

Labor Markets and Residential Real Estate Began Slow Recoveries in 2012

Once again in 2012, the Fifth District economy grew slowly and inconsistently. The year started out well, but conditions slumped in the summer months before picking up again toward the end of the year. The most promising news came in residential real estate, which began a slow but steady recovery in the District and the nation. In addition, although activity among area businesses was volatile, by the end of the year most industries had strengthened overall.

Labor Markets

Fifth District labor markets expanded in 2012, growing 1.5 percent with the addition of 209,600 net new jobs. Employment growth exceeded that of 2011 (1.2 percent) and 2010 (1.3 percent). Net hiring activity was promising at the beginning of the year, but then flattened in the spring and declined some during the summer before picking up again in the fall. In fact, the overall job expansion fluctuated over months, across states, and among industries. The summer slump in the District contrasted somewhat with U.S. employment activity, which improved more steadily over the year. Employment in the United States grew 1.7 percent during 2012.

Among Fifth District jurisdictions, employment trends in Maryland and South Carolina most closely resembled the District's overall employment performance. North Carolina posted the strongest growth in 2012, with employment increasing 2.3 percent. The Tarheel State's steady employment growth enabled it to contribute more than 40 percent of net jobs gained in the District. Virginia also experienced relatively steady job growth throughout 2012. The worst performance in the District was in West Virginia. Economic indicators are often more volatile in West Virginia than in other District

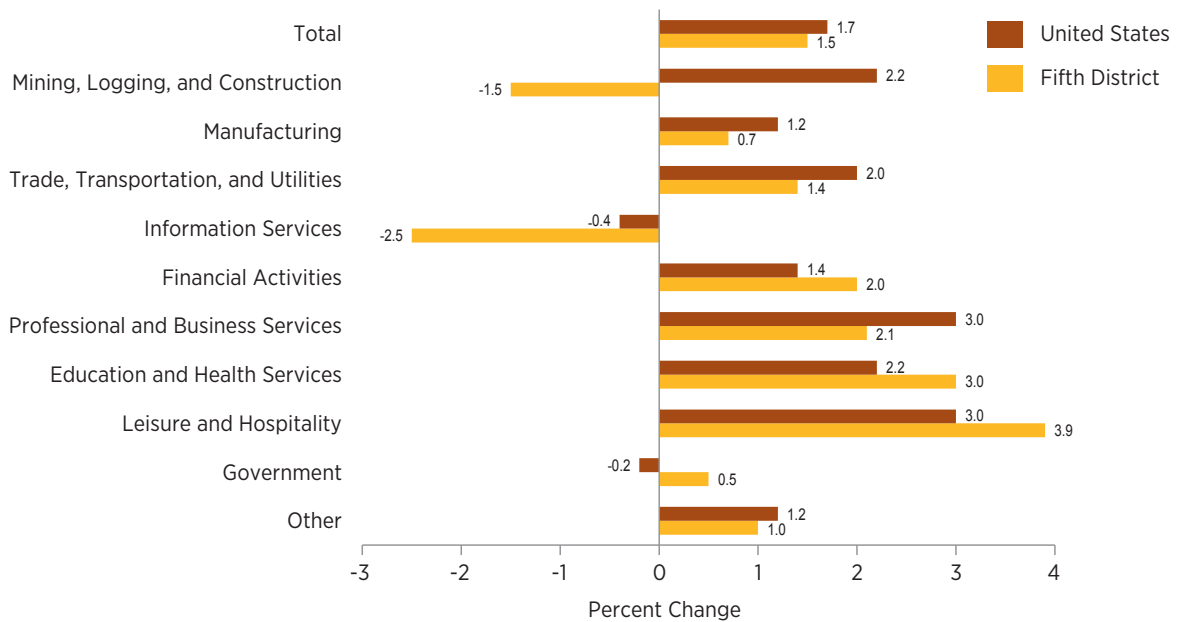
states, but 2012 was a troubling year for labor markets in the Mountaineer State, which in previous years seemed to weather the economic downturn better than other states. Firms in West Virginia added only 1,400 jobs in 2012, with the worst performances in mining and logging (a loss of 2,700 jobs) and manufacturing (a loss of 1,200 jobs). There were reports throughout the year of challenges in the coal mining industry due, at least in part, to low natural gas prices and federal regulatory policy.

The government sector struggled in the Fifth District during 2012, adding only 13,700 jobs (0.5 percent), while the private sector added more than 220,000 jobs. In fact, only two private sector industries performed worse than the government sector—mining, logging, and construction lost more than 10,500 jobs, and information services shed 6,000 jobs. Of the 10,500 jobs lost in mining, logging, and construction, West Virginia mining layoffs accounted for 2,700 lost jobs, but that was not the whole story. Construction companies in North Carolina and Virginia together lost (on net) more than 10,000 jobs in 2012. These losses ran counter to national trends—U.S. construction employment increased 1.8 percent, while mining and logging employment expanded 3.2 percent. In fact, the national construction industry posted consistent year-over-year growth every month since May 2011, and the mining and logging industry posted consistently positive year-over-year growth since April 2010.

In the Fifth District, almost 75 percent of the net job gain in 2012 was in professional and business services, education and health services, and leisure and hospitality. More broadly, service-providing industries

FIGURE 1: Employment Growth by Sector

December 2011–December 2012



Sources: Bureau of Labor Statistics, Haver Analytics

accounted for almost all of the gain in 2012, with many employment agencies reporting particularly strong demand for skilled information technology professionals throughout the year. There were also numerous reports in the District of manufacturers being unable to fill vacancies for skilled positions.

News from the household employment survey was also encouraging, but not overwhelmingly so. The unemployment rate in the District dropped from 8.1 percent to 7.6 percent in 2012, while the labor force increased 1.0 percent. This performance was similar to the U.S. unemployment rate, which decreased from 8.5 percent to 7.8 percent while the national labor force expanded 1.0 percent.

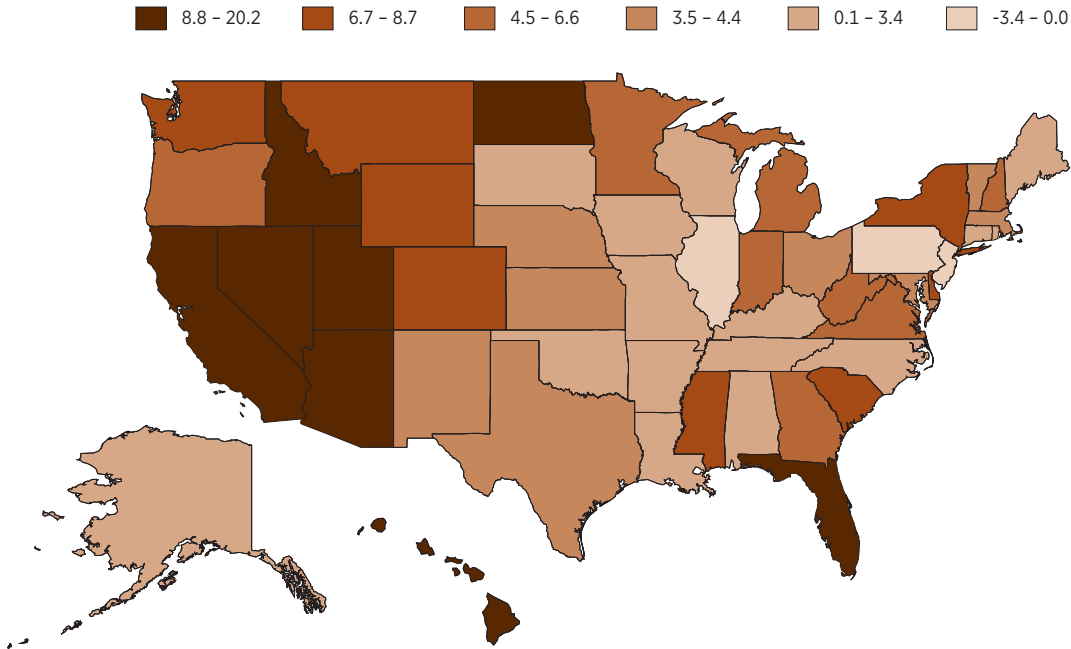
Real Estate

A bright spot in the Fifth District economy came from the slow but steady housing market recovery that started in 2012.

According to the CoreLogic Information Solutions house price index, home values in the District appreciated 4.7 percent in 2012, with year-over-year prices rising for 10 straight months—the first time that has happened since 2007. This trend was true throughout the District; by May, every state and the District of Columbia had begun to experience year-over-year appreciation in house prices that lasted through the year. In December, every state and D.C. posted the strongest year-over-year house price growth since 2006.

FIGURE 2: Change in U.S. House Prices by State

Percent Change from December 2011 to December 2012



Sources: CoreLogic Information Solutions, Federal Reserve Bank of Richmond

The inventory of distressed home loans in the District also shrank in 2012. The inventory of loans in foreclosure fell from 3.2 percent in the second quarter to 2.7 percent in the fourth quarter, even with documented increases in the length of time that a mortgage spends in foreclosure in most District states. It is also promising that only 0.65 percent of mortgages in the District entered foreclosure in the fourth quarter, which was the lowest foreclosure start rate in the District since the fourth quarter of 2007. The share of mortgages with payments more than 90 days past due declined from 3.2 percent in the fourth quarter of 2011 to 2.8 percent in the third quarter of 2012. Unfortunately, the metric edged up to 3.0 percent in the fourth quarter, which was one of only two increases in that rate since the end of 2009. These trends in delinquent mortgages

were generally consistent, with most District states posting drops in foreclosure starts, particularly in the last two quarters of the year, and all states posting declines in the 90-day delinquency rate until the fourth quarter.

Throughout the year, there were increasing numbers of anecdotes about lower inventory of new and existing homes, reduced days on market, increased traffic and sales, and fewer foreclosures and short sales. The reports were not consistent across every locality, and every report was prefaced with observations that housing activity was still sluggish from a historical perspective, but the positive feeling emanating from residential real estate professionals was widespread, particularly toward the middle and end of 2012. The



PHOTO: VIRGINIA PORT AUTHORITY

Boosted by automotive imports and exports, port activity in the Fifth District was generally strong throughout the year.

one exception was in construction, where positive reports were slightly less prevalent. However, even in residential construction, there were reports of activity in areas that had not seen home building for several years, and there were few, if any, reports of further declines in residential construction.

Commercial real estate trends were not as clearly upbeat as residential activity. By the end of the year, the number of reports indicating improved conditions had increased, but reports continued to vary by locality and by type of real estate. Absorption and vacancy rates seemed to improve generally, although vacancy rates remained elevated in many areas. Government-related projects slowed throughout the year, but private sector projects edged forward. Retail leasing activity also seemed to be relatively weak throughout the year.


Business Conditions

On the whole, business activity generally improved in 2012, but progress varied over months and across industries. Manufacturing output, like the rest of the economy, expanded moderately in the early months of

the year, weakened a bit in the summer months, and picked up again toward the end of the year. Compared to other goods, auto parts manufacturing generated the strongest reports, with conditions either improving beyond expectations or at least remaining flat when demand for other products was declining. Many manufacturers that reported weakening conditions cited decreased government spending—including defense spending—and economic problems in Europe as reasons for the softening.

The Federal Reserve Bank of Richmond maintains a composite manufacturing index based on the Bank's Fifth District Survey of Manufacturing Activity—available at richmondfed.org/research/regional_economy/. The index is a diffusion index in which a positive reading indicates that the number of firms reporting expansion exceeds the number reporting contraction. The index hovered close to zero for much of the year, but it was positive for more months than it was negative.

Despite the troubles in Europe, Fifth District port activity was generally strong, with exports outperforming imports throughout the year. Autos and automotive



parts boosted both imports and exports. Although rising fuel prices often were cited as a challenge, most port contacts maintained positive outlooks throughout the year.

Overall, service sector firms in the District reported generally improving conditions throughout 2012, although the Federal Reserve Bank of Richmond service sector indexes—particularly the retail revenues index—continued to be volatile. To view these indexes, visit richmondfed.org/research/regional_economy/.

Banking Markets

In 2012, banks in the nation and the Fifth District continued to face a challenging environment that included distressed international markets, slow economic recovery, a low-rate environment, and elevated reputational and operational risks. Despite these challenges, banking conditions showed signs of stabilization with improved credit quality that allowed for reduced loan-loss provisioning and increased earnings.

Balance sheets expanded modestly, driven by loan growth, which moved into positive territory for the first time since 2010. The median commercial bank in the District posted annual loan growth of 0.48 percent compared to a post-recession low of -3.07 percent during 2011. Meanwhile, loan losses improved by 42 basis points, warranting continued declines in provisioning. This, in turn, helped generate a modest increase in earnings, with a median return on average assets of 0.57 percent for commercial banks in the District. In fact, the share of unprofitable institutions in the District fell from 25 percent to 16 percent during the year. Despite this improvement, however, earnings performance still remained depressed relative to historical trends, down 50 percent from prerecession levels in large part due to low interest rates compressing net interest margins.

Prolonged low interest rates put pressure on earnings, but they had a positive effect on liquidity positions at commercial banks. These higher liquidity ratios could decrease when interest rates eventually rise. Aggregate deposits at commercial banks in the District grew almost \$196 million (or 12.3 percent) from the beginning of the recession, with the bulk of the growth centered on non-maturity deposits. This flow of non-maturity deposits into the banking system led to elevated core funding ratios and reduced non-core funding dependency.

As in previous years since the recession, capital recovery in 2012 was mainly reliant on deleveraging the asset side of the balance sheet. Overall capital levels improved despite a slight downturn in the fourth quarter. Commercial banks ended the year with tier-one leverage ratios at prerecession levels and risk-based capital at levels not seen since the late 1990s.

The Bottom Line

Once again, economic growth in the Fifth District was positive but somewhat disappointing. Given the heavy federal government presence in the District—especially the high concentrations of military spending—concerns about the effects of sequestration and government budget cuts loomed large in 2012 and continued to create concern in 2013. Even so, Fifth District labor markets expanded for the second consecutive year, and residential real estate recorded its best and most consistent performance since 2006. In general, the outlook for most District industries improved during 2012. ■