains in natural resources and mining, trade, transportation and utilities, education and health services, and leisure and hospitality were more than offset by losses in the construction, manufacturing, and government payrolls.

U.S. and WV Employment Growth Since Jan. 2001



SOURCE: Nonfarm Payroll Employment, BLS/Haver Analytics

In addition, West Virginia's unemployment rate edged higher by 0.2 percentage point to 4.7 percent, though it remained a touch

below the state's mark — 4.9 percent — from the third quarter of 2006.

On the real estate front, housing market activity declined further across the state in the third quarter. Permit issuance fell 15.4 percent during the three-month period and the pace of existing home sales in the state slowed 15.8 percent. Moreover, the state experienced a deceleration in year-over-year home price growth, but the decline was relatively modest in comparison to other Fifth District jurisdictions.

The financial condition of West Virginia households was supported by positive income growth. Household incomes grew 3.0 percent in the third quarter on the heels of a small decline in the second quarter. Additionally, the number of personal bankruptcies declined slightly. However, the state's already elevated rate of home foreclosures inched higher in the third quarter, highlighting mortgage problems among some segments of the populace.

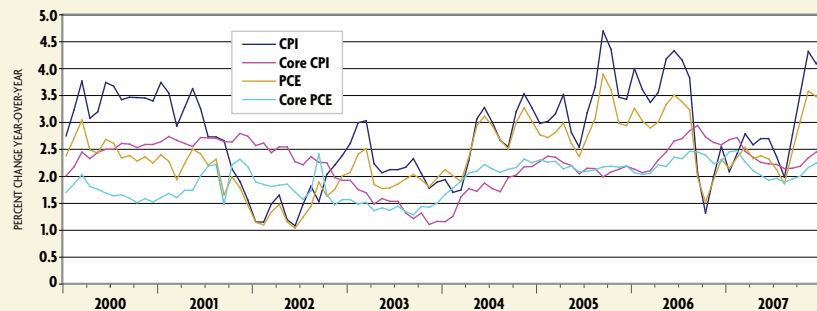
Behind the Numbers: Which Price Index?

When the press talks about inflation, it usually cites the Consumer Price Index, or CPI. This statistic measures the average price of a basket of goods and services regularly bought by a typical American family. Core CPI, by contrast, usually excludes food and energy on the premise that prices for these items tend to be volatile and lack persistence, and thus may not reflect the true source of inflation — too much new money chasing too few goods. As the graphic shows, the subtraction of food and energy makes core inflation much less volatile than “headline inflation.”

The Bureau of Labor Statistics releases the CPI data each month. The result is based on a massive collection process, encompassing 87 urban areas across the nation, with prices on approximately 80,000 items gathered from supermarkets, hospitals, stores, and gas stations, among many other establishments.

Economic policymakers, including those at the Federal Reserve, also closely monitor the Personal Consumption Expenditures (PCE) price index. The PCE is published by the Bureau of Economic Analysis. Its most frequently cited version uses a chain index, a formula that more accurately reflects the tendency of consumers to substitute away from items with fast-rising prices. (However, the PCE index isn't the result of individual data collection; the index is

Tracking Inflation



SOURCE: Bureau of Labor Statistics and Bureau of Economic Analysis

mostly based on the same item prices in the CPI.) Also, the PCE applies different weights than the CPI to items in its basket, captures some items not included in the CPI (but excludes others), and follows different seasonal adjustment patterns.

There is a large body of economic research on the accuracy of the various price indices. In the end, careful analysts take the time to understand the differences between the indices in determining the relative importance of changes in any of them. Roy Webb, a senior economist with the Richmond Fed, says that in general, both the CPI and the PCE indexes do a good job. “Any index is going to have the same problems that the CPI and PCE do,” Webb says. “I could make a good policy recommendation based on either the CPI or the PCE.”

— DOUG CAMPBELL

State Data, Q3:07

	DC	MD	NC	SC	VA	WV
Nonfarm Employment (000's)	699.9	2,625.3	4,096.6	1,934.3	3,794.3	758.6
Q/Q Percent Change	0.3	0.6	-0.1	0.5	0.4	-0.1
Y/Y Percent Change	1.8	1.5	1.7	1.9	1.8	0.4
Manufacturing Employment (000's)	1.6	133.8	543.0	243.6	287.4	59.4
Q/Q Percent Change	-4.1	-0.3	-0.7	-0.5	0.2	-0.3
Y/Y Percent Change	-7.8	-1.7	-1.9	-2.9	-0.2	-2.3
Professional Business Services Employment (000's)	160.1	402.8	491.2	217.9	646.8	61.4
Q/Q Percent Change	0.2	0.3	0.6	-0.1	-0.1	0.8
Y/Y Percent Change	4.2	2.0	3.2	-0.1	2.9	2.7
Government Employment (000's)	235.1	480.6	672.3	336.8	685.4	142.9
Q/Q Percent Change	0.5	2.0	-2.1	1.1	0.7	-1.2
Y/Y Percent Change	0.7	1.7	0.0	2.5	1.4	-1.1
Civilian Labor Force (000's)	315.4	2,994.3	4,526.5	2,145.2	4,053.3	815.9
Q/Q Percent Change	-1.4	-0.1	-0.1	-0.2	0.1	0.2
Y/Y Percent Change	0.1	-0.8	1.1	0.8	1.0	0.6
Unemployment Rate (%)	5.7	3.9	4.9	5.7	3.0	4.8
Q2:07	5.6	3.7	4.8	5.6	3.0	4.4
Q3:06	6.0	4.0	4.9	6.5	3.1	5.2
Real Personal Income (\$Mil)	30,194.7	221,332.1	260,813.7	116,291.0	272,608.5	45,629.4
Q/Q Percent Change	1.0	0.7	0.9	1.0	1.0	0.8
Y/Y Percent Change	3.7	3.4	4.5	4.2	3.6	2.6
Building Permits	527	4,680	19,872	8,430	8,352	979
Q/Q Percent Change	5.2	-25.5	-14.0	-29.8	-22.7	-15.4
Y/Y Percent Change	167.5	-27.1	-16.7	-29.9	-19.4	-18.8
House Price Index (1980=100)	681.1	542.8	344.9	317.3	481.2	234.8
Q/Q Percent Change	2.3	-0.3	0.9	0.1	0.1	1.4
Y/Y Percent Change	5.7	2.6	6.6	4.9	2.9	3.8
Sales of Existing Housing Units (000's)	9.2	78.0	202.8	101.6	108.4	25.6
Q/Q Percent Change	-11.5	-15.9	-12.3	-13.0	-12.6	-15.8
Y/Y Percent Change	-11.5	-28.6	-13.0	-10.6	-19.1	-19.0

NOTES:

Nonfarm Payroll Employment, thousands of jobs, seasonally adjusted (SA) except in MSAs; 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 MSAs; 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, Q3:07

	Washington, DC MSA	Baltimore, MD MSA	Charlotte, NC MSA
Nonfarm Employment (000's)	2,429.5	1,313.3	839.5
Q/Q Percent Change	-0.3	-0.1	-0.5
Y/Y Percent Change	1.5	0.7	0.0
Unemployment Rate (%)	3.1	4.1	4.9
Q2:07	3.0	3.8	4.7
Q3:06	3.3	4.4	4.9
Building Permits	4,530	1,741	4,826
Q/Q Percent Change	-38.0	5.9	-23.5
Y/Y Percent Change	-30.5	-2.5	-25.1

	Raleigh, NC MSA	Charleston, SC MSA	Columbia, SC MSA
Nonfarm Employment (000's)	499.9	295.0	362.8
Q/Q Percent Change	0.2	0.1	-0.8
Y/Y Percent Change	2.4	3.0	1.1
Unemployment Rate (%)	3.7	4.7	5.2
Q2:07	3.7	4.2	4.7
Q3:06	3.8	5.5	5.9
Building Permits	4,541	1,601	1,372
Q/Q Percent Change	7.8	-27.1	-40.7
Y/Y Percent Change	25.7	-19.3	-24.7

	Norfolk, VA MSA	Richmond, VA MSA	Charleston, WV MSA
Nonfarm Employment (000)	783.9	635.1	151.6
Q/Q Percent Change	0.0	-0.5	-0.2
Y/Y Percent Change	1.8	1.1	0.8
Unemployment Rate (%)	3.2	3.1	4.1
Q2:07	3.1	3.0	4.1
Q3:06	3.5	3.3	4.5
Building Permits	1,357	1,559	75
Q/Q Percent Change	-13.8	-27.0	7.1
Y/Y Percent Change	-15.2	-14.9	8.7

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