REGIONAL HIGHLIGHTS

Federal Reserve Bank of Philadelphia

First Quarter 2001

2001: After Weak First Half, a Return to Moderate Growth in Second Half

- *Revisions to Employment Data Show More Rapid Growth in 2000*
- *Weakness in Manufacturing Is Major Factor in Soft Economy of First Half*
- *Construction Activity Is Supported by Nonresidential Projects*
- *The Consumer Is Key to Growth in 2001*

Major revisions to state payroll employment data show much faster job growth in Pennsylvania and New Jersey last year than first reported. The regional economy had considerably more momentum than the official data were suggesting. The faster job growth translated into higher growth rates for the revised economic activity indexes for Pennsylvania and New Jersey; both indexes advanced more than 2 percent over the past year (**Figure 1**). Revisions to Delaware's employment data were minor, and the state had its slowest job growth since 1992. Growth in Delaware's economic activity index was just over 1 percent in the 12 months ending January 2001. The payroll employment data for the U.S. will not be revised until later this year.

Despite the momentum in the region's economy last year, 2001 got off to a rocky start. The manufacturing sector has been especially weak since the turn of the year. Construction has held up well on the strength of contracts for nonresidential buildings and non-building projects. The key to this year's economy, however, will be the consumer. Retail sales were lackluster during the 2000 holiday shopping season, but there have been some signs of improvement in the first quarter of this year.

The outlook for the region is for a pickup in economic activity in the second half of this year. Nevertheless, job growth for the year as a whole will be below last year's pace, and the state unemployment rates will rise slightly.

Manufacturing Sector Falters in First Quarter

Manufacturing activity in the region declined sharply in the beginning of the year. In January the general activity index from the Philadelphia Fed's *Business Outlook Survey* (BOS) suffered its second largest monthly decline in the survey's 32-year history (**Figure 2**). The index recovered somewhat in February and March, but it was still significantly negative. Manufacturing activity in the region continued to decline, but at a slower pace than in January.

The manufacturing sector was already showing signs of strain last year. The tri-state region lost almost 13,000 manufacturing jobs in 2000. In January of this year, factories in the three states shed another 6,000 jobs. The negative indexes for hours worked and employment from the BOS in February and March indicate that the region's manufacturers continued to reduce hours and employment through the entire first quarter.

Despite poor current conditions, manufacturers in the region expect shipments and overall activity to be at higher levels six months from now. The pickup in manufacturing, however, will probably be moderate. The future employment index from the BOS is only marginally positive, and capital expenditure plans are weak. Nonetheless, conditions in manufacturing are expected to improve before the end of the third quarter of this year.

Construction Sector Is Still Strong

Construction was the fastest growing job category in the tri-state region last year. The three states added 25,000 new construction jobs. The largest percentage increases occurred in Pennsylvania and New Jersey. Most of the recent strength in the region's construction industry has been in nonresidential buildings and nonbuilding projects. Construction contracts in these two categories were stronger in the second half of 2000 than in the first half (**Figure 3**). Housing permits, on the other hand, were down in all three states for the year as a whole, and they were lower in the second half of the year than in the first half. The value

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Department of Research Ten Independence Mall, Philadelphia, PA 19106-1574

of residential construction contracts was up about 3 percent from the previous year but declined in the second half of 2000.

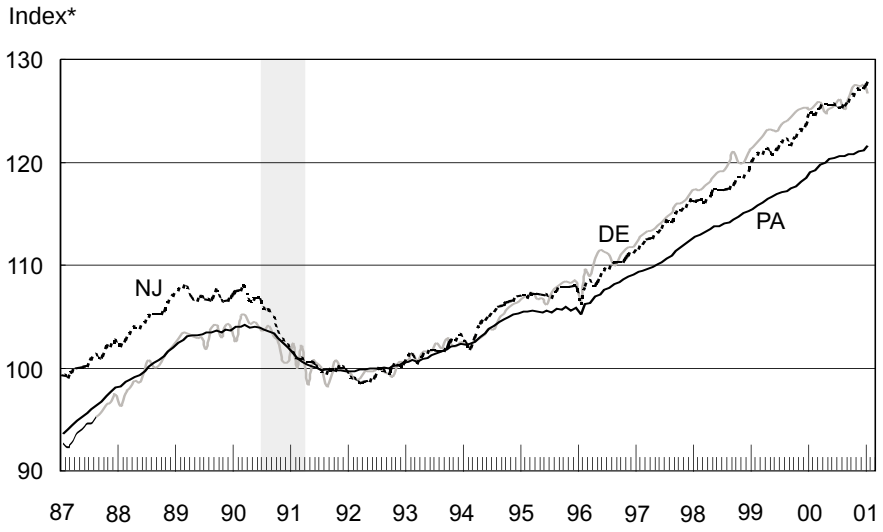
A rebound in permits in January 2001 from weather-related weakness in December suggests that residential construction is not likely to contract significantly in the near term. Moreover, major casino construction in Atlantic City and the beginning of construction on new stadiums in Philadelphia later this year should keep most construction workers employed through the rest of this year. Continued strength in the construction industry is important for the outlook on the overall economy because one of the early signs of a general economic downturn is weakness in the construction sector.

Consumer Sector Is the Key to Growth

Growth in consumer spending, especially for durable goods, slowed at the end of 2000. Nominal retail sales at the national level were basically flat in the fourth quarter after a rise of 1.4 percent in the third quarter. Retail sales data are not available at the state level, but retailers reported a similar weakness in sales in the region. Sales and use tax collections in Pennsylvania confirm reports of slow sales in the region in the second half of 2000. There was even a dip in seasonally adjusted sales tax collections in the fourth quarter of the year (**Figure 4**). Much of the weakness in the second half of the year was due to auto sales, which slowed from a strong first quarter in 2000. Reports from retailers and data on Pennsylvania state tax collections suggest that sales rose slightly in the first two months of this year.

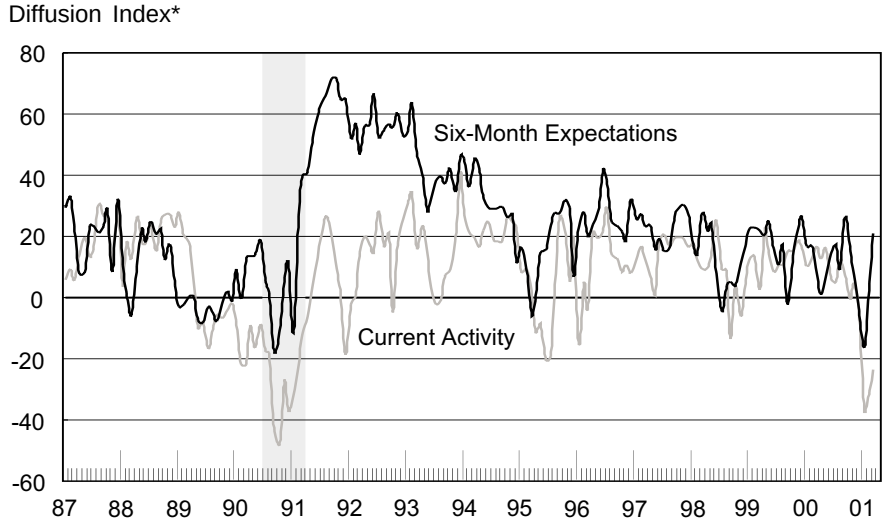
Retailers have suggested that increases in consumer energy costs may be limiting the growth of sales for discretionary items. In the Philadelphia-Wilmington-Atlantic City area gasoline prices are up more than 10 percent over the past year; consumer electricity prices are up almost 8 percent, and the cost of

Figure 1
STATE ECONOMIC ACTIVITY INDEXES
January 2001



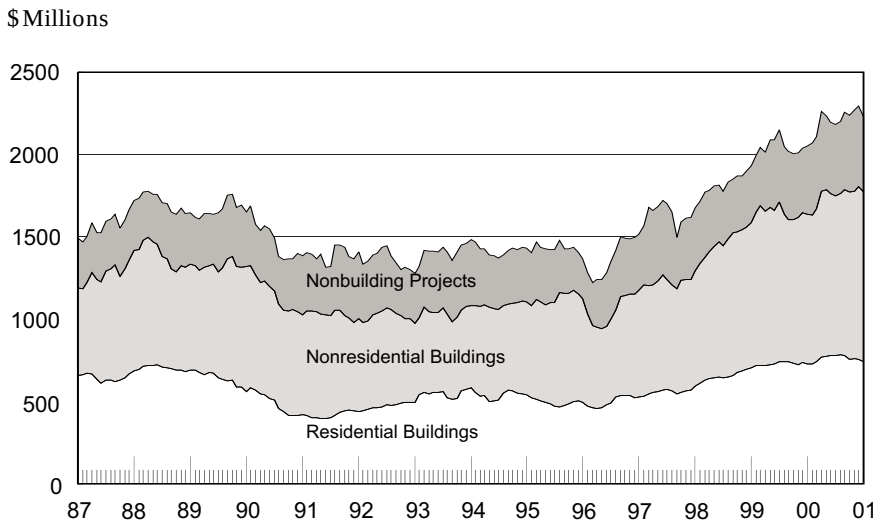
*July 1992 = 100

Figure 2
BUSINESS OUTLOOK SURVEY
Current and Future Manufacturing Activity Indexes



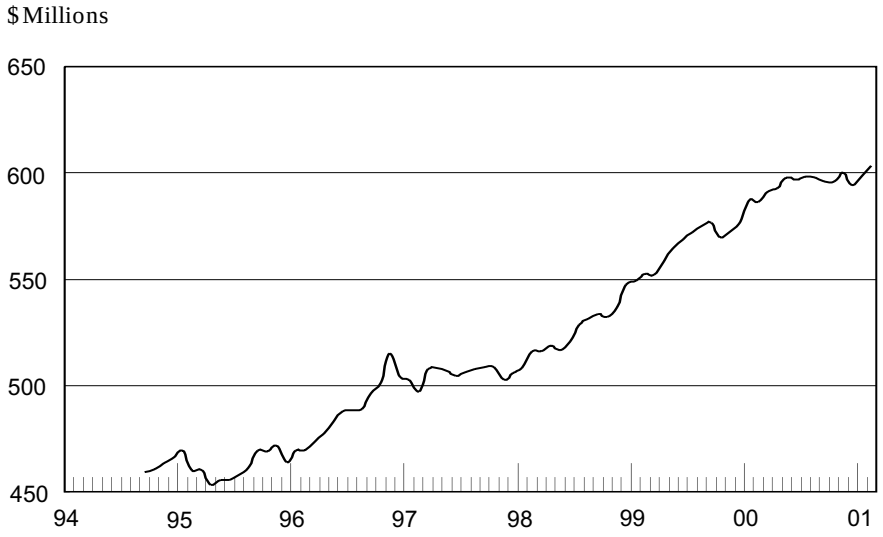
* Percentage of respondents indicating an increase minus percentage indicating a decrease

Figure 3
VALUE OF CONSTRUCTION CONTRACTS AWARDED
Three States



Six-month moving average. Source: F.W. Dodge

Figure 4
PENNSYLVANIA SALES AND USE TAX COLLECTIONS



Three-month moving average. Data are seasonally adjusted by the Federal Reserve Bank of Philadelphia.

natural gas is up more than 30 percent (**Figure 5**).

Consumer confidence has also been shaken in recent months. The Conference Board's Consumer Confidence Index for the Middle Atlantic region has declined almost 25 percent from its August level, about the same as the decline in the national index. A rebound in consumer confidence will be necessary for any significant pickup in general economic activity later in the year. Only increases in consumer spending, especially for durable goods, will support a recovery in the struggling manufacturing sector.

Economy Shows Differences Across the Tri-State Region

Revisions to the payroll employment data changed reported job growth in Delaware very little. For the first time since 1992, Delaware had fourth-quarter-over-fourth-quarter job growth of less than 2 percent, a slower rate than either of the other two states in the region. Last year's slower growth in Delaware was primarily the result of larger declines in manufacturing and less rapid growth in nonfinancial services than in the other two states. Preliminary data for January show a sharp drop in manufacturing employment, but much of this was the result of temporary cutbacks in the auto industry. Delaware's employment picture for the quarter as a whole and for the year as a whole will be much better than the January data suggest.

Financial service jobs in Delaware continue to grow at a faster rate than the national average and faster than in the other two states in the District. However, job growth this year was below 2 percent in Delaware's financial services industries for only the second time since 1992. Jobs in nonfinancial services in Delaware grew at about the same pace as the national average but at a much slower pace than in Pennsylvania and New Jersey. Slower growth in nonfinancial services limited overall job growth in Delaware, since this is the largest employment category in the state

Figure 5
ENERGY PRICE INCREASES
January 2000 to 2001 (Philadelphia CMSA)

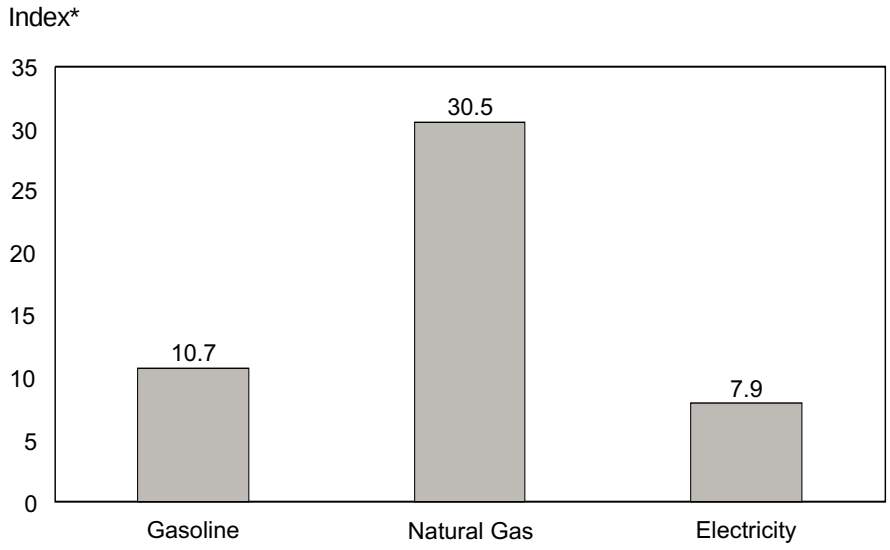


Figure 6
UNEMPLOYMENT RATES AND EMPLOYMENT GROWTH*
Seasonally Adjusted

	2000				2001
	I	II	III	IV	Jan
3-STATE TOTAL					
Unemployment Rate	3.9	4.0	4.0	4.1	4.0
Payroll Employment Growth	0.8	0.5	0.3	0.4	0.2
PENNSYLVANIA					
Unemployment Rate	4.1	4.1	4.2	4.3	4.3
Payroll Employment Growth	0.9	0.5	0.4	0.3	0.3
NEW JERSEY					
Unemployment Rate	3.7	3.7	3.8	3.8	3.6
Payroll Employment Growth	0.8	0.7	0.1	0.5	0.2
DELAWARE					
Unemployment Rate	3.9	4.0	4.1	3.9	4.1
Payroll Employment Growth	0.1	0.1	0.5	1.1	-0.9
PHILADELPHIA MSA					
Unemployment Rate	4.0	3.8	3.8	3.9	4.1
Payroll Employment Growth	0.9	0.5	0.0	-0.2	0.4
UNITED STATES					
Unemployment Rate	4.0	4.0	4.0	4.0	4.2
Payroll Employment Growth	0.6	0.7	0.1	0.2	0.2

* Employment growth is percent change from previous quarter. For January 2001, it is the percent change from the fourth-quarter average.

as well as in the nation.

The slower job growth in Delaware has resulted in a significant rise in the unemployment rate. The quarterly rate had been as low as 3.4 percent in 1999, but it averaged 4 percent in 2000. The state's unemployment rate registered 4.1 percent in January 2001.

Among the three states in the region, New Jersey had the highest overall job growth last year. The manufacturing sector did not fare so well, however. The state's factories trimmed 6,000 jobs in 2000 (1.3 percent). New Jersey, however, added almost 50,000 jobs in nonfinancial services last year (3.7 percent), 20,000 jobs in wholesale and retail trade (2.2 percent), and almost 9,000 jobs in construction (5.9 percent). Strong growth in trade and construction continued in January 2001.

The strong job growth in New Jersey last year reduced the state's unemployment rate. The rate in January 2001 was 3.6 percent, matching the lowest monthly rates recorded in this expansion and much lower than the unemployment rates for the other states in the region (**Figure 6**). We have to go back to the late 1960s to find a lower monthly unemployment rate for New Jersey. We do not expect the state's unemployment rate to remain this low, however. Monthly unemployment insurance claims in January were at their highest level in more than a year and a half, and the demand for temporary workers has slowed in New Jersey.

Of the three states in the region, Pennsylvania had the most extensive revision of its payroll employment numbers for 2000. The revised 2 percent job growth for the year was the best annual performance in the current expansion. More than half of the new jobs were in nonfinancial services, but the highest rate of growth was in the construction industry, which added almost 16,000 jobs (6.7 percent). The loss of manufacturing jobs in Pennsylvania in 2000 (0.6 percent) was far less than that for the other two states in the region

Figure 7
STATE FORECASTS

	PA	NJ	DE
Job Growth (2000: IV to 2001: IV)	1.0	1.2	1.1
Unemployment Rate (Level 2001: IV)	4.5	4.0	4.3
Housing Permits (Annual Growth 2000-2001) Buildings of Less than 5 Units	-4.4	-5.3	-3.7

and somewhat less than the national decline. The rate of manufacturing job losses increased in January 2001 as shipments and new orders fell dramatically at plants in the region. But every major industry category in Pennsylvania except manufacturing experienced an increase in jobs in the first month of this year.

Despite the better than expected job growth in Pennsylvania last year, the state's unemployment rate inched up from 4.1 percent in the first quarter to 4.3 percent in the fourth quarter, where it remained in January of this year.

In the Philadelphia metro area, job growth last year (1.2 percent) was somewhat below the state average. The city of Philadelphia had positive job growth for the fourth consecutive year. The increases were less than in the two previous years, however, and the city lost jobs in the final quarter of the year. Some of those losses were reversed in January 2001. Even suburban job growth in Philadelphia did not match state averages for Pennsylvania or New Jersey last year. But job levels in the Philadelphia suburbs reached an all-time high in January 2001.

Outlook for 2001

Tri-state job growth in 2000 was stronger than we predicted last year, but with the exception of New Jersey's, the unemployment rates rose as we had forecasted. Despite the regional economy's stronger than expected momentum at the end of last year, we are forecasting slower growth in 2001. The manufacturing sector will be a drag on the regional and national economy through the first half of the year. Residential construction will be a bit slower this year, but nonresidential construction, including nonbuilding projects, is likely to take up the slack. We expect a return to moderate overall growth in the second half of the year. Fourth-quarter-over-fourth-quarter job increases are expected to be smaller this year than last in all three states in the region (**Figure 7**). State unemployment rates are expected to rise by the fourth quarter of the year and range between 4.0 and 4.5 percent.

Ted Crone

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