Economic Indicators

Prepared by the Department of Finance • February 2007

The purpose of this report is to keep policy makers apprised of changes in the national and local economies that the Montgomery County Department of Finance believes may impact current and/or future revenues and expenditures.

This report is also available through the Internet on the Montgomery County Web Page: http://www.montgomerycountymd.gov

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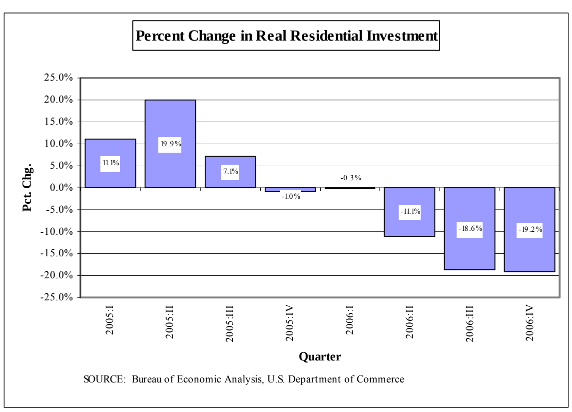
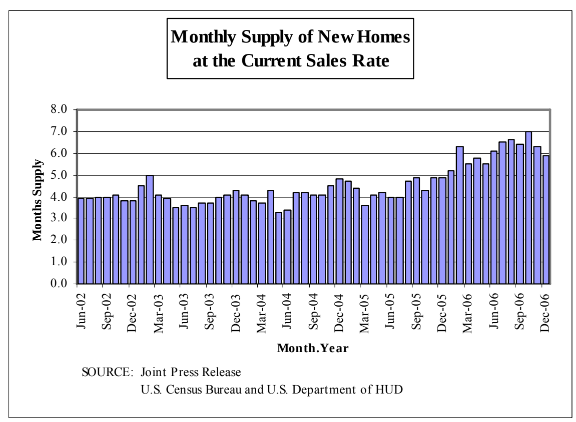
ECONOMIC OVERVIEW

According to “advance” estimates from the Bureau of Economic Analysis (BEA), U.S. Department of Commerce, the U.S. economy grew at a 3.5 percent seasonally adjusted annual rate during the fourth quarter of 2006, its strongest pace since the first quarter (5.6%). That rate was in line with the recent trend of 3.4 percent and was higher than anticipated by market analysts due to unexpectedly low oil prices and mild weather. According to Maury Harris of UBS, “those two factors were probably temporary and should not boost growth in the first quarter of 2007.” Although the growth rate is based on incomplete data, the major contributors were consumer spending (↑4.4%), exports (↑10.0%), state and local government spending (↑3.3%), and federal government spending (↑4.5%). Such increases offset the decrease in residential fixed investment (↓19.2%).

The decline in residential investment represented the fifth consecutive quarter in which residential construction has declined. Real growth in home building declined 19.2 percent and follows declines of 0.9 percent (2005:IV), 0.3 percent (2006:I), 11.1 percent (2006:II), and 18.7 percent (2006:III). The last time real residential investment declined by a least five consecutive quarters was during the 1981-1982 recession.

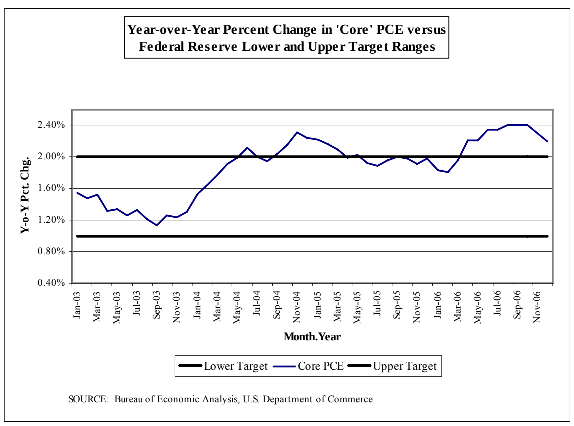


Sales of existing homes reached a 6.22 million unit annual rate in December, but were 0.8 percent below sales in November 2006 and 7.9 percent below December 2005. For the year, home sales were down 8.4 percent – the first such decline this decade. The median price for an existing home increased 2.3 percent, which was the first monthly increase since July. For the year, prices were up only 1.1 percent. Sales of new single-family homes in December were up 4.8 percent on a seasonally adjusted annual rate compared to November’s sales but 11.0 percent below December 2005. The median price of a new home was $235,000 compared to $232,000 in November 2006 and $238,600 in December 2005. The inventory of new homes for sale has steadily declined from a seven month supply in October to less than a six month supply in December. The inventory-to-sales ratio of 5.9 in December was the lowest since May (5.5). For the year, the average inventory-to-sales ratio was 6.1 compared to 4.4 for 2005 and 4.0 for 2003 and 2004.

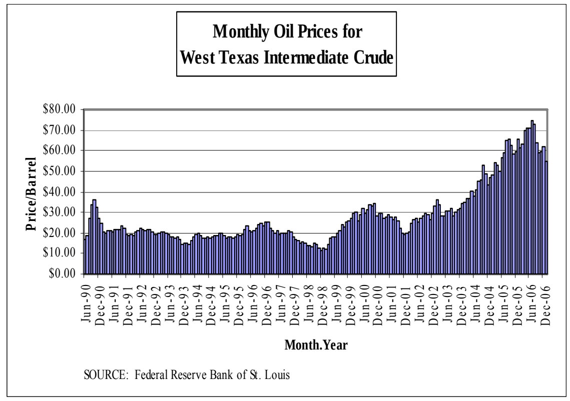


On January 31st, the Federal Open Market Committee (FOMC) of the Federal Reserve kept the target rate for federal funds at 5.25 percent. This was the fifth consecutive meeting in which the FOMC did not change the target rate. However, inflation remains the primary concern of the FOMC. In its press release, the FOMC stated that "readings on core inflation have improved modestly in recent months, and inflation pressures seem likely to moderate over time. However, the high level of resource utilization has the potential to sustain inflation pressures. The Committee judges that some inflation risks remain."

As measured by the price index for personal consumption expenditures excluding food and energy (core PCE), inflation grew 2.2 percent from December 2005 to December 2006. While that rate is below the year-over-year change of 2.4 percent during the previous three months, it remained above the Fed's target range between 1 and 2 percent.

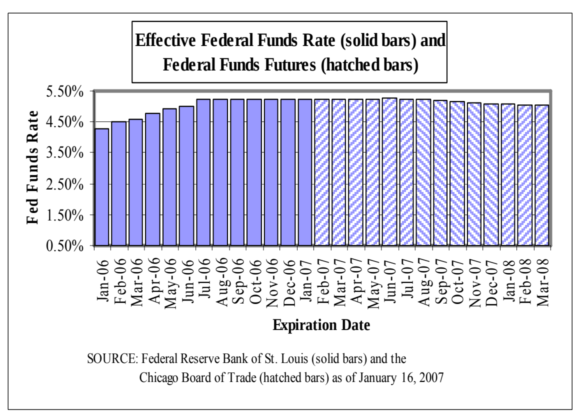


The price of West Texas Intermediate crude oil declined from the July average of $74.41 to the January average of $54.57 − nearly $20 a barrel. The January average was the lowest since May 2005 and was the result of the unusually warm weather in December and most of January. Because of the warm temperatures, the demand for weather-related energy products such as heating oil was below the average for this time of the year However, the Energy Information Agency, U.S. Department of Energy, reports that crude oil futures prices rose from $50 per barrel to $57 per barrel on January 30. Whether such a shift in prices will persist into the spring and beyond is uncertain.



Because of the concerns expressed by the members of the FOMC about inflation and inflation expectations, their focus has shifted from energy prices to resource utilization. At the December meeting, the members expressed concern about the tight labor market that "could lead to sustained upward pressure on nominal labor costs." The language in the January press release contained the same concerns by the FOMC about resource utilization

The members of the FOMC await progress on inflation before the financial markets expect a decline in the target rate for federal funds. The Federal Funds Futures Market anticipates the next rate adjustment no sooner than November 2007.

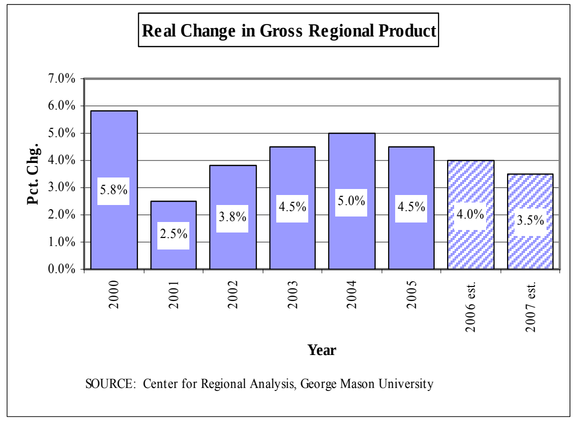


The stock market was a solid performer in 2006. The Dow Jones Industrial Average (DJIA) pierced the 12,000 level on October 19, exactly 19 years to the day since the 508 point crash (↓22.6%) of October 19, 1987, and since November 3 remained above that level through the rest of the year. For the year, the DJIA was up 16.3 percent, the largest increase since 2003 and is currently at an all-time high. The broader S&P 500 was up 13.6 percent for the year, its largest increase since 2003. The NASDAQ experienced the smallest gain of the three indices for the year with an increase of 9.5 percent but still its largest one year gain since 2003.

REGIONAL ECONOMY

According to the latest report from the Center for Regional Analysis (CRA), George Mason University, the Washington Leading Index, which is developed to forecast the performance of the regional economy six to eight months ahead, decreased by less than one percent in November after decreasing 0.7 percent in October. For the twelve-month period ending in November 2006, the leading index declined 0.6 percent and declined five out of the past seven months which suggests that the region's economy is expected to experience a modest slowdown in the foreseeable future.

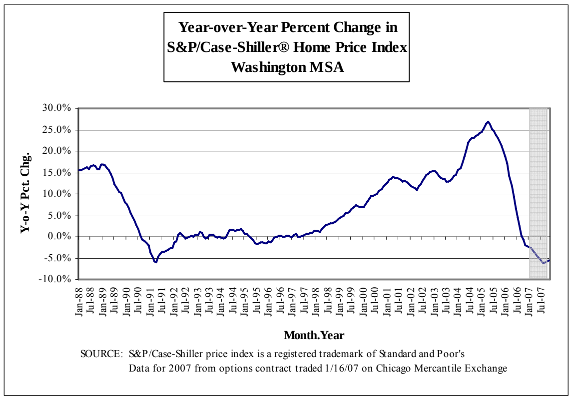
According to CRA's latest report about the Washington economic indicators, "the outlook for the Washington area economy is rosier than for the national economy but will be subject to the same assumptions and risks." Those risks include the status of the real estate market particularly residential sales and the future of energy prices. Also other factors in the outlook are federal spending, which is expected to grow at its historic average, and non-residential construction, which is not expected to exceed demand, particularly office buildings. Reflecting those various trends, the regional economy is expected to decelerate to a 3.5 percent growth rate this calendar year.



The Washington metropolitan area continues to be a national leader in job creation. Between December 2005 and December 2006, the region added 71,200 jobs, which ranked third behind only the Phoenix and Houston metropolitan areas. The region's unemployment rate stood at 2.9 percent in December − the second lowest in the nation.

For the twelve-month period ending in December 2006, the Bethesda-Gaithersburg-Frederick metropolitan division added nearly 13,000 jobs during the same twelve-month period and experienced an unemployment rate of 2.7 percent in December, the lowest among the 34 most populous metropolitan divisions throughout the nation.

Home prices in the region have weakened dramatically since August of last year. Based on the S&P/Case-Shiller® Home Price Index for the Washington region, prices in November 2006 decreased nearly 0.7 percent in one month. That decrease followed five consecutive monthly declines starting in June of last year. On a year-over-year basis, home prices decreased 1.9 percent with most of that decline occurring in the last six months, and 3.6 percent since May.



According to the options market on the Chicago Mercantile Exchange, the index is expected to decline for the region through November. That decline suggests that home prices could drop an additional 5.0 percent between November 2006 and November 2007. According to an article entitled "Getting Real About Real Estate" in the special issue of *Fortune,* median home prices are estimated to decline in the Washington metropolitan division by 3.8 percent in 2007 and 3.2 percent in 2008. For the Bethesda-Gaithersburg-Frederick metropolitan division, median prices are estimated to decline 2.7 percent in 2007 and 4.3 percent in 2008.

The recent drop in home prices coupled with the increase in the number of non-traditional mortgages could increase the foreclosure rate for the metropolitan area. According to a study by the Center for Responsible Lending, the projected foreclosure rate for homeowners with subprime loans originated in 2006 could increase to 22.8 percent. That rate is significantly higher compared to 8.2 percent rate for loans originated between 1998 and 2001. That rate represents the ninth highest foreclosure rate among major metropolitan areas around the county. The report also states that the projected foreclosure rate for the Bethesda-Gaithersburg-Frederick metropolitan division could quadruple from 5.1 percent of the subprime loans originated between 1998 and 2001 to 20.4 percent for loans originated in 2006.

MONTGOMERY COUNTY ECONOMIC INDICATORS

Montgomery County experienced mixed economic activity during 2006. The primary reasons for the County's mixed performance were a continuation in the contraction of residential construction growth, a dramatic decline in home sales, and slowdown in consumer spending.

Residential construction activity in the County declined during 2006. The number of projects, total number of units, and the value added were down significantly. However, non-residential construction, especially new commercial properties, improved during the year.

Home sales in the County declined nearly 24 percent during the year compared to 2005. Although housing prices continued to increase, they have decelerated dramatically to a 3.7 percent increase compared to over 18 percent annually during the previous two years.

However, a number of economic indicators for the County continued to experience significant improvement during this period. Foremost among the indicators that exhibited strong performance was the labor market.

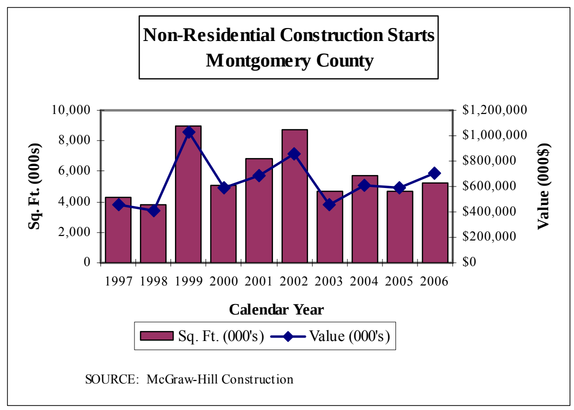
Employment Situation

Based on data derived by the Department of Finance, the County's total payroll employment grew over 10,500 (↑2.2%) between December 2005 and December 2006 . While payroll employment made significant gains during this period, data from the labor force series reported that employment based on place of residence rather than place of employment grew 3.5 percent between December 2005 and December 2006, or nearly 17,400. With significant improvement in resident employment, the unemployment rate for the County remained well below the State's average. As of December 2006, the County's rate at 2.6 percent was a full percentage point below the State. For the entire year, the County's unemployment rate was 2.8 percent. The low unemployment rate also suggests that both the public and private sectors are providing a stable foundation against significant labor market volatility and that the County is close to full employment.

Construction Activity

Construction activity in the County during 2006 was mixed. The number of non-residential construction projects was up 30.5 percent, the amount of square footage added through new construction increased 10.4 percent. Also the value of new construction increased 19.0 percent. Construction of new homes continued to decline in 2006. With home sales and homebuilding declining and price increases decelerating, the residential real estate market continued to experience a correction that began in the summer of 2005.

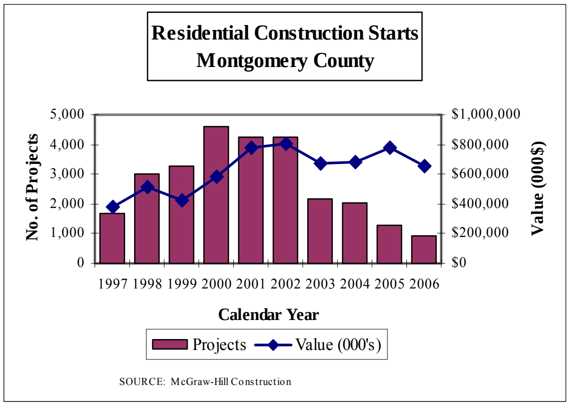
The major contributor to the growth in non-residential construction was commercial construction, led by the office and banking sector. Additions of square footage were up nearly 64 percent and represented nearly 82 percent of the added non-residential capacity. Office and bank building properties experienced the most dramatic turnaround in 2006. Additions to square footage were up over nineteen fold and the added construction value was up thirteen fold. While construction activity of office and building properties in 2005 was the lowest in over ten years, a better comparison is between 2006 and 2004, which represented an average year for non-residential construction. Office and bank building construction doubled the amount of addition square footage in 2006 compared to 2004 and added nearly three times the value of new construction.



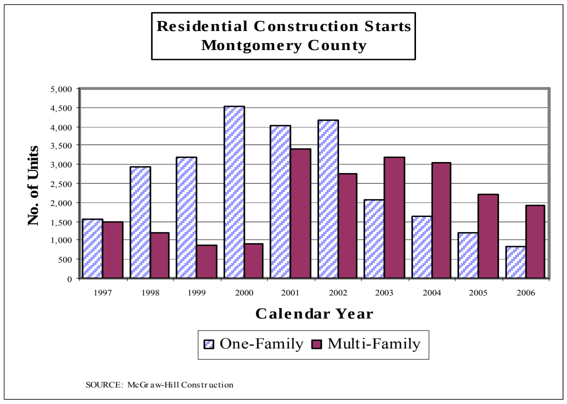
The office vacancy rate for Class A property in the County was 6.1 percent in December. That rate represents a slight increase compared to the 5.7 rate in June of last year. However, since March 2005, the vacancy rate for Class A property has declined four percentage points and is at its lowest point since 2000. Montgomery County also had the lowest rate amongst all of the jurisdictions in the Washington metropolitan region.

Residential Real Estate

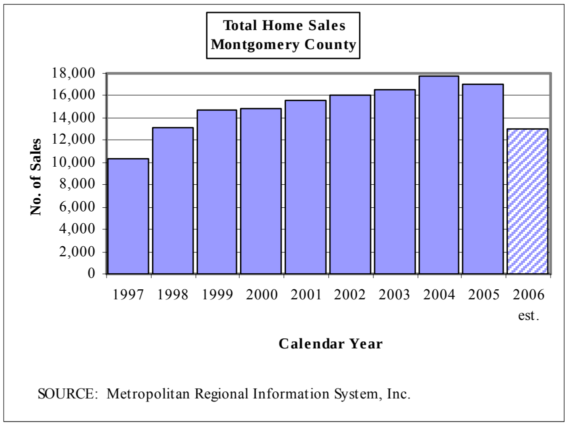
Construction of new residential properties continued to decrease in response to the correction in the real estate market that began in summer of 2005. Even with the mild weather toward the end of 2006, the number of new residential projects declined (↓26.8%) and the total value of new construction decreased over 15 percent.



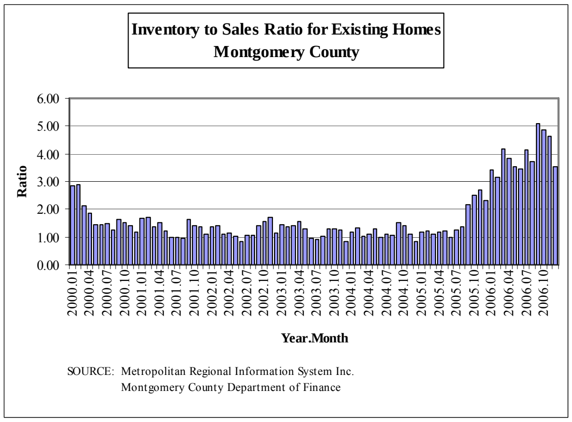
Based on data provided by McGraw-Hill Construction, the number of residential units built in the County totaled nearly 2,800 in 2006, a decline of 18.9 percent. The decline was across the board with the construction of new single-family houses down from 1,200 units in 2005 to 835 units in 2006, a decline of 40 percent. The number of multi-family units also decreased from 2,200 units in 2005 to slightly more than 1,900 units in 2006 (↓16.8%).



Home sales declined 23.8 percent, which followed a 4.2 percent decline in 2005. However, average home prices were up a modest 3.7 percent for the year, which followed increases of 18.3 percent and 18.1 percent for 2003 and 2004, respectively.



The contraction in sales is reflected in the dramatic increase in inventory-to-sales ratio. From June 2005 to September 2006, the ratio increased from 0.98 to 5.10. This means that in June of 2005 for every home listed on the market, there was one buyer. By September of last year, for every five homes listed, there was only one buyer. Such a dramatic increase in the ratio suggests that buyers are not in a rush to purchase a home compared to the overheated housing market in 2004 and the first half of 2005. Since that time the ratio had steadily declined to 3.53 by December indicating that many sellers withdrew from the market. While the number of listings to buyers has declined, the high ratio still remains above the historical average. That fact may be attributed to an affordability issue or the potential buyer is anticipating either a further deceleration or a decline in prices. As a result, even though thirty-year fixed rate mortgages are at only 6.34 percent as of February 1, potential home buyers are still anticipating further corrections in home prices and are sitting on the sidelines.



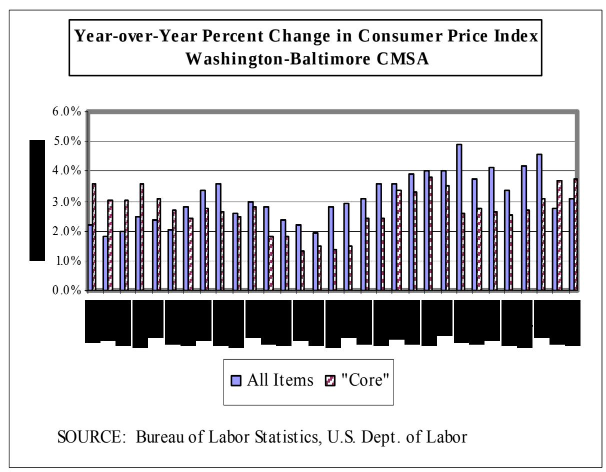
Retail Sales

Using sales tax receipts as a measure of the level in retail sales for the County, the growth of sales of durable and nondurable goods were down in 2006 compared to 2005. Purchases of nondurable goods, which include food and beverage, apparel, general merchandise, and utilities and transportation, increased 4.0 percent during this period while sales of durable goods were down 4.9 percent.

For the year, purchases of energy products (↑12.8%), apparel (↑2.9%), and general merchandise (↑3.2%) led sales of nondurable goods. Purchases of building and industrial supplies (↑3.3%) were the only category of durable goods that experienced an increase during 2006. Sales of furniture and appliances (↓18.7%) and hardware, machinery and equipment (↓1.4%) reflected the slowdown in the housing market.

Consumer Prices and Inflation

As measured by the Consumer Price Index for All Urban Consumers (CPI-U), inflation in the Washington-Baltimore consolidated statistical metropolitan area increased 3.1 percent over the twelve-month period ending in November. That rate was above the national average of 2.0 percent and a significant deceleration compared to the 4.6 percent rate between July 2005 and July 2006, the height of energy prices. Consumer prices excluding food and energy purchases were up significantly at 3.7 percent in the region, based on the latest data available compared to 2.6 percent for the nation over the same November-to-November period.



METROPOLITAN AREA OFFICE MARKET

Office Vacancy Rate by Jurisdiction and Class, 2006:4Q

Jurisdiction	Class A	Class B	Class C	Total
Loudon	10.28%	14.10%	3.37%	11.44%
Fairfax	8.39%	10.81%	6.18%	9.11%
Frederick	8.34%	13.12%	12.77%	11.12%
Alexandria/Arlington	10.23%	6.38%	6.03%	8.42%
Montgomery	***6.13%***	***8.27%***	***8.35%***	***7.25%***
District of Columbia	7.81%	4.88%	3.80%	6.42%
Prince George's	18.13%	11.45%	7.76%	13.79%
Metropolitan Area	8.62%	8.04%	5.84%	8.19%

Vacant Office Space Inventory by Jurisdiction and Class (sq.ft.)

Jurisdiction	Class A	Class B	Class C	Total
Loudoun	724,462	684,087	19,917	1,428,466
Fairfax	5,355,691	3,411,101	166,502	8,933,294
Frederick	191,240	341,344	92,291	624,875
Alexandria/Arlington	2,945,595	1,241,503	309,962	4,497,060
Montgomery	***1,826,000***	***2,164,504***	***500,538***	*4,491,042*
District of Columbia	5,612,156	2,087,023	497,917	8,197,096
Prince George's	1,734,355	1,059,921	256,234	3,050,510
Region	18,389,499	10,989,483	1,843,361	31,222,343

Office Space Inventory by Jurisdiction and Class (sq.ft.)

Jurisdiction	Class A	Class B	Class C	Total
Loudoun	7,046,417	4,850,067	590,640	12,487,124
Fairfax	63,850,757	31,547,372	2,692,547	98,090,676
Frederick	2,293,867	2,600,881	722,794	5,617,542
Alexandria/Arlington	28,801,505	19,461,948	5,142,665	53,406,118
Montgomery	***29,800,643***	***26,180,296***	***5,991,772***	*61,972,711*
District of Columbia	71,856,481	42,763,424	13,107,334	127,727,239
Prince George's	9,563,865	9,256,731	3,300,052	22,120,648
Region	213,213,535	136,660,719	31,547,804	381,422,058

Share of Office Space Inventory by Jurisdiction and Class

Jurisdiction	Class A	Class B	Class C	Total
Loudon	56.4%	38.8%	4.7%	100.0%
Fairfax	65.1%	32.2%	2.7%	100.0%
Frederick	40.8%	46.3%	12.9%	100.0%
Alexandria/Arlington	53.9%	36.4%	9.6%	100.0%
Montgomery	***48.1%***	***42.2%***	***9.7%***	***100.0%***
District of Columbia	56.3%	33.5%	10.3%	100.0%
Prince George's	43.2%	41.8%	14.9%	100.0%
Metropolitan Area	55.9%	35.8%	8.3%	100.0%

Share of Total Regional Vacant Office Space by Jurisdiction and Class

Jurisdiction	Class A	Class B	Class C	Total
Loudon	3.9%	6.2%	1.1%	4.6%
Fairfax	29.1%	31.0%	9.0%	28.6%
Frederick	1.0%	3.1%	5.0%	2.0%
Alexandria/Arlington	16.0%	11.3%	16.8%	14.4%
Montgomery	***9.9%***	***19.7%***	***27.2%***	***14.4%***
District of Columbia	30.5%	19.0%	27.0%	26.3%
Prince George's	9.4%	9.6%	13.9%	9.8%
Total	*100.0%*	*100.0%*	*100.0%*	*100.0%*

Note: Office Space inventory includes leasable and owner-occupied space.
Totals exclude non-classified space.
Vacant means "direct vacant" and does not include sublease space.

Source: Montgomery County Department of Planning, Research and Technology Center
Data compiled from CoStar Information Group, property database, fourth quarter

Updated January 11, 2007

SELECTED ECONOMIC INDICATORS	Reporting Period	Current Period	Prior Year's Period	Year To-Date 2006	Year To-Date 2005	2005
Leading Indicators						
National	Dec	0.3%		1.2%		2.1%
Washington MSA	Nov	-0.2%		0.3%		-0.1%
Coincident Indicators						
National	Dec	0.2%		2.5%		1.5%
Washington MSA	Nov	0.7%		0.2%		1.7%
Consumer Confidence Index						
National	Jan	0.2%		5.5%		1.1%
South Atlantic Region	Jan	-1.6%		2.7%		2.7%
Consumer Sentiment (University of Michigan)	Dec (p)	-2.1%		-1.5%		-5.8%
Consumer Price Index						
All Items (nsa)						
National	Dec	2.5%		3.2%		3.4%
Washington - Baltimore CMSA	Nov	3.1%		3.7%		4.0%
Core CPI (nsa)						
National	Dec	2.6%		2.5%		2.2%
Washington - Baltimore CMSA	Nov	3.7%		3.1%		3.2%
Retail Trade						
National (sales - nsa)	Dec	3.6%		6.0%		6.9%
Washington MSA (sales - nsa)	Nov	1.2%		4.7%		6.8%
Maryland (sales tax)	Nov	-2.1%		5.2%		6.4%
Montgomery County (sales tax)	Nov	-6.9%		3.0%		5.0%
Employment						
National (labor force data - nsa)	Jan	144,275,000	141,481,000	144,427,000	141,730,000	141,730,000
- Percent Change		2.0%		1.9%		1.8%
Bethesda-Federick-Gaithersburg (establish.)	Dec	594,300	581,700	584,100	570,900	570,900
- Percent Change		2.2%		2.3%		0.9%
Montgomery County (labor force data)	Dec	514,559	497,194	508,486	491,801	491,801
- Percent Change		3.5%		3.4%		2.1%
Montgomery County (QCEW)	June	470,650	464,850	462,373	455,812	458,668
- Percent Change		1.2%		1.4%		2.2%
Unemployment						
National (nsa)	Jan	5.0%	5.1%	4.6%	5.1%	5.1%
Maryland (nsa)	Dec	3.6%	3.5%	3.8%	4.1%	4.1%
Montgomery County (nsa)	Dec	2.6%	2.6%	2.8%	3.1%	3.1%
Construction						
Construction Starts - Montgomery County						
Total ($ thousands)	Dec	$146,809	$65,827	$1,360,774	$1,367,266	$1,367,266
- Percent Change		123.0%		-0.5%		0.1%
Residential ($ thousands)	Dec	$18,435	$56,137	$657,118	$775,737	$775,737
- Percent Change		-67.2%		-15.3%		9.6%
Non-Residential ($ thousands)	Dec	$128,374	$9,690	$703,656	$591,529	$591,529
- Percent Change		1224.8%		19.0%		-10.4%
Building Permits (Residential)						
National	Dec	113,085	147,560	1,837,287	2,147,617	2,147,617
- Percent Change		-23.4%		-14.4%		6.1%
Maryland	Dec	2,780	2,167	27,062	32,276	32,276
- Percent Change		28.3%		-16.2%		13.7%
Montgomery County	Dec	92	79	3,038	3,564	3,564
- Percent Change		16.5%		-14.8%		-6.2%
Building Permits (Non-Residential)						
Montgomery County	Dec	108	121	1,775	2,154	2,154
- Percent Change		-10.7%		-17.6%		9.6%
Real Estate						
National						
Sales (saar)	Dec	6,220,000	6,750,000	6,480,000	7,075,000	7,075,000
- Percent Change		-7.9%		-8.4%		4.4%
Median Price	Dec	$222,000	$222,000	$222,000	$219,600	$219,600
- Percent Change		0.0%		1.1%		12.4%
Montgomery County						
Sales	Dec	963	1,105	12,964	17,011	17,011
- Percent Change		-12.9%		-23.8%		-4.2%
Average Price	Dec	$512,897	$541,782	$526,299	$507,340	$507,340
- Percent Change		-5.3%		3.7%		18.1%
Median Price	Dec	$435,600	$449,000	$437,779	$425,000	$425,000
- Percent Change		-3.0%		3.0%		19.7%
Average Days on the Market	Dec	83	38	59	25	25

NOTES:

(nsa): not seasonally adjusted
(saar): seasonally adjusted at annual rates
(p): preliminary