

REGIONAL

H I G H L I G H T S

Federal Reserve Bank
of Philadelphia

Third Quarter 2000

Region's Growth Stalled in the Third Quarter

- *Employment Declined Slightly in the Third Quarter*
- *Slowdown Is Most Pronounced in Construction*
- *Upward Pressure on Industrial Prices Weakens*

Growth in the tri-state economy appears to have stalled in the third quarter. Preliminary data for the third quarter of 2000 indicate that job growth in the region declined and the unemployment rate held steady. The region's manufacturing sector declined slightly in October, after a general trend of slowing growth over the last five months, and manufacturing employment decreased slightly this year. After exhibiting strong growth earlier this year, both residential and nonresidential construction declined in the second and third quarters. Despite reports of labor shortages in the sector, construction employment has declined in recent months. Retail sales, which were flat in June and July, were boosted during the back-to-school shopping period. Year-over-year increases in sales, however, were somewhat below retailers' expectations. Consistent with slower growth, bank lending has slowed in recent months. Reflecting the slowing economy, there appears to be somewhat less upward pressure on industrial prices in recent months than earlier this year. Looking ahead, growth of the regional economy

is likely to rebound over the next six months but will probably be less rapid than that experienced during the first half of this year.

Employment Decreased Modestly; Unemployment Rate Held Steady

Early payroll employment figures for the third quarter show weakness in the tri-state area's labor market. Payroll employment in the region decreased 0.3 percent during the first two months of the third quarter, after increasing 0.3 percent in the second quarter (**Figure 1**). Part of the decline in employment is temporary. The August strike by Verizon communication workers shows up as a decline in establishment employment. Because these workers all returned to their jobs before the end of August, employment in September will show an increase. Resident employment, however, counts people as employed if they are on strike but expected to return to work. At this time, the resident employment series is most likely a better indicator of job growth in the third quarter than is the establishment series. Resident employment fell 0.1 percent in the region in the third quarter. Resident employment fell 0.1 percent in Pennsylvania and 0.2 percent in New Jersey but increased 0.4 percent in Delaware. Employment growth was held down in both the establishment and the household surveys by layoffs of temporary Census Bureau workers in August, which represent the last large group of workers who have finished work on the decennial census. If we

disregard the Verizon workers who were temporarily on strike and the temporary census workers, employment declines were recorded in construction, wholesale trade, retail trade, and the fire, insurance, and real estate sector in the third quarter.

The unemployment rate in Pennsylvania has been steady at 4.0 percent all year. The rate in both New Jersey and Delaware increased to 3.9 percent during the first two months of the third quarter. Only four of the Third District's 17 labor markets (Dover at 6.0 percent, and State College, Williamsport, and Wilmington at 2.5 percent) exceeded national employment growth of 2.1 percent for the three months ending in August 2000 compared with the same period last year.

Signs of Less Upward Pressure on Industrial Prices in Recent Months

The region, like the nation, has seen an acceleration in CPI inflation this year. After increasing at an annual rate of 2.4 percent during 1999, consumer price inflation in the Philadelphia area increased 3.3 percent on an annualized basis during the first eight months of the year, compared with 3.5 percent for the nation. The upward pressure on prices this year is related to higher energy prices. For the nation, core measures of inflation that exclude the vola-

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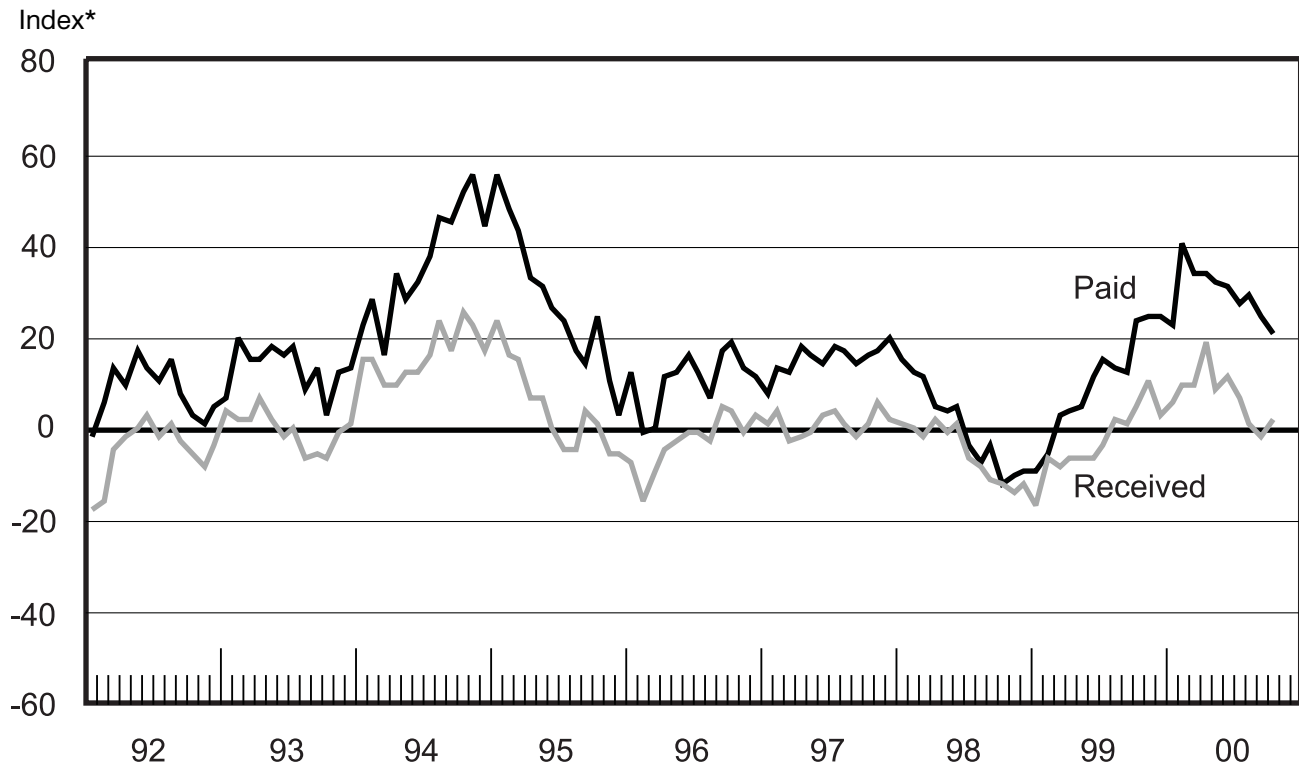
Figure 1
UNEMPLOYMENT RATES AND EMPLOYMENT GROWTH*
Seasonally Adjusted

	1999			2000		
	II	III	IV	I	II	III**
3-STATE TOTAL						
Unemployment Rate	4.5	4.5	4.3	4.0	3.9	3.9
Payroll Employment Growth	0.4	0.2	0.2	0.5	0.3	-0.3
Resident Employment Growth	0.3	0.3	0.4	0.4	0.1	-0.1
PENNSYLVANIA						
Unemployment Rate	4.4	4.4	4.2	4.0	4.0	4.0
Payroll Employment Growth	0.4	0.1	0.0	0.7	0.0	-0.4
Resident Employment Growth	0.3	0.1	0.1	0.4	-0.3	-0.1
NEW JERSEY						
Unemployment Rate	4.7	4.7	4.4	3.9	3.7	3.9
Payroll Employment Growth	0.5	0.3	0.5	0.4	0.6	-0.3
Resident Employment Growth	0.4	0.5	0.7	0.3	0.5	-0.2
DELAWARE						
Unemployment Rate	3.6	3.4	3.5	3.3	3.6	3.9
Payroll Employment Growth	0.5	0.5	1.0	0.6	1.1	0.1
Resident Employment Growth	-0.4	0.6	1.6	1.3	1.5	0.4
PHILADELPHIA MSA						
Unemployment Rate	4.0	4.3	4.0	4.0	3.8	3.8
Payroll Employment Growth	0.4	0.2	0.4	0.9	0.3	0.0
Resident Employment Growth	0.5	-0.2	0.1	1.5	0.0	0.1
UNITED STATES						
Unemployment Rate	4.3	4.2	4.1	4.1	4.0	4.1
Payroll Employment Growth	0.5	0.5	0.6	0.6	0.7	0.0
Resident Employment Growth	0.1	0.2	0.5	0.8	0.0	-0.3

* Employment growth is percent change from previous quarter.

** Based on two months of data.

Figure 2
BUSINESS OUTLOOK SURVEY
Current Prices



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

tile food and energy components have accelerated only modestly.

Wages and salaries in the Northeast increased at a rate of 4.0 percent in the previous 12 months through June, slightly less than the increase of 4.1 percent for the nation. In the Northeast, employment costs including benefits increased at a rate of 4.3 percent, compared with an increase of 4.6 percent nationally. In the Northeast, as in the nation, the 12-month increases for total compensation and wages and salaries were somewhat higher in the first half of 2000 than the second half of 1999. Although employment costs have accelerated this year, gains in productivity have largely offset these increases in

compensation costs. Therefore, labor costs have not had a net inflationary impact.

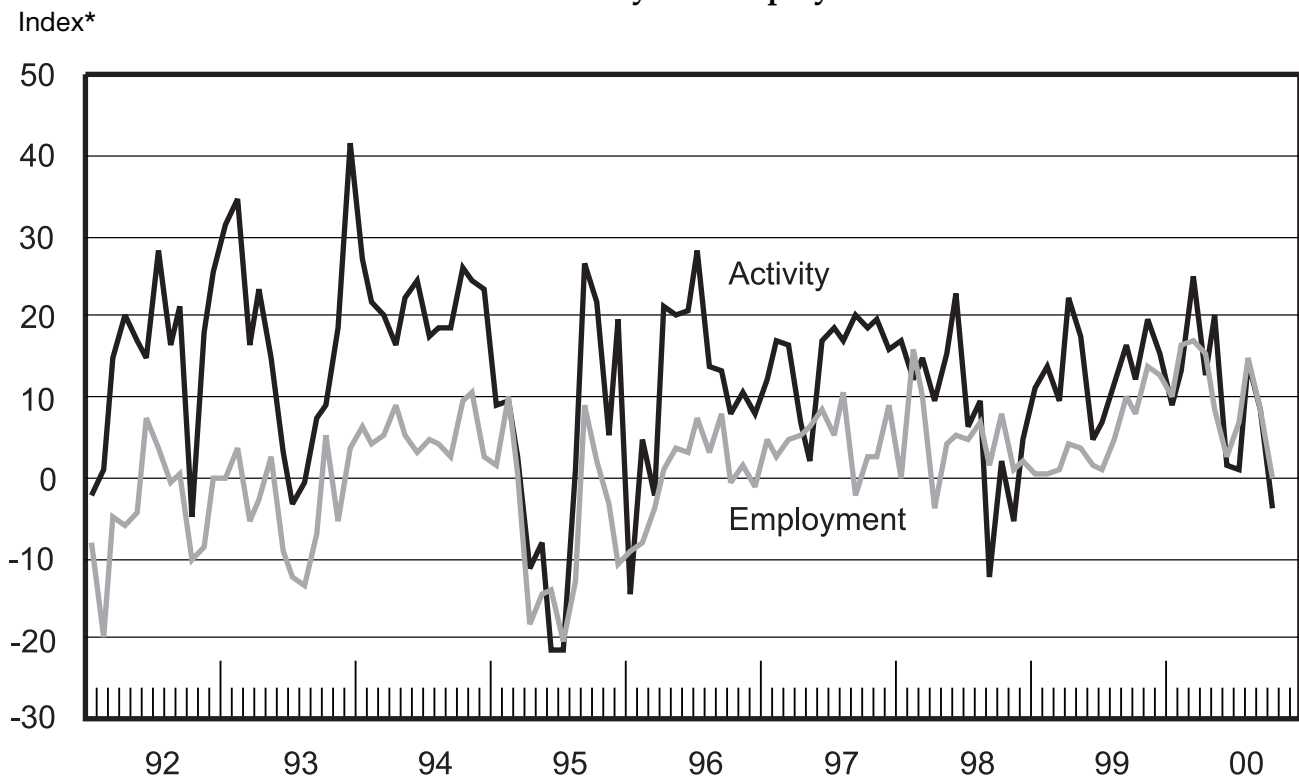
According to the *Business Outlook Survey* (BOS), upward pressure on industrial prices appears to have weakened in recent months (**Figure 2**). Twenty-six percent of firms responding to the October survey reported increases in input prices, about the same number reporting increases in September. Even though the input price readings are relatively high, they have declined in five of the last six months, offering hope that input price pressures are moderating. Eighty-four percent of firms reported no change in prices received in October. The diffusion index for prices

received, which measures the difference in the percentage of firms experiencing increases in output prices and the percentage experiencing declines, has decreased from 18.2 in March (the highest reading since January 1995) to 1.5 in October. This index has hovered around zero for the past three months. Taken together, the indexes suggest less upward pressure on industrial prices.

Manufacturing Output Weakened in October, and Employment Continued To Decline

After a sharp increase in the spring, growth in the District's manufacturing sector weakened considerably in recent months, and manufacturing employ-

Figure 3
BUSINESS OUTLOOK SURVEY
Current Activity and Employment



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

ment continued to decline. After increasing to a high of 20.2 in May (the highest level in a year), the BOS's main index of current economic activity stood at -3.8 in October, down from 7.9 in September. The index has generally declined over the past five months (**Figure 3**). Consistent with the decrease in overall activity, the indexes for new orders and shipments also declined in October.

The demand for manufacturing workers showed some weakness in October. The index for current employment was flat in October, following a modest increase in September. According to payroll employment figures, manufacturing employment in the tri-

state region declined 0.7 percent (1100 jobs) during the first eight months of this year, compared with an increase of 0.1 percent nationally.

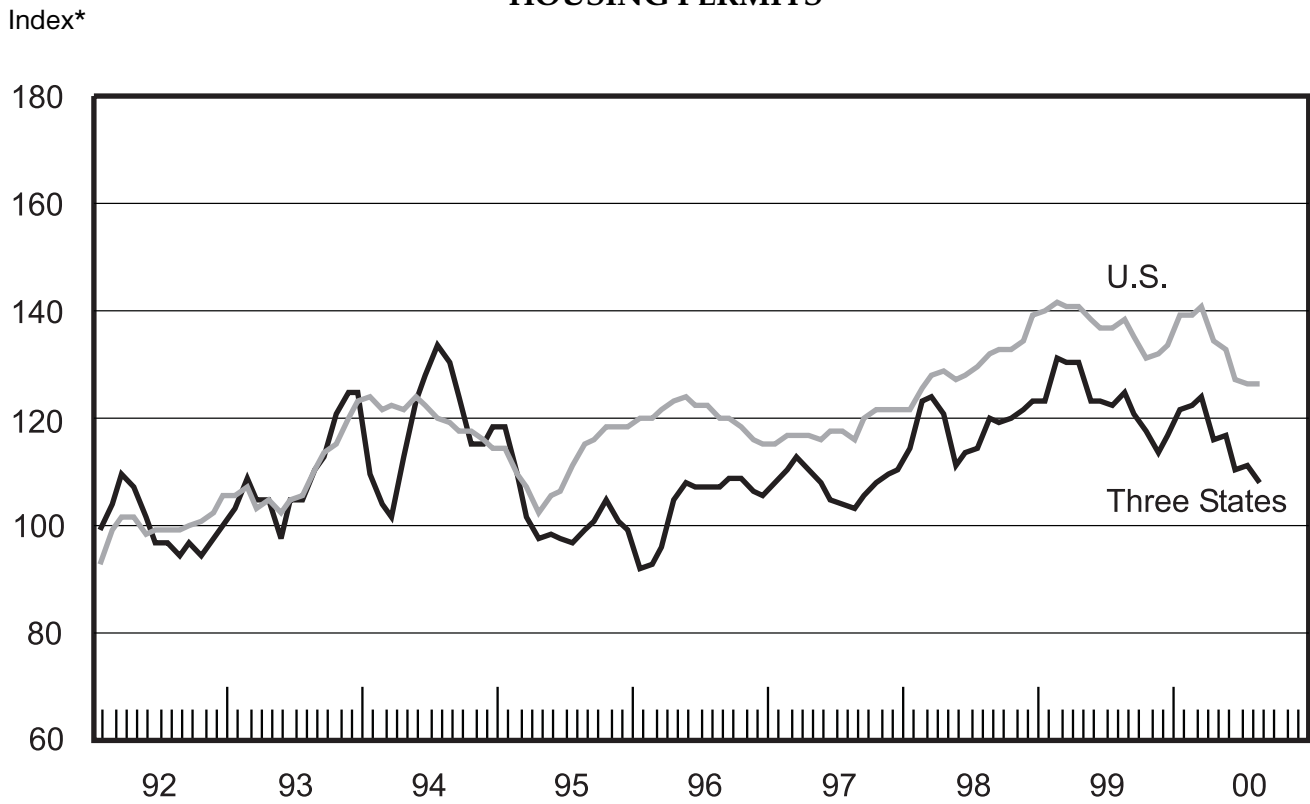
Construction Activity Edged Down, But Levels Are Healthy

After an exceptionally strong first quarter, the pace of both residential and nonresidential construction has slowed considerably. Issuance of housing permits for buildings with 1 to 4 units has declined substantially from the first quarter and is now considerably lower than the average rate of issuance that prevailed over the past three years (**Figure 4**). Permits are down in all three states for the three months ending in

August, compared with the same period last year. Permits are down 13.6 percent in New Jersey, 9.3 percent in Pennsylvania, and 8.6 percent in Delaware.

The value of residential contracts in the tri-state region also fell substantially from its first-quarter peak, although it remains at relatively high levels. After increasing 16 percent in the first quarter, the value of residential construction contracts declined almost 9.0 percent in the tri-state region in the second quarter and fell 1.0 percent in the first two months of the third quarter. Still, the value of new residential contracts was up about 6.0 percent in the first eight months of the year compared with the

Figure 4
HOUSING PERMITS



* 1992=100

Housing units authorized by building permits; based on a three-month moving average.

same period last year. Residential contracts were strongest in Pennsylvania, increasing 9.2 percent in the first eight months of this year over the same period last year, while New Jersey's contracts increased 3.6 percent, and Delaware's increased 0.2 percent.

Tri-state nonresidential construction, as reflected in the value of new contracts, rose sharply in the first four months of the year but has retreated considerably since May. Compared with the same period last year, nonresidential construction contracts in the tri-state area increased 0.2 percent in the first eight months of 2000. In New Jersey nonresidential contracts fell 7.9 percent, and Pennsylvania managed a gain of

4.5 percent. Contracts in Delaware increased 139 percent, but because Delaware's nonresidential construction industry is so small, individual projects can have large effects on the numbers. Even though there has been some slowing in nonresidential construction in the second and third quarters of this year, the demand for office space remains strong in the region. The office vacancy rate for the Philadelphia area dropped from 10.3 percent in the second quarter of last year to 8.8 percent during the second quarter of this year. Office vacancy rates in the Philadelphia CBD have fallen to just under 10 percent, and the suburban office market now has vacancy rates just over 8 percent.

The slowing in the residential and nonresidential sectors has resulted in a decline of 1.3 percent in construction jobs between April and August. This drop, however, followed very rapid growth of 2.8 percent in the first quarter, so overall the construction sector in the tri-state area gained 6000 jobs since the beginning of the year.

Retail Sales Improve

After being mostly flat in June and July, retail sales in the region registered gains in August and September. According to the Federal Reserve System's Beige Book, retail sales got a boost during the back-to-school shopping period, but some retail

contacts indicated that year-over-year gains were somewhat below their expectations. Auto sales in the region have been easing, although sales of luxury models are strong. Area dealers are expecting sales to be steady for the remainder of the year but below the relatively high pace set last year and earlier this year.

Area bankers report slow growth in loans. Growth in both commercial and consumer lending has slowed since June. Commercial real estate lending increased slightly in August and early September. On balance, residential mortgage lending appears to be declining. Area bankers expect the current pace of economic activity to persist for the balance of the year, and they do not anticipate significant changes in credit conditions. But some bankers indicated they would consider implementing more restrictive credit standards in the fourth quarter, especially for commer-

cial real estate loans, if the region's business conditions show any signs of weakening.

Region's Growth Will Rebound

Growth of the regional economy is likely to rebound over the next six months but will probably be less rapid than that experienced during the first half of this year. Our regional forecasts indicate that growth in the three states as a whole will rebound in the near term. Growth in employment and income is forecasted to increase at a somewhat slower pace through the first half of next year than during the first half of 2000, however, and the declines seen recently in issuance of housing permits will continue.

Despite the recent slowdown in current activity, the manufacturers' outlook about the near future remains positive, although their expectations diminished somewhat in October. The BOS

index for future activity fell from 24.7 in September to 14.0 in October. On balance, manufacturers plan to add to their payrolls six months out, although they were less optimistic regarding future employment growth in October than they had been in earlier months. The index for future employment fell from 11.1 in September to 3.7 in October.

Other indicators also suggest slower growth in the near term than that experienced during the first half of this year. Initial unemployment claims, another indicator of future employment, have moved up in recent months. Our leading indexes for both Pennsylvania and New Jersey turned lower in recent months. The index for Pennsylvania has been negative for the past six months, marking the longest series of negative readings since early 1991. Although the index for New Jersey remains positive, it's registering the lowest levels since early 1996.

Gerald A. Carlino

Federal Reserve Bank of Philadelphia
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