

The economy of the Fifth Federal Reserve District is similar in many ways to the national economy. For instance, the distribution of employment and output across industry sectors in the District is similar to the United States as a whole. As a result, broad measures of economic conditions within the District often track national movements. Recently, the nation has experienced relatively strong growth in the services sector, while segments of the manufacturing sector have fared less well. The same is true in the Fifth District. This has led to differing levels of economic performance within the region. Notably, economic growth in the Fifth District tends to be centered in urban areas with weaker economic performance in rural areas.

In the region’s largest metropolitan center—Washington, D.C., along with its suburbs in Northern Virginia, southern and central Maryland, and the eastern panhandle of West Virginia—the government and services sectors play large roles in the economy. The strong government presence is not surprising given that the District of Columbia is the seat of the federal government and the neighboring states catch a lot of the spillover. In addition, high-wage service components such as professional services and health care boost the area’s income levels.

While North Carolina and South Carolina also have large services sectors, they have a bigger manufacturing presence than do other District states. Manufacturing is mainly located in the weaker-performing rural areas of the Carolinas, while the states’ faster growing urban areas—such as Raleigh, Charlotte, Columbia, and Charleston—have primarily services-based economies. The urban/rural distinction is important in much of West Virginia, Virginia, and Maryland as well. Beyond the sprawling suburbs of Washington, D.C, large parts of those states remain rural, though a number of moderate-to-large urban areas are scattered throughout. These urban pockets have typically seen somewhat stronger economic growth, while the rural regions exhibit economic characteristics similar to those found in the rural parts of North and South Carolina.

Reflecting on 2005, the overall Fifth District economy posted a solid performance during the year. The District’s unemployment rate remained below the national figure, job growth was strong, and personal income expanded briskly. Households shook off higher gasoline prices and prospects of softening housing prices, keeping consumer spending on track. Other measures were bright as well. Though business and household bankruptcy filings increased, the increases were below the national averages and likely boosted by impending changes in the law. Despite the overall positive tone, however, pockets of concern remained. In some industries and in some areas of the District, economic performance was less than robust.

### Nonfarm Payroll Employment

	DECEMBER 2005 (thousands of persons)	% CHANGE FROM DECEMBER 2004
DISTRICT OF COLUMBIA	687	1.4
MARYLAND	2,568	1.3
NORTH CAROLINA	3,944	1.6
SOUTH CAROLINA	1,876	1.4
VIRGINIA	3,700	2.1
WEST VIRGINIA	752	1.6
<b>FIFTH DISTRICT</b>	<b>13,526</b>	<b>1.6</b>
<b>UNITED STATES</b>	<b>134,376</b>	<b>1.5</b>

SOURCE: Bureau of Labor Statistics/Haver Analytics  
NOTE: All data are seasonally adjusted.

### EMPLOYMENT

In labor markets, further tightening was the major trend in 2005. Districtwide, the unemployment rate edged down slightly, ending the year at 4.7 percent, 0.2 percentage points below the national rate. But there was significant variation among District jurisdictions. Virginia and Maryland posted the lowest rates, while West Virginia and North Carolina came in around the national average. In contrast, Washington, D.C., and South Carolina saw their unemployment rates on the high end, hovering well above both the District and national levels.

The District labor market entered 2005 somewhat tighter than even the taut national market, and a

number of businesses in our region reported some difficulty finding workers, especially in the latter part of 2005. This situation hampered the pace of job growth in some urban areas as a result. Overall, jobs in the Fifth District expanded at a 1.6 percent clip for the year, a bit above the national pace.

## Total Personal Income

	FOURTH QTR. 2005 (chained 2000 dollars, in billions)	% CHANGE FROM FOURTH QTR. 2004
DISTRICT OF COLUMBIA	28	2.8
MARYLAND	212	1.8
NORTH CAROLINA	240	1.5
SOUTH CAROLINA	109	1.8
VIRGINIA	264	2.9
WEST VIRGINIA	45	1.9
FIFTH DISTRICT	898	2.1
UNITED STATES	9,318	1.7

SOURCE: Bureau of Economic Analysis/Haver Analytics

By sector, job growth was brisker in the goods-producing side of the economy than in the services side, a surprise perhaps given recent weakness in District factory employment. Manufacturing continued to shed quite a few jobs in 2005—about 2.0 percent of total employment in that sector—with the losses coming primarily in the Carolinas, where, despite these job cuts, the manufacturing presence remains pronounced. Nevertheless, strong growth in District construction jobs, combined with solid growth in natural resource and mining jobs, was more than enough to offset the factory losses, netting a solid gain in the Fifth District for the year. As for services, the pace of job growth was hampered by sluggish growth in the information, government, and trade/transportation/mining categories. In contrast, job growth was strong in the professional/business services and education/health services categories. Solid growth in these areas was welcome news, since many of the highest-paying services jobs are concentrated

in these sectors. To round out the job numbers, respectable gains were also registered in the financial activities and leisure/hospitality categories.

## PERSONAL INCOME AND HOUSEHOLD FINANCIAL CONDITIONS

Reasonably strong growth in personal income accompanied strong growth in labor markets. For the year, total personal income in the District advanced 2.1 percent—several notches above the national pace. More impressive, perhaps, all District jurisdictions except North Carolina outpaced the nation. Virginia led the pack with the District of Columbia close behind.

With firm labor markets and solid growth in personal income, improvement in households' financial conditions would be expected. Although that was generally the case, not all measures strengthened. Personal bankruptcy filings, for example, increased sharply across the Fifth District. The increase, however, was significantly below the national rate and was likely driven by households' awareness of more stringent bankruptcy requirements that took effect October 31. The expectation of tougher requirements likely led many households to file in advance of the changes, leading to a bulge in third-quarter bankruptcies.

The story was more straightforward with past-due mortgages. At the end of the fourth quarter, only 3.1 percent of mortgages districtwide were past due 30 days or more. This figure represented a small decline from a year earlier and matched the national average. The improved performance likely reflected the firming of household income prospects but also may have been boosted by relatively low interest rates and widely available refinancing options. Overall, there was little evidence that the ability of Fifth District households to service their mortgage debt was much changed as 2005 drew to a close.

## BUSINESS CONDITIONS

Broad measures of District business conditions also generally firmed in 2005, though not all gauges pointed higher. On balance, our monthly surveys of business conditions painted a fairly positive picture of services-producing firms in 2005. Over the year, revenues at these businesses generally expanded moderately, and managers remained optimistic about



their customer demand going forward. District retailers also generally reported good growth in sales, though strong incentives-driven automobile sales boosted summer activity, with some slowing noticed in the late fall. But as the holiday season got underway, retailers saw sales strengthen in December.

The firming of retail sales late in the year was comforting. Solid household financials should have bolstered spending as the year came to an end, but households faced several potential obstacles. First, of course, was the aftermath of the Gulf Coast hurricanes and the higher energy prices that followed. Second were the blaring headlines of a pending cooling or collapse in housing prices and the hit to household net worth that would ensue. Each of these factors could have derailed consumer confidence and dampened spending, but they didn't.

Manufacturers responding to our surveys reported that they struggled to gain traction on both revenues and new orders for the first half of the year. Both measures would register gains only to see the improvement fade in subsequent months—a pattern that repeated itself several times. Some momentum appeared to be building late in the year with several strong months of revenues and orders, but the December report showed retrenchment on both fronts, leaving prospects for early 2006 uncertain. Compounding the situation, factory job numbers slipped late in the year.

Another key indicator of District business conditions suggested a mixed message in 2005. Business bankruptcy filings increased significantly over the previous year, though, like household filings, the increase was probably driven in large part by pending stricter laws, which led businesses to take action sooner than they initially planned. At year's end, bankruptcy filings for the District were 37.1 percent ahead of a year before. While this increase was substantial, the increase was well below the national gain during the period. By jurisdiction, changes in the number of filings varied widely. To cite extreme changes, filings in Maryland were up nearly 160 percent, while they were down nearly 50 percent in neighboring Virginia.

**■■■ HOUSING AND COMMERCIAL REAL ESTATE**  
Real estate remained in the headlines throughout most of the year. The year began with accelerating activity in housing, leading to multiple offers on homes in many areas and sharp rises in prices in the hotter markets. Compared to a year earlier, for example, house prices in the Washington, D.C., metro area posted a 24.7 percent increase, the fastest rate ever recorded. National headlines expressed increasing concern about the sustainability of home prices as the year progressed, leaving many analysts and homeowners uncertain about the future path of home values. At year's end, mounting evidence suggested a cooling in housing activity, as houses remained on the market longer and fourth-quarter home sales slipped 2.4 percent from year-earlier levels, but there were few signs of weakening prices. In commercial real estate, conditions were less frenzied. Steady progress was seen in 2005, with vacancy rates in office buildings gradually falling and some new construction taking hold late in the year. Vacancy rates also moved lower in industrial space and the construction of retail space progressed at a moderate pace.

**■■■ LOOKING TO THE FUTURE**  
The District economy was generally solid in 2005. Gains in jobs and brisk growth in personal income left District households on firm footing as they entered 2006, suggesting bright prospects for the year ahead. Less clear, though, were prospects for District businesses. The strong performance of services firms and retailers in 2005 appeared to suggest momentum going forward, but conditions in manufacturing were spotty as the year drew to a close, creating uncertainty about near-term prospects. Nevertheless, a few bullets appeared to have been dodged during the year, in part because households remained resolute in their spending. Some of their optimism probably reflected housing markets that bent but didn't break. But the optimism may have had deeper roots. High gas prices and rising interest rates apparently didn't substantially change most households' opinions about their financial prospects. Overall, they remain optimistic. If District household spending holds up, it could boost the sputtering segments of the business sector and make for a bright 2006. But, of course, this outcome is not certain. Only time will tell. ■