

REGIONAL HIGHLIGHTS

Federal Reserve Bank
of Philadelphia

Second Quarter 1999

Region's Steady Growth Continues

- *Moderate Job Growth Continues in Tight Labor Market*
- *Unemployment Falls Below 4 Percent in Many Metro Areas*
- *Little Change in Growth or Inflation Is Expected*

The region's economy continued its steady, if unspectacular, growth in the second quarter. As was the case throughout 1998 and the first quarter of 1999, the region's growth lags that of the nation. Still, the Third District economy is operating near capacity, at least as reflected in the labor market. Unemployment rates have dipped to their lowest levels in 10 years. Most regional economic indicators point to continued moderate growth in the near term. Despite tight labor markets, there is little hard evidence of strong upward pressure on wages. Some manufacturers, however, are reporting increases in prices for intermediate goods, but these manufacturers are not reporting increases in output prices. Growth in the region cuts across most industrial sectors. Manufacturers have reported healthy growth for most of the second quarter, although June appears weaker and manufacturing employment continues to shrink. The construction industry is operating at a rapid pace with high employment, although the pace eased a little in the second quarter. Retailers report healthy sales, and employment continues to expand in this

sector. Reflecting the healthy economy, bank lending is expanding, especially in real estate, both residential and commercial.

Jobs Continue to Increase and Unemployment Continues to Fall

Tri-state employment continued its modest growth in the second quarter, increasing 0.3 percent, after growing 0.3 percent in both the first quarter of this year and the fourth quarter of 1998 (Figure 1). These employment growth rates are lower than the national growth rate of 0.5 percent in the second quarter and 0.6 percent in the first quarter of this year. The region's employment growth rate averaged roughly 60 percent of the nation's over the last year-and-a-half.

Second-quarter employment growth cut across all sectors except manufacturing. The personal and business service sector recorded the fastest rate of growth, followed by Finance, Insurance and Real Estate (FIRE), and the trade sectors. The hospital sector—especially teaching hospitals—is a potential drag on employment growth, particularly in the Philadelphia metropolitan economy. Both Jefferson University and the Hospital of the University of Pennsylvania have recently announced layoffs, and there is concern that more cost-cutting may be necessary. Still, based on payroll employment data, the hospital and health care sector is not contracting.

All three states in the Third District are experiencing employment growth. Payroll employment in Pennsylvania grew 0.2 percent in the second quarter, after

rising 0.2 percent in the first. New Jersey jobs rose 0.5 percent in the second quarter and 0.4 percent in the first. Delaware, which typically has the fastest job growth in the region, saw employment rise 0.4 percent in the second quarter, after rising a strong 1.1 percent in the first. Employment in the Philadelphia metropolitan area grew 0.1 percent in the second quarter, following a 0.4 percent gain in the first. After a decline of 0.2 percent in the fourth quarter of 1998, the city of Philadelphia managed an increase in jobs of 0.4 percent in the first quarter of this year and an increase of 0.2 percent in the second.

Because of the relatively slow rate of labor force growth in the tri-state area, the moderate gains in payroll employment have resulted in an unemployment rate of 4.2 percent, slightly lower than the national rate. In the second quarter, Pennsylvania's unemployment rate fell from 4.4 percent to 4.0 percent while New Jersey's unemployment rate increased 0.3 percentage point, to 4.6 percent, and Delaware's increased 0.4 percentage point, to 3.5 percent. Most local labor markets have relatively low unemployment rates (Figure 2). The Lancaster metropolitan area has the lowest, 2.3 percent. Philadelphia's rate is 3.7 percent. Vineland's and Atlantic City's unemployment rates, which typically are the highest in the Third District, remain relatively high: 8.7 and 8.1 percent, respectively.

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Figure 1
UNEMPLOYMENT RATES AND EMPLOYMENT GROWTH*
 Seasonally Adjusted

1998

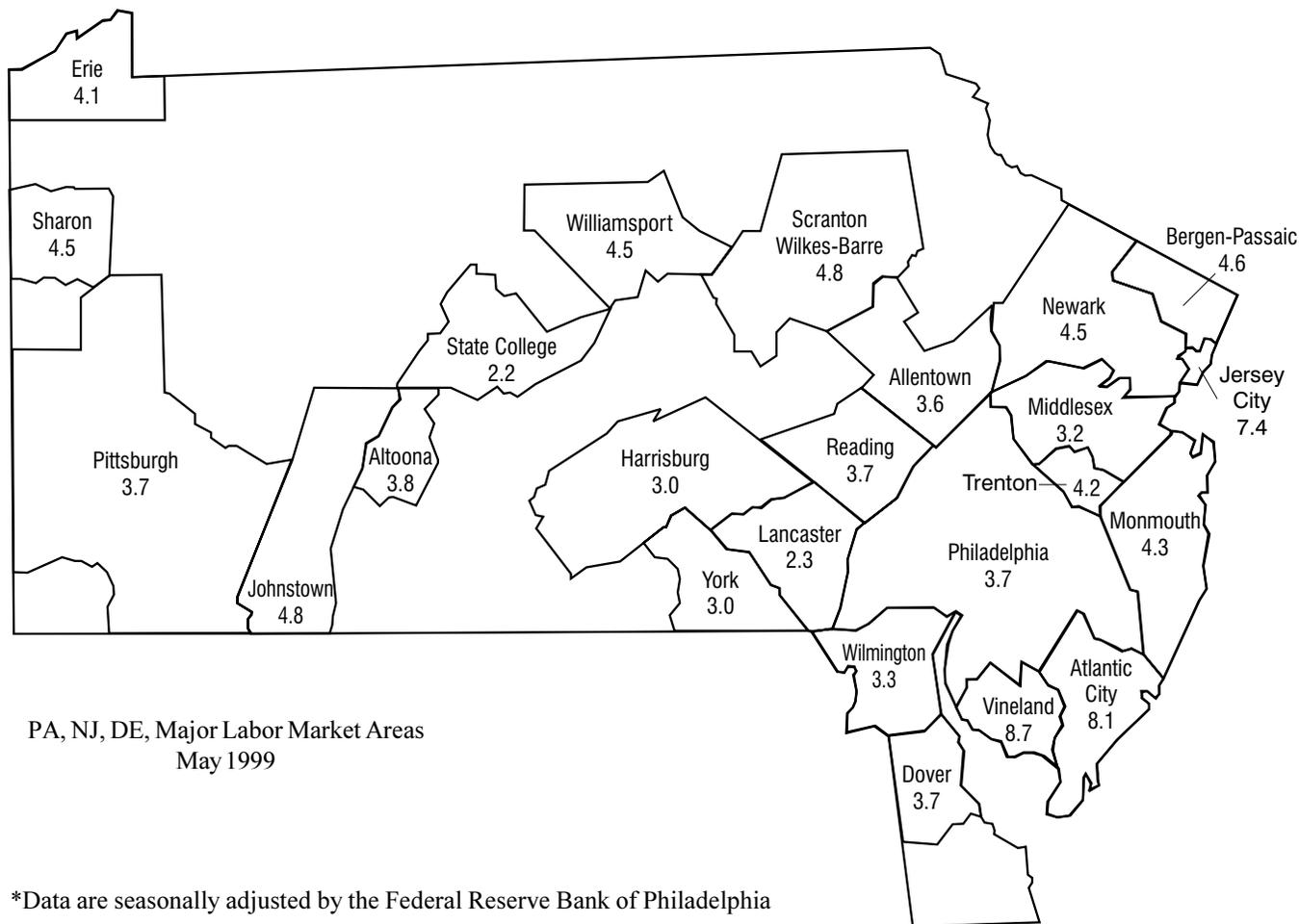
1999

| | I | II | III | IV | I | II** |
|----------------------------|------|------|-----|-----|-----|------|
| 3-STATE TOTAL | | | | | | |
| Unemployment Rate | 4.8 | 4.6 | 4.6 | 4.4 | 4.3 | 4.2 |
| Payroll Employment Growth | 0.5 | 0.3 | 0.4 | 0.3 | 0.3 | 0.3 |
| Resident Employment Growth | -0.3 | -0.1 | 0.1 | 0.5 | 1.0 | 0.4 |
| PENNSYLVANIA | | | | | | |
| Unemployment Rate | 4.8 | 4.6 | 4.6 | 4.5 | 4.4 | 4.0 |
| Payroll Employment Growth | 0.5 | 0.3 | 0.4 | 0.1 | 0.2 | 0.2 |
| Resident Employment Growth | -0.2 | -0.1 | 0.0 | 0.1 | 0.9 | 0.6 |
| NEW JERSEY | | | | | | |
| Unemployment Rate | 4.7 | 4.7 | 4.6 | 4.5 | 4.3 | 4.6 |
| Payroll Employment Growth | 0.5 | 0.4 | 0.4 | 0.4 | 0.4 | 0.5 |
| Resident Employment Growth | -0.6 | -0.2 | 0.1 | 0.9 | 1.1 | 0.2 |
| DELAWARE | | | | | | |
| Unemployment Rate | 4.0 | 4.1 | 3.8 | 3.4 | 3.1 | 3.5 |
| Payroll Employment Growth | 0.6 | 0.5 | 0.7 | 0.9 | 1.1 | 0.4 |
| Resident Employment Growth | 0.8 | 0.8 | 1.1 | 1.4 | 0.6 | -0.6 |
| PHILADELPHIA MSA | | | | | | |
| Unemployment Rate | 4.5 | 4.4 | 4.3 | 4.0 | 4.0 | 3.8 |
| Payroll Employment Growth | 0.9 | 0.1 | 0.5 | 0.2 | 0.4 | 0.1 |
| Resident Employment Growth | 0.0 | -0.3 | 0.5 | 0.3 | 0.3 | 0.7 |
| UNITED STATES | | | | | | |
| Unemployment Rate | 4.6 | 4.4 | 4.5 | 4.4 | 4.3 | 4.3 |
| Payroll Employment Growth | 0.7 | 0.6 | 0.5 | 0.6 | 0.6 | 0.5 |
| Resident Employment Growth | 0.4 | 0.3 | 0.1 | 0.6 | 0.8 | 0.0 |

* Percent change from previous quarter.

** Percent change based on two months of data. US unemployment rate and employment growth based on a full quarter of data.

Figure 2
THREE-STATE UNEMPLOYMENT RATES*



Inflation Remains in Check, But Caution Needed

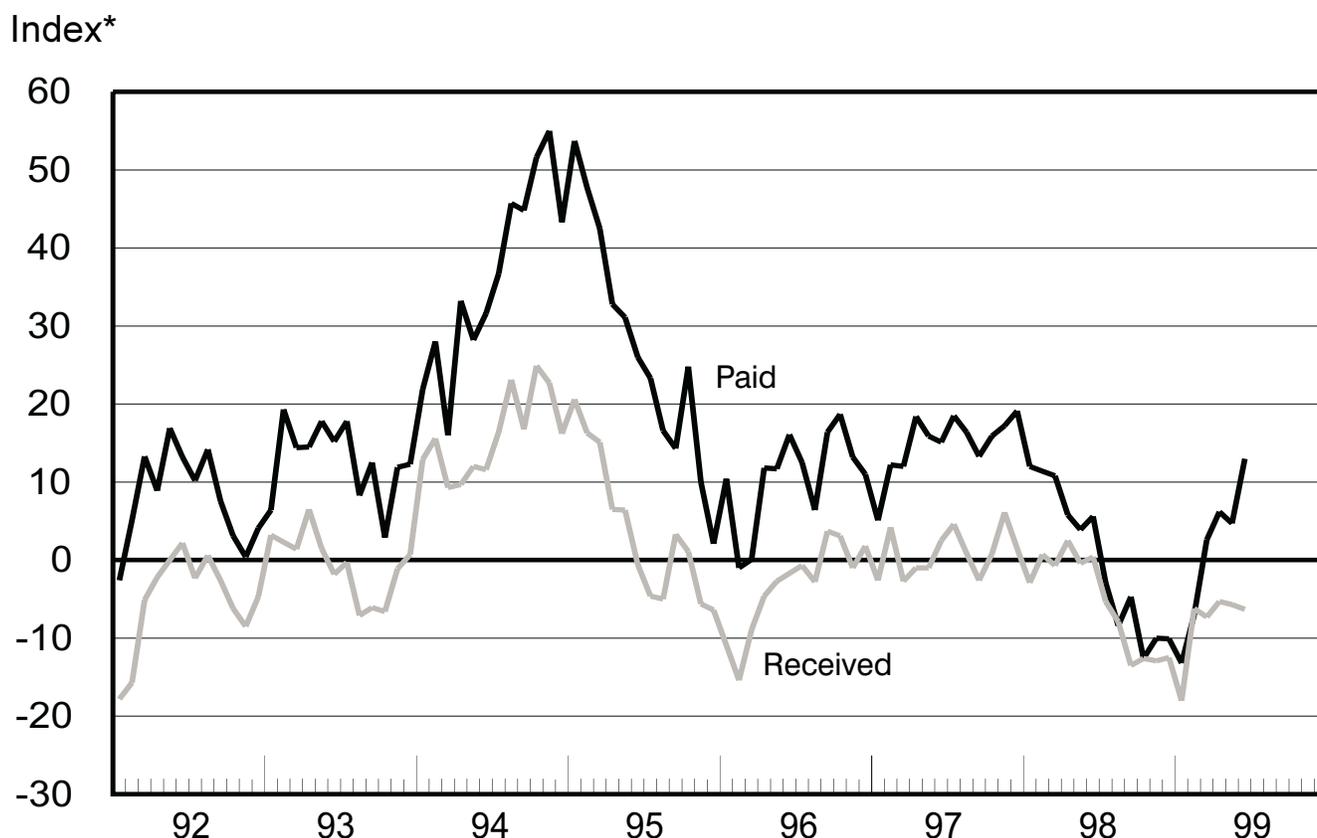
Prices in the region remain stable, although there are some mixed signals regarding prices. The CPI in the Philadelphia region appears to be increasing at roughly the same rate as in the nation. The annualized rate of CPI inflation for the Philadelphia area during the first four months of 1999 (measured from the December 1998 level) is 2.4 percent, compared with 2.3 percent for the nation. Note, however, that the Philadelphia CPI

is available only every other month, so that our CPI information is based on only two data points this year: February and April. Moreover, there have been wide swings in the Philadelphia CPI this year, reducing confidence in any single reading. For example, the CPI fell at an annual rate of 4.5 percent from December of 1998 to February 1999, but it rose at an annual rate of 9.6 percent from February to April. If one is searching for signs of increasing price pressure in the region, the April number can be interpreted that

way. Because of the recent variability in the Philadelphia CPI, however, little weight should be placed on the April reading alone.

According to the Employment Cost Index, despite tight labor markets, wages and salaries in the Northeast increased only 3.4 percent over the last 12 months, slightly faster than wages and salaries for the nation, which increased 3.3 percent. Total compensation, including benefits, increased 3.3 percent in the Northeast and 3.0 percent in the nation. The 3.4 percent

Figure 3
BUSINESS OUTLOOK SURVEY
Current Prices



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

increase in wages and salaries was slightly lower than the 3.6 percent increase for the 12-month period ending December 1998. On the negative side, while the rates of increase in the national indexes for wages and salaries and for total compensation have fallen sharply from their peak in September 1998, these indexes for the Northeast have fallen only marginally over the same period.

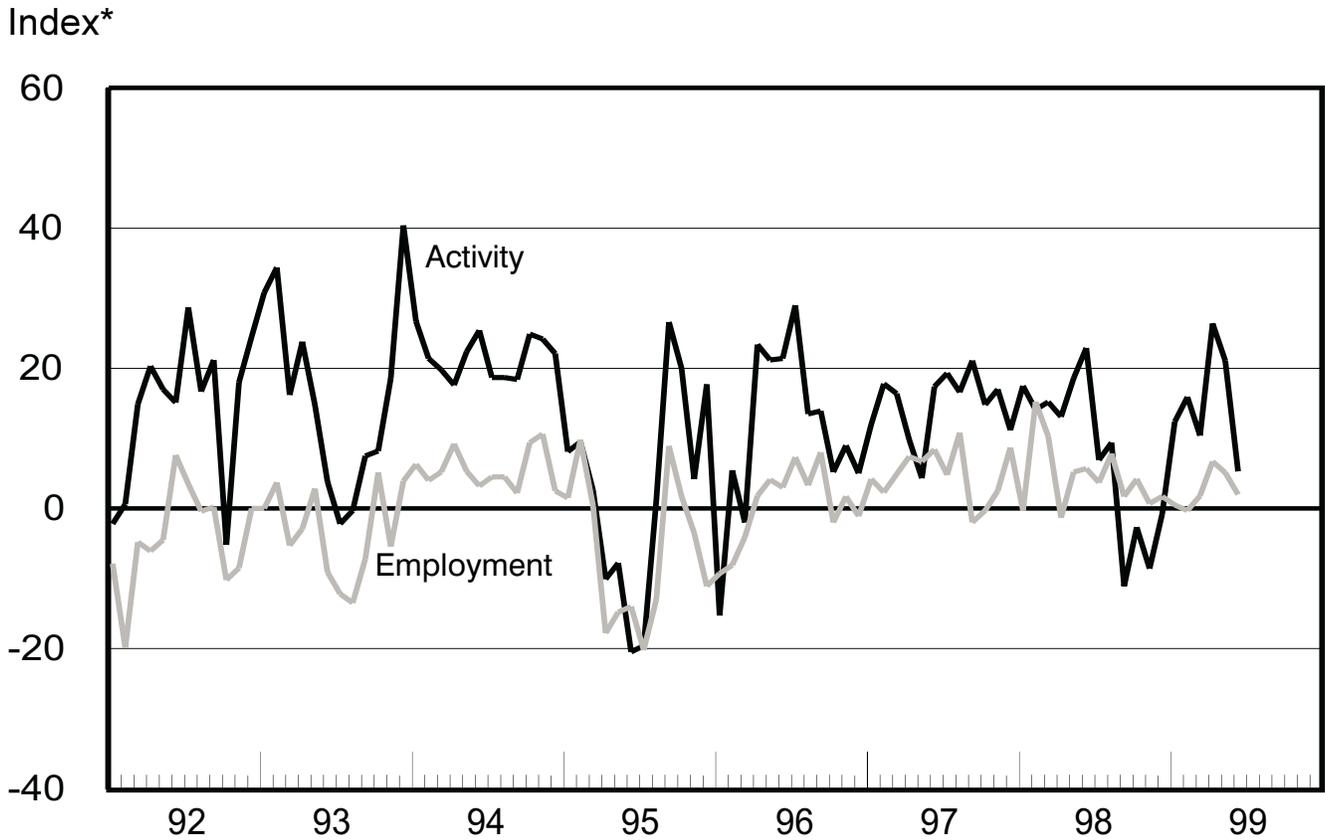
The Philadelphia Federal Reserve Bank's Business Outlook Survey (BOS), which reports on the manufacturing

sector and is the most current indicator, yields a mixed picture for industrial prices. The index for manufacturing input prices has been rising in recent surveys, from -13.2 in January to its reading of 13.0 in June (Figure 3). The diffusion index for prices received remains negative at -6.3. Based on this index, there is no evident upward trend in prices for final manufactured goods.

Growth Continues in Most Sectors, But Some Evidence of a Slower Pace

Indicators of growth for the Third District's manufacturing sector are mixed. The BOS data for June point to a slowdown in the pace of growth for the Third District's manufacturing sector. This information must be interpreted cautiously because it reflects only a single month, following strong readings in the preceding two months. The Business Outlook Survey's main index of current economic activity fell sharply from 21.1 in May to 5.3 in June (Figure 4). Consistent with the general activity index, indexes for

Figure 4
BUSINESS OUTLOOK SURVEY
Current Activity and Employment



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

new orders, shipments, and employment all fell in June, but remained positive.

Despite strong readings for the general activity index earlier this year, manufacturing employment in the region continues to fall. Manufacturing employment in the tri-state area fell 0.5 percent in the first quarter and fell another 0.5 percent in the second quarter. Manufacturing employment has fallen in each of the last four quarters. Since the fourth quarter of 1998, nearly 14,300 manufacturing jobs have been eliminated in the

region.

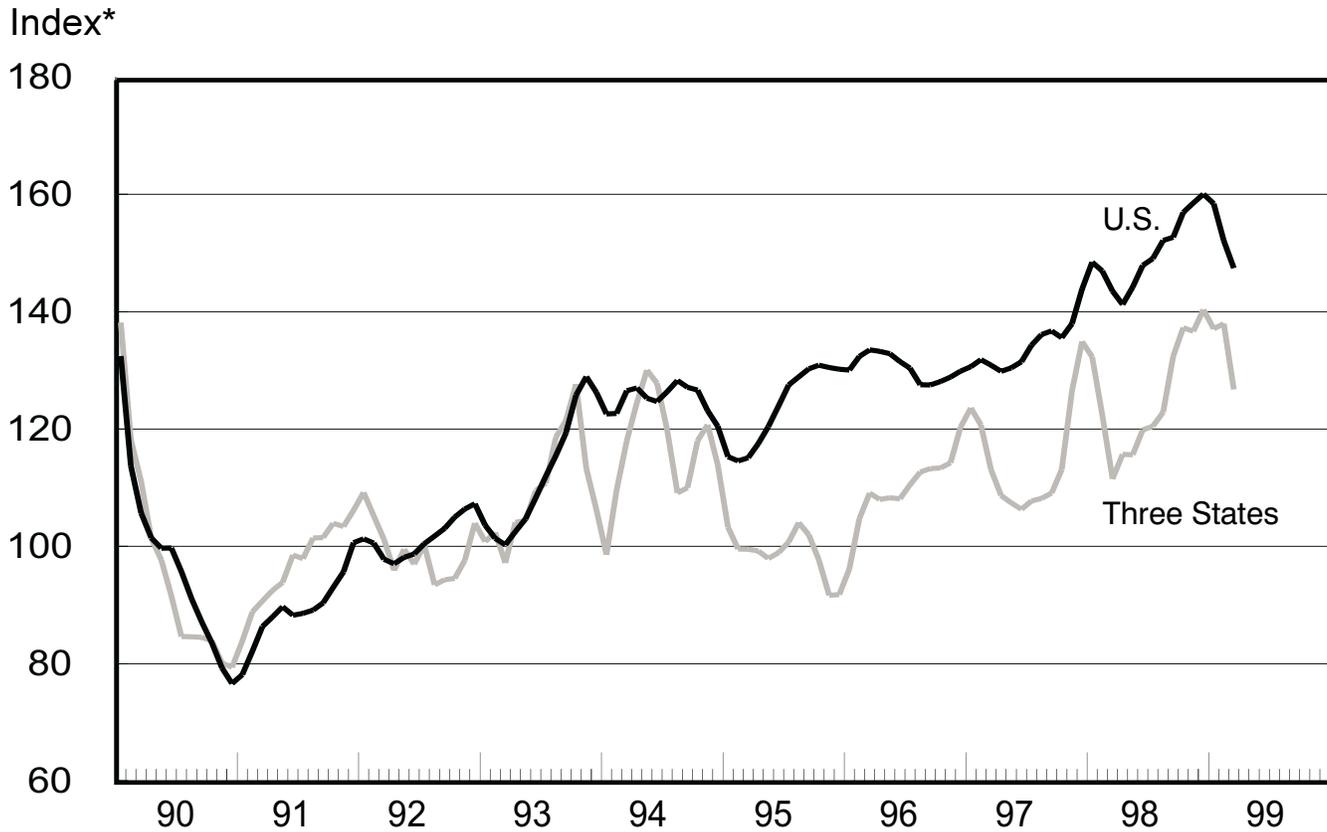
Although it has slowed somewhat in recent months, the construction sector is strong. The strength of the sector is reflected in construction employment: tri-state construction jobs are now at their highest level since 1990. Tri-state construction employment has increased by 9200 jobs this year.

Residential construction has been strong so far this year, especially in Delaware and New Jersey, but the pace appears to be easing in recent months.

Issuance of housing permits in the tri-state area continued at very high levels in the first quarter but dipped in the second quarter. Permits are still being issued at a relatively fast pace (Figure 5). The rate of permit issuance is more than 50 percent higher than the level that prevailed in the beginning of 1996.

The value of residential construction contracts follows a pattern similar to that of permits. For the first five months of this year, the value of residential construction contracts in the tri-state area is

Figure 5
HOUSING PERMITS



* 1992=100

Housing units authorized by building permits; based on a three-month moving average.

up 9.2 percent, compared with the same five months last year. Note that the first quarter of 1998 was very strong as well, so the increase is on a high base. Delaware led the growth with a gain of 23.3 percent, New Jersey followed with a gain of 16.2 percent, and Pennsylvania increased 2.8 percent. The pace of growth of tri-state residential construction contracts, at 9.2 percent, was slightly higher than the 8.7 percent growth for the nation.

Nonresidential construction, while

still relatively healthy, has weakened considerably during the first half of the year. Tri-state nonresidential construction, as reflected in the value of new contracts, fell in the first quarter from the very high levels prevailing in the fourth quarter of 1998. Compared with the same period last year, construction contracts were down 5.7 percent in the first five months of 1999. Pennsylvania experienced a decline of 4.4 percent, New Jersey fell 3.0 percent, and Delaware dropped a substantial 53.8 percent.

However, little should be read into the Delaware numbers because they are very volatile and a relatively small part of the Third District economy. The tri-state decline was slightly greater than the national decline of 5.6 percent.

Office markets in the region continue to tighten, an occurrence that bodes well for future nonresidential construction. The office vacancy rate in Philadelphia's central business district was 11.7 percent in the first quarter, down 4.4 percentage points from the same period a year ago.

This performance is good, especially considering the effects of mergers and consolidations, such as First Union's purchase of CoreStates and the split of Conrail among Norfolk Southern and CSX. CBD office rents increased \$2.34 per square foot, or 10 percent, compared with the same period last year. Suburban office vacancy rates have fallen into single digits (9.9 percent).

Retail sales in the region are good, and they improved in April and May. Retailers report strong year-over-year gains. Sales of autos, apparel, and seasonal goods have led the growth. Employment in the trade sector continues to expand; during the first five months of the year, jobs in the wholesale and retail trade sector increased by 12,500 over the fourth quarter of last year.

Area banks report an expansion in loans. Real estate lending, both residential and commercial, is strong. Banks also suggest that real estate developers are seeking higher leverage in their development projects. There is also rising loan demand from small and medium-size businesses. Banks report that consumer lending was flat, but some banks were reallocating lending from consumers to other, more profitable sectors.

Region's Moderate Growth Will Continue

The outlook for the region's economy is for growth at roughly the same pace as last year, but slower than that expected for the nation. Time-series forecasts suggest that the region will grow moderately on a first-quarter over

first-quarter basis. From the first quarter of 1999 to the first quarter of 2000, employment is forecast to grow 1.2 percent in Pennsylvania, 1.1 percent in New Jersey, and 2.8 percent in Delaware. Unemployment rates are expected to remain near their current levels.

Other indicators also suggest moderate growth in the second half of the year. The future general activity index from the June BOS fell somewhat but remains positive at 10.4. The index for future employment is slightly positive as well. Unemployment claims in the tri-state area have basically been flat in recent months, although they fell somewhat in May. Our leading indexes for both New Jersey and Pennsylvania are now positive and have been trending up in recent months.

Richard Voith

