



REGIONAL HIGHLIGHTS

Second Quarter 2001

Region's Economic Growth Ebbled in the Second Quarter

- *Job Growth Slows in the Region, and Unemployment Rate Rises*
- *Slowdown Is Most Pronounced in Manufacturing*
- *Compensation Costs Rise Less Rapidly*

Growth in the tri-state economy stalled in the second quarter. Preliminary data for the second quarter suggest that employment in the tri-state area will decline, after increasing modestly in the first quarter. Consistent with weakness in the region's labor markets, the unemployment rate moved up in the second quarter. Much of the region's weakness in the first half of the year can be attributed to the weak performance of major goods-producing sectors — manufacturing and residential construction. Growth in the region's manufacturing sector continues to decline, and manufacturing employment continues to shrink. Residential construction is below last year's levels, and housing permits — a future indicator of residential construction — have recently declined. Nonresidential construction has increased modestly in recent months. The retail trade sector has been mostly flat, held back by a slowing economy and unseasonably cool weather in May. Area bankers report modest increases in consumer and real estate lending; however, the demand for business

loans has slowed. Bankers expect overall loan growth to remain slow for the balance of this year. Consumer price inflation in the region is running at a somewhat faster pace than in the nation. Consistent with slower growth, there appears to be somewhat less upward pressure on employment costs in the Northeast and the nation over the past six months. Looking ahead, growth of the regional economy is likely to rebound during the second half of the year but probably at a less rapid pace than during the second half of last year.

Employment Is Flat During First Half of Year and Unemployment Rises

Payroll employment figures show no job growth in the tri-state area's labor market this year. Payroll employment in the region decreased 0.2 percent during the first two months of the second quarter, offsetting an increase of 0.2 percent in the first quarter (Figure 1). Declines in employment in the second quarter were broad-based, with the largest declines in manufacturing; transportation, communications and public utilities; and construction; even the sectors that grew (services and government) did so at a slower pace than in the previous quarter. Payroll employment decreased in Pennsylvania and New Jersey during the second quarter while increasing in Delaware. Although Delaware managed a slight gain in jobs in the second quarter, the gain was more than offset by losses sustained during the first quarter. The region's unemployment rate was 4.4 percent

during the second quarter, up from its first-quarter average of 4.1 percent. The unemployment rate increased in nearly all of the District's 16 labor markets in April, over April of last year. (The lone exception is Dover, where the unemployment rate fell 0.4 percent.)

More Upward Pressure on Consumer Prices Recently; Less Upward Pressure on Compensation Costs This Year

The region, like the nation, has seen somewhat more upward pressure on consumer prices this year than last. After increasing at an annual rate of 2.4 percent in 2000, the Philadelphia-area Consumer Price Index (CPI) increased 5.8 percent on an annual basis during the first four months of 2001, compared with 3.8 percent nationally. The most recent reading (April) showed a sharp increase in the bimonthly Philadelphia CPI, reflecting increases in all categories. Apparel and housing showed the biggest increases. For the Philadelphia area, core measures of inflation that exclude the volatile food and energy components increased 3.8 percent during the first four months of 2001 after increasing at an annual rate of only 1.9 percent in 2000. For the nation, core measures of inflation increased 3.3 percent during the first four months of this year after increasing at an annual rate of 2.5 percent last year.

Wages and salaries in the Northeast increased at a rate of 3.5 percent in the previous 12 months through March, slightly less than the increase of 3.8 percent for the

Figure 1
UNEMPLOYMENT RATES AND EMPLOYMENT GROWTH*
Seasonally Adjusted

	2000				2001	
	I	II	III	IV	I	II**
3-STATE TOTAL						
Unemployment Rate	3.9	4.0	4.0	4.1	4.1	4.4
Payroll Employment Growth	0.8	0.5	0.3	0.4	0.2	-0.2
PENNSYLVANIA						
Unemployment Rate	4.1	4.1	4.2	4.3	4.5	4.6
Payroll Employment Growth	0.9	0.5	0.4	0.3	0.2	-0.2
NEW JERSEY						
Unemployment Rate	3.7	3.7	3.8	3.8	3.7	4.3
Payroll Employment Growth	0.8	0.7	0.1	0.5	0.2	-0.1
DELAWARE						
Unemployment Rate	3.9	4.0	4.1	3.9	3.7	3.4
Payroll Employment Growth	0.1	0.1	0.5	1.1	-0.4	0.1
PHILADELPHIA MSA						
Unemployment Rate	4.0	3.8	3.8	3.9	4.2	3.9
Payroll Employment Growth	0.9	0.5	0.0	-0.2	0.4	-0.2
UNITED STATES						
Unemployment Rate	4.0	4.0	4.0	4.0	4.2	4.5
Payroll Employment Growth	0.9	0.7	0.1	0.2	0.2	-0.1

* Employment growth is percent change from previous quarter.

** Based on April and May. Philadelphia MSA data based on April.

nation. In the Northeast, total employment costs including benefits increased at a rate of 3.6 percent compared with an increase of 4.2 percent nationally. In the Northeast, as in the nation, the 12-month increases for total compensation and wages and salaries were somewhat lower in the first quarter of 2001 than in the same period last year.

The Federal Reserve Bank of Philadelphia's *Business Outlook Survey* (BOS) yields a mixed picture for industrial prices (Figure 2). Twenty-seven percent of firms responding to the June survey reported increases in input prices, up from 15 percent reporting increases in April. The diffusion index for prices paid, which measures the difference in the percentage of firms experiencing increases in input prices

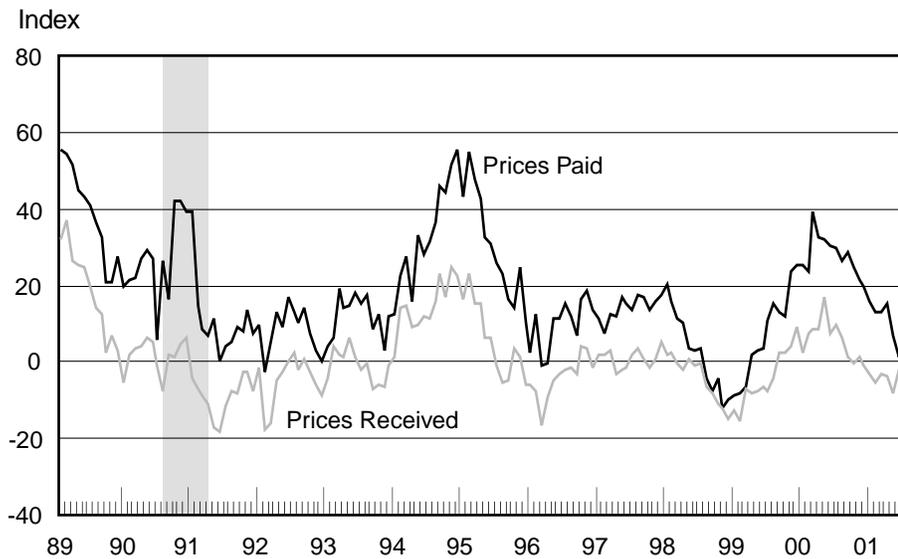
and the percentage experiencing decreases, stood at 18 in June, up sharply from 1.5 in April. This marks the highest level for the index since November 2000. Still, until June, this index had steadily declined from a reading of 40 in February of last year. Recent readings on the expected path of future industrial prices have not increased in recent months, however, suggesting that the spike in the prices paid index in June may reflect temporary factors. In contrast to the current prices paid index, the diffusion index for prices received remained in negative territory in June; it has been negative for nine of the past 10 months. And the largest percentage of firms reported no change in either input prices (62 percent) or output prices (72 percent). Taken together,

the indexes show little evidence of upward pressure on industrial prices.

Manufacturing Output Continues to Decline

Although growth in the Third District's manufacturing sector continues to decline, there are signs that the worst may be behind us. The BOS's main index of current activity remains negative, but it increased from -8.8 in May to -3.7 in June and has been steadily improving from a low reading of -31 in January (Figure 3). Other indicators of current activity, such as the indexes for new orders, shipments, and employment deteriorated in June; however, these indexes have significantly improved from low levels recorded earlier this year. Bureau of Labor

Figure 2
BUSINESS OUTLOOK SURVEY
Current Prices



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

Statistics (BLS) employment data indicate the manufacturing sector continued to lose jobs this year. Manufacturing employment in the tri-state region declined 2.0 percent (over 29,000 jobs) during the first five months of this year, compared with a decline of 2.6 percent for the nation.

Construction Is Mixed

After decreasing almost 3.2 percent during the first four months of this year, residential construction, as measured by the value of contracts awarded, rebounded strongly in May. Despite May's increase, residential construction decreased 12.6 percent for the first five months of 2001 compared with the same period in 2000, while increasing 2.7 percent nationally. Residential construction declined in all three states for the five months ending in May of this year, compared with the same period last year. Residential construction was weakest in New Jersey, where it declined almost 15 percent, followed by Pennsylvania, down 11.6 percent, and Delaware, down 6.4 percent. A similar

decline is evident in housing permits and existing home sales. The issuance of housing permits decreased almost 5.0 percent during the first four months of this year, compared with an increase of 5.2 percent nationally. The recent downturn in permits — a future indicator of residential construction — suggests that the improvement in residential construction in May might be temporary in nature. Permits are down in all three states for the first four months of the year. According to local real estate contacts, sales for both existing and new homes have slowed in recent months. The slowdown has been most pronounced for higher priced homes. Still, real estate agents and builders indicate that the inventory of homes for sale has been running close to or slightly below demand.

After declining in the fourth quarter of 2000, nonresidential construction contracts in the tri-state region increased modestly during the first five months of this year. Compared with the same period last year, the value of nonresidential construction contracts increased 2.4 percent in the tri-

state region for the first five months of 2001 while increasing 5.2 percent nationally. All of the weakness in nonresidential contracts is in Pennsylvania: contracts there fell 7.0 percent during the first five months of 2001 compared with the same period last year. In contrast, nonresidential contracts increased 12.2 percent in New Jersey. Although nonresidential contracts more than doubled in Delaware, the industry in the state is so small that individual projects can have large effects on the number.

Construction employment in the tri-state area increased 0.9 percent (almost 4000 jobs) during the first five months of the year, following an increase of 0.6 percent in the fourth quarter. However, construction employment fell in two of the past three months, suggesting that the general weakness observed this year in housing permits and residential contracts awarded may be showing up in activity and employment.

The demand for office space softened in the region in the first quarter. Although the office vacancy rate was mostly steady in Philadelphia's central business district, it has moved up in some suburban markets, where an increasing amount of space has been offered for sublease mainly by Internet-related firms. The biggest jump in office space offered for sublease has been in Philadelphia's Pennsylvania suburbs. The rise in sublease space — much of it offered at 10 percent to 15 percent below market rates — has not slowed the rise of rental rates. Rents for Class A space in the Philadelphia region moved up in the first quarter at rates consistent with increases of recent years.

Retail Sales Are Mostly Flat and Bank Lending Improves Slightly

Retail sales in the region have moderated. According to local retailers, a period of cool, wet weather hampered sales of summer clothing and other seasonal merchandise, such as lawn and garden supplies. Sales of big-ticket items have been slow as well. Several retailers indicated they are prepared to cut or reduce orders if sales do not turn up. Reflecting the lackluster performance in retail, sales tax collections in Pennsylvania through May (which include sales through April) declined in

recent months. Auto dealers in the region reported that the pace of sales has been steady, but below year-ago levels. Pennsylvania's sales tax collections for motor vehicles confirm reports of slow auto sales in the region this year.

Area bankers report a modest increase in loan demand, with most of the increase in consumer lending, boosted by increases in credit card loans. Other types of consumer lending, such as auto loans and home improvement loans, have declined. Mortgage refinancing continues to grow, but some bankers report that the pace of growth has recently slowed. Although commercial lending has been weak, some bankers noted a recent pickup in business loan demand, mainly from existing customers. Still, area bankers expect overall loan growth to increase only slightly during the second half of the year. They anticipate that commercial and industrial loan volumes outstanding will remain near current levels.

Outlook: Growth in Region's Economy Will Resume

Growth in the tri-state economy should resume in the second half of this year, but the pace of growth will be slower than that experienced during the second half of last year. Our regional forecasts indicate that the region should grow modestly in the near term (Figure 4). From the first quarter of 2001 to the first quarter of 2002, payroll employment will grow at a relatively slow rate of 0.5 percent in Pennsylvania and about 1.0 percent in New Jersey and Delaware. These forecasted employment growth rates are lower than the previous year's growth. And initial unemployment claims — another indicator of future employment — have risen steadily over the past year. The unemployment rates in Pennsylvania, New Jersey, and Delaware are expected to move up over the year. By the first quarter of 2002, Pennsylvania's unemployment rate is expected to be 5.0 percent, New Jersey's 4.3 percent, and Delaware's 4.1 percent.

Despite recent declines in current activity, manufacturers' expectations about the near future have improved significantly in recent months. The future index of general activity from the June BOS increased from 33.1 in May to 58.2. June marks the fifth consecutive month during which this index

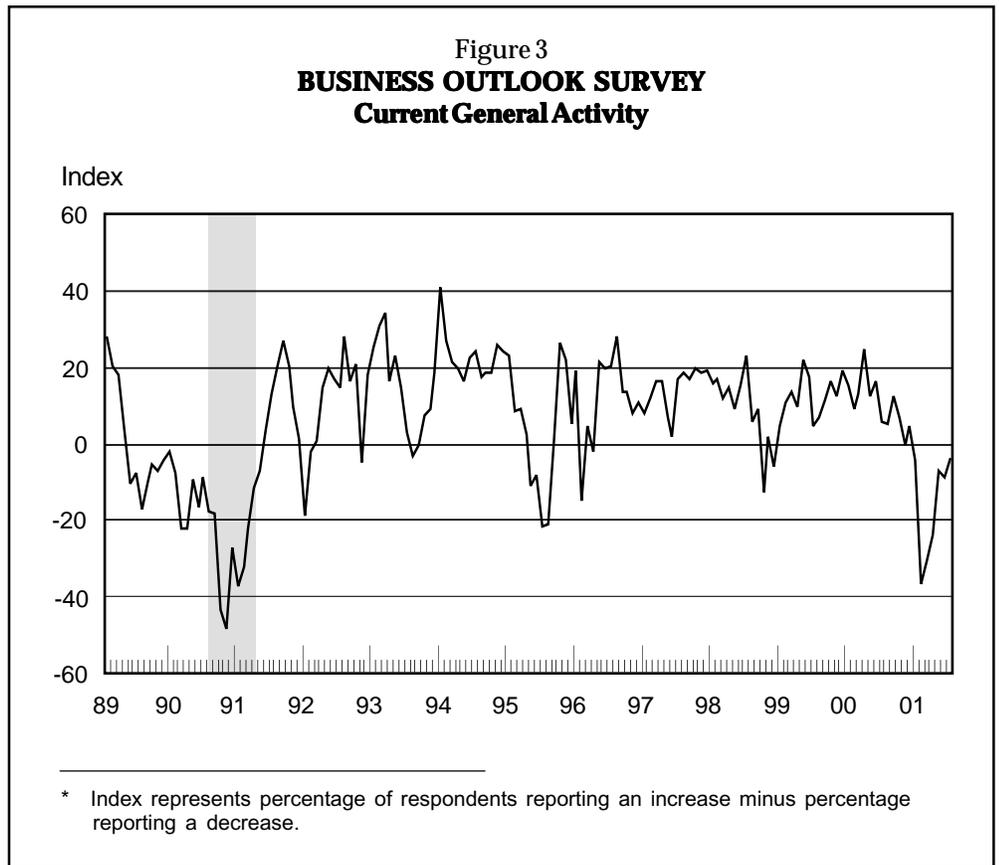


Figure 4
STATE FORECASTS

	PA	NJ	DE
Job Growth (2001:I to 2002:I)	0.5	1.1	1.0
Unemployment Rate (Level 2002:I)	5.0	4.3	4.1
Housing Permits (Annual Growth 2001-2002) Buildings of Less than 5 Units	-5.3	-6.7	-1.7

has increased. The last negative reading on the index was recorded in January of this year. A similar pattern is seen in indexes for both future new orders and shipments in June: the future new orders index improved from -4 in January to 55.8 in June, and the future shipments index improved to almost 48 in June. Consistent with the anticipated improvement in future activity, manu-

facturers' responses indicated plans to maintain or increase payroll levels over the next six months. The index for future employment improved from 1.5 in May to 15.0 in June. Despite June's improvement, the index has been either negative or at relatively low levels since the beginning of last year.

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