



Economic Indicators

Prepared by the Department of Finance • January 2006

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:
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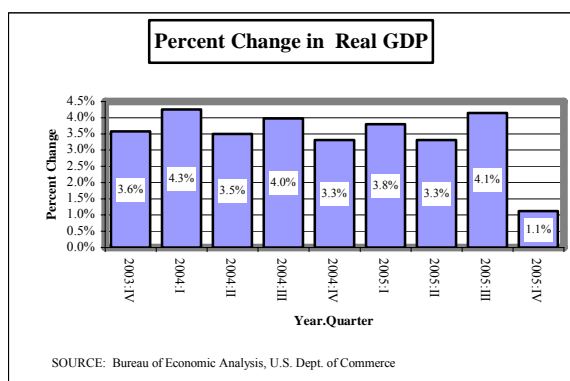
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ECONOMIC OVERVIEW

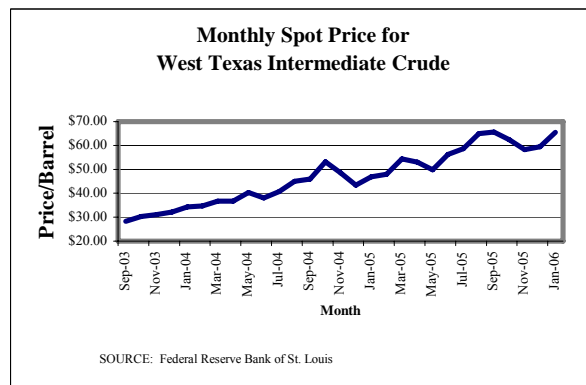
According to the latest economic data, the U.S. economy grew at a 1.1 percent seasonally adjusted annual rate during the fourth quarter of 2005 which was well below the average forecast of 3.2 percent from the *Wall Street Journal* (WSJ) economic survey conducted in December. Of the 56 economists surveyed, only one predicted a rate of less than 2.3 percent. Although the rate is based on incomplete data or data subject to revisions, the major contributors to the very modest increase were weak consumer spending, a slowdown in residential investment, and a modest increase in business purchases of equipment and software. Led by a decline in national defense (\downarrow 13.1%), government purchases were down 2.4 percent for the quarter. GDP is expected to grow 3.6 percent during the first quarter of this year according to the economists surveyed by the *WSJ*.

For the year, real GDP increased 3.5 percent which followed a strong 4.2 percent in 2004. Since the end of the recession in November 2001, real GDP has increased an average of 3.0 percent per year compared to the 3.6 percent average growth experienced between 1992 and 2000.

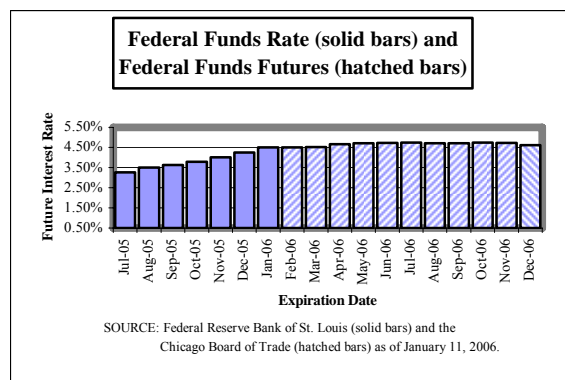


The price for West Texas Intermediate (WTI) crude increased to \$65.61 per barrel, the highest monthly price since September

(Katrina level) and at least \$6.00 above December's price and \$18.67 above January 2005. NYMEX energy futures for crude oil suggest that energy prices may steadily increase with the price of light sweet crude reaching \$68.18 for August delivery.



On January 31st, the FOMC raised the target rate to 4.5 percent. In its press release, the FOMC stated that “although recent economic data have been uneven, the expansion in economic activity appears solid. Nevertheless possible increases in resource utilization as well as elevated energy prices have the potential to add to inflation pressures.” The FOMC replaced its policy of measured rate increases to a policy that will respond to changes in economic prospects to attain a balance of both sustainable growth and price stability.

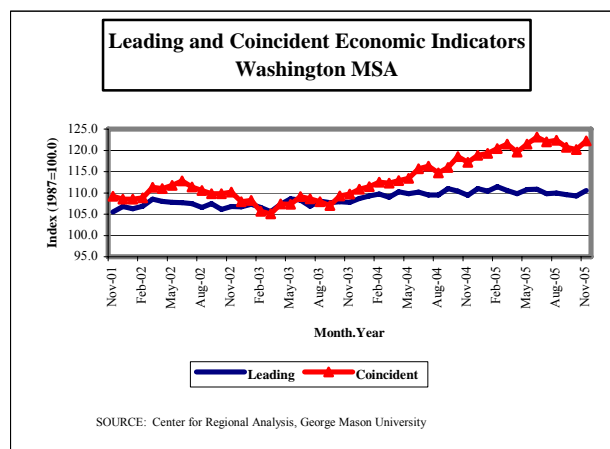


Recent economic releases showed mixed results due to the impact of higher energy

prices, particularly gasoline and natural gas, and the monetary tightening by the Federal Reserve. The Conference Board's consumer confidence index increased in January (↑2.4%) for the third month in a row. Also the leading indicator of economic activity was up 0.1 percent in December for the third month in a row and the coincident indicator was up 1.2 percent for the third consecutive month as well. The national economy added 193,000 jobs and the unemployment rate declined to 4.7 percent at a seasonally adjusted rate. However, sales of existing homes dropped in December to 6.6 million units at an annual rate, which was 5.7 percent below the November level and represented the third consecutive monthly decline. On the other hand, sales of new single-family homes were up 2.9 percent in December compared to November's sales and 1.8 percent for the year. Home prices are beginning to show signs of easing with the median price of a new home decreasing the last three months of the year from a high of \$240,400 in September to \$221,800 in December.

While the national economy grew 3.5 percent in 2005, the region's economy grew 4.2 percent according to the latest report from the Center for Regional Analysis, George Mason University. The Washington Leading Index, which is developed to forecast the performance of the regional economy six to eight months ahead, increased 1.2 percent in November, the first increase since last August. With the leading index slowing to a rate below one percent for the year, the regional economy is expected to experience a slight deceleration during the second half of this year and into 2006. In fact, CRA estimates that the Washington area economy is expected to grow 4.0 percent in 2006.

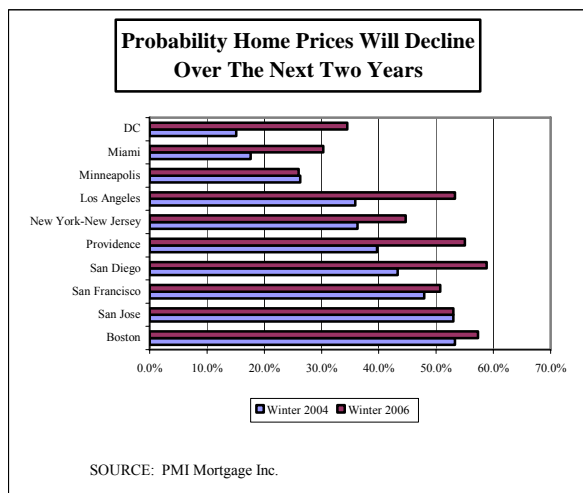
The region's economy showed renewed strength in November. The Washington Coincident Index, which represents the current state of the Washington economy, increased 1.4 percent in November, which also was the first increase since August. Even though the economy slowed in recent months, in part because of higher energy costs, CRA states that the area's economy is "set to reaccelerate if energy costs remain neutral."



The hallmark of the region's economy is its ability to create jobs. For the twelve-month period ending in December, the regional economy generated nearly 81,600 jobs and has led the nation in job creation. According to the Center for Regional Analysis (CRA), "the success of the Washington area in attracting new workers to the area to fill its jobs has been and will be the key to achieving the economy's potential."

Concern about the vitality of the housing market in the Washington area is reflected in the latest report from PMI Mortgage, Inc. The likelihood that home prices in the Washington Metropolitan area will decrease in the next two years increased from 15 percent in the winter of 2004 to nearly 35 percent in PMI's winter 2006 report. Of this group of ten metropolitan areas, the increase

in the probability for Washington was the largest two-year change.



MONTGOMERY COUNTY ECONOMIC INDICATORS

Montgomery County experienced stronger economic growth in 2005 compared to 2004. However, economic activity during this period was not stellar. The primary reasons for the County’s less than stellar performance were a contraction in the growth of residential and non-residential construction, a decline in housing sales particularly during the second half of the year, and rising energy costs attributed to high oil prices. Inflation in the Washington-Baltimore region increased dramatically during 2005 and reached nearly 4 percent.

However, a number of economic indicators for the County experienced significant improvement during 2005. Foremost among the indicators that exhibited strong performance was the labor market. After growing an average of less than one percent between 2001 and 2004, total payroll employment growth is estimated at nearly 2 percent during 2005, its strongest performance in over four years. Average weekly wages are expected to

increase 4.6 percent in 2005, which follows a strong 6.0 percent in 2004.

Because of high-energy costs, retail sales as measured by sales tax receipts increased 5.7 percent during the first eleven months of 2005 compared to 6.5 percent for the same eleven-month period in 2004. After growing 6.1 percent and 6.6 percent during 1999 and 2000, respectively, sales grew 3.8 percent in 2001 less than 1.0 percent during 2002, and 4.0 percent in 2003. The effects of a strong labor market during 2005 helped offset the dramatic increases in energy costs to households thereby enabling households to maintain a somewhat higher level of consumer spending in 2005 albeit at a slightly lower rate compared to 2004.

The strong employment activity has affected the real estate market in the County. With mortgage rates remaining at historic lows during 2005, home sales continued to increase during the first half of 2005 while average sales prices continued their meteoric rise of an estimated 18.5 percent reaching an average of over \$509,000 for the year. However, residential construction has not matched the rise in home sales and prices.

Construction in the County experienced a significant slowdown in 2005. Non-residential construction reflected in the square footage and dollar value decreased and are attributed to a decline in the commercial sector, while the number of new residential projects declined for the third year in a row. Vacancy rates for office space in the County moderated at the beginning of the year and improved slowly reaching 7.4 percent by December for Class A property.

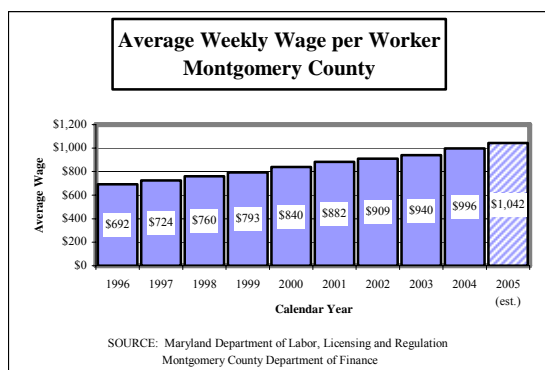
It is against this backdrop of a strong labor market, high-energy costs, a decline in

home sales, modest consumer spending, and weak construction activity that the Department of Finance estimates a slightly slower pace of growth in employment, a slight deceleration in the growth of personal income and wages and salaries and somewhat higher yields on investment attributed to the policy of the Federal Reserve Board for 2006.

Employment Situation

In terms of the County’s total payroll employment, an average of approximately 2,400 jobs per year was added to the County’s employment between 2000 and 2004. However, in 2005 companies in Montgomery County have increased their hiring. Based on preliminary estimates derived by the Department of Finance, the County added over 9,000 jobs in 2005.

From 1996 through 2001, wages of Montgomery County employees increased an average of 4.9 percent per year but decelerated in 2002 and 2003 to an average annual rate of slightly less than 3.2 percent. Since that time the average weekly salary increased 6.0 percent in 2004 and is expected to have grown 4.6 percent in 2005 based on data for the first half of 2005 the latest date for which data are available.



While the payroll employment made significant gains during 2005, data from the labor force series reported that employment

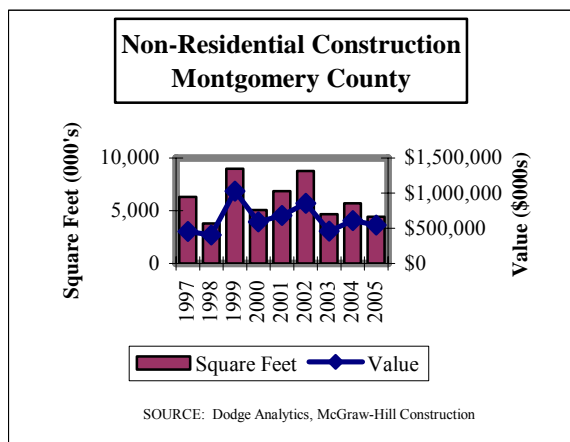
based on place of residence grew 2.1 percent, or 10,000 in 2005. With significant improvement in resident employment, the unemployment rate for the County remained well below the State’s average. As of December, the County’s rate at 2.6 percent was a full percentage point below the State’s average and slightly below the region’s 2.9 percent.

Although the County’s payroll employment may not be growing at the same pace compared to the 2.8 percent for the Washington Metropolitan Area, the low unemployment rate suggests that both the public and private sectors are providing a stable foundation against significant labor market volatility in the County.

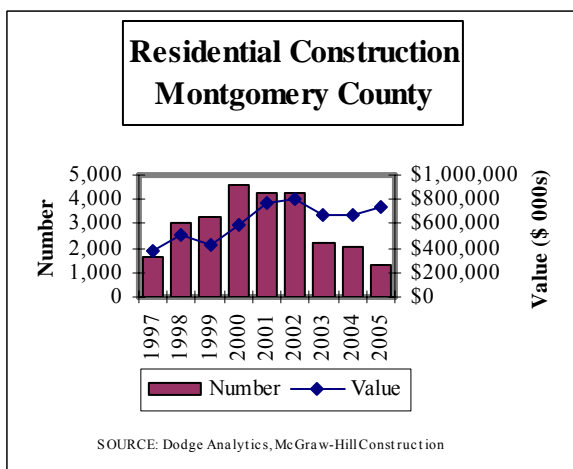
Construction Activity

The amount of square footage added to non-residential property declined 22.5 percent in 2005 from 5.7 million square feet to 4.4 million square feet, while the value of new construction in the County decreased 10.4 percent. Additions of square footage by commercial property were down 43.5 percent and represented 58.8 percent of the added non-residential capacity. Most of that percentage decrease occurred among office and bank buildings (↓83.3%) while stores and food services experienced the second largest decline (↓60.3%). With the decline in the rate of office and bank building construction, vacancy rates in the County improved during 2005 from a high of 10.3 percent in March to 7.4 percent in December, which was below the region’s rate of 7.9 percent. That vacancy rate reflects an inventory of 2.1 million square feet of vacant office space (Class A properties). Fairfax County had a vacancy rate of 8.5 percent with 5.3 million square feet of vacant office space, the City of Alexandria and Arlington County had a

combined vacancy rate of 9.4 percent with 2.5 million square feet of vacant office space, and the District of Columbia had a vacancy rate of 6.5 percent with 4.3 million square feet of vacant office space.

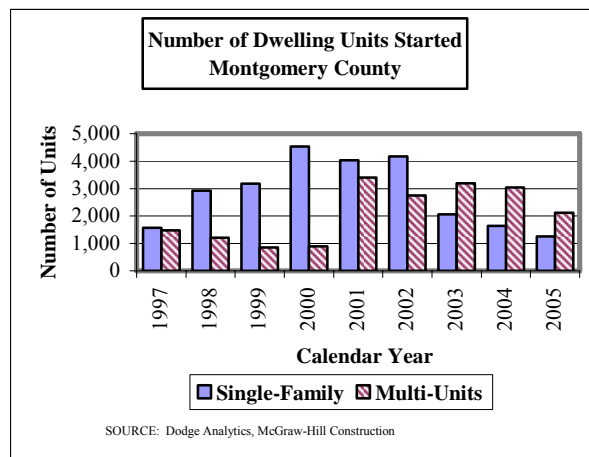


While the number of new residential projects declined (↓35.1%), the total value of new construction increased 9.6 percent. These diverging trends reflect the sharp jump in construction costs stemming from both labor and materials. As a result, the average cost per square foot increased from \$80 in 2004 to \$125 per square foot in 2005.



Based on data provided by McGraw-Hill Construction, the number of new single-family houses built in Montgomery County fell sharply from a little over 1,640 units in

2004 to 1,250 in 2005 (↓23.9%) and the number of multi-family units declined from approximately 3,050 units in 2004 to slightly above 2,100 units (↓30.3%).

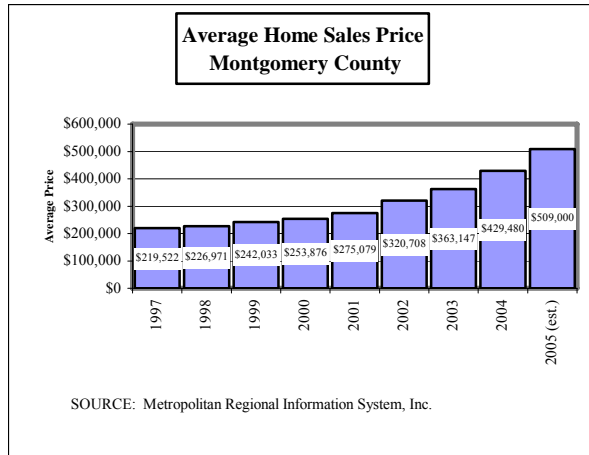


The weak growth in the number of new residential starts is not enough to match the modest growth in the formation of households which would require an additional 4,000 to 5,000 units annually between 2006 and 2012. Montgomery County Department of Park and Planning Commission (MNCPPC) estimates that the number of households in the County will increase 1.2 percent annually over the next three years comparable to the late 1990s through 2004.

Residential Real Estate

The housing market in Montgomery County continues to be a remarkable story. When the national economy was experiencing a recession and weak recovery and subsequent expansion during the past five years, the housing market in Montgomery County experienced average annual growth of 2.5 percent in sales and an average annual price appreciation of nearly 15.4 percent. However, because of the decline in homes sales beginning in June, the sale of homes in the County decreased an estimated 4.2 percent for the year, the first such decline in

over eight years. This follows 2004 when housing sales increased 7.4 percent and average prices increased 18.3 percent.



Retail Sales

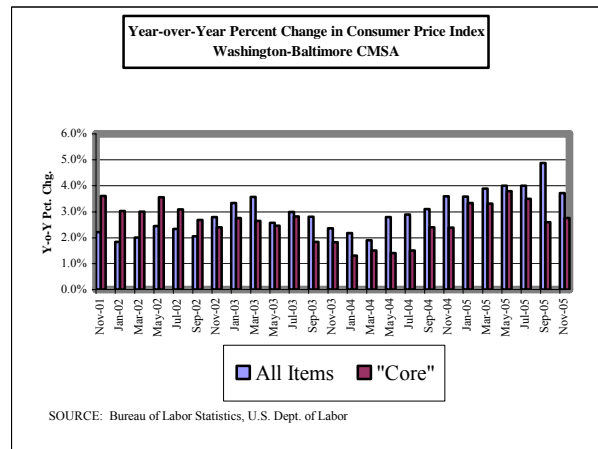
Using sales tax receipts as a measure of the level of retail sales for the County, retail sales increased 5.5 percent during the first eleven months of 2005 compared to the same period in 2004. The sale of nondurable goods, which includes food and beverage, apparel, general merchandise, and utilities and transportation, increased 5.7 percent during the first eleven months while purchases of durable goods were up only 1.5 percent.

For the year (January-November), sales of food (↑7.6%) and general merchandise (↑6.2%) led purchases of nondurable goods. Sales of building and industrial supplies (↑12.0%) led purchases of durable goods. Sales of hardware, machinery and equipment and furniture and appliances were off 13.0 percent and 5.4 percent, respectively, compared to the January-November period for 2004.

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 was slightly above the national average in 2005. Overall consumer prices were up nearly 4.0 percent in the region, based on the latest data available compared to 2.9 percent in 2003, and 2.8 percent in 2004.

While overall consumer prices increased largely attributed to energy prices, the “core” inflation rate, which is the CPI excluding the volatile food and energy prices, increased 3.2 percent during the first eleven months of 2005. That rate was significantly higher compared to the rate of 1.8 percent in 2004 and 2.6 percent during 2003.



SELECTED ECONOMIC INDICATORS	Reporting Period	Current Period	Prior Year's Period	Year To-Date		2004
				2005	2004	
Leading Indicators						
National	Dec	0.1%		2.4%		5.2%
Washington MSA	Nov	1.2%		0.4%		2.1%
Coincident Indicators						
National	Dec	0.2%		0.2%		3.6%
Washington MSA	Nov	1.7%		5.9%		7.1%
Consumer Confidence Index						
National	Jan	2.4%		4.4%		8.3%
South Atlantic Region	Jan	-2.3%		5.1%		11.4%
Consumer Price Index						
<u>All Items (nsa)</u>						
National	Dec	3.4%		3.4%		2.7%
Washington - Baltimore CMSA	Nov	3.7%		4.0%		2.8%
<u>Core CPI (nsa)</u>						
National	Dec	2.2%		2.2%		1.7%
Washington - Baltimore CMSA	Nov	2.8%		3.2%		1.8%
Retail Trade						
National (sales - nsa)	Jan	6.2%		7.3%		7.6%
Washington MSA (sales - nsa)	Nov	8.8%		6.9%		6.4%
Maryland (sales tax)	Nov	6.4%		6.2%		9.1%
Montgomery County (sales tax)	Nov	10.2%		5.5%		6.7%
Employment						
National (labor force data - nsa)	Jan	141,481,000	138,682,000	141,730,000	139,252,000	139,252,000
- Percent Change		2.0%		1.8%		1.1%
Bethesda-Federick-Gaithersburg (establish.)	Dec	577,900	567,600	568,500	557,700	557,700
- Percent Change		1.8%		1.9%		0.7%
Montgomery County (labor force data)	Dec	499,650	482,597	491,608	481,555	481,555
- Percent Change		3.5%		2.1%		n.,m.
Montgomery County (adjusted)	June	464,850	454,647	455,812	446,196	444,591
- Percent Change		2.2%		2.2%		0.9%
Unemployment						
National (nsa)	Dec	4.6%	5.1%	5.1%	5.5%	5.5%
Maryland (nsa)	Dec	3.6%	4.1%	4.2%	4.2%	4.2%
Bethesda-Federick-Gaithersburg (nsa)	Dec	2.6%	2.9%	3.2%	3.2%	3.2%
Montgomery County (nsa)	Dec	2.6%	2.9%	3.2%	3.1%	3.1%
Construction						
<u>Construction Starts - Montgomery County</u>						
Total (\$ thousand)	Dec	\$44,994	\$78,154	\$1,286,612	\$1,285,294	\$1,134,582
- Percent Change		-42.4%		0.1%		-31.6%
Residential (\$ thousand)	Dec	\$31,104	\$72,114	\$742,279	\$677,545	\$676,613
- Percent Change		-56.9%		9.6%		-15.7%
Non-Residential (\$ thousand)	Dec	\$13,890	\$6,040	\$544,333	\$607,749	\$457,969
- Percent Change		130.0%		-10.4%		-46.5%
<u>Building Permits (Residential)</u>						
National	Dec	147,560	152,432	2,147,617	2,024,211	2,024,211
- Percent Change		-3.2%		6.1%		8.7%
Maryland	Dec	2,167	2,089	32,276	28,384	28,384
- Percent Change		3.7%		13.7%		-5.8%
Montgomery County	Dec	79	211	3,564	3,798	3,798
- Percent Change		-62.6%		-6.2%		-17.3%
<u>Building Permits (Non-Residential)</u>						
Montgomery County	Dec	121	161	2,154	1,966	1,966
- Percent Change		-24.8%		9.6%		9.3%
Real Estate						
<u>National</u>						
Sales (saar)	Dec	6,600,000	6,810,000	7,050,000	6,784,000	6,784,000
- Percent Change		-3.1%		3.9%		9.7%
Median Price	Dec	\$211,000	\$191,000	\$207,667	\$185,200	\$185,200
- Percent Change		10.5%		12.1%		9.3%
<u>Montgomery County</u>						
Sales	Dec	1,105	1,493	17,000	17,753	17,753
- Percent Change		-26.0%		-4.2%		7.4%
Average Price	Dec	\$541,782	\$451,839	\$509,000	\$429,480	\$429,480
- Percent Change		19.9%		18.5%		18.3%
Median Price	Dec	\$449,000	\$369,900	\$420,523	\$355,000	\$355,000
- Percent Change		21.4%		18.5%		20.1%
Average Days on the Market	Dec	38	34	27	26	26

NOTES:

(nsa): not seasonally adjusted

(adjusted): ES-202 series adjusted for noneconomic coding revisions by DLLR

(saar): seasonally adjusted at annual rates

