

DISTRICT ECONOMIC OVERVIEW

BY ANDREA HOLMES

The Fifth District's economy expanded at a more modest pace in the third quarter, as the continued deceleration in housing activity was joined by further weakening in the retail sector. News from District labor markets remained generally upbeat though, with a steady increase recorded in third-quarter payrolls. Also, third-quarter readings from manufacturing and services establishments were mostly positive across the board.

Housing Activity Slows

Residential real estate activity slowed further in the third quarter, with the National Association of Realtors reporting a 1.5 percent decline in Fifth District home sales. Consistent with the latest data, District realtors noted that new construction and home sales had softened further across most markets. Illustrating this, a District of Columbia agent described that area's housing market as "horrible," and added that sales were down 25 percent from a year earlier. Keeping with the downshift in sales volume, dwindling demand continued to draw down the pace of home price appreciation in many areas. Third-quarter District home prices were only 5.4 percent higher compared to a quarter earlier, the lowest quarterly growth rate since early 2003.

Labor Markets Expand

Fifth District labor market conditions remained generally solid outside of a slowdown in retail hiring. Compared to the second quarter, districtwide payrolls advanced 1.1 percent in the third quarter. Demand for bilingual employees was strong, as evidenced by a Richmond, Va., agent who noted that further strengthening in the area's economy had helped boost demand for employees fluent in Spanish, especially in the transportation and health care industries.

The Fifth District's economy expanded at a more modest pace in the third quarter.

According to the Bureau of Labor Statistics, another large inflow of new entrants to the labor force was recorded in the third quarter, pushing the District's unemployment rate up 0.2 percentage point to 4.5 percent, slightly below the 4.8 percent rate posted a year ago.

Services Revenues Strong

News from Fifth District service-providing firms remained upbeat, with third-quarter measures of employment and wage growth expanding at

a healthy clip over the period and revenue growth outpacing that of mid-2006. Contacts at professional, scientific, and technical firms indicated that demand strengthened late in the third quarter. An executive at a financial services firm in Baltimore, Md., attributed his clients' bullishness in part to the recent drops in energy prices.

Activity at Fifth District retail firms contracted further, however, with contacts reporting a continued deceleration in third-quarter sales activity. Executives at two building supply chains noted that sales growth at District stores eased as new residential construction softened. The pace of sales also cooled at furniture and home accessories stores in central Virginia, according to an industry contact in Richmond, Va.

In labor markets, retailers continued to trim employee levels and wages over the period. District contacts from both service-providing and retail businesses noted that price growth moderated from July to September.

Manufacturing Rebounds

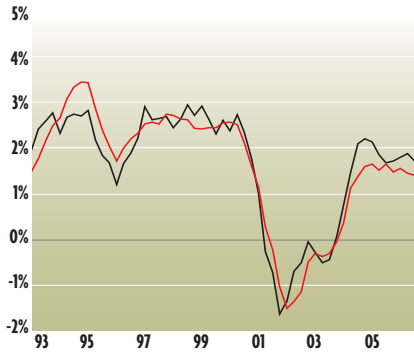
The Fifth District's manufacturing sector rebounded strongly in the third quarter, following a drop-off in momentum during the second quarter. Indicators that were generally lackluster at midyear, such as growth in factory shipments and new orders, had picked up considerably by September. In response to the pickup, District manufacturers added employees and extended hours, as evidenced by the length of the average workweek and factory employment activity, both of which expanded strongly. Among industries, contacts in electronic, plastics, and printing and publishing reported the strongest growth in demand over the period. Manufacturers reported that raw materials and finished goods price growth moderated to a degree from July to September, but they anticipated a somewhat faster rate of increase moving forward. **RF**

Economic Indicators

	3rd Qtr. 2006	2nd Qtr. 2006	Percent Change (Year Ago)
Nonfarm Employment (000)			
Fifth District	13,673	13,636	1.7
U.S.	135,595	135,128	1.4
Real Personal Income (\$bil)			
Fifth District	910.7	904.1	2.6
U.S.	9,490.0	9,416.0	3.8
Building Permits (000)			
Fifth District	54.2	64.2	-15.1
U.S.	437.9	529.5	-23.9
Unemployment Rate (%)			
Fifth District	4.5%	4.3%	
U.S.	4.7%	4.6%	

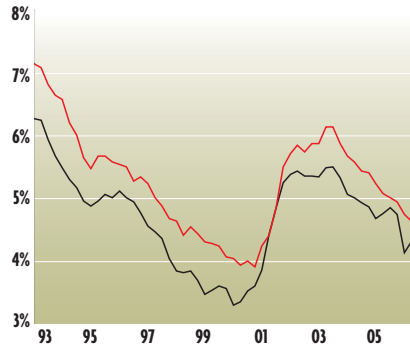
Nonfarm Employment

Change From Prior Year
First Quarter 1993 - Third Quarter 2006



Unemployment Rate

First Quarter 1993 - Third Quarter 2006



Real Personal Income

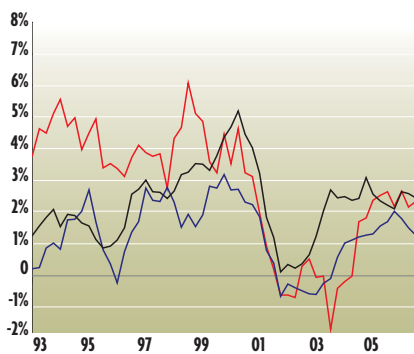
Change From Prior Year
First Quarter 1993 - Third Quarter 2006



— Fifth District — United States

Nonfarm Employment Metropolitan Areas

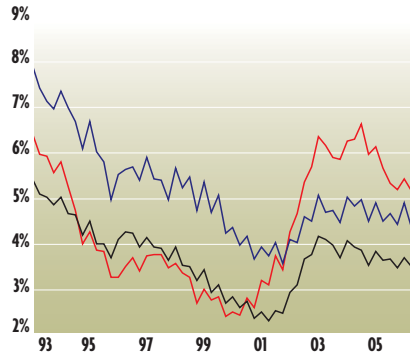
Change From Prior Year
First Quarter 1993 - Third Quarter 2006



— Charlotte — Baltimore — Washington

Unemployment Rate Metropolitan Areas

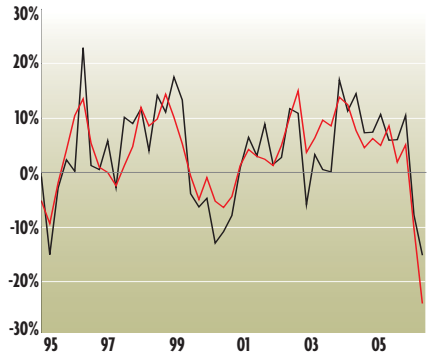
First Quarter 1993 - Third Quarter 2006



— Charlotte — Baltimore — Washington

Building Permits

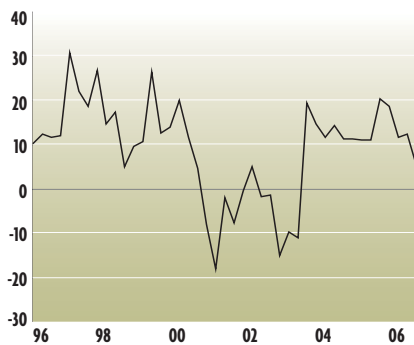
Change From Prior Year
First Quarter 1995 - Third Quarter 2006



— Fifth District — United States

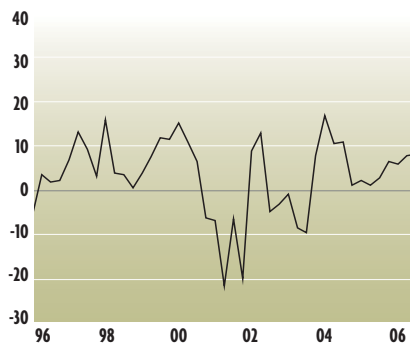
FRB—Richmond Services Revenues Index

First Quarter 1996 - Third Quarter 2006



FRB—Richmond Manufacturing Composite Index

First Quarter 1996 - Third Quarter 2006



House Prices

Change From Prior Year
First Quarter 2001 - Third Quarter 2006



— Fifth District — United States

NOTES:

1) FRB-Richmond survey indexes are diffusion indexes representing the percentage of responding firms reporting increase minus the percentage reporting decrease. The manufacturing composite index is a weighted average of the shipments, new orders, and employment indexes.
2) Metropolitan area data, building permits, and house prices are not seasonally adjusted (nsa); all other series are seasonally adjusted.

SOURCES:

Real Personal Income: Bureau of Economic Analysis/Haver Analytics.
Unemployment rate: LAUS Program, Bureau of Labor Statistics, U.S. Department of Labor, <http://stats.bls.gov>.
Employment: CES Survey, Bureau of Labor Statistics, U.S. Department of Labor, <http://stats.bls.gov>.
Building permits: U.S. Census Bureau, <http://www.census.gov>.
House prices: Office of Federal Housing Enterprise Oversight, <http://www.ofheo.gov>.

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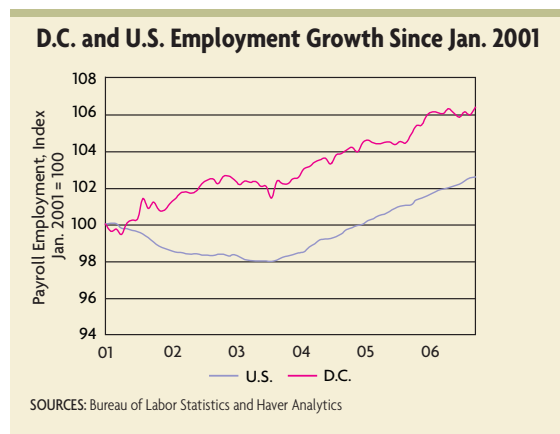
STATE ECONOMIC CONDITIONS

BY MATTHEW MARTIN

District of Columbia

The District of Columbia's economy has slowed of late and most labor market measures of economic performance have been moving sideways. There has been very little in the way of payroll job gains so far this year, while the household survey indicates that the labor force contracted again in the third quarter. The decline in housing activity has been modest compared to neighboring states, but existing home sales in the third quarter were lower than both previous quarter and year earlier totals.

Employment statistics indicate a continuation of modest growth in the third quarter for the District of Columbia. The number of payroll jobs actually contracted by a small



margin compared to the previous quarter, though the number of jobs is 1.5 percent higher than a year ago. Most of these gains occurred at the very end of last year and there has been little increase so far in 2006. The District of Columbia's large government sector has not added many new positions over the past year, but there is also some softness evident in the outsized professional and business services sector.

Periods of slower growth are not uncommon for the District of Columbia. During the most recent recession, for example, job growth actually accelerated, but was then followed by a period similar to that seen recently. In the nation's capital, outright declines in employment are rare; however, the number of people actually living there has declined at times. This may be one reason the household survey reported another sharp drop in the labor force in the third quarter. Over the past year the labor force has declined 2 percent, possibly reflecting population declines within the District of Columbia. However, the area has long had more jobs than laborers, given the large number of commuters.

As is the case in neighboring states, residential real estate activity has declined recently. Existing home sales fell 5.6 percent in the third quarter and have fallen 15 percent since

the third quarter of last year. Even though these declines are sharp, they are still smaller than those in both Maryland and Virginia. Residential permit issuance actually rose in the third quarter, though the numbers tend to be volatile from quarter to quarter.

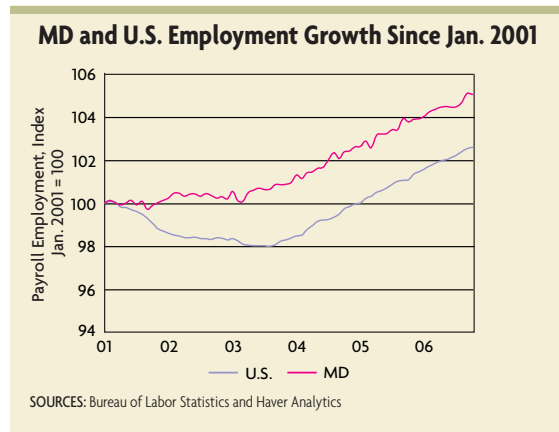
Maryland

Maryland's economy continues to grow at a steady pace, despite a continued pullback in the state's housing market. Payroll job growth has slowed to just over 1 percent annually, but Maryland possesses the second-lowest unemployment rate in the District. The state's job market remained relatively strong through the last recession. Both new home building and existing home sales dropped sharply in the third quarter, but there is little evidence of a broader impact from housing on the state's economy.

Labor market indicators for Maryland are broadly positive. The third-quarter average unemployment rate of 4.1 percent is 0.3 percent above the second quarter, but the increase reflected more of a jump in the labor force growth rather than a decline in employment. As it stands, the unemployment rate is still marginally lower than a year earlier and is the second-lowest rate among all jurisdictions in the District. Job growth from the establishment survey has been steady, with gains of 1.1 percent at an annual rate in the third quarter equal to the rate of increase since the third quarter of last year.

Maryland's job performance has outpaced the national labor market in the last several years. Since the beginning of 2001, the number of persons employed in the state has increased 5 percent against slightly more than half that amount for the United States as a whole. The difference is entirely due to the lack of job losses during the recession and weak recovery early in the decade. Since 2004, however, job growth has been faster nationally.

Other than Virginia, no other state in the District has seen as sharp a pullback in residential housing as Maryland.



The decline in activity has been notable for both new residential construction and sales of existing homes. In the third quarter, permit issuance was 15.8 percent below the year-ago level compared to a 19.4 percent drop in existing home sales. The decline in activity has slowed house price appreciation, though the 7.6 percent increase at an annual rate in the third quarter was the second-largest gain among all jurisdictions in the District. Prices are also 13.3 percent higher than a year earlier, on average, suggesting that further slowing might be forthcoming.



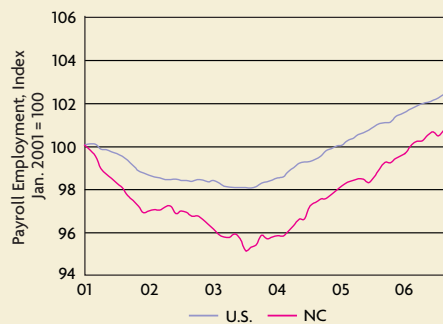
North Carolina

The North Carolina economy is performing well, though the pace of expansion appears to have moderated in the second half of the year. Labor market data are generally positive even though the rate of job growth slowed in the third quarter. The state is likely to see fewer new jobs for all of 2006 compared to the previous year despite fewer manufacturing job cuts. By contrast, housing markets in the state have shown considerably more strength than those in every other jurisdiction in the District, including a substantial increase in third-quarter existing homes sales.

Labor market data for the third quarter were generally positive, though various indicators present something of a mixed picture. Payroll employment slowed in the third quarter to 1.1 percent, down from 1.9 percent in the second quarter. However, compared to a year earlier, growth remained robust, with a 1.9 percent increase that was nearly identical to the second-quarter rate. Additionally, the household survey was more optimistic, with large gains in both employment and the labor force. Growth in the latter was stronger, causing the state's unemployment rate to average 4.8 percent in the third quarter, up 0.3 percent from the prior period.

Despite good job growth throughout 2006, North Carolina remains a trailing state by at least one measure. Current employment levels in the state are only fractionally higher than levels at the beginning of 2001, about the time national employment reached a prerecession peak. Even South Carolina has surpassed the previous employment peak by a larger margin, despite having a higher unemployment rate from the household survey. Unlike the establishment survey data shown in the chart, North Carolina's household survey shows much stronger growth over the same period, outpaced only by Virginia over the same period within the District. While differences between what the two surveys measure account for much of the difference in measured employment, the growing disparity in the two measures suggests future data revisions. The establishment data will be revised early next year as part of an annual process. In North Carolina's case the revision will

NC and U.S. Employment Growth Since Jan. 2001



SOURCES: Bureau of Labor Statistics and Haver Analytics

likely improve the employment picture by increasing payroll employment figures from a year ago.

Although there is some slowing in residential real estate markets, there has not yet been an overall pullback across the state. New building construction peaked earlier in the year and has since slowed. Third-quarter permits were sharply lower than second-quarter levels and 7.5 percent below than a year earlier. However, existing home sales have held up well, rising 5.3 percent in the third quarter at an annual rate and they remain nearly 10 percent higher than a year ago.



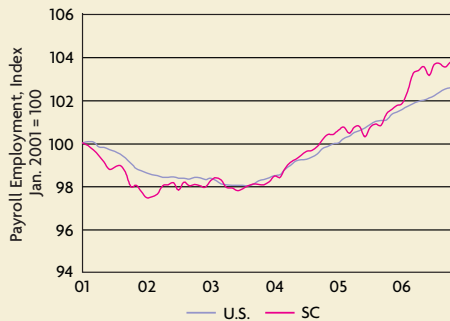
South Carolina

Solid employment growth so far this year and more resilient real estate markets than most have improved the economic outlook for South Carolina. Admittedly, the state has more room for improvement than others in the District, especially with an unemployment rate that remains above 6 percent. However, that figure is now more than half a percentage point lower than a year ago amid job growth in excess of 2.5 percent over the past 12 months. As with North Carolina, the manufacturing sector remains the primary weight on economic growth, though at least job losses have slowed so far in 2006.

Employment growth slowed to 1.1 percent in the third quarter, down from 3.4 percent in the second. However, there was little change in the rate of growth over the past year, which actually ticked slightly higher to 2.8 percent. At 6.4 percent, however, the unemployment rate is the highest in the District, even though payroll job growth has actually been better than average since the last recession. Employment in South Carolina is now nearly 4 percent higher than it was in early 2001, outperforming the national economy. Most of the difference between the two is due to net job growth in 2006. As job growth has accelerated, the labor force has expanded more quickly, keeping the unemployment rate elevated.

Labor force growth has slowed, allowing the unemployment rate to slowly trend lower compared to both the

SC and U.S. Employment Growth Since Jan. 2001



SOURCES: Bureau of Labor Statistics and Haver Analytics

second quarter and a year earlier. In the second quarter, South Carolina had the fastest rate of labor force growth in the District at 3.4 percent. A slight drop in the third quarter still leaves the labor force 1.6 percent larger than a year ago.

Like the rest of the District, new home construction slowed considerably in the third quarter, with new permit issuance down 9.9 percent compared to a year ago. Unlike North Carolina, however, existing home sales also declined in the third quarter yet remained marginally higher than a year earlier. As might be expected, the pullback was sharper in the state's coastal areas, which comprise a significant share of total state activity. The moderating real estate market also slowed house price appreciation, though the house price index rose a respectable 6.5 percent at an annual rate in the third quarter.



Virginia

Virginia remains a model of steady, mature growth while also possessing the lowest unemployment rate in the District. Employment growth has slowed this year, but with an unemployment rate hovering near 3 percent and modest labor force growth, some slowing was inevitable. Activity in the state's residential real estate market has declined sharply so far this year, with both existing and new home sales sharply lower than last year. Price growth has also slowed, though broader impacts on the economy are not evident at this point.

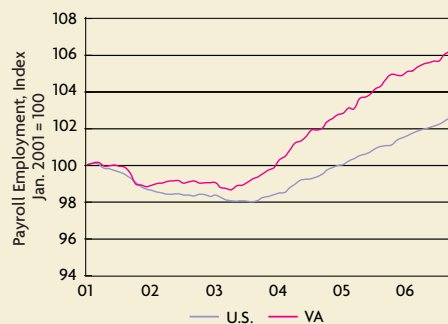
The pace of job growth in the third quarter was similar to the second quarter, with a nearly equal pace of growth posted over the past year as well. At 1.5 percent, Virginia's job growth is not the fastest in the District, but the unemployment rate was a District low 3.2 percent in the third quarter, leaving little room for a faster expansion. Even the state's labor force has grown by 1.5 percent over the past year, suggesting a balanced economy that is adding jobs as workers become available to fill them.

The chart shows the strength of Virginia's labor market over time. Employment in the state fell less than that seen nationally during the last recession, with a faster pace of

growth since the recession, helping the state easily outperform the nation as a whole. As it now stands, employment in the state grew 6 percent since early 2001.

The sharp pullback in the state's residential real estate market remains the one sector that is under pressure. The decline in existing home sales has been particularly sharp and the 24.4 percent fall in sales since last year is the fastest rate of decline in the District. The fall in permit issuance has been even larger, falling 32.2 percent since the third quarter of last year. Not surprisingly, house price appreciation has slowed, but so far it remains positive. The 2.7 percent increase in the third-quarter house price index stands in sharp contrast to the 21 percent increase posted in the third quarter of 2005. So far, however, weaker results in real estate seem to have only a limited impact on the rest of the economy, with even construction employment still expanding at a robust pace thanks to healthy commercial construction.

VA and U.S. Employment Growth Since Jan. 2001



SOURCES: Bureau of Labor Statistics and Haver Analytics

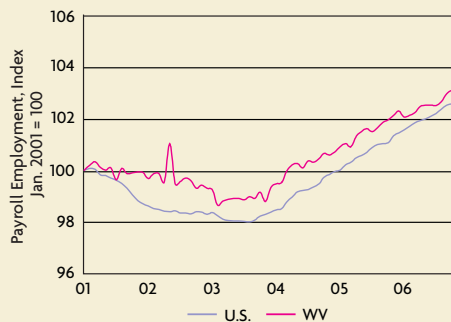


West Virginia

West Virginia's economy continues to expand with some encouraging signs in some sectors. Job growth slowed in the third quarter and residential real estate activity contracted sharply, but the state is still benefiting from elevated energy prices and a newfound stability in manufacturing employment. Both new residential construction and existing home sales contracted sharply in the third quarter, but house price growth accelerated compared to the prior period.

Labor market conditions remained generally positive for West Virginia in the third quarter. Quarterly payroll job growth slowed to 0.8 percent at an annual rate, in part due to a sizable drop in government employment. However, employment in the state's mining sector expanded again and is now as high as it has been at any point in more than 10 years. The manufacturing sector managed to add a few jobs, bringing at least temporary stability to a sector that has been contracting throughout the current expansion.

WV and U.S. Employment Growth Since Jan. 2001



SOURCES: Bureau of Labor Statistics and Haver Analytics

Measures of labor market activity from the household survey have been volatile recently, but suggest strong growth in the state's labor force. The unemployment rate jumped a full percentage point to 5.6 percent in the third quarter, but the increase owed more to a 3.2 percent increase in the labor force than the 1 percent decline in household employment.

Monthly volatility in the household survey data limits the inference value of the reported figures, but a three-month moving average of the unemployment rate is currently higher than a year earlier by about 0.3 percent.

West Virginia's labor market actually came through the last recession in better shape than the national market. Since then, however, job growth in the state has slowed and the advantage over the national economy has eroded. As a result, employment in the state is 3.1 percent higher than it was at the start of 2001, marginally above the 2.6 percent growth seen nationally over the same period.

Residential real estate markets generally showed further signs of slowing, with existing home sales down 11.5 percent in the third quarter. Comparisons to a year earlier were even less favorable, with a decline in sales of 19.4 percent. Permit issuance has also fallen sharply and is now 21.2 percent lower than a year ago. Despite these figures, house price appreciation accelerated in the third quarter to 8.2 percent, up from 1.8 percent in the second quarter.

Behind the Numbers: Updating GDP

In late October, the Commerce Department announced that the "advance" estimate of third-quarter gross domestic product (GDP) rose at an annual rate of 1.6 percent. It was "a more moderate rate of growth" than seen in the first half of 2006, Commerce Secretary Carlos Gutierrez said in a statement.

In response, some economic analysts said they were worried about a slowdown. But in November, the department's "preliminary" estimate for GDP growth was revised upward to 2.2 percent, close to the 2.6 percent pace of the previous quarter, and analysts were reassured. Then in late December came the final report on third-quarter GDP — an even 2 percent. Markets were mostly unrattled, however, with the Dow Jones dropping for the day but by only 0.34 percent.

Early GDP results are always subject to change. They are "based on partial and incomplete source data," according to the Bureau of Economic Analysis (BEA). For example, only two months of data are usually available for most data sources 30 days after the close of a quarter, at which time the government's "advance" estimate

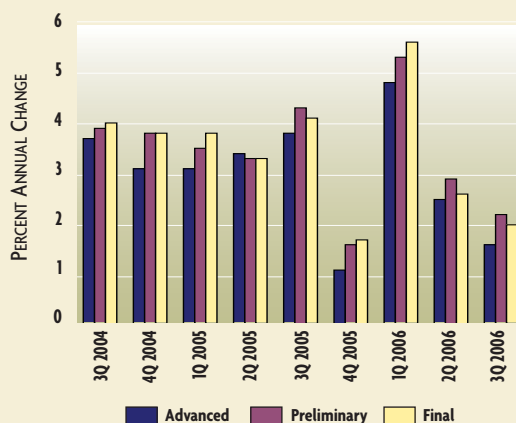
of GDP appears. So why does the government release these historically inaccurate advance reports if it knows the numbers will inevitably move up or down?

One reason is that the advance and preliminary reports are often close to the mark. According to a BEA study, early estimates "consistently indicate

"consistently indicate whether growth is positive or negative, whether growth is accelerating or decelerating, whether growth is high or low relative to trend, and where the economy is in relation to the business cycle." The chart provides visual confirmation of this finding. In the past two years, revisions to GDP growth haven't significantly deviated from the overall trend.

Another reason is that economic analysts know that revisions are coming and hedge their own forecasts accordingly, taking the advance and preliminary GDP figures as just that — early indicators. "We recognize that none of these statistics are as precise as we'd like them to be," says Roy Webb, a senior economist at the Richmond Fed. "We accept them for what they are and make allowances." — DOUG CAMPBELL

GDP Revisions
Despite quarterly revisions, final GDP results are usually close to early estimates.



NOTE: Estimates are in chained 2000 dollars.
SOURCE: Bureau of Economic Analysis

State Data, Q3:06

	DC	MD	NC	SC	VA	WV
Nonfarm Employment (000)	690.1	2,588.9	3,991.3	1,910.3	3,737.3	755.3
Q/Q Percent Change	-0.6	1.1	1.1	1.1	1.4	0.8
Y/Y Percent Change	1.5	1.1	1.9	2.8	1.5	1.0
Manufacturing Employment (000)	2.2	138.0	558.5	256.6	297.5	61.5
Q/Q Percent Change	13.1	-0.7	-1.9	-5.4	-0.9	0.2
Y/Y Percent Change	6.5	-1.6	-1.1	-1.4	0.6	0.2
Professional/Business Services Employment (000)	151.4	394.3	455.8	210.7	626.3	59.4
Q/Q Percent Change	-0.1	3.8	2.9	4.0	3.7	3.9
Y/Y Percent Change	2.1	2.2	2.3	2.0	2.6	1.0
Government Employment (000)	233.3	464.7	682.0	338.0	672.8	142.7
Q/Q Percent Change	2.6	-3.2	0.6	5.0	1.9	-1.7
Y/Y Percent Change	-0.1	-0.3	3.0	2.8	1.2	-0.7
Civilian Labor Force (000)	289.8	3,005.7	4,446.7	2,117.6	4,008.4	821.4
Q/Q Percent Change	-3.3	1.8	4.5	-0.7	0.7	3.2
Y/Y Percent Change	-2.0	2.0	2.3	1.6	1.5	2.1
Unemployment Rate (%)	5.8	4.1	4.8	6.4	3.2	5.6
Q2:06	5.5	3.8	4.5	6.6	3.1	4.6
Q3:05	6.3	4.2	5.4	6.8	3.6	5.2
Personal Income (\$bil)	28.5	217.0	248.2	111.4	261.9	43.7
Q/Q Percent Change	2.0	3.1	3.1	3.2	2.7	3.8
Y/Y Percent Change	2.0	2.6	2.7	3.4	2.4	3.0
Building Permits	232	6,423	23,868	12,034	10,357	1,205
Q/Q Percent Change	9.4	-70.2	-45.2	-31.6	-61.2	-13.1
Y/Y Percent Change	27.5	-15.8	-7.5	-9.9	-32.3	-21.2
House Price Index (1980=100)	644.61	533.27	326.43	309.64	463.42	231.09
Q/Q Percent Change	4.0	7.6	6.5	5.5	2.7	8.2
Y/Y Percent Change	11.3	13.2	8.4	7.8	9.9	6.3
Sales of Existing Housing Units (000)	10.2	110.0	242.6	119.2	136.0	31.6
Q/Q Percent Change	-5.6	-5.3	5.3	-2.7	-5.6	-11.5
Y/Y Percent Change	-15.0	-19.4	9.7	0.7	-24.4	-19.4

NOTES:

Nonfarm Payroll Employment, thousands of jobs, seasonally adjusted (SA) except in MSA's; Bureau of Labor Statistics (BLS)/Haver Analytics. Manufacturing Employment, thousands of jobs, SA in all but DC and SC; BLS/Haver Analytics. Professional/Business Services Employment, thousands of jobs, SA in all but SC; BLS/Haver Analytics. Government Employment, thousands of jobs, SA; BLS/Haver Analytics. Civilian Labor Force, thousands of persons, SA; BLS/Haver Analytics. Unemployment Rate, percent, SA except in MSA's; BLS/Haver Analytics. Building Permits, number of permits, NSA; U.S. Census Bureau/Haver Analytics. Sales of Existing Housing Units, thousands of units, SA; National Association of Realtors®

Metropolitan Area Data, Q3:06

	Washington, DC MSA	Baltimore, MD MSA	Charlotte, NC MSA
Nonfarm Employment (000)	3,003.2	1,304.1	808.9
Q/Q Percent Change	1.3	-0.4	0.1
Y/Y Percent Change	2.4	1.2	2.3
Unemployment Rate (%)	3.2	4.5	4.7
Q2:06	3.0	4.0	4.5
Q3:05	3.4	4.4	5.2
Building Permits	6,522	1,785	6,442
Q/Q Percent Change	-49.6	-61.6	-17.5
Y/Y Percent Change	-16.6	-28.3	5.7
	Raleigh, NC MSA	Charleston, SC MSA	Columbia, SC MSA
Nonfarm Employment (000)	276.3	289.5	361.5
Q/Q Percent Change	-1.6	-4.3	-0.3
Y/Y Percent Change	2.7	2.9	3.3
Unemployment Rate (%)	3.9	5.4	5.7
Q2:06	3.7	5.1	5.6
Q3:05	4.3	5.7	6.0
Building Permits	832	1,984	1,822
Q/Q Percent Change	-70.1	-41.0	-35.0
Y/Y Percent Change	-29.8	-24.2	-1.3
	Norfolk, VA MSA	Richmond, VA MSA	Charleston, WV MSA
Nonfarm Employment (000)	780.3	622.3	152.2
Q/Q Percent Change	0.2	-2.4	2.9
Y/Y Percent Change	1.7	1.1	1.9
Unemployment Rate (%)	3.7	3.4	4.8
Q2:06	3.5	3.2	4.4
Q3:05	4.1	3.7	4.6
Building Permits	1,600	1,831	69
Q/Q Percent Change	-54.8	-68.7	-60.4
Y/Y Percent Change	-38.0	-31.3	-15.9

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