

# REGIONAL

## H I G H L I G H T S

Federal Reserve Bank  
of Philadelphia

Fourth Quarter 2000

### Region's Growth Ebbled in the Fourth Quarter

- *Job Levels Are Mostly Flat in the Region*
- *Slowdown Is Most Pronounced in Pennsylvania*
- *Pressure on Consumer and Industrial Prices Lessens, but Compensation Costs Increased in 2000*

Economic activity in the tri-state region is mostly flat and price pressures have eased. Early data for the fourth quarter suggest that employment in the tri-state area will bounce back from a decline in the third quarter. Nonetheless, job growth has been flat since mid-year. New Jersey has been the fastest growing of the three states with moderate job growth. Delaware has been mostly flat, and Pennsylvania's job levels have declined since mid-year.

Much of the region's slower growth in the second half of 2000 can be attributed to the weak performance of major goods-producing sectors—manufacturing and residential construction. The pace of growth in the region's manufacturing sector has slowed considerably from last spring, and manufacturing employment has declined this year. After improving this summer, the value of residential construction contracts awarded declined in both September and October. However, housing permits—an indicator of future residential construction—improved in recent

months, and nonresidential construction has increased considerably since mid-year. Retail sales started off on a weak note in November but finished the month with an unexpectedly strong Thanksgiving-weekend surge. Still, retailers expect sales for the holiday shopping season to be up only moderately in real terms over 1999 levels. Banks report modest increases in consumer lending, but demand for business loans has slowed. Bankers expect overall loan growth to remain slow into 2001.

Reflecting the slowing economy, there appears to be somewhat less upward pressure on industrial and consumer prices in recent months. On the other hand, compensation costs increased somewhat in 2000, reflecting higher costs of health care benefits. Looking ahead, the pace of growth of the regional economy will continue to be slower than that experienced during the first half of 2000.

#### **Employment Is Flat and the Unemployment Rate Held Steady**

Payroll employment figures show no job growth in the tri-state area's labor market since mid-year. Payroll employment in the region increased 0.3 percent in October, offsetting a decline of 0.3 percent in the third quarter (**Figure 1**). Employment growth in October was concentrated in communications and government industries, reversing the third-quarter decline in employment that was a result of layoffs of temporary Census 2000 workers and the strike

against Verizon Communications. Employment has fallen 0.3 percent in Pennsylvania since the end of the second quarter, the first quarterly decline in almost four years. Employment was up 0.3 percent in New Jersey and 0.1 percent in Delaware. Only five of the District's 16 labor markets (Dover at 3.0 percent, Williamsport at 2.5 percent, State College at 2.3 percent, Atlantic City at 2.1 percent, and Wilmington at 2.0 percent) exceeded national employment growth of 1.9 percent for the three months ending in October 2000 compared with the same period in 1999. The unemployment rate in the region has been steady at around 4.0 percent. The unemployment rate increased 0.2 percent to 4.2 percent in Pennsylvania in October, while it was steady at 3.8 percent in New Jersey. Delaware's unemployment rate fell 0.1 percent to 3.8 percent in October.

#### **Pressure on Industrial Prices Lessened in Recent Months; Compensation Costs Increased in 2000**

The region, like the nation, has seen somewhat less upward pressure on consumer prices in recent months. After increasing at an annual rate of 2.4 percent in 1999, the Philadelphia area Consumer Price Index (CPI) increased 3.7 percent on an annual basis during the

To subscribe to this publication call (215) 574-6428. This publication can be found on the Internet at <http://www.phil.frb.org>.

Figure 1  
**UNEMPLOYMENT RATES AND EMPLOYMENT GROWTH\***  
 Seasonally Adjusted

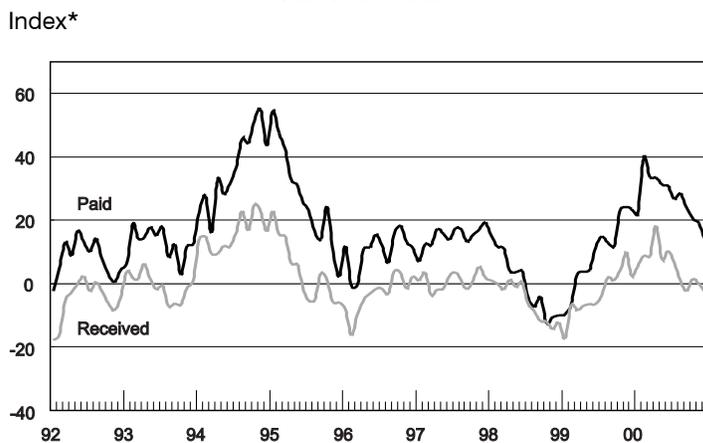
2000

	I	II	III	Oct**
<b>3-STATE TOTAL</b>				
Unemployment Rate	4.0	3.9	3.9	4.0
Payroll Employment Growth	0.5	0.3	-0.3	0.3
Resident Employment Growth	0.4	0.1	-0.1	0.1
<b>PENNSYLVANIA</b>				
Unemployment Rate	4.0	4.0	4.0	4.2
Payroll Employment Growth	0.7	0.0	-0.4	0.1
Resident Employment Growth	0.4	-0.3	0.0	0.0
<b>NEW JERSEY</b>				
Unemployment Rate	3.9	3.7	3.8	3.8
Payroll Employment Growth	0.4	0.6	-0.2	0.5
Resident Employment Growth	0.3	0.5	-0.3	0.3
<b>DELAWARE</b>				
Unemployment Rate	3.3	3.6	3.9	3.8
Payroll Employment Growth	0.6	1.1	-0.1	0.1
Resident Employment Growth	1.3	1.5	0.5	0.1
<b>PHILADELPHIA MSA</b>				
Unemployment Rate	4.0	3.8	3.8	3.8
Payroll Employment Growth	0.9	0.3	0.0	0.2
Resident Employment Growth	1.5	0.0	0.1	-0.1
<b>UNITED STATES</b>				
Unemployment Rate	4.1	4.0	4.0	3.9
Payroll Employment Growth	0.6	0.7	0.1	0.2
Resident Employment Growth	0.8	0.0	-0.2	0.4

\* Employment growth is percent change from previous quarter.

\*\* Employment growth is percent change from the third quarter 2000.

Figure 2  
BUSINESS OUTLOOK SURVEY  
Current Prices



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

first four months of 2000 (measured from the December 1999 level) compared with 4.3 percent nationally. The upward pressure on prices earlier in 2000 was related to rising energy prices at that time. Subsiding energy prices have curbed overall inflation in recent months. The most recent reading (October) showed a drop in the bimonthly Philadelphia CPI, reflecting a drop in food and energy costs. The annualized inflation rate for the Philadelphia area during the first 10 months of 2000 is 2.3 percent, compared with 3.6 percent for the nation. For the Philadelphia area, core measures of inflation that exclude the volatile food and energy components increased 3.0 percent during the first 10 months of 2000 compared with 2.7 percent for the nation.

Wages and salaries in the Northeast increased at a rate of 3.9 percent in the previous 12 months through September, slightly less than the increase of 4.1 percent for the nation. In the Northeast, total employment costs including benefits increased at a rate of 4.3 percent

compared with an increase of 4.6 percent nationally. In the Northeast, as in the nation, the 12-month increases for total compensation and wages and salaries were somewhat higher in the first nine months of 2000 than the same period last year. According to a recent survey of more than 3300 firms, for the third consecutive year the cost of health care coverage for the nation's employers increased at more than twice the rate of inflation. The overall cost of health benefits to employers rose 8.4 percent in the Philadelphia area in 2000, compared with an increase of 8.1 percent for the nation, the biggest annual increases, both nationally and locally, since 1992. Until recently, gains in productivity have largely offset these increases in compensation costs, and unit labor costs rose slowly. But rapidly rising compensation costs outpaced productivity growth in the third quarter, causing unit labor costs to rise at their fastest pace since the second quarter of 1998. Many employers are reporting increases in the costs of health ben-

efits ranging from 10 to 20 percent or more for next year. The third-quarter pattern of moderate productivity growth and sharp compensation growth is likely to continue over the next few quarters, causing businesses to pass these extra costs to their customers or resulting in slow profit growth.

According to the Business Outlook Survey (BOS), there continues to be less upward pressure on industrial prices than reported earlier in 2000 (Figure 2). Seventeen percent of firms responding to the December survey reported increases in input prices, down from 21 percent reporting increases in November. The diffusion index for prices paid, which measures the difference in the percentage of firms experiencing increases in input prices and the percentage experiencing decreases in input prices, stood at 14 in December, down from 19 in November. This marks the lowest level for the index since September 1999. This index has steadily declined from a reading of 40 in February 2000. The diffusion index for prices received has hovered around zero for the past five months. And the majority of firms reported either a decrease or no change in input prices (83 percent) and output prices (93 percent). Taken together, the indexes show little, if any, upward pressure on industrial prices.

### Manufacturing Output Weakened in December

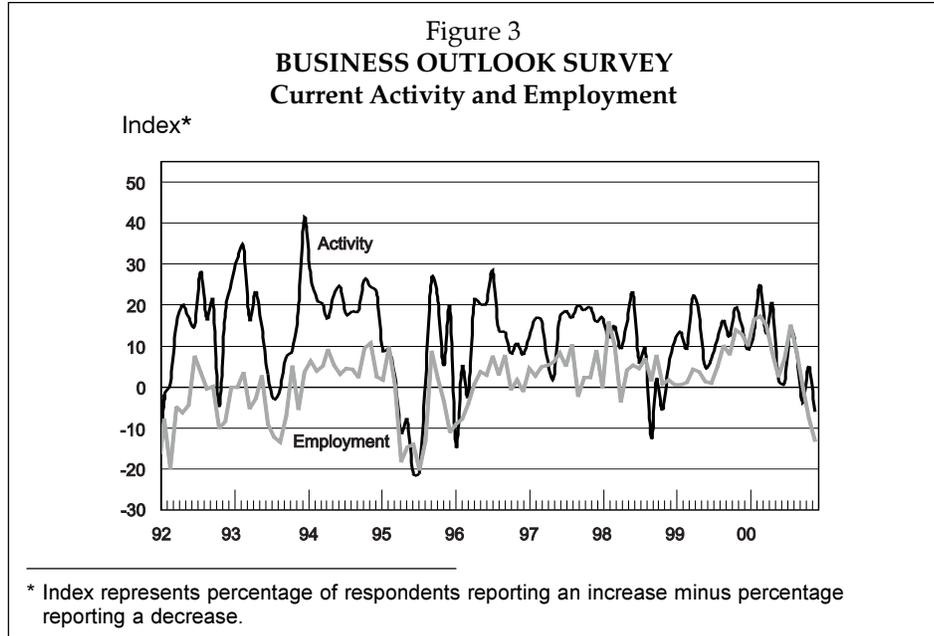
After a sharp increase in the first half of 2000, growth in the District's manufacturing sector weakened considerably in the second half of the year, and manufacturing employment declined this year. After increasing to a high of 20.2 in May, the BOS's main index of current economic activity stood at -6.1 in December, down from 5.2 in November. The index has generally declined during the second half of the year (Figure 3). Consistent with the lower level of the general activity index, indexes for new orders, order backlogs, and em-

ployment have declined substantially from levels recorded earlier in 2000. Increased energy costs and increased import competition (stemming from the strong dollar) were cited as adversely affecting some industries, especially steel and metals producers in recent months. Bureau of Labor Statistics (BLS) employment data indicate the manufacturing sector lost jobs in the third quarter of 2000, after being mostly flat in the first six months of the year. Manufacturing employment in the tri-state region declined 0.6 percent (about 9400 jobs) for the three months ending in October, the same rate of decline as in the nation.

### Construction Is Mixed

After an exceptionally strong first quarter, the pace of residential construction has slowed considerably. After increasing almost 16 percent in the first quarter of 2000, the value of residential construction contracts declined 9.2 percent in the tri-state region in the second quarter and fell 1.4 percent in the third quarter. Contracts fell almost 4.0 percent in October. Still, the value of new residential contracts was up about 4.5 percent in the first 10 months of the year compared with the same period last year, while increasing 5.3 percent nationally. Of course, this increase is the result of a strong first quarter. Residential contracts were strongest in Pennsylvania, increasing 9.6 percent in the first 10 months of 2000 over the same period in 1999, while New Jersey's contracts increased a scant 1.0 percent. Contracts fell almost 4.0 percent in Delaware.

After declining sharply during the second and third quarters of the year, issuance of housing permits for buildings with one to four units improved in both September and October. The recent upturn in permits—an indicator of future residential construction—offers hope that residential construction may improve in the near future. Despite this rebound, permits are down in all three



states for the three months ending in October compared with the same period last year. Permits are down 13.5 percent in New Jersey, 11.8 percent in Delaware, and 8.8 percent in Pennsylvania. Permits declined 5.3 percent in the nation.

Tri-state nonresidential construction, as reflected in the value of new contracts, displayed more volatility than residential construction in 2000. After a strong first quarter, nonresidential construction contracts in the tri-state region decreased sharply in the second quarter, only to rebound strongly in the third quarter of the year. Compared with the same period in 1999, the value of nonresidential construction contracts increased 6.2 percent in the tri-state region for the first 10 months of 2000, while falling 2.2 percent nationally. Nonresidential construction increased 10.3 percent in New Jersey, 4.5 percent in Pennsylvania, and 138 percent in Delaware during the first 10 months of 2000. The nonresidential construction industry in Delaware is so small that individual projects can have large ef-

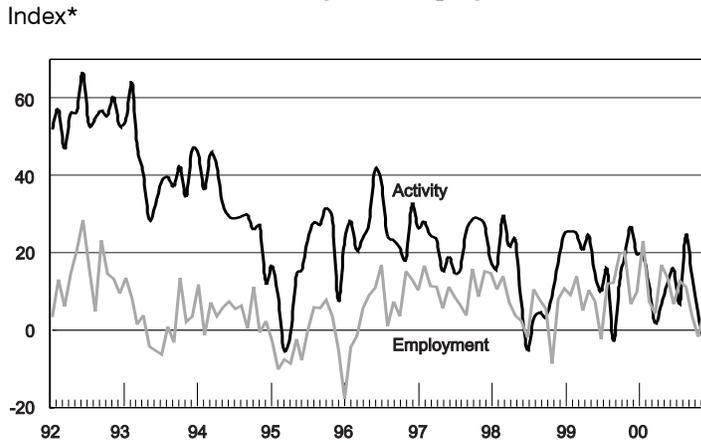
fects on the number. Consistent with the strength in nonresidential construction, the demand for space remains strong in the region and rental rates, although leveling off, have risen this year.

On balance, construction employment in the tri-state area decreased 0.3 percent in the third quarter, following a decrease of 0.9 percent in the second quarter. Even with this decline, however, construction employment is at a relatively high level, with builders reporting shortages of skilled craftsmen.

### Retail Sales and Bank Lending Improve

Retail sales in the region increased moderately in November, with a lackluster performance for much of the month followed by an unexpectedly strong rebound in sales over the Thanksgiving weekend. On the basis of the strength at the end of November, retailers expected a year-over-year increase in sales of about 4 percent in nominal terms for the holiday season at that time. A national survey of 4000 mall

Figure 4  
**BUSINESS OUTLOOK SURVEY**  
**Future Activity and Employment**



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

specialty stores reported that holiday sales between Thanksgiving weekend and mid-December were down 8.2 percent from the same period in 1999. Still, across the entire retail sector, sales growth for the holiday season is predicted to be half of last year's 7.7 percent. Auto dealers in the region report that the pace of sales slipped in November compared with October as well as with November of 1999. Local dealers expect sales to be slow in December, but they expect a small pickup following the holiday season.

Reflecting the lackluster performance of sales, employment in the retail sector declined in October, following two quarters of no job growth. Still, employment in the sector remains at relatively high levels, increasing 0.8 percent for the three months ending October 2000 compared with the same period last year, while increasing 1.8 percent nationally.

Area bankers report a moderate increase in loan demand, with most of the increase in consumer lending. Bankers noted that consumer lending was getting a boost from increases in credit

card loans. However, business lending has eased, and bankers do not anticipate a significant pickup in business loan demand. Some bankers noted that business borrowers were scaling back expansion plans and prospective borrowing needs.

#### **Outlook: Slow Growth in Region's Economy Will Continue**

The tri-state economy should continue to grow in 2001, but at a slower pace than in the first half of 2000. Our regional forecasts indicate that the region will grow modestly in the near term. Growth in employment and income is forecasted to increase at a somewhat slower pace through the first half of 2001 than during the first half of 2000, and the improvement seen recently in issuance of housing permits will be temporary. The unemployment rates in Pennsylvania, New Jersey, and Delaware are expected to move up over the year. By the third quarter of 2001, Pennsylvania's unemployment rate is expected to be 4.4 percent, New Jersey's 4.0 percent, and Delaware's 4.1 percent.

Consistent with recent declines in current activity, manufacturers' outlook about the near future has weakened significantly in recent months. The future index of general activity from the BOS decreased from 4.2 in November to -3.7 in December (**Figure 4**). December marks the third consecutive month this index has decreased and the first negative reading since September 1999.

A similar pattern is seen in indexes for both future new orders and order backlogs in December: the future new orders index fell from 11.2 in November to 3.3 in December, and the future order backlog index has been negative for the past three months. Despite the anticipated weakness in future activity, most manufacturers responding to the survey plan to maintain their payroll levels or increase them in the next six months. The index for future employment rebounded from a decline of 3.7 in November to 5.6 in December. Despite the improvement in December, the index has been at relatively low levels for the past three months. After declining sharply in 1999, initial unemployment claims—another indicator of future employment—were mostly flat in 2000.

Gerald A. Carlino

**Federal Reserve Bank of Philadelphia**  
**Research Department Publications**

**Banking Brief**

*Analyzes recent trends in the tri-state region of Pennsylvania, New Jersey, and Delaware. Quarterly.*

**Banking Legislation & Policy**

*Summarizes and updates pending banking and financial legislation, regulation, and judicial activity at the federal level and for the Third District states. Published four times a year.*

**Business Outlook Survey**

*A survey of manufacturers located in the Third Federal Reserve District and having 100 employees or more. Monthly.*

**Business Review**

*Presents articles written by staff economists and dealing with economic policy, financial economics, banking, and regional economic issues. Quarterly.*

**Livingston Survey**

*A summary of forecasts from business, government, and academic economists. Published in June and December.*

**Regional Highlights**

*Analyzes recent economic activity in the Third Federal Reserve District. Quarterly.*

**Research Rap**

*Presents summaries of recent Philadelphia Federal Reserve Bank Working Papers. Published several times a year.*

**South Jersey Business Survey**

*A survey of business establishments located in the South Jersey region. Quarterly.*

**Survey of Professional Forecasters**

*Contains short-term forecasts of major macroeconomic data, plus long-term forecasts of inflation. Quarterly.*

For subscriptions to Research Department publications call (215) 574-6428.

All of these publications can be found on the Federal Reserve Bank of Philadelphia's web site, <http://www.phil.frb.org>.

Need information on banking and financial markets, forecasting, or the regional economy? Check out the Federal Reserve Bank of Philadelphia's web site at <http://www.phil.frb.org> for economic data, current and back issues of Research Department publications, Fed news releases, and speeches by Bank officers. See what's new in Community Affairs in the Third District, and find resources for a variety of audiences such as small businesses and educators. Get the answers to frequently asked questions about the Fed, find information on issues important to consumers, and more.

