

# Economic Indicators

Prepared by the Department of Finance • July 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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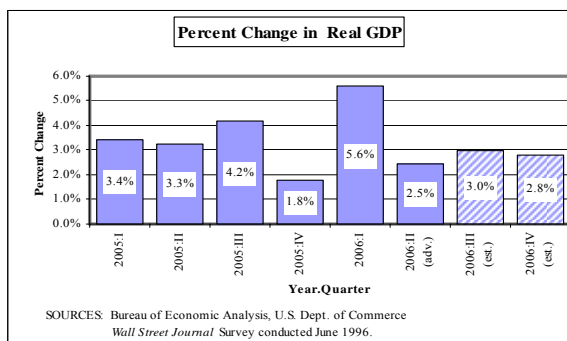
*For questions regarding this report, please contact:*

*David Platt  
Chief Economist  
Montgomery County Department of Finance  
255 Rockville Pike, Suite L-15  
Rockville, Maryland 20850*

*Phone: (240) 777-8866  
Fax: (240) 777-8954  
Email: [David.Platt@montgomerycountymd.gov](mailto:David.Platt@montgomerycountymd.gov)*

### ECONOMIC OVERVIEW

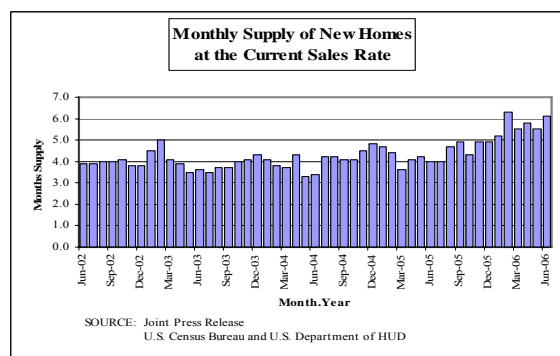
According to “advance” estimates from the Bureau of Economic Analysis (BEA), U.S. Department of Commerce, the U.S. economy grew at a 2.5 percent seasonally adjusted annual rate during the second quarter of 2006 which was well below the 5.6 percent experienced during the first quarter. Although the rate is based on incomplete data, the major contributors to the modest increase were investment in nonresidential structures (↑12.7%), personal consumption expenditures for services (↑3.5%), and state and local government spending (↑3.0%). The long string of interest rate hikes the past two years and high energy costs are finally affecting economic growth especially household spending as measured by BEA’s personal consumption expenditures (PCE). PCE grew a meager 2.5 percent overall which was the second lowest growth rate in two and a half years. Based on the survey of fifty economists conducted by the *Wall Street Journal* (WSJ), the third quarter GDP is expected to grow by 3.0 percent and the fourth quarter GDP by 2.8 percent.



Residential construction was down 6.3 percent in the second quarter, which follows similar decreases of 0.9 percent and 0.3 percent during the fourth quarter of 2005 and the first quarter of 2006, respectively. The drop in residential construction for three consecutive quarters, especially the

significant drop during the second quarter, suggests that the home building industry is adjusting its inventory of new homes to current and future demand.

Sales of existing homes, a 6.6 million unit annual rate in June, were 8.9 percent below sales in June 2005. Median prices for existing homes also have decelerated. After increasing 12.4 percent in 2005, prices during the first half of this year increased 7.8 percent and June prices grew a modest 0.9 percent compared to June of last year. While the National Association of Realtors’ Pending Home Sales Index increased 1.3 percent in May for the first time since January, the index declined 10.1 percent since May 2005, which confirms a significant slowdown in new and existing home sales. For example, sales of new single-family homes in June were down 3.0 percent compared to May’s sales and 11.1 percent below June 2005. Median prices of new home prices also show signs of easing with the price of a new home decreasing from a high of \$309,300 in April to \$290,600 in June. The inventory of new homes for sale was up dramatically in June to a 6.1 months supply based on current sales rate. For the first half of this year, the average inventory of homes was at a 5.8 months supply compared to 4.2 months during the same period in 2005 and 3.8 months during the first half of 2004.

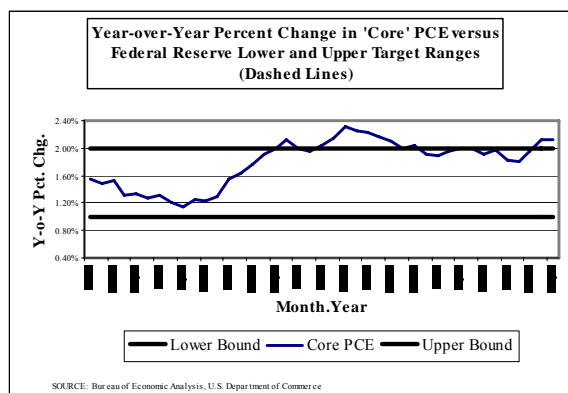


Recent economic releases showed mixed results in June and July. The Conference Board's consumer confidence index increased in July (↑1.1%) which followed a modest 0.2 percent increase in June. The leading indicator of economic activity was up a weak 0.1 percent in June after two monthly declines. The economy added over 325,000 jobs during the second quarter which followed an increase of 530,000 during the first.

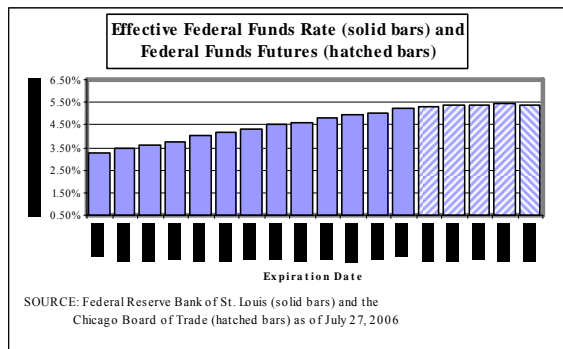
On June 29th, the Federal Open Market Committee (FOMC) of the Federal Reserve increased the target rate for federal funds by 25 basis points to 5.25 percent. This was the seventeenth consecutive 25 basis point increase since the FOMC began its rate hikes in June 2004. Inflation remains the primary concern of the FOMC. In the minutes from the June 28-29 meeting, the members cited several factors as "potentially sustaining upward pressure on inflation." Those factors included increased wage pressures experienced by businesses because of difficulty in hiring certain types of skilled workers, the ability of businesses to pass those higher wage costs on to customers, the relatively taut resource market, and the lagged effects of the increase in energy prices. Because of such factors, inflation could continue at elevated levels for some time although the members did not specify how long such levels could continue. The concern discussed at that meeting was if such high levels of inflation persist, those levels could be "embedded in inflation expectations" thereby significantly driving up long-term interest rates above current levels. Raising the federal funds target rate to 5.25 percent was appropriate given the current readings of inflation and to abate the rise in inflation expectations.

During his testimony before the U.S. Senate Committee on Banking, Housing,

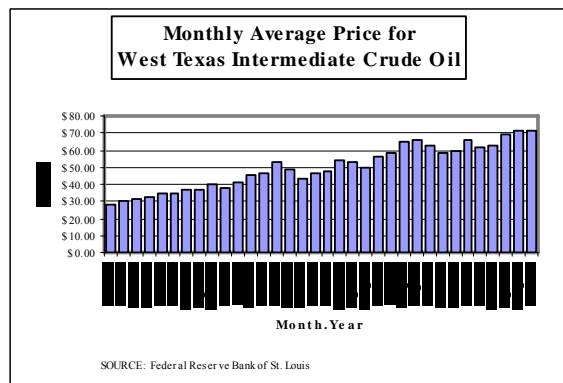
and Urban Affairs, Fed Chairman Bernanke stated that the Federal Reserve projects a gradual decline in inflation in coming quarters. As measured by the price index for personal consumption expenditures excluding food and energy (core PCE), the Federal Reserve projects inflation to be within the 2.25-2.50 percent range for the remainder of this year and edge lower to 2.00-2.25 percent in 2007. While the latter range is similar to the rate of the core PCE price inflation in 2004 and 2005 (see chart below), it will remain above the Federal Reserve's target range of 1.00-2.00 percent. As such, some analysts predict another 25 basis point increase is in the offing possibly at the next FOMC meeting on August 8 and another 25-basis-point increase by yearend.



However, according to the *Financial Times* (July 29/30 edition), the Federal Funds Futures Market lowered its probability from 40 percent to less than 30 percent for a rate increase in August by the FOMC. The futures market anticipates the next rate increase either in late October or early December.



Because of the concerns expressed by the members of the FOMC about inflation and inflation expectations, their focus has been the pass through of energy costs into the core PCE. Oil prices averaged nearly \$71 a barrel during the second quarter. The price for West Texas Intermediate (WTI) crude was nearly \$71 a barrel in June which was the same price in May. The June price was nearly \$15 above the price in June 2005 and \$33 above June 2004, an increase of nearly 90 percent.

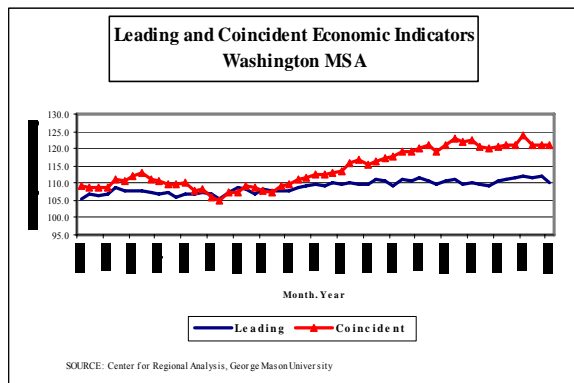


As of July 28, the stock market showed mixed results for the year. Because of the anticipated slowdown in the U.S. economy as reflected by the second quarter GDP, the markets anticipate that the FOMC will halt its string of rate increases in August. The stock markets reversed their negative trends prior to the release of the GDP data and ended on a positive note for the month. As such, the S&P 500 was up 0.66 percent for the month and 2.42 percent for the year and

the Dow Jones Industrial Average was up 0.62 percent for the month and 4.69 percent for the year. The NASDAQ experienced the biggest gain of the three indices for the (↑3.65%) but still down 5.04 percent for the year.

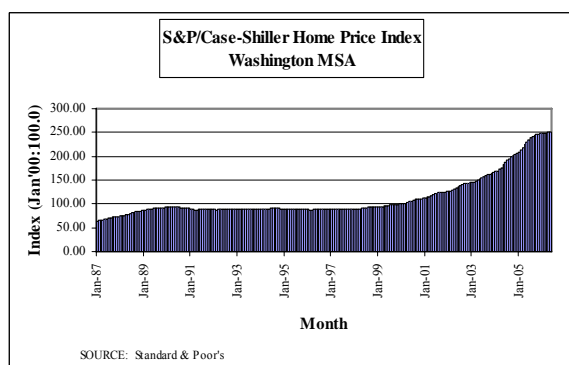
According to the latest report from the Center for Regional Analysis (CRA), George Mason University, the Washington Leading Index, which is developed to forecast the performance of the regional economy six to eight months ahead, decreased 1.79 percent in May after increasing 0.45 percent in April. For the twelve-month period ending in May, the leading index declined 0.81 percent which suggests that the region's economy is expected show a slight moderation after experiencing continued strength through May. Higher energy costs, rising interest rates, inflationary pressures caused by energy prices, and a drop in consumer confidence will temper the area's extraordinary economic expansion.

According to CRA, the region's economy managed to extend its three-year expansion and continued to generate new jobs in spite of rapidly rising energy prices and a slowdown in new home construction. The Coincident Index, which measures the current performance of the region's economy, declined two of the past three months after experiencing solid growth prior to March. The region added nearly 77,000 jobs the past year (June 2005 over June 2006)



As stated by CRA’s recent report, the hallmark of the region’s economy is its ability to create jobs. For the twelve-month period ending in June, the Bethesda-Gaithersburg-Frederick metropolitan division added over 15,500 jobs during the same twelve-month period and experienced an unemployment rate of 3.2 percent in June, one of the lowest among the 34 most populous metropolitan divisions throughout the nation.

Increases in home prices have decelerated dramatically since August of last year. Based on the S&P/Case-Shiller® Home Price Index for the Washington region, prices in May increased 0.3 percent over April and averaged 0.4 percent per month since August 2005. Comparing both averages since August to the average monthly increase of 1.3 percent between January 2000 and August 2005, the housing market has “cooled” dramatically since the summer of last year.



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, excluding B-G-F division, will decrease in the next two years jumped from 15 percent in the winter of 2004 to nearly 43 percent in PMI’s summer 2006 report. The probability that home prices will decline in the B-G-F corridor is an even more troubling 45 percent. Both metropolitan divisions have a significantly greater probability compared to the Baltimore-Towson area which has a probability of 30 percent. *Note that PMI’s percentage indicates the probability of a decline, not that prices will decline by 43 to 45 percent.*

### MONTGOMERY COUNTY ECONOMIC INDICATORS

Montgomery County experienced mixed economic activity during the first half of this year. The primary reasons for the County’s mixed performance were a contraction in the growth of residential construction and a decline in housing sales.

However, a number of economic indicators for the County experienced significant improvement during this period. Foremost among the indicators that exhibited strong performance was the labor market. Based on estimates derived by the Department of Finance, the County’s businesses added 11,500 jobs to total payroll employment during the first half of this year. The County’s unemployment rate of 3.2 percent remains one of the lowest in the State.

Residential construction in the County experienced mixed results during the first half of 2006. The number of projects and

total units were down significantly but the value added was up 9.6 percent during the first half compared to the same period in 2005. Non-residential construction, on the other hand, improved during the first half compared to the same period in 2005. The number of projects and value were up 22.2 percent and 17.8 percent, respectively.

Home sales in the County declined over 20 percent during the January-June period compared to the same six months in 2005. Although housing prices continued to increase, they have decelerated dramatically to less than 10 percent compared to over 17 percent during the January-June 2005 period.

**Employment Situation**

Based on data derived by the Department of Finance, the County’s total payroll employment grew by nearly 11,500 (↑2.4%) during the first half of this year. While payroll employment made significant gains during the first quarter, preliminary data from the labor force series reported that employment based on place of residence grew 3.3 percent, or 16,300, compared to the January-June period of 2005. With significant improvement in resident employment, the unemployment rate for the County remained well below the State’s average. As of June, the County’s rate at 3.2 percent was nearly a full percentage point below the State’s average of 4.1 percent and slightly above the region’s 2.9 percent.

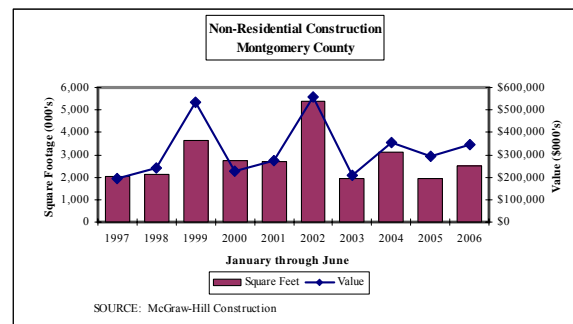
The County’s payroll employment grew at a slightly lower rate during the first half of this year compared to the 2.6 percent for the entire Washington Metropolitan Area but significantly above the 1.5 percent for the State. The low unemployment rate also suggests that both the public and private sectors are providing a stable foundation

against significant labor market volatility and that the County is close to full employment.

**Construction Activity**

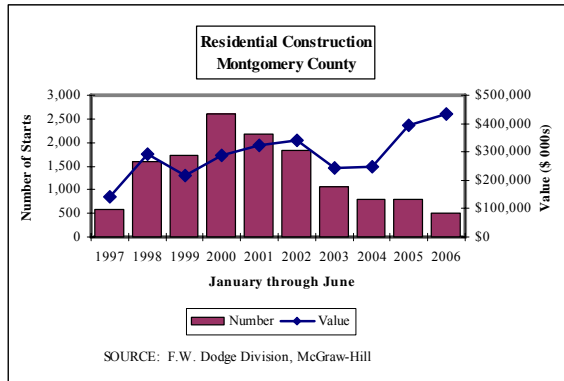
Construction activity in the County during the first half of this year was mixed. While non-residential construction improved, construction of new homes declined dramatically compared to January-June period in 2005. With home sales and homebuilding declining and price increases decelerating, the residential real estate market continued to experience a correction during the first half that began in September of last year.

The amount of square footage added to non-residential property through new construction increased 29.0 percent during the first half from 1.9 million square feet to 2.5 million square feet, while the value of new construction in the County increased nearly 17.8 percent. Additions of square footage by commercial property were up 89.1 percent and represented 76 percent (1.9 million square feet) all of the added non-residential capacity.

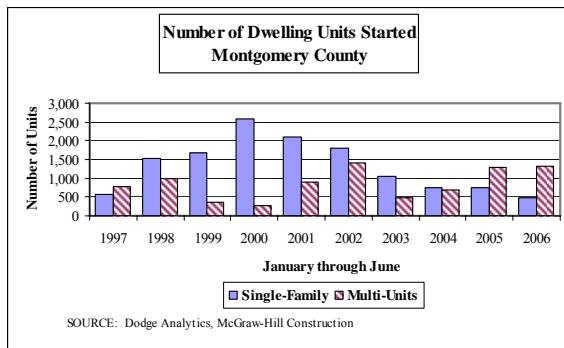


Residential construction experienced mixed performance during the first half. Even with the mild winter weather, the number of new residential projects declined (↓35.7%) but the total value of new construction increased nearly 10 percent attributed to an increase in the number of multi-family units and

construction of larger single-family homes.



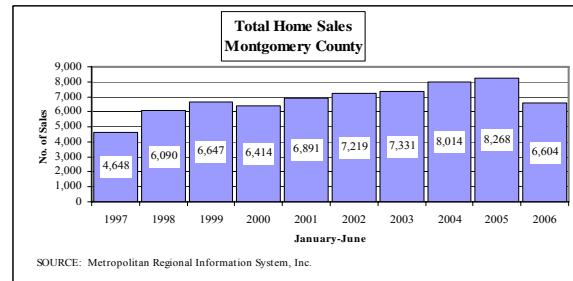
Based on data provided by McGraw-Hill Construction, the number of residential units built in the County totaled nearly 1,800, a decline of slightly over 11 percent from the January-June period last year. The decline occurred in the construction of new single-family houses which dropped from nearly 750 units during the first half of 2005 to 480 units during the first half of this year, a decline of 36 percent. However, the number of multi-family units increased from approximately 1,280 units in 2005 to 1,310 units during the first half of this year (↑2.1%).



**Residential Real Estate**

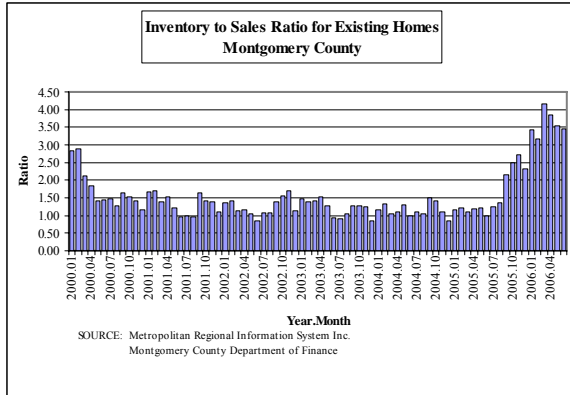
The housing market in Montgomery County continued to experience a dramatic slowdown during the first half of this calendar year. During the January-June period, home sales declined 20.1 percent

compared to the same period in 2005. However average home prices were up 9.1 percent for the period compared to the first half of 2005. On a fiscal year basis, home sales were down 15.7 percent in FY06 compared to last fiscal year. Home prices, on the other hand, were up 13.9 percent for fiscal year 2006.



The contraction in sales is reflected in the dramatic increase in inventory-to-sales ratio. Since August, the ratio increased from 1.37 to 3.46 by June. This means that in August for every home listed on the market, there was one buyer. By June, for every three to four 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 2004 and 2005. Such action may be attributed to an affordability issue or the potential buyer is anticipating a further deceleration or even a decline in prices. As a result, because of the modest increase in mortgage rates and the anticipation of a correction in home prices, potential home buyers are sitting on the sidelines and as such the market has shifted from a seller's market to a buyer's, e.g., *The Washington Post* reported (July 15 edition) that the condominium project in Rockville sold only 244 of the 600 units to date.





**Retail Sales**

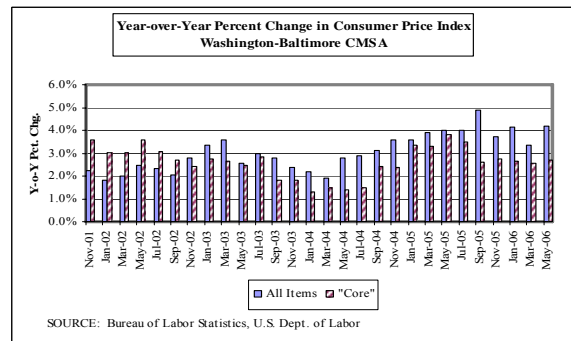
Using sales tax receipts as a measure of the level of retail sales for the County, retail sales were up 2.8 percent in May compared to May 2005 and up 4.7 percent during the first five months of this year compared to the same period in 2005. The sale of nondurable goods, which includes food and beverage, apparel, general merchandise, and utilities and transportation, increased 6.2 percent during the quarter while purchases of durable goods were down 4.9 percent.

For the five-month period, purchases of energy products (↑16.1%), food (↑5.6%), and apparel (↑4.4%) led sales of nondurable goods. Purchases of building and industrial supplies (↑9.1%) led sales of durable goods followed by hardware, machinery and equipment (↑8.2%). However, consumer purchases of the “big ticket” items were down compared to the first three months of

last year. Purchases of furniture and appliances were off 23.8 percent and automotive products were up less than 0.5 percent. The dramatic decline in furniture and appliance expenditures could be attributed to the decline in home sales.

**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 4.2 percent over the twelve-month period ending in May. That rate was slightly below the national average of 4.3 percent but the highest since September of last year which reflected the dramatic post-Katrina energy increase. Consumer prices excluding food and energy purchases were up 2.7 percent in the region, based on the latest data available compared to 2.6 percent for the nation.



SELECTED ECONOMIC INDICATORS	Reporting Period	Current Period	Prior Year's Period	Year To-Date		2005
				2006	2005	
<b>Leading Indicators</b>						
National	June	0.1%		1.9%		1.8%
Washington MSA	May	-1.8%		0.6%		-0.1%
<b>Coincident Indicators</b>						
National	June	0.2%		2.3%		1.5%
Washington MSA	May	0.3%		1.1%		1.7%
<b>Consumer Confidence Index</b>						
National	July	1.1%		2.8%		1.1%
South Atlantic Region	July	9.9%		3.5%		2.7%
Consumer Sentiment (University of Michigan)	July(p)	-2.2%		-7.4%		-5.8%
<b>Consumer Price Index</b>						
<u>All Items (nsa)</u>						
National	June	4.3%		3.8%		3.4%
Washington - Baltimore CMSA	May	4.2%		3.8%		4.0%
<u>Core CPI (nsa)</u>						
National	June	2.6%		2.3%		2.2%
Washington - Baltimore CMSA	May	2.7%		2.6%		3.2%
<b>Retail Trade</b>						
National (sales - nsa)	June	6.2%		7.6%		6.9%
Washington MSA (sales - nsa)	May	7.7%		7.2%		6.8%
Maryland (sales tax)	May	4.9%		6.7%		6.4%
Montgomery County (sales tax)	May	2.8%		4.7%		5.0%
<b>Employment</b>						
National (labor force data - nsa)	June	145,216,000	142,456,000	143,152,000	140,421,000	141,730,000
- Percent Change		1.9%		1.9%		1.8%
Bethesda-Federick-Gaithersburg (establish.)	June	588,000	576,300	578,400	564,800	570,900
- Percent Change		2.0%		2.4%		0.9%
Montgomery County (labor force data)	June	507,513	494,888	502,805	486,524	491,801
- Percent Change		2.6%		3.3%		2.1%
Montgomery County (QCEW)	Dec'05(a)	467,977	458,671	458,652	449,397	449,397
- Percent Change		2.0%		2.1%		1.1%
<b>Unemployment</b>						
National (nsa)	June	4.8%	5.2%	4.8%	5.3%	5.1%
Maryland (nsa)	June	4.1%	4.2%	3.8%	4.4%	4.1%
Montgomery County (nsa)	June	3.2%	3.3%	2.8%	3.3%	3.1%
<b>Construction</b>						
<u>Construction Starts - Montgomery County</u>						
Total (\$ thousand)	June	\$189,533	\$104,394	\$777,493	\$687,542	\$1,286,612
- Percent Change		81.6%		13.1%		0.1%
Residential (\$ thousand)	June	\$134,958	\$58,498	\$432,585	\$394,640	\$742,279
- Percent Change		130.7%		9.6%		9.6%
Non-Residential (\$ thousand)	June	\$54,575	\$45,896	\$344,908	\$292,902	\$544,333
- Percent Change		18.9%		17.8%		-10.4%
<u>Building Permits (Residential)</u>						
National	June	180,178	207,948	1,029,805	1,070,972	2,147,617
- Percent Change		-13.4%		-3.8%		6.1%
Maryland	June	3,392	3,310	14,869	17,143	32,276
- Percent Change		2.5%		-13.3%		13.7%
Montgomery County	June	339	413	1,702	2,510	3,564
- Percent Change		-17.9%		-32.2%		-6.2%
<u>Building Permits (Non-Residential)</u>						
Montgomery County	June	211	215	968	1,257	2,154
- Percent Change		-1.9%		-23.0%		9.6%
<b>Real Estate</b>						
<u>National</u>						
Sales (saar)	June	6,620,000	7,270,000	6,740,000	7,070,000	7,075,000
- Percent Change		-8.9%		-4.7%		4.4%
Median Price	June	\$231,000	\$229,000	\$223,000	\$206,833	\$219,600
- Percent Change		0.9%		7.8%		12.4%
<u>Montgomery County</u>						
Sales	June	1,406	2,040	6,604	8,268	17,011
- Percent Change		-31.1%		-20.1%		-4.2%
Average Price	June	\$572,978	\$536,098	\$526,909	\$488,256	\$507,340
- Percent Change		6.9%		7.9%		18.1%
Median Price	June	\$467,000	\$440,000	\$435,125	\$402,213	\$425,000
- Percent Change		6.1%		8.2%		19.7%
Average Days on the Market	June	44	20	49	27	25

**NOTES:**

(nsa): not seasonally adjusted

(saar): seasonally adjusted at annual rates

(a): Year-to-date data are for 2005 and 2004 respectively. Annual data are for 2004.

(p): Preliminary