Region’s Economy Grew Moderately in Recent Months

- Region’s Economy Grew, but Less Rapidly Than the Nation’s
- Little Upward Pressure Seen on Prices and Wages
- Region’s Growth Expected to Continue to Lag Nation’s

The tri-state area’s economy continued to expand in the fourth quarter, but at a less rapid pace than the nation’s. Delaware has experienced faster growth than Pennsylvania and New Jersey. Still, the region’s economy is operating near capacity, at least as reflected in the labor market.

Even though the pace of growth in the region lags the pace of growth in the nation, the level of activity in the region is healthy. Employment in the region improved moderately during the first two months of the fourth quarter, and the unemployment rate fell. The pace of growth in the region’s manufacturing sector has slowed in recent months. Manufacturing employment was mostly flat in October and November, following a modest decline in the third quarter. The pace of growth in the construction industry continued to slow in the fourth quarter, but the level of activity remains relatively high. Retailers report healthy sales for the holiday season, and employment in the retail industry continues to expand. Bank lending, led by consumer loans, has increased somewhat in recent months.

Consistent with the modest pace of activity, there is little upward pressure on wages and prices in the region, although some area manufacturers have reported increases in input prices in recent months. The outlook suggests that the pace of growth of the regional economy will continue to lag growth nationally.

Employment Increased Modestly and The Unemployment Rate Fell

Early payroll employment figures for the fourth quarter show continuation of moderate growth in the tri-state area’s labor market. Payroll employment in the region increased 0.2 percent during the first two months of the fourth quarter, the same pace as in the third quarter (Figure 1). These employment growth rates are lower than the national growth rate of 0.5 percent in the third quarter and 0.4 percent in the fourth quarter of 1999. The region’s employment growth rate averaged roughly 55 percent of the nation’s over the last year and a half.

All three states in the region experienced employment growth in the fourth quarter. Payroll employment in Pennsylvania grew a scant 0.1 percent in the fourth quarter, following a flat third quarter. Jobs in New Jersey rose 0.3 percent in both the third and fourth quarters of the year. Delaware, which typically has the fastest job growth in the region, saw employment rise a strong 0.9 percent in the fourth quarter, after rising only 0.3 percent in the third quarter. Only three of the Third District’s 17 labor markets (Dover at 3.5 percent, Wilmington at 2.8 percent, and Monmouth/Ocean at 2.3 percent) essentially matched or exceeded national employment growth of 2.2 percent for the three-month period ending in November 1999 compared with the same period in 1998 (Figure 2).

The region’s unemployment rate fell to 4.3 percent during the first two months of the fourth quarter—the same rate that prevailed during the first half of this year and down from 4.5 percent in the third quarter. The unemployment rate fell 0.1 percentage point in Pennsylvania and 0.3 percentage point in New Jersey but increased 0.3 percentage point in Delaware during the fourth quarter.

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### Figure 1

**UNEMPLOYMENT RATES AND EMPLOYMENT GROWTH**

*Seasonally Adjusted*

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* Percent change from previous quarter.

** Percent change based on two months of data.
Prices and Wages Remained in Check
The Philadelphia-area Consumer Price Index (CPI), the Northeast Employment Cost Index, and the Philadelphia Fed’s Business Outlook Survey (BOS) suggest that inflation in the region continues to be moderate. Consumer prices in the Philadelphia area advanced 2.3 percent in 1999, less than the 2.7 percent increase for the nation. Wages and salaries in the Northeast increased at a rate of 3.3 percent for the 12 months ending in September, slightly faster than the 3.2 percent increase for the nation. Benefits in the Northeast rose at a slightly slower pace than wages and salaries; total employment costs increased at a rate of 3.2 percent compared with an increase of 3.1 percent nationally. Thus, despite relatively low unemployment rates, there is little evidence of rapid increases in compensation costs.

The January BOS continues to yield a mixed picture for industrial prices (Figure 3). The diffusion index for input prices, which is the difference between the percentage of firms reporting price increases and those reporting price declines, stood at 22 in January, essentially unchanged for the past four months. The diffusion index for prices paid, which started the year in negative territory, has been at double-digit levels since June. There is, however, less evidence of upward pressure on output prices. The prices received index decreased notably from 10.0 in November to 2.5 in December.
and increased only slightly to 5.2 in January. With the exception of November, the index has remained at relatively low levels since turning positive in August. A large number of firms that responded to the January survey reported no increase in prices for either inputs (68 percent) or outputs (63 percent), providing further evidence that increases in industrial prices are moderate.

**Growth Continued in Most Sectors, But at a Slower Pace**

The District’s manufacturing output continued to grow in January, but at a slower pace than at the end of 1999, and manufacturing employment was unchanged in October and November. After increasing to 19.5 in November, the BOS’s main index of current activity slipped to 15.1 in December and to 9.1 in January, suggesting a slowdown in growth in the sector. Consistent with the lower level of the general activity index, the index for new orders declined in December and January, and the indexes for order backlogs and delivery times have been negative in recent months. Although the index for manufacturing employment declined from 12.9 in December to 10.2 in January, it has been at double-digit levels in four of the past five months.

The BOS presents a more positive picture of manufacturing employment than do payroll employment figures. Employment in the tri-state region’s manufacturing sector was flat during the first two months of the fourth quarter, following six consecutive quarterly declines. Manufacturing employment in the region declined 1.4 percent (about 21,000 jobs) during the first 11 months of this year, about the same rate of decline as in the nation.

The pace of residential and nonresidential construction slowed considerably from their first-quarter peaks. Despite this decline, residential and nonresidential construction remain at relatively high levels. Reflecting the slower pace of growth and a tighter labor market in the sector, construction employment in the tri-state area has been mostly flat following a strong increase in the first quarter of 1999. Still, construction employment is at a relatively high level with builders reporting shortages of skilled craftsmen.

After increasing 4.3 percent in the first quarter of 1999, housing permits fell 8.2 percent during the second and third quarters. For the three months ending in November, housing permits in the tri-state area were down 6.6 percent compared with the same period in 1998. Nationally, permits declined 4.2 percent over the same period. Permits were down in all three states for the three months ending November compared with the same period last year (Figure 4).

For the first 11 months of 1999, the value of residential construction contracts in the tri-state area was up 7.7 percent compared with the same 11 months in the previous year. Of course, this increase is the result of a strong first quarter. The region’s growth slightly exceeded the nation’s growth of 7.5 percent. Residential construction was strongest in Delaware (up 11.9 percent), followed by New Jersey (up 10.4 percent) and Pennsylvania (up 5.1 percent).

Tri-state nonresidential construction, as reflected in the value of new contracts, was up 3.1 percent in the first 11 months of the year compared with the same period in 1998. Nationally, nonresidential construction rose 5.1 percent over the period. As with residential construction, this increase is the result of a strong first quarter. Nonetheless, on a year-over-year basis, New Jersey and Pennsylvania experienced gains of 5.2 percent and 3.2 percent, respectively. The value of contracts in Delaware, on the other hand, declined 19.7 percent in the first 11 months of the year compared with the same period in the previous year.

The demand for office space in the region remains strong, although construction activity has eased. The office vacancy rate in Philadelphia’s central business district was 11.1 percent in the third quarter, down 5.3 percentage points from the same period one year ago. This decrease is remarkable considering the effects of mergers and consolidations, such as First Union’s merger with CoreStates in 1998. The Pennsylvania suburban office market had an overall vacancy rate of 10.3 percent at the end of the third quarter. Construction of office buildings, which had been particularly strong in Delaware and in the Pennsylvania suburbs, has slowed, and a further decline is expected in 2000. Recent increases in new space and the renting of subleased space appear to have brought supply and demand for space into balance.

Retail sales in the region remain healthy, registering strong increases for the holiday shopping season. Retailers’ reported year-over-year sales increases of around 6 percent in nominal terms for the holiday season. Discount and club stores reported even greater increases. Retailers benefited from the strong stock market, high consumer confidence, and tight labor markets this holiday season. Employment in the retail sector continues to expand. Tri-state employment in the retail sector was up 1.0 percent (16,700 jobs) during the first 11 months of 1999 compared with 1.6 percent for the nation.

Area banks report generally modest growth in loan demand, led by consumer lending. Consistent with the slowing of residential and nonresidential construction, real estate lending has eased, according to area bankers. Bankers indicated that the decline in real estate lending is partly related to a drop in the demand for residential mortgages and partly due to the implementation of more stringent standards for commercial real estate.
Figure 3
BUSINESS OUTLOOK SURVEY
Current Prices

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

Figure 4
HOUSING PERMITS

*1992 = 100
Housing units authorized by building permits.
Based on a three-month moving average.
loans. The level of commercial and industrial lending was described as mostly flat. Area bankers believe many business borrowers arranged bank financing earlier in the year to avoid delays that might occur if Y2K problems materialized. Bankers expect business lending to improve by the end of the first quarter of 2000.

**Outlook: Region’s Economy Will Continue to Grow at a Moderate Pace**

The tri-state economy should continue to grow at a moderate pace, but slower than the national economy in the first half of 2000. The Philadelphia Fed’s regional forecasts call for job growth of around 2 percent or less in all three states. From the third quarter 1999 to the third quarter 2000, employment is forecast to grow 1.1 percent in Pennsylvania, 1.2 percent in New Jersey, and 2.2 percent in Delaware. Unemployment rates are expected to remain near their current levels.

Despite the recent slowdown in current activity, the manufacturers’ outlook about the near future has generally improved in recent months. The BOS index for future activity increased from 18.9 in November to 26.7 in December, the third consecutive monthly increase. Although the index declined to 19.7 in January, it has been at double-digit levels since October. On balance, manufacturers plan to add to their payrolls six months out, although they were less optimistic regarding future employment growth in December and January than they had been in earlier months. The index for future employment rose from 6.8 in December to 9.9 in January; the index stood at 20.2 in November. Other indicators also suggest moderate growth in the first half of 2000. Initial unemployment claims, another indicator of future employment, have declined in recent months. Our leading indexes for November for Pennsylvania and New Jersey also suggest moderate to weak growth. Pennsylvania’s index is weakest at 0.1, suggesting only slight near-term growth, and New Jersey’s index is somewhat stronger at 0.7.

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