



REGIONAL HIGHLIGHTS

First Quarter 2005

Business Activity Advances; Employment Increases Moderately

Business activity in the tri-state region (Pennsylvania, New Jersey, and Delaware) expanded moderately in the first quarter. Manufacturing continued to expand, and service-sector activity increased. Sales of general merchandise rose compared with a year ago, although auto sales slowed. Residential building activity picked up slightly, and conditions in commercial real estate markets were steady. Employment in the three states of the region increased in the first quarter, but the gain was less than in the fourth quarter of last year. The Philadelphia Fed is forecasting continued job growth in each of the three states this year and further declines in each state's unemployment rate.

Manufacturing Activity Still on an Upward Trend

Activity in the region's manufacturing sector continued to expand in the first quarter. Although the pace of improvement eased somewhat from the fourth quarter of last year, it was the seventh consecutive quarter of expansion among the firms participating in the Philadelphia Fed's *Business Outlook Survey* (Chart 1). Area manufacturers reported increases in shipments and new orders (Chart 2). Business rose for firms in most of the region's major manufacturing industries during the first quarter. Growth in demand was especially notable among makers of industrial materials and equipment. Increased demand for these products reflects rising capital investment in the national and regional economies. Nationally, capital spending grew much more rapidly in 2004 than in 2003. National data for the first quarter were unavailable when this issue was prepared, but our *Business Outlook Survey* indicates that capital spending in the region continued to be strong in the first quarter. In fact, through March the survey's capital spending index was 20 or higher for 16 months, the longest string of readings at 20 or above since 1983-84 (Chart 3).

Area manufacturers continued to note rising prices for industrial commodities, and they raised prices for their own products as well. Although reports of rising prices were much less widespread than in the fourth quarter of 2004, the incidence of price increases remained high (Chart 4). Similarly, although the number of manufacturers anticipating further price hikes has dropped somewhat, many more anticipate increases than decreases.

Area manufacturers expect continued increases in activity (Chart 5). About four out of 10 of the firms polled in the March

survey anticipate that business will rise during the next six months; only one out of eight expects business to slow.

Retail Sales Advance

Retailers in the region generally posted moderate increases in sales of general merchandise for the first quarter of 2005 compared with the first quarter of 2004, and sales continued to trend up during the quarter. Retailers cleared out winter merchandise through discounting, and as the spring selling season began, most stores saw a favorable reception for spring apparel by consumers. However, as the quarter came to a close, unseasonably cold and rainy weather in March held down sales of spring apparel and other seasonal merchandise. In a continuation of a trend noticed last year, stores specializing in luxury goods continued to post better year-over-year sales gains than stores selling less expensive merchandise. Also, stores in the region's largest metropolitan areas generally had better sales performance in the first quarter than stores in less urbanized areas. Looking ahead, the region's retailers generally expect the pace of sales to improve as spring progresses, and most anticipate that sales for the rest of the year will be modestly above last year's.

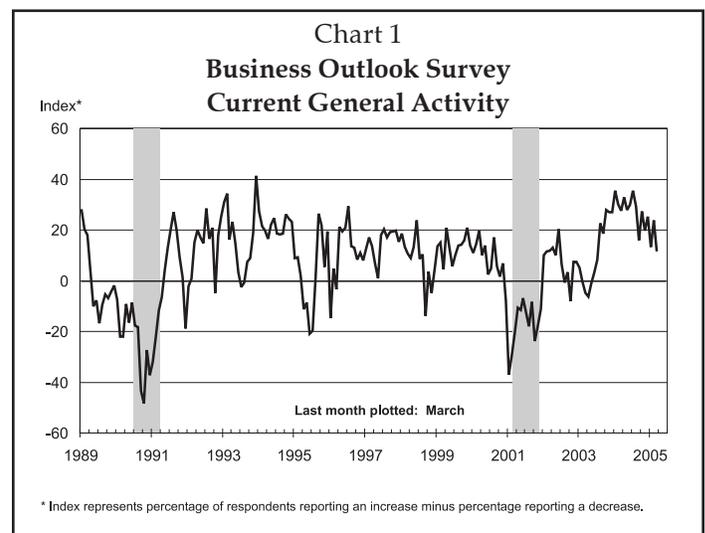
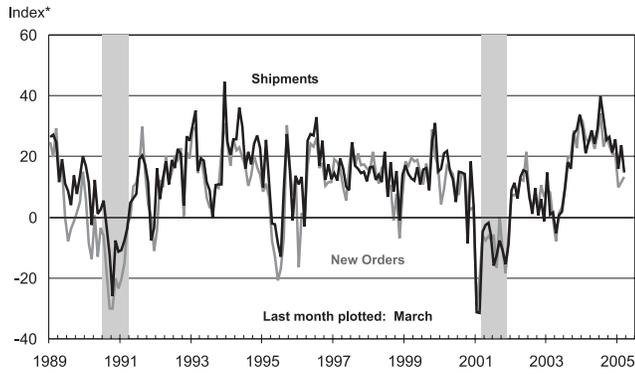


Chart 2
Business Outlook Survey
Current New Orders and Shipments



* Index represents percentage of respondents reporting an increase minus percentage reporting a decrease.

Auto sales in the region generally followed the same trend as national sales in the first quarter of 2005. Sales were weak in January, then picked up in February and March. Despite that improvement, sales for the quarter as a whole were below sales in the first quarter of 2004. Some, though not all, import dealers posted healthy year-over-year gains, while sales of most domestic makes were weaker. The inventories of most area dealers remained high, although not as much as at the beginning of the quarter. Auto dealers in the region expect sales to move up during the spring, boosted by manufacturers' rebates. Nevertheless, they expect that sales for 2005 as a whole will be down from 2004.

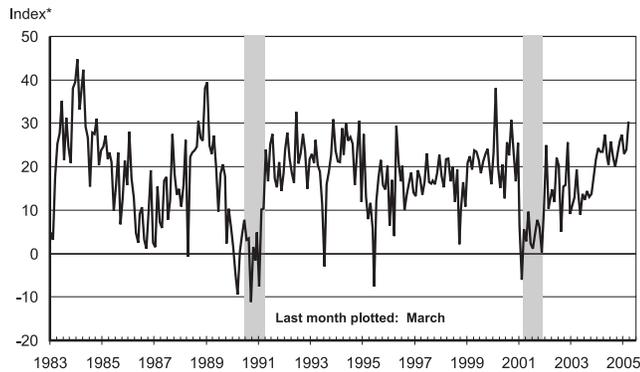
Residential Building Strengthens;
Home-Price Increases Moderate

Residential building generally increased in the region during the first quarter. The number of housing permits rose in New Jersey and Delaware but was virtually flat in Pennsylvania (Chart 6). The upturn in permits was a break from the generally downward trend of most of last year. The increase in permits in the region was about in line with the increase in the nation.

Residential real estate agents in the region indicated that home sales were slow in January but picked up subsequently. Real estate agents expect the pace of sales to accelerate somewhat with the arrival of spring, although they anticipate sales for the year as a whole will be slightly below last year.

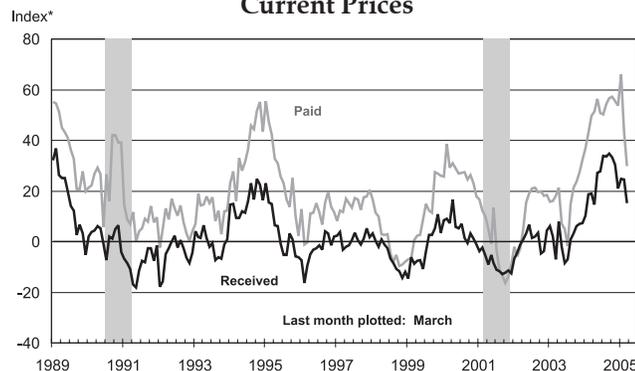
The latest data from the Office of Federal Housing Enterprise Oversight indicates a moderation in the rate of price increases for existing houses throughout the country during the fourth quarter of last year (latest available data). Nevertheless, compared with the fourth quarter of 2003, existing house prices showed large gains. In the region, price appreciation has generally been more rapid in New Jersey and Delaware than in the nation, and on par with the nation in Pennsylvania (Chart 7). In the fourth quarter, the year-over-year increase was 14 percent in New Jersey, 15 percent in Delaware, and 11 percent in Pennsylvania. The national increase was 11 percent. New Jersey ranked 11th in house-price appreciation among the 50 states and the District of Columbia, Delaware ranked ninth, and Pennsylvania ranked 16th. In the first quarter, residential real estate agents in the region reported continuing price appreciation for existing homes, although they noted that asking prices for houses in the highest price range have apparently risen to a level that has slowed sales.

Chart 3
Business Outlook Survey
Future Capital Expenditures



* Index represents percentage of respondents reporting an increase minus percentage reporting a decrease.

Chart 4
Business Outlook Survey
Current Prices



* Index represents percentage of respondents reporting an increase minus percentage reporting a decrease.

Commercial Real Estate Conditions Are Steady

There has been little change in commercial real estate conditions in the region, but the demand for commercial real estate appears to have strengthened somewhat. Rental rates have been mostly unchanged around the region. Vacancy rates in the region's office markets have been roughly steady, on balance, in the past few months. There have been slight increases in some areas, including Philadelphia's central business district, and slight decreases in other areas. However, the amount of occupied office space has grown, and commercial real estate firms expect office vacancy rates to decrease through the year in most parts of the region as economic activity and hiring expand. Vacancy rates for retail space have improved a bit, and leasing activity has edged up. Industrial building vacancy rates have declined slightly in recent months, but rents have been nearly steady. Commercial real estate firms have observed an increase in the speculative construction of warehouses and other industrial

buildings, which they believe reflects optimism among developers that regional economic conditions are improving.

Employment Improves but at a Slower Pace

Employment increased in the first quarter in each of the states, as it did in the nation. The pace of growth in the region eased somewhat from the fourth quarter of last year in Pennsylvania and New Jersey, but quickened in Delaware (see Table 1 on page 4). Compared with the fourth quarter, there were gains in most of the major industry supersectors defined by the U.S. Bureau of Labor Statistics. The largest percentage increase in Pennsylvania was in professional and business services. In New Jersey, the greatest gain was in other services (repair and personal services), followed closely by leisure and hospitality. In Delaware, the largest relative increase was in leisure and hospitality. The largest percentage increase nationally was in natural resources and mining, although this supersector has less employment than any other. There were decreases in employment in manufacturing in the nation and in Pennsylvania and New Jersey. Information services employment declined in the nation and in Delaware. In the region, construction employment fell in Pennsylvania and New Jersey, and professional and business services employment fell in New Jersey.

The unemployment rates of Pennsylvania and New Jersey decreased from the fourth quarter of last year to the first quarter of this year, whereas Delaware's rate edged up. The national rate declined slightly in the first quarter. The unemployment rates in New Jersey and Delaware are a percentage point below the national rate; Pennsylvania's rate is roughly the same as the national rate.

Moderate Expansion Is Forecast

The consensus view of the region's business community is that business activity will continue to expand at about its current growth rate. Manufacturers forecast increases in shipments and orders during the next six months. Firms in the service sectors of the regional economy look for steady or slightly quicker growth in the rest of the year. Retailers expect the pace of sales to pick up as warm weather takes hold, and they look for modest gains for the year as a whole. However, auto dealers anticipate lower sales this year than in 2004, even though they expect sales to be better in the spring than in the winter. Likewise, both home builders and residential real estate agents expect home sales to be lower this year than last. Commercial real estate firms expect vacancy rates for office buildings to begin edging down during the rest of the year in most parts of the region.

The employment outlook is positive, as comments from employers indicate that more plan to add than reduce staffing levels in the second quarter. The Philadelphia Fed is forecasting increases in employment in each of the three states of 1.4 to 1.6 percent from the fourth quarter of 2004 to the fourth quarter of this year. This represents a pickup in job growth compared with the previous four quarters for Pennsylvania and New Jersey, but slower growth for Delaware (see Table 2).

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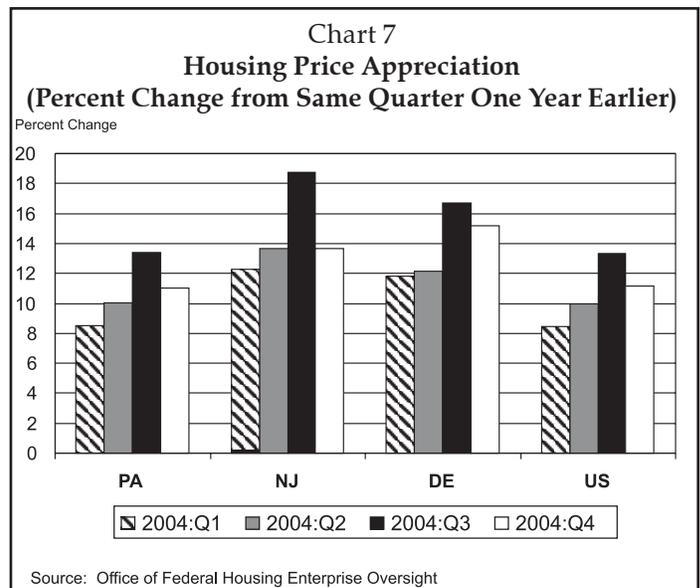
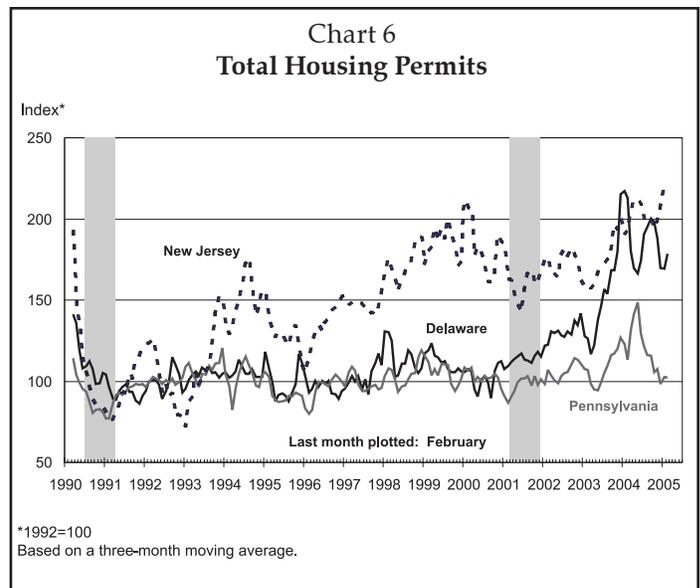
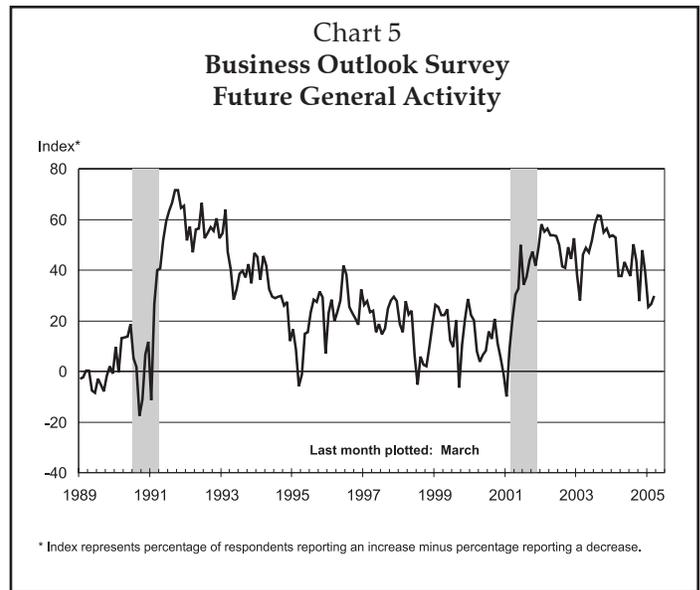


Table 1
Unemployment Rates and Employment Growth
Seasonally Adjusted

	Quarterly*					Annual	
	2004				2005	2003:I - 2004:I	2004:I - 2005:I
	I	II	III	IV	I**		
3-STATE TOTAL							
Unemployment Rate	5.3	5.2	5.2	5.1	4.7	5.6	5.1
Payroll Employment Growth	-0.1	1.3	1.2	1.4	1.0	0.2	1.2
PENNSYLVANIA							
Unemployment Rate	5.5	5.5	5.6	5.6	5.2	5.6	5.5
Payroll Employment Growth	0.0	1.4	0.8	1.2	0.8	0.0	1.0
NEW JERSEY							
Unemployment Rate	5.3	4.9	4.7	4.4	4.2	5.8	4.7
Payroll Employment Growth	-0.8	1.4	1.6	1.6	0.8	0.3	1.4
DELAWARE							
Unemployment Rate	4.0	4.1	4.1	4.1	4.2	4.0	4.1
Payroll Employment Growth	4.0	0.3	2.3	2.4	4.2	2.7	2.3
UNITED STATES							
Unemployment Rate	5.7	5.6	5.4	5.4	5.3	5.9	5.5
Payroll Employment Growth	1.2	2.4	1.2	1.7	1.4	0.3	1.7

* Payroll employment growth is annualized change from previous quarter.

** State values are calculated with two months of data.

Table 2
Regional Forecast

	Forecast 2004:IV - 2005:IV			Actual 2003:IV- 2004:IV		
	PA	NJ	DE	PA	NJ	DE
Employment	1.6	1.6	1.4	0.8	1.0	2.2
Unemployment Rate*	5.0	4.0	3.9	5.6	4.4	4.1

* Unemployment rate forecasts represent the expected unemployment rate in 2005:IV, while the actual unemployment rate represents 2004:IV.