REGIONAL HIGHLIGHTS

Fourth Quarter 2001

Turnaround in the Region's Economy Expected by Mid-2002

- *Manufacturing Sector Hit Hard in the Recession*
- *Decline in Business Investment a Major Factor in the Economic Downturn*
- *Housing Investment Holding Up Much Better in This Recession Than in Earlier Ones*
- *The Consumer Will Lead Recovery*
- *Recovery in Region's Economy Expected by Mid-2002*

The nation has been in recession for nine months. Since U.S. employment peaked in March 2001, the nation has lost about 1 percent of its nonfarm jobs, and the unemployment rate has increased about 1.5 percentage points. The onset of the recession in Pennsylvania and New Jersey coincided closely with the beginning of the national recession. But job losses in the two states have been less severe than in the nation as a whole, and the unemployment rates in Pennsylvania and New Jersey have not increased as much as the national average. In October New Jersey actually gained some jobs that were displaced from Manhattan because of the terrorist attacks of September 11. Delaware's employment peaked in the fourth quarter of 2000, and the state has lost a higher percentage of its jobs than the nation in the current downturn. However, Delaware's unemployment rate has remained very low (Figure 1).

Both the national and regional economies are expected to come out of recession in 2002. But the reverberations from the terrorist attacks have made it difficult to gauge when the recovery will begin. Forecast models and survey responses suggest that economic activity and employment in the tri-state region will pick up by mid-year 2002. Increased consumer spending will lead the recovery. Housing investment has held up well in this recession, so analysts are not looking to any increases in housing construction to help jump start the economy. And significant increases in business investment will have to wait until capacity utilization improves.

Manufacturing Has Borne the Brunt of the Recession

Manufacturing jobs in the nation and the region have been declining since mid-year 2000, long before the onset of the

Figure 1
UNEMPLOYMENT RATES AND EMPLOYMENT GROWTH*
Seasonally Adjusted

	2000		2001			
	III	IV	I	II	III	IV**
3-STATE TOTAL						
Unemployment Rate	4.0	4.1	4.1	4.4	4.5	4.8
Payroll Employment Growth	0.3	0.4	0.2	-0.2	-0.2	0.0
PENNSYLVANIA						
Unemployment Rate	4.2	4.3	4.5	4.6	4.7	5.0
Payroll Employment Growth	0.4	0.3	0.2	-0.2	-0.2	-0.2
NEW JERSEY						
Unemployment Rate	3.8	3.8	3.7	4.3	4.3	4.8
Payroll Employment Growth	0.1	0.5	0.2	-0.1	-0.3	0.2
DELAWARE						
Unemployment Rate	4.1	3.9	3.7	3.3	3.3	3.0
Payroll Employment Growth	0.5	1.1	-0.4	0.0	-0.3	-0.2
UNITED STATES						
Unemployment Rate	4.0	4.0	4.2	4.5	4.8	5.6
Payroll Employment Growth	0.1	0.3	0.2	-0.1	-0.1	-0.6

* Percent change from previous quarter.
** Fourth-quarter average reflects October and November data.

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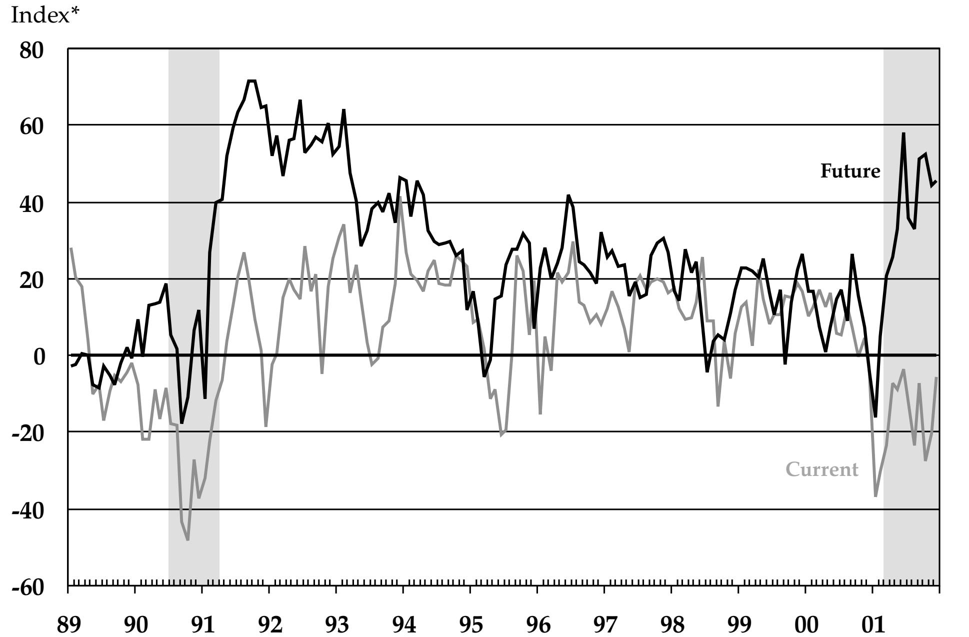
recession. Monthly job losses in manufacturing increased dramatically, however, in January 2001. And since the recession began, more than half the job losses in the U.S. and the tri-state region have been in the manufacturing sector. According to the Philadelphia Fed's *Business Outlook Survey*, overall activity at the region's manufacturing plants has declined for 13 consecutive months. Although the survey's index of current activity is still negative, it improved in December 2001 from its readings in October and November, and the index of future activity remained high by historic standards (Figure 2). The current indexes for new orders and shipments also improved in December, but there was no improvement in the indexes of employment or average hours worked.

Figure 2
BUSINESS OUTLOOK SURVEY
General Outlook



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

Business Investment Has Fallen Sharply in This Recession; Likely to Pick Up Only Slowly

The decline in business investment spending was a major factor in pushing the economy into recession. Nationally, nonresidential fixed investment slowed significantly in the last quarter of 2000 and declined in the first three quarters of this year. (Fourth-quarter data are not yet available.) Respondents to the Philadelphia Fed's *South Jersey Business Survey* reported declines in spending for both new space and equipment in the third quarter of 2001 (Figure 3). This was the second consecutive quarter in which spending for additional space had declined. Office vacancy rates have risen in the Philadelphia metro area since the first quarter of the year, and contracts for commercial office buildings have been down sharply since mid-year in the tri-state region. Capital expenditure plans by the respondents to our *Business Outlook Survey* of manufacturers have been weak since the beginning of the year. Nationally, capacity utilization in the manufacturing sector is at its lowest level since 1983, and this number will have to rise significantly before there are any large increases in capital spending in the manufacturing sector.

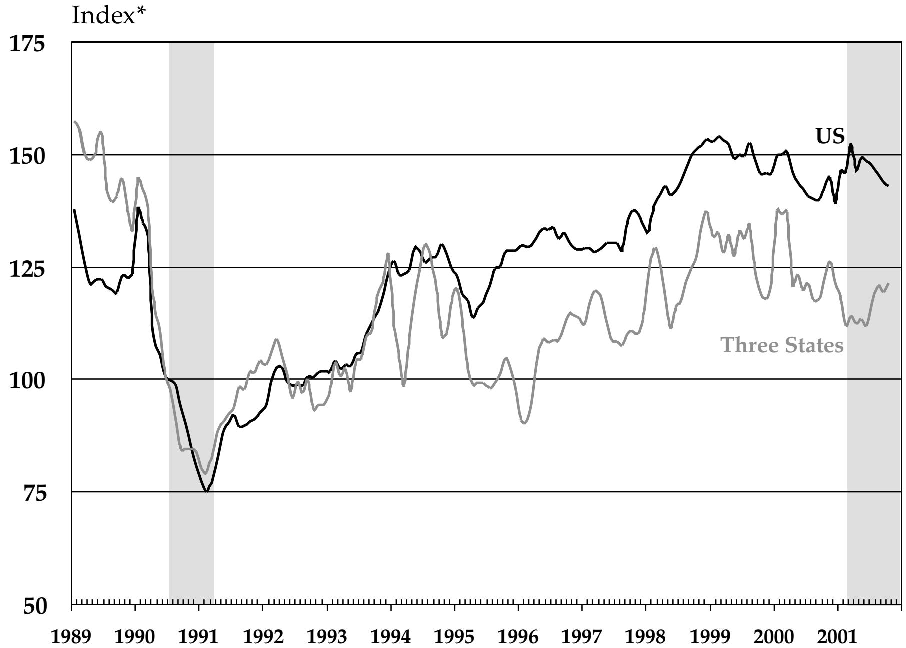
Figure 3
SOUTH JERSEY BUSINESS SURVEY
Change in Spending for New Space and Equipment

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

Housing Has Held Up Well in the Recession

One of the differences between the current recession and past ones has been the resilience of the housing market. Typically,

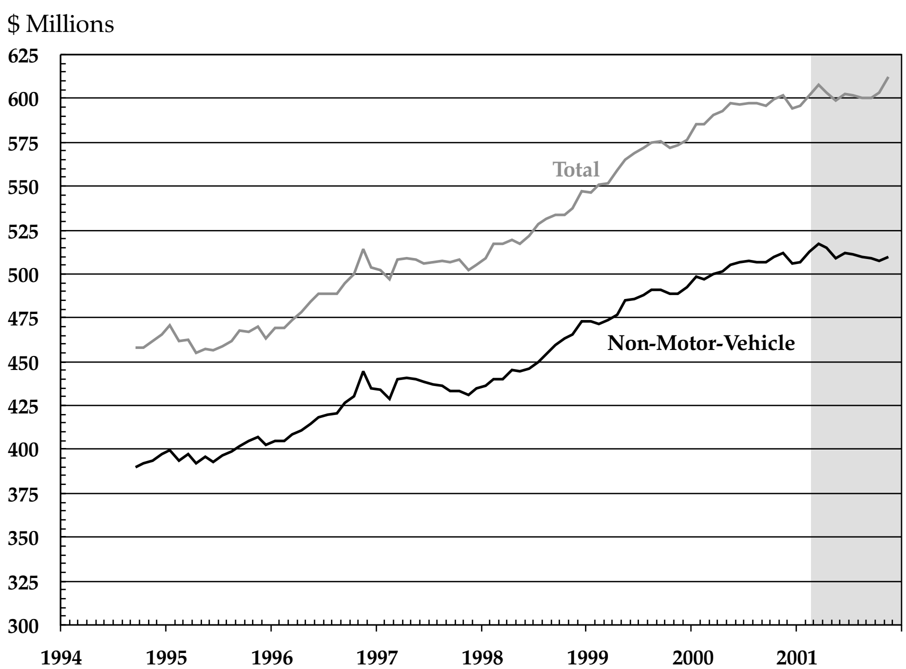
Figure 4
HOUSING PERMITS



*1992=100

Data based on a three-month moving average.

Figure 5
PENNSYLVANIA SALES AND USE TAX REVENUE



Three-month moving average.
Data seasonally adjusted by the Federal Reserve Bank of Philadelphia.
Source: PA Department of Revenue

housing permits decline sharply several months before or at the beginning of a recession; that did not happen in the current recession. Permits in the tri-state region drifted down slightly between early 2000 and spring 2001, but they picked up in the summer. Unfortunately, the momentum in housing construction seems to have stalled after the September attacks. But permits in the three states have not fallen back to their levels in the spring (Figure 4). The resilience of the housing market bodes well for a recovery in the first half of 2002. Because we have not seen the typical drop in permits in this recession, housing is not likely to provide an engine of growth as we come out of recession. But housing should provide a base on which the economy can build. Purchases of new and existing homes are generally followed in about six months with the purchase of home furnishings and appliances.

The Consumer Will Lead the Recovery

The consumer will lead the nation and the region out of the current recession. Consumer spending in the region slowed prior to the recession, and general merchandise retailers have been reporting flat sales for most of the year. Sales declined sharply in the weeks after the September terrorist attacks but have recovered gradually since then. Sales in general have not been robust, however, and most of the sales increases have been in motor vehicles. This pattern is reflected in the Pennsylvania sales and use tax revenues (Figure 5). These revenues increased substantially on the strength of new car sales in October and November. The non-motor-vehicle portion of the sales tax revenues remained basically flat, however. The prospects of recovery will depend on how well car sales hold up in the new year and whether retail sales pick up in other areas.

The holiday shopping season has been mixed. As of mid-December, sales at traditional department stores were generally lower on a year-over-year basis while discounters had respectable increases. In recent years, holiday purchases have been pushed later in December, and last year some of the biggest year-over-year increases in the region were recorded in the post-New Year sales period. If the same pattern is

Figure 6
SPECIAL QUESTION
Business Outlook Survey and South Jersey Business Survey

If you experienced a downturn in activity before or after September 11, when do you expect to see a turnaround?

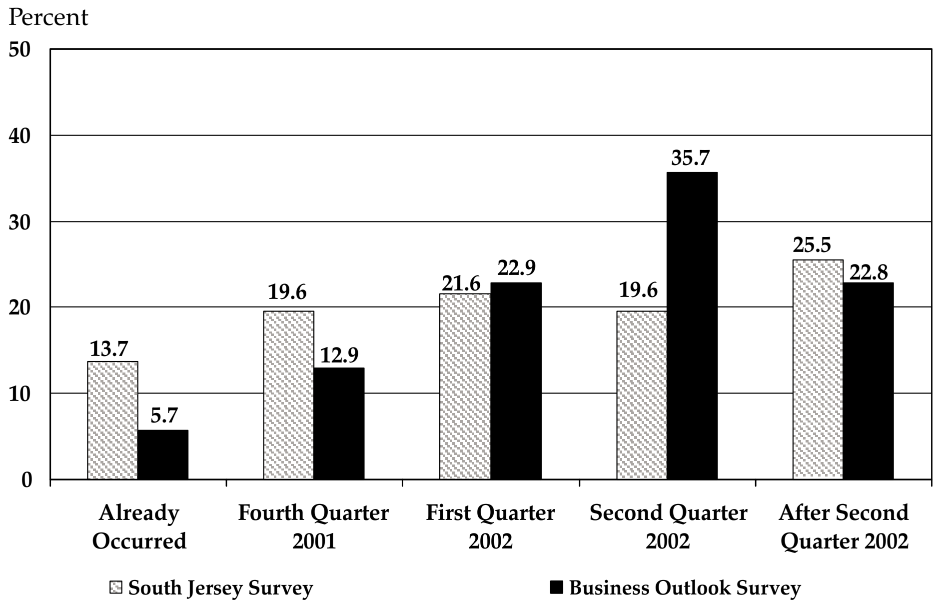


Figure 7
STATE FORECASTS

	PA	NJ	DE
Job Growth (2001:III to 2002:III)	0.2%	0.3%	-0.1%
Unemployment Rate 2002:III	5.7%	5.4%	3.7%

repeated this year, a considerable amount of inventory will be removed from the shelves, paving the way for growth later in the year.

The Outlook Is for the Region's Recovery to Begin by Mid-year 2002

A recovery in the first half of 2002 depends upon the continuation of a healthy housing market, a pickup in sales in the non-auto sector, and a pullback, rather than a collapse, of auto sales after the robust sales in the fourth quarter. This is the most likely scenario in the months ahead.

Most respondents to our regional surveys agree that the recovery will begin by the middle of 2002. In early October the respondents to the Philadelphia Fed's *Business Outlook Survey* and the *South Jersey Business Survey* were asked when they expected to see a turnaround. In both surveys about 75 percent of the respondents reported that they expected a turnaround before or during the second quarter of 2002 (Figure 6).

The Philadelphia Fed's forecast models for the three states also indicate the beginning of a recovery for the region in the first half of the year. Because of further job losses in the fourth quarter of 2001 and the first quarter of next year, total job gains from the third quarter 2001 to the middle of 2002 will be meager at best. But each of the states in the region should begin to experience sustained job growth by the second quarter of next year (Figure 7). Job growth in the early stages of the recovery will probably not be strong enough to keep the unemployment rates from rising, however. These rates are projected to continue increasing at least through the third quarter of next year.

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