



REGIONAL HIGHLIGHTS

First Quarter 2003

Momentum Fades in First Quarter

Regional economic activity eased in the first quarter as the slight upward momentum noticed at the end of last year faded. Business conditions were adversely affected by weather and war. February snowstorms caused transportation interruptions that hampered workers' commutes and delayed business shipments. The storms also kept shoppers away from stores during the Presidents' Day weekend sales period. The outbreak of hostilities in Iraq also had some influence on business activity. Reports of more cautious buying, investing, and hiring came from a range of industries in the region, although it is not possible to quantify the extent to which the international situation has been a factor in the first quarter's slowdown.

Looking ahead, businesses in the region see continued caution in the near term giving way to slow growth, at best, later in the year. Manufacturers and retailers expect business to improve some time during the next six months, but gains are not forecast to be large. Residential construction, which has been fairly strong in the region, is expected to ease as the year progresses. With only slight improvement in business conditions on the horizon, our projections for employment growth in Pennsylvania, New Jersey, and Delaware have been trimmed; we now expect employment in the fourth quarter of this year to be around 1 percent higher than in the fourth quarter of last year in each of the three states.

Manufacturing Activity Drops

The pace of manufacturing activity in the region fell during the course of the first quarter. Manufacturing firms in the region participating in the Philadelphia Fed's *Business Outlook Survey* reported rising business in January, but growth slackened in February, and the manufacturing sector turned down in March (Chart 1). As the quarter ended, manufacturers reported declines in new orders and a flat rate of shipments (Chart 2).

The heavy snowfall that hit the region in mid-February hampered manufacturing activity as transportation interruptions impeded travel to work as well as industrial shipments. But the drop in manufacturing in March indicates that fundamental business conditions in the sector remain fragile. Responding to special

questions in the February *Business Outlook Survey*, a majority of area manufacturers (58 percent) indicated that they were delaying adding workers and stepping up capital spending because demand for their products remained soft. A significant percentage of respondents (40 percent) said they were delaying hiring and capital expenditures because of uncertainties about the economy related to the geopolitical situation. It remains to be seen how soon after the conclusion of military action in Iraq businesses will implement their hiring and spending plans. In response to questions about the timing of those plans, a majority of respondents to the February survey indicated they would resume hiring and investment spending within three to six months after the international situation becomes more stable.

The index of future general activity from the *Business Outlook Survey* may be a signal that regional manufacturing could rebound soon after the Iraq conflict ends. This index, which measures

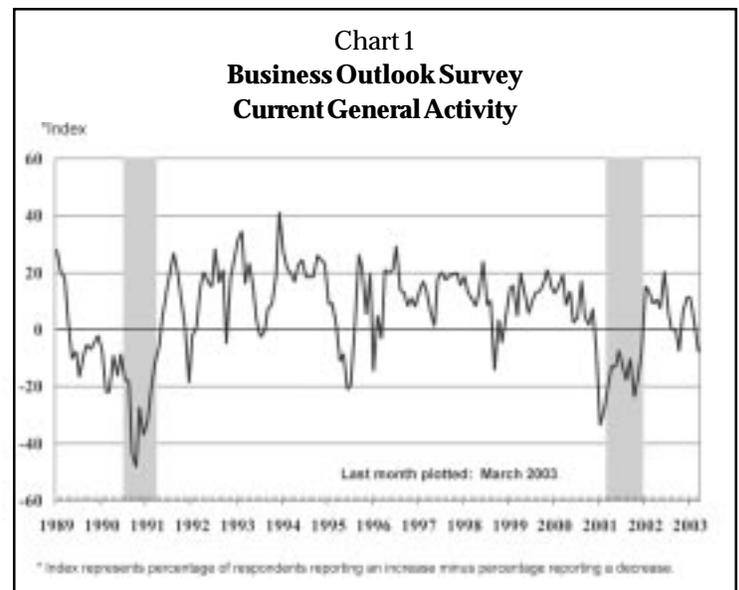
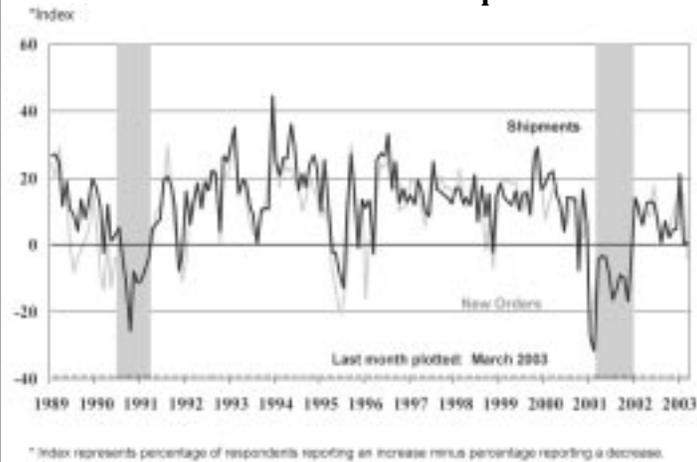


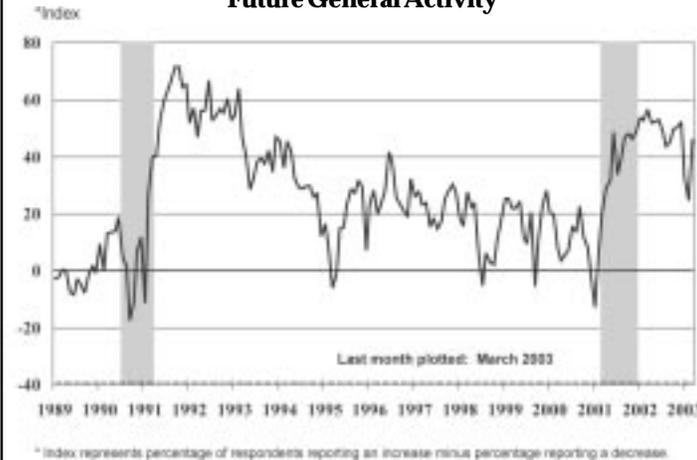
Chart 2
Business Outlook Survey
Current New Orders and Shipments



though many stores extended their holiday promotions. The Commerce Department reported that national retail sales (excluding autos and gasoline) rose in January and fell in February. General merchandise sales in the region appeared to be about steady through most of March, and merchants generally indicated that sales remained steady as the war in Iraq began late in the month. Nonetheless, consumer confidence in the region has been fragile, as it has been throughout the country, and shoppers remain cautious in their spending. Consumers continue to purchase home furnishings and consumer electronic items, but they have been limiting their purchases of other goods such as new fashion apparel and jewelry. The cutbacks in discretionary spending could result in a drop in overall retail sales in April.

Auto sales in the region also slipped from January to February, as they did nationally, and the slower sales pace continued into March. Some auto makers announced new rounds of zero-percent financing at the end of the month, but it is too soon to tell if the financing incentives will overcome lower consumer confidence and higher gasoline prices to prompt a rebound in sales of cars and light trucks.

Chart 3
Business Outlook Survey
Future General Activity



manufacturers' forecast of business six months ahead, rose in March to its highest level so far this year (Chart 3). Indexes of future new orders and shipments rose as well. However, the index of future employment remained only weakly positive, suggesting that an improvement in manufacturing output, when it does come, will not bring much of a boost to employment among the region's manufacturing firms.

Retail Sales Are Sluggish

Retail sales of general merchandise slowed in the region from January to February, and many stores indicated that sales have been running at a slower pace than in the first quarter of last year. The major snowstorm that hit the region over the Presidents' Day weekend kept shoppers from stores during this important selling period, and sales did not rebound in the days after the storm even

Residential Real Estate Markets Ease

Residential construction has eased in the region since last fall. Winter storms and a drop in consumer confidence have had a negative impact on housing construction and home sales in the first months of the year. In each of the three states—Pennsylvania, New Jersey, and Delaware—the average monthly number of housing permits issued in January and February, on a seasonally adjusted basis, was below the average monthly number in the fourth quarter of last year (Chart 4). In recent months permit issuance in the three states has been generally weaker than in the nation, although the most recent national data also indicate a drop. The most recent monthly levels of permit issuance in the region have been around the same as the average level of last year, and the recent national level has been above that of last year.

The National Association of Home Builders reported a sharp deterioration in buyer traffic, current sales, and prospective sales in March as a result of bad weather and a decline in buying interest with the outbreak of hostilities in Iraq. Still, the association expects sales of new homes to rebound once the fighting ends. Their forecast anticipates only a slight drop—1 percent—in new home sales for 2003 as a whole compared with 2002. Home builders in the three states of the region also anticipate a decline in sales this year compared with last year, but they generally report that their backlogs are sufficient to generate new housing starts this year at least equal to last year. So, while sales may decline this year, building activity should remain high.

Residential real estate agents characterized sales of existing homes as steady in January and February. Price appreciation has eased since the middle of last year in the nation as well as in each of the three states of the region (Chart 5). In the most recent quarter for which data are available (fourth quarter 2002) all three states had year-over-year house price appreciation above the national average. Also, each of the states exceeded the nation for the period from the fourth quarter of 2001 to the fourth quarter of 2002. In the first quarter of this year real estate agents reported that price appreciation,

although slowing, continued to be strong in many parts of the region. The market for existing homes will probably exhibit conditions similar to the new home market in the region, as real estate agents expect a slight drop in sales this year compared with last.

Employment Falls

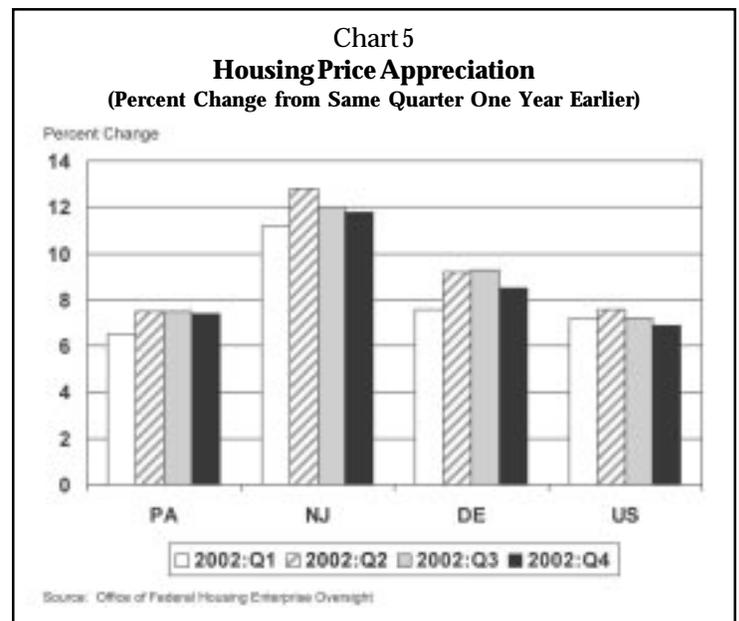
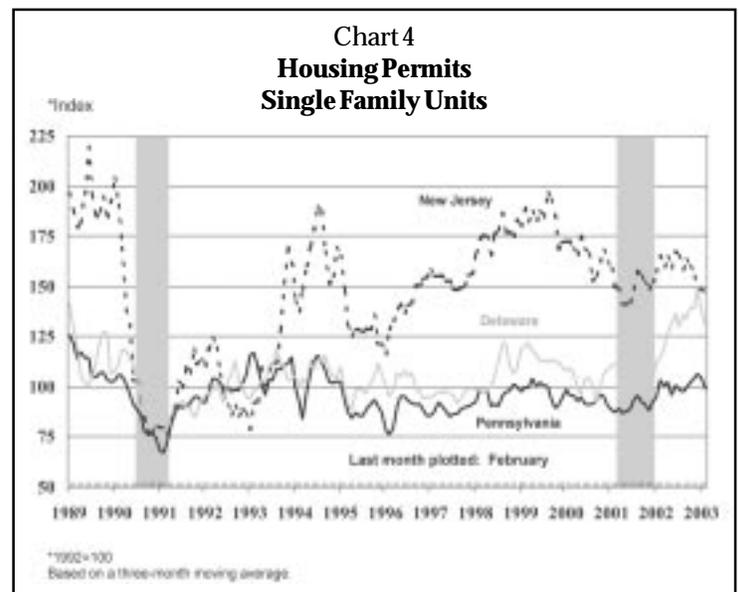
Employment in January in each of the three states of the region was below the fourth-quarter average (see Table 2 on page 4). The unemployment rate rose in Pennsylvania and is now above the national rate. Unemployment rates fell in New Jersey and Delaware, and each state's rate remains below the nation's. In Pennsylvania, employment fell in most sectors but was about steady in the financial industry and up slightly in education, health, and hospitality services. In New Jersey, employment was down from the fourth-quarter average in most sectors but nearly steady in the financial sector and up slightly in education and health services and the government sector. In Delaware, employment was down in most sectors but up by small amounts in construction and professional and business services.

The release of the January employment data for the states marks the beginning of the use of a new industrial classification system for U.S. labor statistics. The new system—the North American Industrial Classification System—replaces the old Standard Industrial Classification system. It will be used in Canada and Mexico as well as the United States, facilitating statistical comparisons among the three nations of the North American Free Trade Agreement. The new system better reflects the structure of the economy in North America, including the United States, especially with more precise definitions of high-tech industries. The new industry divisions are called supersectors. There are 11 private industry supersectors and a public administration (government) supersector. Perhaps the most significant change from the former industry divisions is the new supersector for the information industry. The newly defined information industry brings together companies that are involved in publishing, sound and motion picture recording, broadcasting, telecommunications, information services, and data processing, and includes all Internet-related industries.

The mix of employment by supersector in the region is broadly similar to the national mix, but there are some exceptions (Table 1). There are a few supersectors that are more important in the regional economy than in the nation. These are education and health services in Pennsylvania and financial and professional and business services in Delaware. Less important regionally is manufacturing, which plays a smaller role in New Jersey and Delaware than in the nation.

Slow Return to Growth Expected

Business conditions are likely to improve slowly this year, although the immediate future is very uncertain—that's the consensus of business firms in the region. Manufacturers expect a modest revival in business once the international situation stabilizes, and retailers foresee similar developments. In other sectors, views are mixed, although major changes in business conditions are not anticipated. Residential real estate sales are likely to moderate as the year progresses, but not drop significantly. The region's commercial



real estate markets will probably remain soft until late in the year, when some firming might take hold. The Philadelphia Fed's forecasting model for employment now predicts slower growth for the four quarters ahead than it did last fall (see Table 3). We now expect employment in the fourth quarter of this year to be around 1 percent higher than in the fourth quarter of last year in each of the three states, around one-half percentage point less than the forecast made at the end of last year.

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Table 1
Employment by NAICS Supersector
(Percent of Total)

	PA	NJ	DE	US
Natural Resources & Mining	0.3	0.0	N/A*	1.2
Construction	4.4	4.1	6.0*	5.0
Manufacturing	13.2	9.0	8.7	12.9
Trade, Transportation, & Utilities	19.7	22.2	19.0	19.7
Information Services	2.3	2.8	1.9	2.8
Financial Activities	6.0	7.0	9.3	5.9
Professional & Business Services	10.6	14.5	16.3	12.7
Education & Health Services	17.4	13.5	12.0	11.3
Leisure & Hospitality Services	8.3	7.8	9.2	8.9
Other Services	4.7	3.7	4.3	3.2
Public Admin.	13.3	15.5	13.7	16.0

*Natural resources and mining employment and construction employment are not reported separately for Delaware. Total employment in these industries is reported in the construction industry.

Table 2
Unemployment Rates and Employment Growth*
Seasonally Adjusted

	2001		2002			2003
	IV	I	II	III	IV	I**
3-STATE TOTAL						
Unemployment Rate	5.0	5.5	5.6	5.7	5.9	5.8
Payroll Employment Growth	-0.2	0.1	-0.1	-0.1	0.0	-0.2
PENNSYLVANIA						
Unemployment Rate	5.2	5.5	5.6	5.7	5.9	6.1
Payroll Employment Growth	-0.4	0.1	0.1	0.0	-0.2	-0.3
NEW JERSEY						
Unemployment Rate	5.0	5.5	5.8	6.0	6.0	5.5
Payroll Employment Growth	0.2	0.2	-0.3	-0.1	0.2	-0.2
DELAWARE						
Unemployment Rate	3.5	4.0	4.3	4.3	4.3	3.4
Payroll Employment Growth	-0.2	-1.0	-0.2	-0.3	0.5	-0.4
UNITED STATES						
Unemployment Rate	5.6	5.6	5.8	5.8	5.9	5.8
Payroll Employment Growth	-0.6	-0.3	0.0	0.1	0.0	-0.2

* Percent change from previous quarter.

** U.S. numbers reflect two months of data. All other numbers reflect one month of data.

Table 3
Regional Forecast

	Forecast 2002:IV - 2003:IV			Actual 2001:IV - 2002:IV		
	PA	NJ	DE	PA	NJ	DE
Employment	1.0	1.2	1.2	-0.6	-0.3	-1.9
Unemployment Rate	5.8	5.6	4.0	5.6	5.6	4.0

* Unemployment rate forecasts represent the expected unemployment rate in 2003:IV, while the actual unemployment rate represents 2002:IV.