REGIONAL HIGHLIGHTS

Federal Reserve Bank
of Philadelphia

Third Quarter 1999

Region's Growth Continues at a Slower Pace

- *Job Growth Slows Despite Reports of Tight Labor Markets*
- *Unemployment Ticks Up Slightly*
- *Signs of Upward Pressure on Prices Become Evident*

Although most recent discussions of the regional economy have focused on the tight labor market, the pace of growth of the region's economy appeared to slow somewhat in the third quarter. Tri-state area job growth, which has lagged the nation for the last seven quarters, slowed considerably in the third quarter. In addition, unemployment rates have slowly moved upward in the last two quarters. Most regional economic indicators point to continued growth in the near term, although at a somewhat slower pace. The price picture in the region looks similar to that of the nation: there is increasing evidence of upward price pressures.

Most sectors experienced a slowing in the rate of growth in the third quarter. Performance indicators of the manufacturing sector were mixed, but on balance, they suggested a slight slowing in that sector. Manufacturing employment continues to decline in the region, although the rate of decline in the third quarter was very modest. The pace of activity in the construction industry continued to slow in the third quarter, but the level of activity in the residential construction sector remains relatively high. Retailers report healthy sales, and employment continues to expand, but at a somewhat slower pace than in the previous quarter. Bank loans increased at a relatively slow pace in the third quarter.

Job Growth Slows and Unemployment Rises

Tri-state employment barely increased in the third quarter despite continued healthy job growth in the nation. The region's unemployment rate ticked up as well. The weakness in the labor market runs contrary to anecdotal evidence of very tight labor markets. The Federal Reserve System's *Beige Book*, for example, has noted that some manufacturers and home builders are reporting labor shortages in the Third District. If not for the rise in the unemployment rate, the slow job growth might be attributed to labor shortages in the region; however, this story is consistent only if the rising unemployment rate is a statistical aberration.

Tri-state payroll employment was up only 0.1 percent in the third quarter, after growing 0.3 percent in each of the previous three quarters (**Figure 1**). The slight growth in jobs stands in contrast to the 0.5 percent growth in the nation. Third-quarter job growth was held back by declines in construction, government, and manufacturing, but even the sectors that grew did so at a slower rate than in the previous quarter. Pennsylvania was the weak link in tri-state employment growth. Payroll employment in Pennsylvania fell 0.1 percent in the third quarter, after rising 0.2 percent in the second quarter. New Jersey payroll employment rose 0.3 percent after registering 0.5 percent growth in the second quarter. Delaware jobs increased 0.2 percent following 0.5 percent growth in the second quarter.

Employment in the Philadelphia metropolitan area has been flat in the last two quarters. The lack of job growth is surprising, given the frequent discussion of rapid growth in the Pennsylvania suburbs. More surprising is that the official statistics suggest suburban employment fell almost 5000 jobs in the last two quarters, while city employment increased by an equal amount. In the past, however, periods of rapid city job growth and suburban decline have disappeared with the yearly rebenchmarking; that may happen again when this year's numbers are revised in 2000. The

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Figure 1

UNEMPLOYMENT RATES AND EMPLOYMENT GROWTH*

Seasonally Adjusted

	1998			1999		
	II	III	IV	I	II	III**
3-STATE TOTAL						
Unemployment Rate	4.6	4.6	4.4	4.3	4.3	4.5
Payroll Employment Growth	0.3	0.4	0.3	0.3	0.3	0.1
Resident Employment Growth	-0.1	0.1	0.5	1.0	0.3	-0.1
PENNSYLVANIA						
Unemployment Rate	4.6	4.6	4.5	4.4	4.1	4.4
Payroll Employment Growth	0.3	0.4	0.1	0.2	0.2	-0.1
Resident Employment Growth	-0.1	0.0	0.1	0.9	0.5	-0.4
NEW JERSEY						
Unemployment Rate	4.7	4.6	4.5	4.3	4.7	4.8
Payroll Employment Growth	0.4	0.4	0.4	0.4	0.5	0.3
Resident Employment Growth	-0.2	0.1	0.9	1.1	0.1	0.2
DELAWARE						
Unemployment Rate	4.1	3.8	3.4	3.1	3.5	3.1
Payroll Employment Growth	0.5	0.7	0.9	1.1	0.5	0.2
Resident Employment Growth	0.8	1.1	1.4	0.6	-0.8	0.5
PHILADELPHIA						
Unemployment Rate	4.4	4.3	4.0	4.0	4.0	4.3
Payroll Employment Growth	0.1	0.5	0.2	0.4	0.0	0.0
Resident Employment Growth	-0.3	0.5	0.3	0.3	0.6	-0.2
UNITED STATES						
Unemployment Rate	4.4	4.5	4.4	4.3	4.3	4.2
Payroll Employment Growth	0.6	0.5	0.6	0.6	0.5	0.5
Resident Employment Growth	0.3	0.1	0.6	0.8	0.0	0.1

* Percent change from previous quarter.

** Percent change based on two months of data. U.S. based on full quarter.

city's employment growth, however, is consistent with strong wage tax growth in the city. The city and the metropolitan area as a whole are still vulnerable to mergers and downsizing as evidenced by the recent announcement of PECO's impending merger and Rhone-Poulenc's announced departure from Montgomery County for Northern New Jersey.

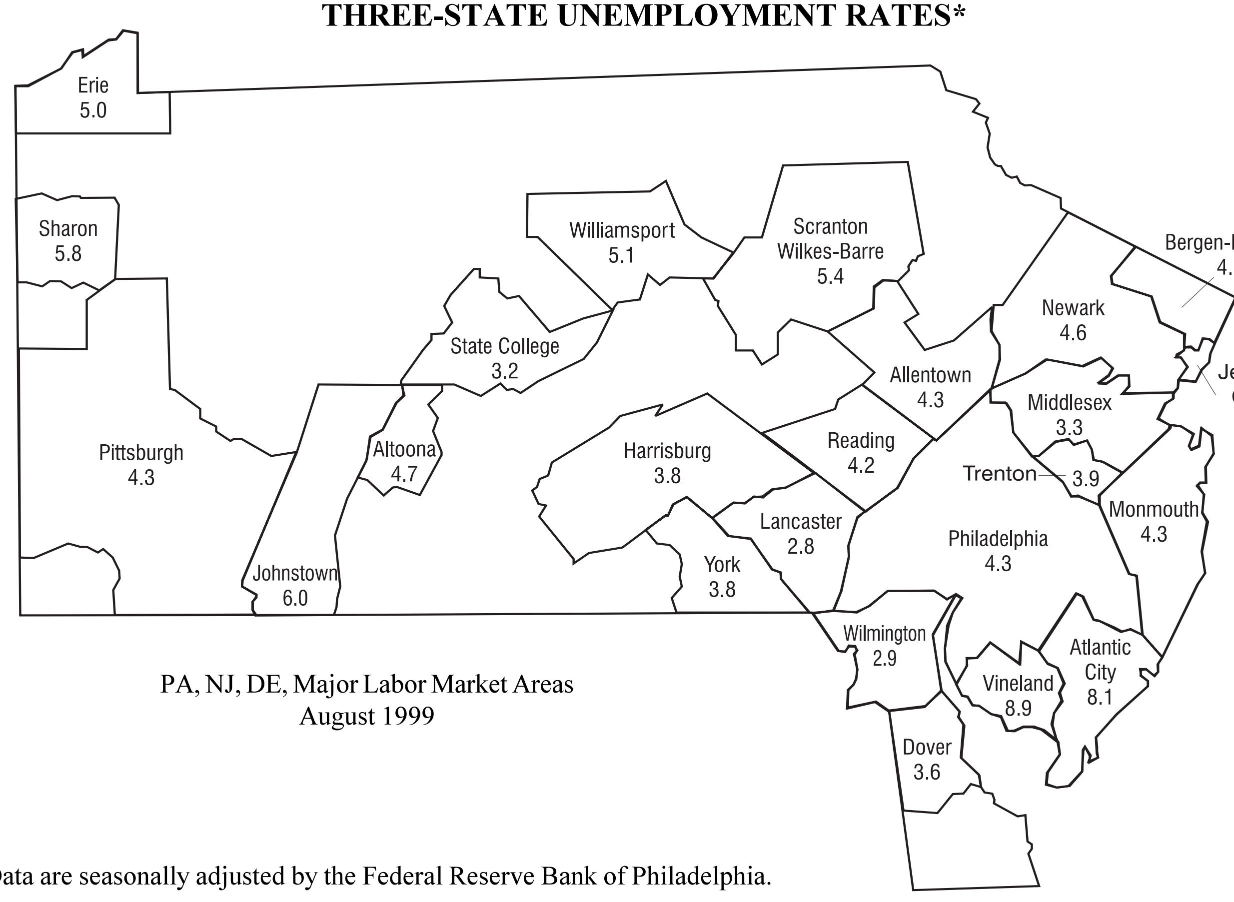
Slow employment growth resulted in an uptick in the tri-state unemployment rate from 4.3 percent in the second quarter to 4.5 percent in the third. The region's August unemployment rate of 4.5 percent is now above the national rate of 4.2 percent. The third-quarter unemployment rate in Pennsylvania rose from 4.1 percent to 4.4 percent. The rate in New Jersey also increased, from 4.7 percent to 4.8 percent. New Jersey's rate is now half a point higher than it was in the first quarter. Delaware was the only state to register a decline, from 3.5 percent to 3.1 percent. Most local labor markets continue to have relatively low unemployment rates (**Figure 2**). However, unemployment rates in all but five of the tri-state area's 25 metropolitan areas rose in the third quarter. Unemployment rates in Vineland and Atlantic City, at 8.9 and 8.1 percent, respectively, remain the highest in the tri-state area.

Inflation Concerns Grow

Recent regional data, like the recent national information, point to greater inflationary pressure. 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 eight months of 1999 (measured from the December 1998 level) is 2.7 percent, compared with 2.6 percent for the nation for the comparable period. Since the Philadelphia CPI is available only every other month, these inflation rates do not reflect any data for September, when the national rate increased 0.4 percent. This increase raised the annualized national rate so far this year to 2.8 percent, which is significantly higher than the 1.6 percent rate that prevailed in 1998.

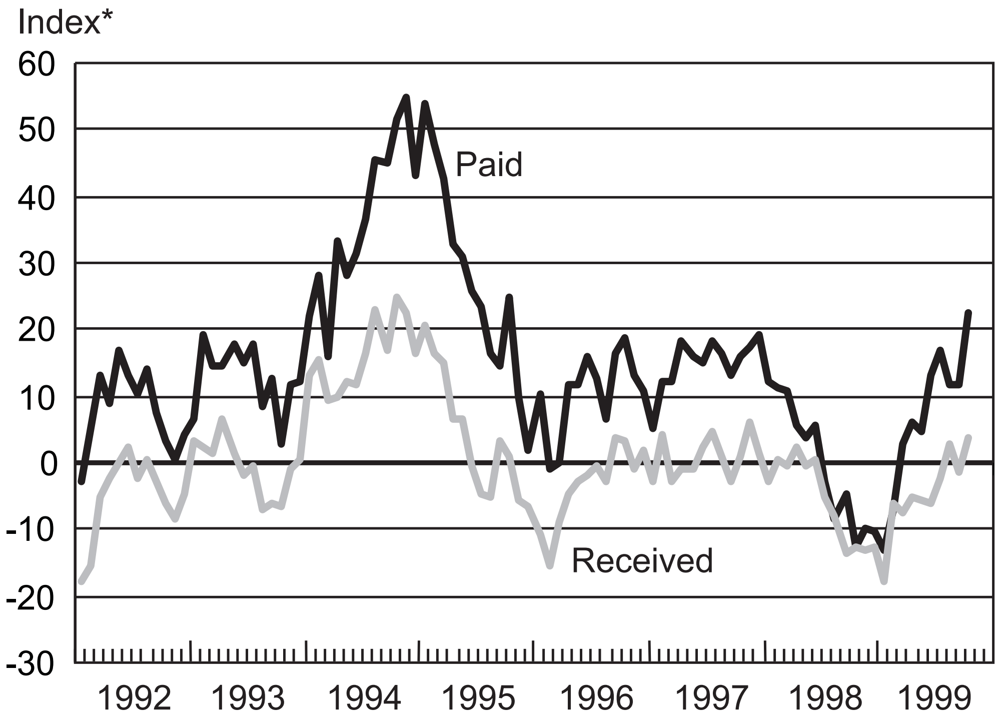
The Philadelphia Federal Reserve

Figure 2
THREE-STATE UNEMPLOYMENT RATES*



* Data are seasonally adjusted by the Federal Reserve Bank of Philadelphia.

Figure 3
BUSINESS OUTLOOK SURVEY
Current Prices



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

Bank's *Business Outlook Survey* (BOS), which is the most current indicator of the manufacturing sector, raises the most concern about inflation. In October, the index for manufacturing input prices rose from 11.8 to 22.5, the highest reading in four years (**Figure 3**). This index, which started the year in negative territory, jumped to double-digit levels in June. The October reading represents another upward jump in the index. There is less evidence of rising prices in the index for prices received, which registered only 3.5 in October. Even though the level of this index remains modest, it too has been on an upward trend.

Perhaps of even more concern are the BOS readings regarding the expected path of industrial prices. The future prices paid index, which reflects the manufacturers' expectations regarding input price changes over the next six months, rose from 23.0 to 43.7 in October. The future prices received index also increased, from 3.7 to 12.0.

The one bright spot in the price picture is that wages and salaries in the Northeast increased at a rate of only 3.3 percent over the latest 12-month period. The 3.3 percent growth indicates that wage pressures are relatively modest. This index, however, has data only through June, and inflationary pressures appear to have increased since then.

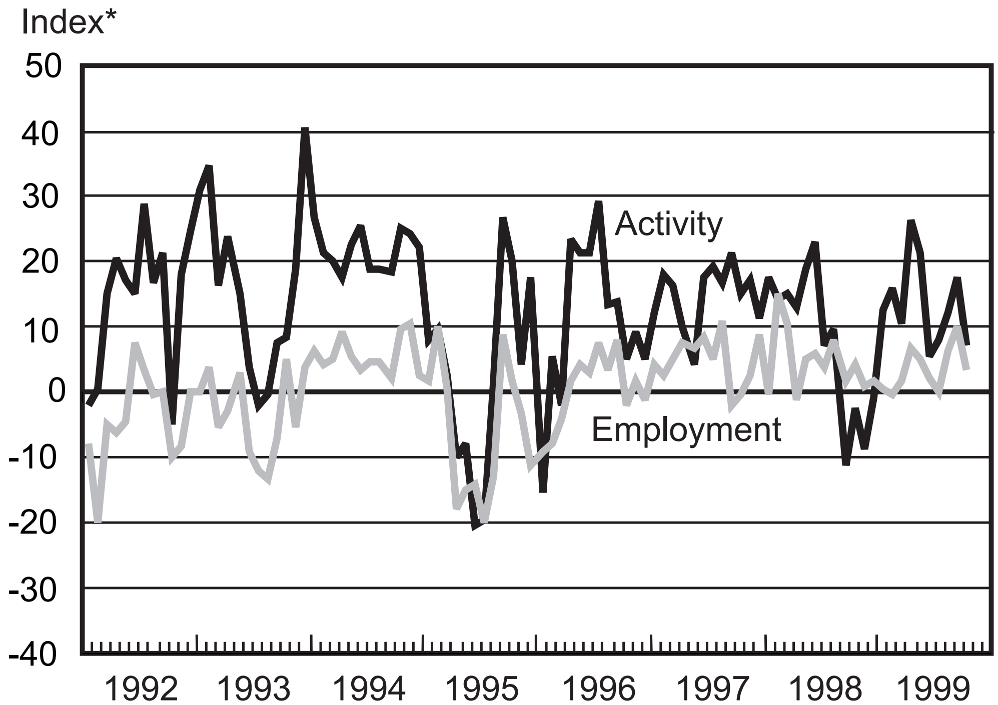
Growth Continues in Most Sectors, But at a Slower Pace

Indicators of growth for the Third District's manufacturing sector are mixed. The general activity index of the BOS slipped from 17.6 percent in September to 6.9 in October, suggesting a slowdown in growth in the sector (**Figure 4**). Consistent with the decline in the general activity index, the index for manufacturing employment declined from 9.9 to 3.5. The news from the survey was not all negative, however, as other indicators moved upward. The current new orders index increased from 6.9 to 20.2, and the current shipments index rose from 5.5 to 19.8. On balance, the October BOS suggests that

Figure 4

BUSINESS OUTLOOK SURVEY

Current Activity and Employment



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

the manufacturing sector continues to grow, but perhaps at a slightly slower pace.

Despite the fact that manufacturers report continued growth, data from the Bureau of Labor Statistics indicate that the manufacturing sector continues to lose jobs. Manufacturing employment in the tri-state area fell again in the third quarter, the sixth consecutive quarterly decline. Since the fourth quarter of 1998, nearly 15,500 manufacturing jobs have been eliminated in the region. Still the third-quarter decline was a modest 0.1 percent, which followed four quarters of 0.5 percent declines.

Both residential and nonresidential construction weakened in the third quarter and have slowed substantially from their first-quarter peaks. Despite the dropoff, residential construction remains relatively strong; the fall in nonresidential construction, however, has been more severe. The slowdown in the construction sector has resulted in a reduction of 2900 construction jobs in the tri-state area since the first quarter.

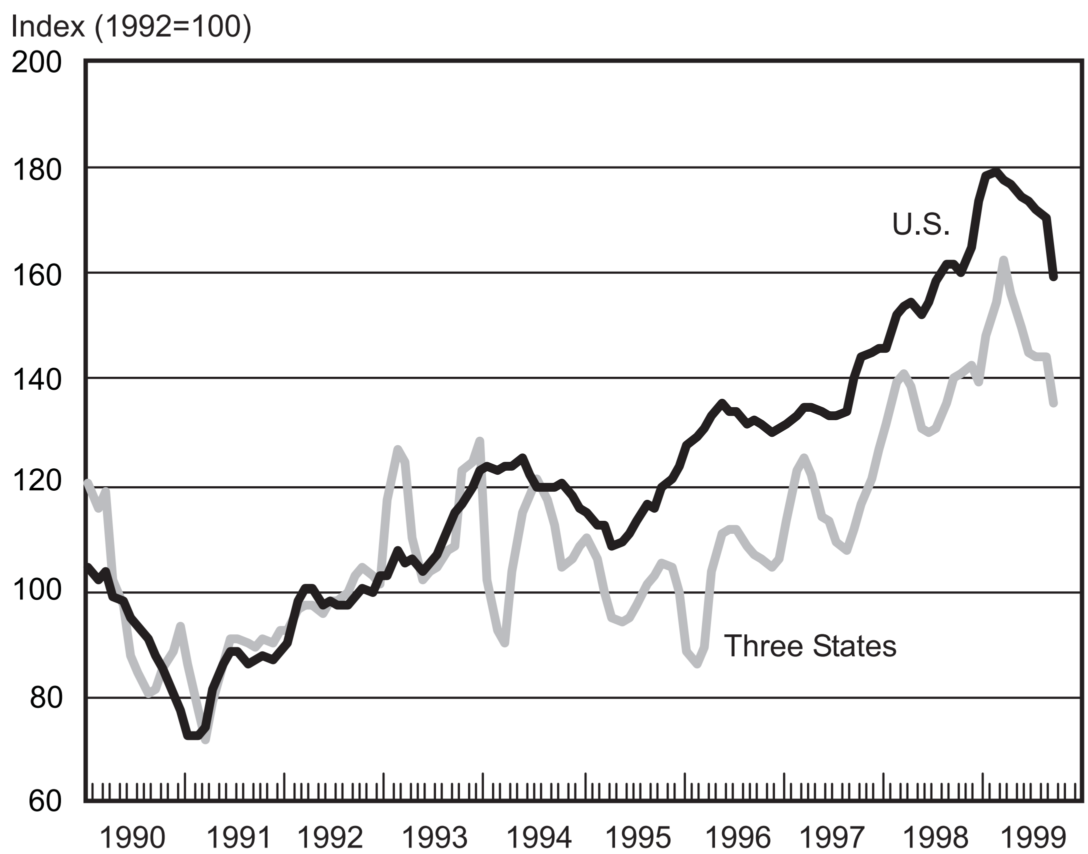
Residential construction in the tri-state area for the first nine months of the year, as measured by the value of contracts awarded, is running 7.5 percent ahead of last year (**Figure 5**). The region's growth slightly lagged the nation's growth of 8.6 percent. The gains over last year reflect the strength in the first quarter and to a lesser extent the second quarter. By September, residential contract awards had fallen to last year's average levels. Residential construction was strongest in New Jersey, up 10.0 percent, followed by Delaware, up 8.8 percent, and in Pennsylvania it was up 5.4 percent.

Nonresidential construction, which had a strong first quarter but since has fallen sharply, has seen construction contract values decline 2.2 percent for the first nine months of the year compared with the same period last year. Nationally, nonresidential construction rose 3.9 percent over the period. Nonresidential

Figure 5
PERCENT CHANGE
IN VALUE OF RESIDENTIAL
CONSTRUCTION CONTRACTS AWARDED

January to September 1999 Over Same Period in 1998

DE	NJ	PA	Three States	PhMSA	U.S.
8.8	10.0	5.4	7.5	-4.4	8.6



Data based on three-month moving average.
Source: F.W. Dodge

construction as measured by construction contracts is slower than it has been in over two years. All three states have experienced declines in nonresidential construction this year. The weakness in the construction sector is somewhat surprising, given reports that office markets, especially in the Philadelphia suburbs, remain tight.

Retail sales in the region remain healthy, registering gains in August and September. Sales of apparel and back-to-school items have been strong. Auto sales in the region have been steady. The trade sector continues to be an engine of job growth for the region. In July and August, the sector added 6100 jobs after adding 9600 jobs in the second quarter.

Area banks report slow growth in loans. Areas of strength were loans to small and medium-size firms and residential lending. Consumer lending was slack, and reports on commercial real estate lending were mixed. Some banks reported limiting commercial real estate lending because of concerns that property values may have peaked.

Region's Growth Will Slow

The outlook for the region's economy is for growth at a slightly slower pace than last year and for slower growth than in the nation. Time-series forecasts suggest that the region will grow moderately on a second-quarter over second-quarter basis. From the second quarter of 1999 to the second quarter of 2000, employment is forecast to grow 1.0 percent in Pennsylvania, 1.3 percent in New Jersey, and 2.5 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 Philadelphia Federal Reserve Bank's *Business Outlook Survey,* which has exhibited considerable variability in recent months, turned negative in September but rebounded to positive territory in October. The future activity index now stands at 7.1, which, though positive, is relatively modest compared with readings earlier in the year. However, the index for future manufacturing employment, at 20.1, is strongly positive. Our leading indexes for both New Jersey and Pennsylvania turned lower in recent months. The index for New Jersey remains positive but Pennsylvania's is near zero. In sum, the indicators suggest relatively slow growth in the upcoming months.

Richard Voith