



REGIONAL HIGHLIGHTS

Fourth Quarter 2002

Slow Growth as the Year Ends

Business activity in the tri-state region (Pennsylvania, New Jersey, and Delaware) improved slowly in the fourth quarter, although employment has not picked up. Fourth-quarter retail sales in the region were up only slightly, and sales during the important holiday shopping period just matched or barely exceeded the prior year's for most stores. Auto sales slowed in the region during the fourth quarter as they did in the nation. Manufacturers reported some improvement as 2002 came to a close, but gains were not as widespread as they were earlier in the year. Home sales and residential construction remain strong, but the pace of growth has eased from the first half of 2002.

The outlook for 2003 in the region's business community is positive, but many business executives expect a bumpy start to the year. In most sectors, only steady conditions or slow growth are anticipated. Our employment projections call for modest job increases in each of the three states in the region and slight declines in unemployment rates.

Manufacturing Edges Up

The region's manufacturing sector continued on a slow growth path in the fourth quarter. After a slip in October, overall manufacturing activity—as measured in the Philadelphia Fed's *Business Outlook Survey*—rose slightly in November and December (Chart 1). Orders at plants in the region traced a similar path, rising in the last two months of the year after a slight decline in October. Shipments varied month-to-month around a nearly flat trend in the fourth quarter (Chart 2). Manufacturing activity in the region was less robust in the second half of the year than in the first half, a pattern similar to the nation's manufacturing output. In the region, as well as in the nation, trends in manufacturing activity have been broad based: most major industry groups posted slight gains earlier in the year but have been experiencing softer conditions since August.

Despite the fluctuations in manufacturing activity in the region in the fourth quarter, at the end of the year a majority of the firms participating in our *Business Outlook Survey* forecasted improvement in the first half of 2003 (Chart 3). Expectations of better business conditions are fairly even across the region's major manufacturing industries, but there is lingering concern among makers of industrial equipment that growth in demand for their products in 2003 will be slow.

Small Gain in Capital Spending Likely in 2003

Capital spending by businesses in the region is poised for a modest increase in 2003 compared with 2002. Gains in spending

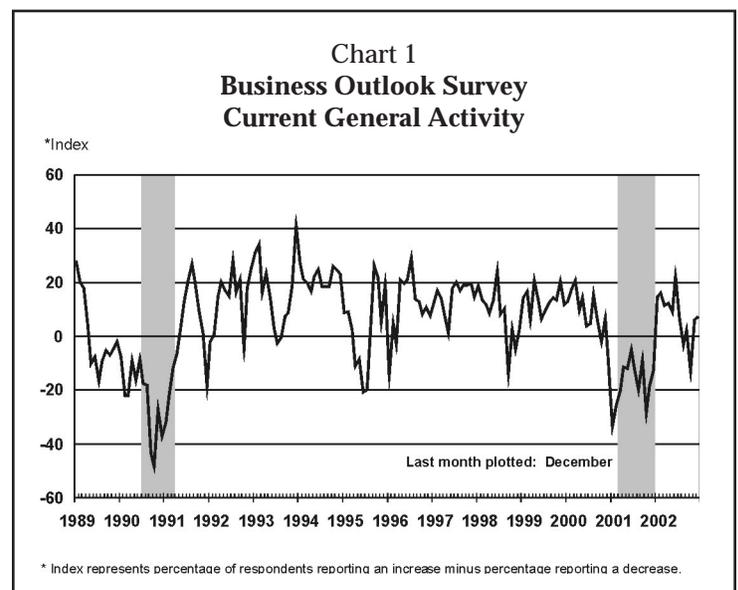
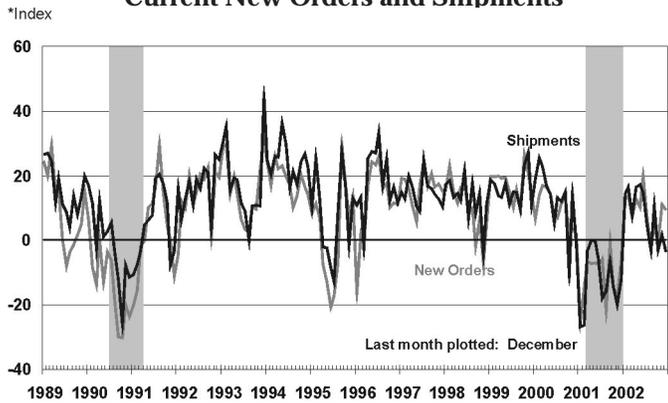
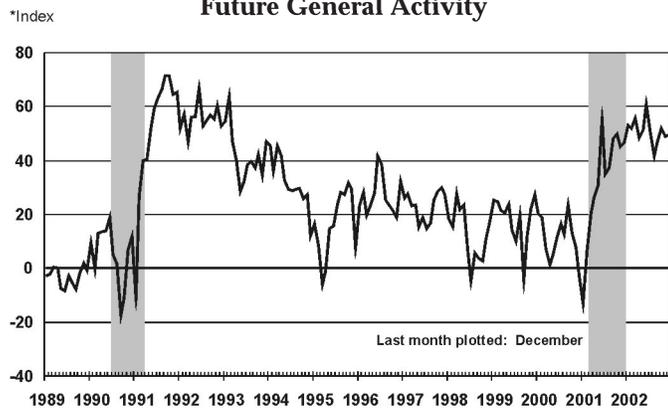


Chart 2
Business Outlook Survey
Current New Orders and Shipments



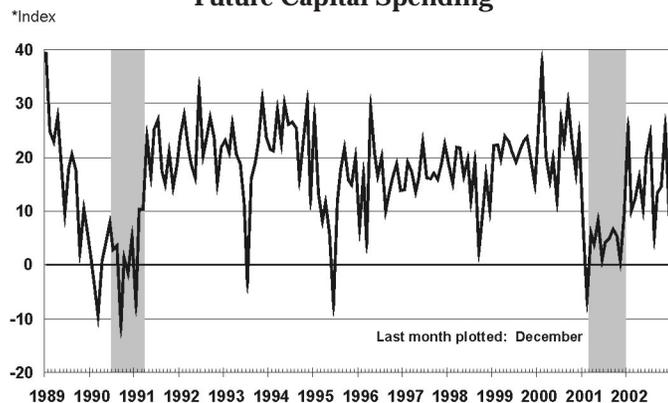
* Index represents percentage of respondents reporting an increase minus percentage reporting a decrease

Chart 3
Business Outlook Survey
Future General Activity



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

Chart 4
Business Outlook Survey
Future Capital Spending



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

for business equipment other than information technology equipment are likely to be relatively greater than for computers and software. In all industries there has been a significant increase in purchases of used computing and telecommunications equipment or equipment that had been ordered but not installed by companies that have scaled back operations or gone out of business. Low rates of capacity utilization and slim profit margins are given as the main factors limiting business capital spending.

In the Philadelphia Fed's *Business Outlook Survey* of manufacturers, the number of firms that plan to increase capital spending has increased slowly since the recession began in March 2001, but there has been considerable month-to-month fluctuation (Chart 4). With respect to capital budgets for 2003 as a whole, more manufacturers plan increases over 2002 budgets than decreases. In a recent special survey question, the number of local manufacturing firms planning increases of 10 percent or more was offset by an equal number planning decreases of 10 percent or more, but more firms were planning small increases than small decreases. On balance, manufacturers plan small increases in spending for equipment other than computers, but they expect declines in spending for computers and related hardware and software.

In contrast to manufacturers, retailers in the region have been generally limiting or cutting back capital spending plans. This includes spending for equipment, new space, and renovation of existing space. Store executives cite slowdowns in sales growth or outright drops in sales volume and shrinking profit margins as the main reasons for reducing capital spending. Warehouse and distribution companies in the region, which have expanded in the past few years, have begun to scale back their growth plans, trimming the number of new locations they plan to open and reducing the size of the new facilities they will open.

Among service firms, capital spending plans are mixed. Telecommunications companies continue to report excess capacity, which will limit capital spending through next year and possibly longer. Financial service firms in the region are also limiting capital spending, with some projects being postponed and others cancelled. Consolidation among banks in the region and lower levels of activity in financial markets have reduced the need for capital spending at depository institutions and other financial service firms. A few information technology consulting firms reported they might increase capital spending as they gain new contracts. High-tech research firms in the District are looking to expand facilities, although the total value of their increases in plant and equipment expenditures is not likely to be large.

Spending on structures in 2003 will probably remain even with or fall somewhat below the 2002 level. A trend of rising vacancies and weakening rents has dampened interest in construction of office, retail, and industrial buildings. Some contacts in commercial real estate believe the trend of industrial and commercial construction activity might pick up late in 2003 for build-to-suit buildings, but they do not expect an upturn in speculative construction.

Biotech Funding Boosted in Pennsylvania

Investment in early-stage biotech businesses will get a boost in 2003 as Pennsylvania's biotech "greenhouses" begin early-stage funding of new enterprises. The three greenhouses—in Philadelphia, Harrisburg, and Pittsburgh—were established earlier this year with state money. The Philadelphia greenhouse,

known as BioAdvance, received applications through December for funding from biotech companies and medical researchers and will review them for possible investment during 2003. The Life Sciences Greenhouse of Central Pennsylvania (Harrisburg) and the Pittsburgh Life Sciences Greenhouse are also in the early phase of reviewing potential investments. There are several locations in the three-state region with concentrations of biotech firms (see Map), and assistance to new firms by each of the states is intended to build on the region's biotech and life sciences strength. In addition to initial funding of start-up companies, the greenhouses and other consortiums in the region provide laboratory space, operate business incubators, and promote established biotech firms. (For more information on biotech in the region see "From Laboratory to Market" in the Philadelphia Fed's *Business Review*, Fourth Quarter 2002.)

Residential Construction Eases

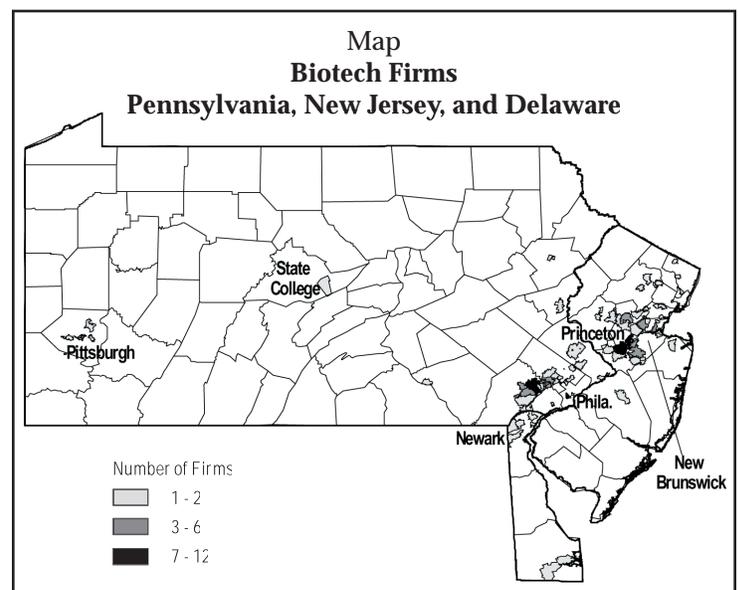
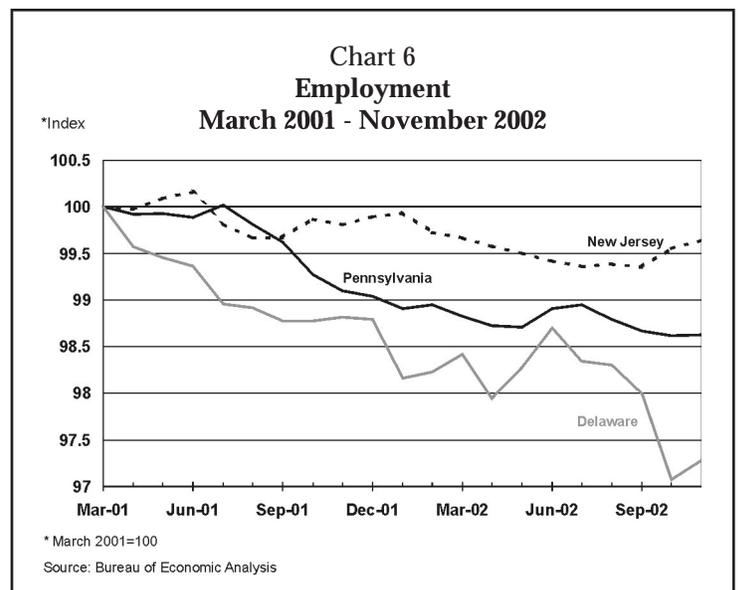
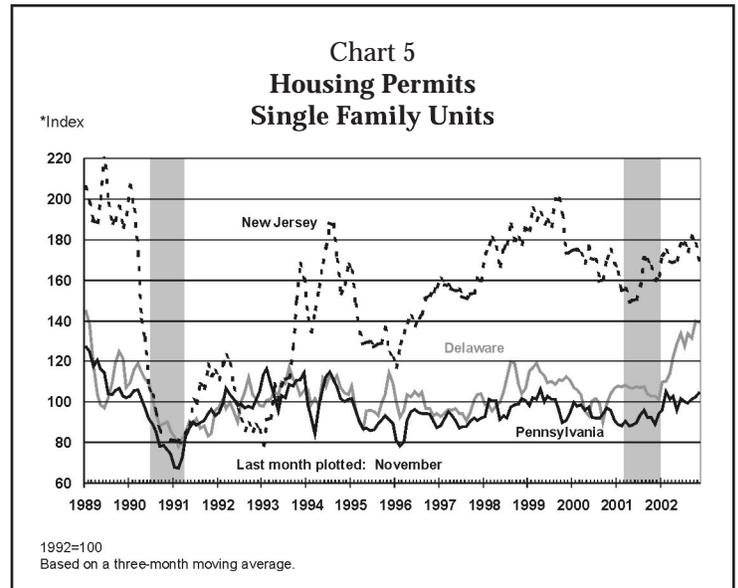
The pace of home building in the region appears to be easing. The number of building permits issued for single-family homes declined from October to November in each of the three states, as it did in the nation. Calculated using a three-month moving average to smooth the data, permit issuance remained nearly steady in Pennsylvania and Delaware, but fell in New Jersey. In the nation there was a slight gain on a three-month moving average basis. The slowdown near the end of 2002 could signal an interruption of the year-long upward trend in home construction in the three states (Chart 5). However, builders in the region generally indicate that they still have fairly large backlogs, so the level of residential construction activity is not likely to suffer a sudden decline.

Employment Remains Weak

In November, employment increased in New Jersey and Delaware, but showed no change in Pennsylvania. Since the beginning of the recession in March 2001, employment has trended down in each of the three states in the region, with the sharpest proportional decline in Delaware (Chart 6). On a quarterly basis, employment remains soft. (See Table 1 on page 4.) For October and November employment fell relatively sharply from the third quarter in Delaware; there was a smaller decline in Pennsylvania, and there was a slight increase in New Jersey. In Delaware the employment decline was relatively greatest in the transportation and public utilities sector. In Pennsylvania the employment drop was relatively greatest in the construction sector. In New Jersey, where total employment rose slightly in the fourth quarter, the relatively greatest gain was in government followed by the finance-insurance-real estate sector. For the nation, total employment was essentially unchanged in the fourth quarter. Among the sectors, the relatively strongest gain at the national level was in finance-insurance-real estate, and the relatively greatest decline was in manufacturing.

Muted Growth Ahead

Business firms in the region foresee very slight growth in the early months of 2003. They remain concerned that economic conditions, especially employment and consumer confidence, are fragile. Manufacturers have the relatively most optimistic outlook. They forecast increases in shipments and orders during the next six months. The outlook among retailers is mixed; some store executives anticipate flat sales during the first half of the year, but



**Table 1
Unemployment Rates and Employment Growth*
Seasonally Adjusted**

	2001		2002			
	III	IV	I	II	III	IV**
3-STATE TOTAL						
Unemployment Rate	4.5	4.9	5.4	5.5	5.3	5.4
Payroll Employment Growth	-0.2	-0.3	-0.2	-0.2	0.0	-0.1
PENNSYLVANIA						
Unemployment Rate	4.8	5.0	5.6	5.5	5.3	5.5
Payroll Employment Growth	-0.1	-0.7	-0.2	-0.1	0.0	-0.2
NEW JERSEY						
Unemployment Rate	4.3	4.8	5.2	5.6	5.4	5.6
Payroll Employment Growth	-0.4	0.1	-0.1	-0.3	-0.1	0.2
DELAWARE						
Unemployment Rate	3.3	3.3	3.7	4.2	3.9	4.0
Payroll Employment Growth	-0.6	-0.1	-0.5	0.0	-0.1	-1.1
UNITED STATES						
Unemployment Rate	4.8	5.6	5.6	5.9	5.7	5.9
Payroll Employment Growth	-0.2	-0.6	-0.3	0.0	0.1	0.0

* Percent change from previous quarter.
** 2002:IV represents two months of data.

a few expect slight gains. Auto dealers expect a lower sales rate in 2003 than in 2002. In the finance and services sectors some gains are expected, although business executives anticipate only slight improvement in the first quarter of the year. The Philadelphia Fed's forecasting model predicts modest upturns in employment and declines in the unemployment rates in each of the three states of the region. (See Table 2.)

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**Table 2
Employment Growth and Unemployment Rate Forecasts**

	PA	NJ	DE
Job Growth (2002:III to 2003:III)	1.3%	1.6%	1.6%
Unemployment Rate (2003:III)	5.2%	5.3%	3.7%