



REGIONAL HIGHLIGHTS

First Quarter 2002

Signs of an Upturn in the Region's Economy

The first quarter brought some signs of improvement in the region's economy amid an ongoing decline in employment. Conditions in the manufacturing sector improved in January and continued to advance through the first quarter. Residential construction and existing home sales have been strong. Retail sales have been rising. Some negative influences persist, however. Commercial real estate markets have eased since last fall. Employment continued to decline, and the unemployment rate has risen.

The outlook is improving. Manufacturers expect business to increase in the months ahead, and they have raised capital spending plans. Homebuilders and residential real estate agents expect a continuing high rate of home sales. Commercial real estate companies look for firming markets by midyear. But employment growth is likely to be slow, and the unemployment rate is forecast to increase a bit more in all three states of the region.

Manufacturing Is Rebounding

The recession that began in March 2001 was preceded by a sharp drop in manufacturing activity in the nation as well as the region. Since January of this year, the manufacturing sector has been improving in both the nation and the region. The Philadelphia Fed's *Business Outlook Survey* of manufacturing companies indicated a turnaround in the region's manufacturing sector in January. Surveys in subsequent months through March show continuing gains (Chart 1). Although the level of the survey's index of current activity eased a bit in March, the positive reading continues to signal improvement in the region's manufacturing sector. At the national level, the Industrial Production Index for manufacturing also turned up in January, as did the overall Industrial Production Index, which includes mining and utilities in addition to manufacturing. Both the manufacturing component and the overall index have continued to increase in the months since January.

The indicators covered by the *Business Outlook Survey* suggest that the region's manufacturing firms are getting increases in

orders, and they are stepping up shipments in response. But order backlogs have not increased, and employment and working hours are still trending down. It is likely that local firms will wait for solid evidence of increased demand for their products before hiring more workers. The time for this hiring might not be too far away, however. Thirty-six percent of the manufacturing firms polled in March expect to increase working hours, and 30 percent plan to hire additional workers within the next six months.

Business Investment Is Turning Up

The region's manufacturers have been boosting their plans for capital spending. The index of capital spending plans in our *Business Outlook Survey* of area manufacturing companies rose sharply in January. Although the index retraced some of the January gain in February, it rose again slightly in March (Chart 2). The current level of the index is above any monthly reading in 2001. Nationally,

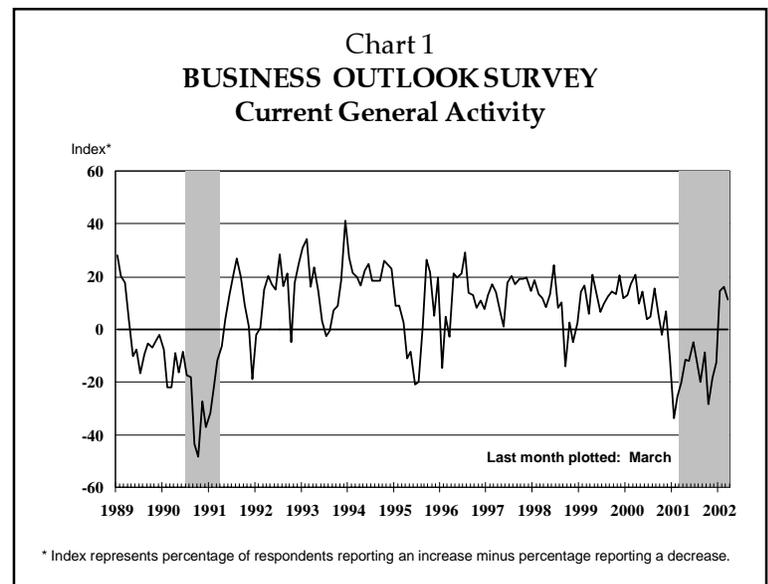
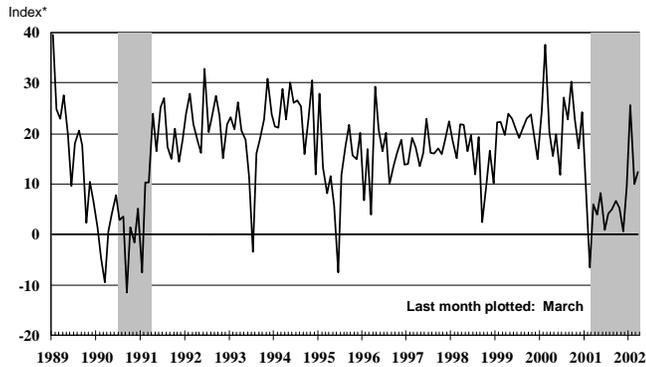
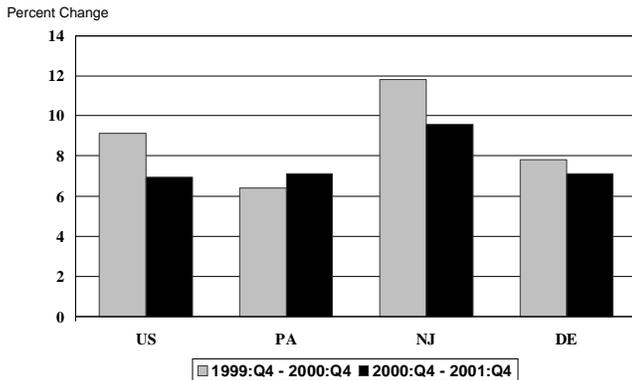


Chart 2
BUSINESS OUTLOOK SURVEY
Planned Capital Expenditures



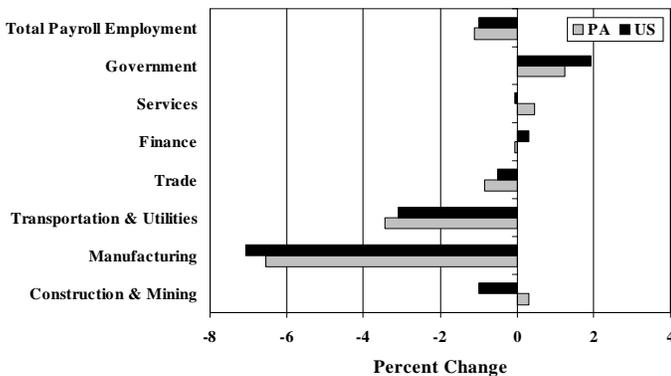
* Index represents percentage of respondents reporting an increase minus percentage reporting a decrease.

Chart 3
HOUSING PRICE INDEX



Source: Office of Federal Housing Enterprise Oversight.

Chart 4a
Change in Employment PA and US
First Quarter 2001 to First Quarter 2002*



*First Quarter 2002 includes only January and February data.

nonresidential fixed investment and investment in equipment and software fell steeply throughout 2001. The sharp decline in business investment was a major factor in the recession. Forecasts for the national economy this year are crucially dependent on the course of business capital spending in the months ahead. If actual capital spending follows the plans indicated in the *Business Outlook Survey*, there will be a noticeable but modest increase in investment outlays among manufacturers.

Residential Real Estate Markets Are Strong

Demand for housing has been strong in the region, as it has in most parts of the country. The number of building permits for new homes issued in the three states of the region has increased sharply since last fall. A large gain in January brought permit issuance in the three states to the highest levels since late 2000, and the gain continued into February. Housing contractors in the region have seen generally steady sales of new homes so far this year. Sales of existing homes have also been strong. According to residential real estate agents in the region, sales picked up late last year and continued at the higher rate during the first quarter of this year. Amid the continuing high rate of overall home sales, demand appears to have eased somewhat for homes in the top price range but increased in lower price ranges.

Strong demand for housing is reflected in rising house prices. Data from the Office of Federal Housing Enterprise Oversight (OFHEO) show that price increases for existing houses in the region in 2001 matched or exceeded the national average of 6.9 percent (Chart 3). In Delaware and Pennsylvania the increase was 7.1 percent; in New Jersey the increase was 9.6 percent. The increase in New Jersey was the seventh highest among all states, and the increases in Delaware and Pennsylvania were tied at 16th among all states. Among metropolitan areas in the region, Monmouth-Ocean, NJ ranked among the 20 metropolitan areas in the nation with the fastest rates of house price appreciation in 2001. The increase in Monmouth-Ocean was 11.2 percent, placing it 16th out of the top 20.

Nominal house price appreciation in the region and the nation eased in the fourth quarter of 2001, but the real price increase (above the inflation rate of all items except housing) was quite comparable to the high rate of price appreciation in the second half of the 1990s, according to OFHEO. The record high sales of existing homes in January of this year suggest that demand for homes remains high and price appreciation could accelerate as economic conditions improve.

Commercial Real Estate Has Weakened

In contrast to strong residential real estate markets, commercial markets have weakened. Commercial real estate agents in the region estimated that the vacancy rate for office buildings in Delaware Valley markets increased around 2 percentage points during the fourth quarter of 2001 to around 12 percent in the Philadelphia central business district and 15

percent in the suburbs. The vacancy rate for Wilmington was estimated to be even higher, around 18 percent. A large amount of space became available for sublease as companies trimmed operations during 2001. Demand for office space in the region is expected to remain just steady at least until the middle of this year, then grow slowly as the national and regional economies gain strength and businesses begin to add employees.

Employment Is Still Moving Down

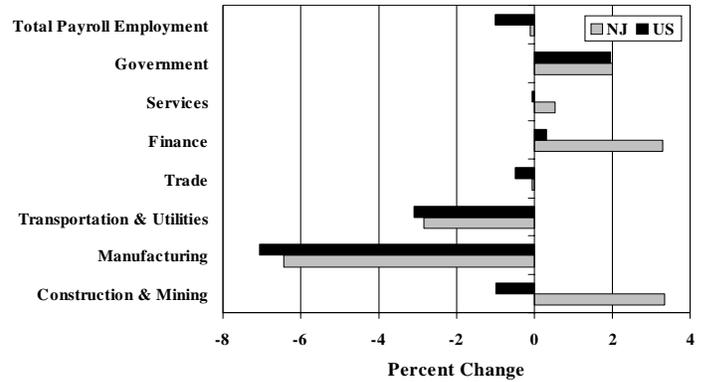
Total employment in the three-state region continued to decline in the first quarter. For January and February, employment fell in Pennsylvania and Delaware but was steady in New Jersey. (See Table 1 on page 4.) The unemployment rate increased in all three states in the first quarter. Pennsylvania's unemployment rate matches the nation's, but Delaware and New Jersey have lower rates. In Pennsylvania and New Jersey the greatest proportional declines in employment over the last four quarters have been in the manufacturing and the transportation and utilities sectors. Transportation and utilities employment declined in Delaware, and the state also had a large percentage decrease in construction employment (Charts 4a-4c). Manufacturers in the region as well as the nation experienced a significant falloff in demand for their products in late 2000 that persisted into 2001, and they reduced employment in response. The transportation sector has suffered from two sources of weakness. In addition to the decline in business travel and shipping activity that has accompanied the recession, there has been a drop in leisure travel in the wake of the September 2001 terrorist attacks.

Employment is likely to grow slowly through the rest of this year. Manufacturing appears to be rebounding, and recent reports from companies in the travel and transportation industries indicate that they are seeing some increases in business. Improvement in these sectors as well as rising overall economic activity should eventually bring an end to the region's and the nation's employment decline. Some further increases in the region's unemployment rate is expected, however, as the increase in jobs falls behind growth in the labor force. Our forecast models predict growth in employment in the three states during the year but increases in each state's unemployment rate. (See Table 2 on page 4.)

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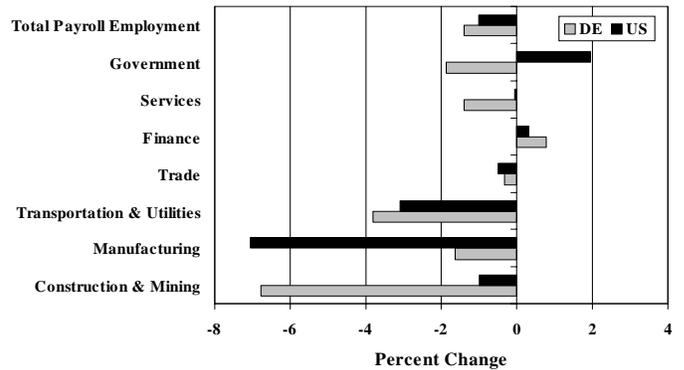
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Chart 4b
Change in Employment NJ and US
First Quarter 2001 to First Quarter 2002*



*First Quarter 2002 includes only January and February data.

Chart 4c
Change in Employment DE and US
First Quarter 2001 to First Quarter 2002*



*First Quarter 2002 includes only January and February data.

Table 1
Unemployment Rates and Employment Growth*
Seasonally Adjusted

	2000	2001				2002
	IV	I	II	III	IV	I**
3-STATE TOTAL						
Unemployment Rate	4.0	4.1	4.4	4.5	4.9	5.3
Payroll Employment Growth	0.2	0.2	0.0	-0.2	-0.3	-0.1
PENNSYLVANIA						
Unemployment Rate	4.3	4.5	4.6	4.8	5.0	5.6
Payroll Employment Growth	0.1	0.2	-0.1	-0.1	-0.7	-0.2
NEW JERSEY						
Unemployment Rate	3.7	3.6	4.1	4.3	4.8	5.1
Payroll Employment Growth	0.3	0.3	0.1	-0.4	0.1	0.0
DELAWARE						
Unemployment Rate	4.0	3.9	3.4	3.3	3.3	3.6
Payroll Employment Growth	0.1	0.0	0.0	-0.7	0.0	-0.8
UNITED STATES						
Unemployment Rate	4.0	4.2	4.5	4.8	5.6	5.6
Payroll Employment Growth	0.3	0.2	-0.1	-0.1	-0.6	-0.2

* Percent change from previous quarter.

** Based on two months of data.

Table 2
Employment Growth and
Unemployment Rate Forecasts

	PA	NJ	DE
Job Growth (2001:IV to 2002:IV)	0.7%	1.0%	0.8%
Unemployment Rate 2002:IV	6.1%	5.4%	4.0%