Economic Indicators

Prepared by the Department of Finance • October 2005

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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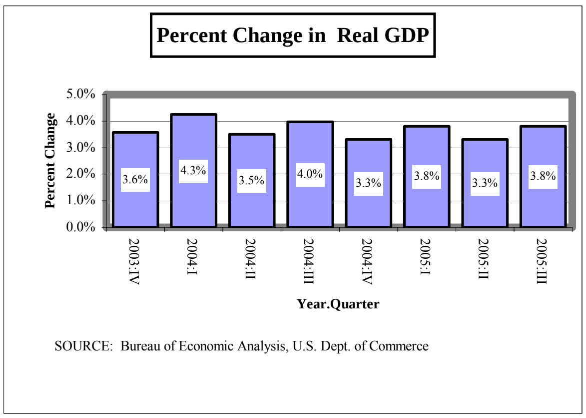
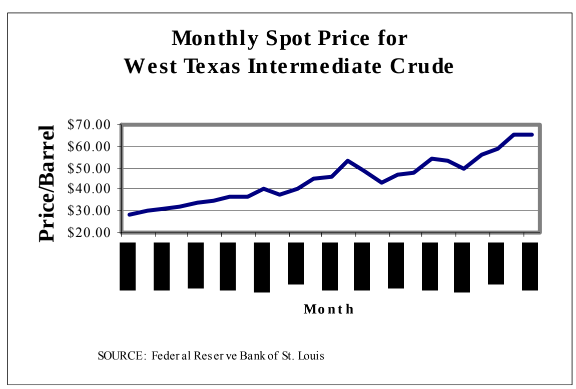
ECONOMIC OVERVIEW

According to the latest economic data, the U.S. economy grew at a 3.8 percent rate during the third quarter of 2005 and an unexpected improvement from the 3.3 percent experienced during the second quarter. Led by purchases of durable goods (↑10.8%), consumer spending grew a strong 3.9 percent during the quarter, capital spending was up 6.2 percent led by business investment in equipment and software (↑8.9%), and investment in housing grew 4.8 percent, which was the lowest rate since the fourth quarter of last year.



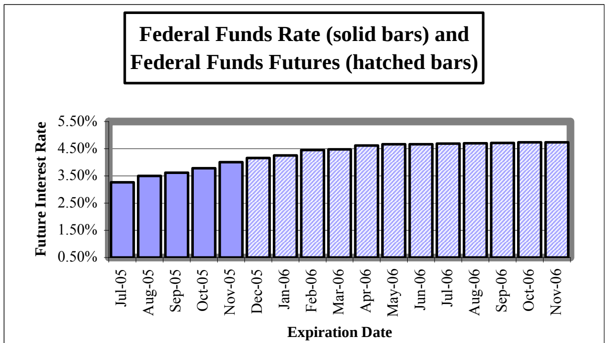
Recent economic releases showed mixed results due to the impact of higher energy prices, particularly gasoline and natural gas, and the monetary tightening by the Federal Reserve. The Conference Board's consumer confidence index declined in October (↓ 2.9%) for the second month in a row. Also both the present situation and expectations components dipped slightly (↓2.0% and ↓3.8%, respectively). Total payroll employment declined by 35,000, albeit slightly lower than expected due to the anticipated effects of Hurricanes Katrina and Rita. Sales of existing homes held steady in September at nearly 7.3 million units at an annual rate, which was the same as August and 7.2 percent above September of last year. Sales of new homes were up 2.1 percent in September following a 17.1 percent drop in August. Home prices are beginning to show signs of easing with the median price of a new home decreasing four of the last five months of this year from a high of $236,300 in April to $215,700 in September.

According to the latest *Weekly Petroleum Status Report* prepared by the Energy Information Agency, U.S. Department of Energy, the world crude oil price on October 21 was $53.96 per barrel, which was 54 cents lower than the previous week but nearly $10 above last year's price. The price for West Texas Intermediate (WTI) crude declined to $61.05 per barrel – $1.56 less than the previous week but $5.22 above October of last year. The national average retail price of regular gasoline was $2.60 per gallon – 12 cents less than the price on October 14 but 57 cents higher than last year at this time. NYMEX energy futures for crude oil and motor gasoline suggest that energy prices should hold steady through the remainder of this year but increase slightly for February deliveries. For example, the future price for WTI for December delivery is $60.63 per barrel, that price is expected to reach $61.02 by February – its current price. Gasoline futures for December delivery is priced at $1.68 per gallon and for February delivery the price is up slightly to $1.71 per gallon.



In its latest edition of *The Beige Book*, the District Banks of the Federal Reserve System reported a "pickup in cost pressures" attributed to recent increases in the price of energy, petroleum-based products, and shipping. They also reported price increases for building materials such as cement, sheetrock, and lumber. Such price increases come largely in the wake of the recent hurricanes but can also be attributed to the boom in housing construction. In addition, most of the District Banks expect high prices for energy and construction materials to persist. District banks also suggested that demand for housing was slowing in some regions.

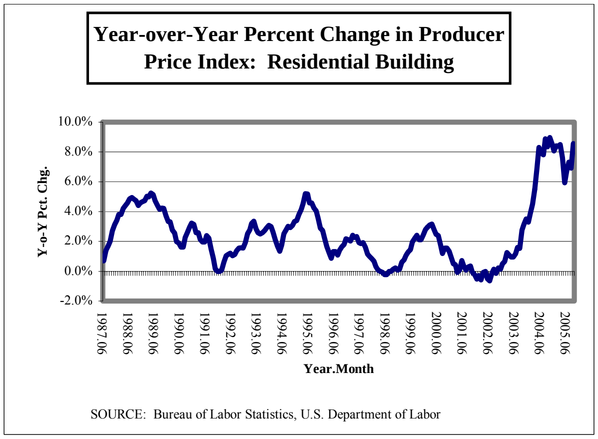
On November 1st, the FOMC raised the target rate an additional 25 basis points to 4 percent. In its press release, the FOMC stated that while "elevated energy prices and hurricane-related disruptions in economic activity have temporarily depressed output and employment … the cumulative rise in energy and other costs have the potential to add to inflation pressures; however, core inflation has been relatively low in recent months and longer-term inflation expectations remain contained." With the strong economic performance during the third quarter and the containment of inflation expectations, the members of the FOMC of the Federal Reserve (Fed) are reassured about the strength of the economic expansion. Even with volatile energy prices, the economy appears resilient according to the latest statement by the FOMC. As such, the measured pace of rate increases are expected to continue over the remainder of this year and into the first half of next year.



SOURCE: Federal Reserve Bank of St. Louis (solid bars) and the Chicago Board of Trade (hatched bars) as of October 29, 2005.

While the Federal Reserve asserts that there are no long-term effects from Hurricane Katrina on the national economy, the size and scope of the hurricane ranks as the costliest natural disaster in U.S. history. Equally significant is the amount of the rebuilding effort. As such, there is concern that this very concentration of activity could raise prices and diminish availability of construction material and skilled labor from other parts of the country. The concern is that many construction materials and skilled construction labor are currently in short supply due in part to the strong housing market over the past three years.

According to the producer price index for residential building, construction costs for a new home moderated in October and November 2004. However, with the continuing boom in residential real estate and the recent natural disaster, those costs began to rise in January of this year. While some wholesale prices, such as those for steel mill products, peaked in February and have declined 13.2 percent since, prices of other construction materials have continued to rise steadily in 2005. The price of gypsum climbed 9.9 percent since February, cement is up 5.6 percent, and construction machinery prices were up 3.5 percent.

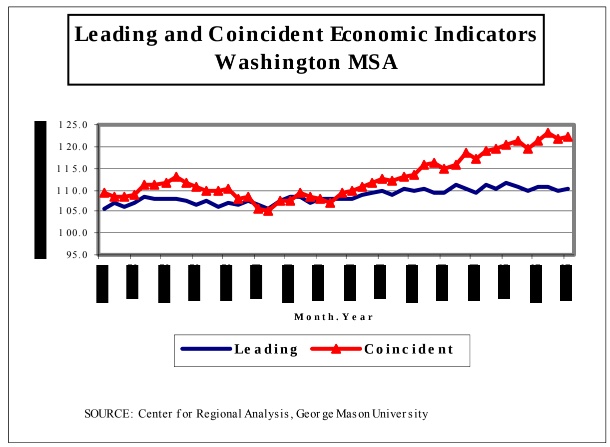


According to a special report by McGraw-Hill Construction, cement remained in short supply in 32 states and the District of Columbia – even before Katrina. The disruption to transportation systems and loss of power to cement plants in the Gulf region further cut into the supply. As such, McGraw-Hill expects increases in cement prices to continue through the remainder of 2005 and into 2006.

While the national coincident indicator of economic activity, which measures the current state of the national economy, achieved a growth rate of 2.6 percent between August 2004 and August 2005, the regional economy also continued its expansion during the year. Over the same period, the latest date for which data are available, the Washington Coincident Index, which represents the current state of the Washington economy, increased 6.6 percent, which was nearly the same rate as in 2004. The expansion that started in mid-2003 is greater than the one during same period that followed the 1990-91 recession.

The Washington Leading Index, which is developed to forecast the performance of the regional economy six to eight months ahead, increased in August for the fourth consecutive month. 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.

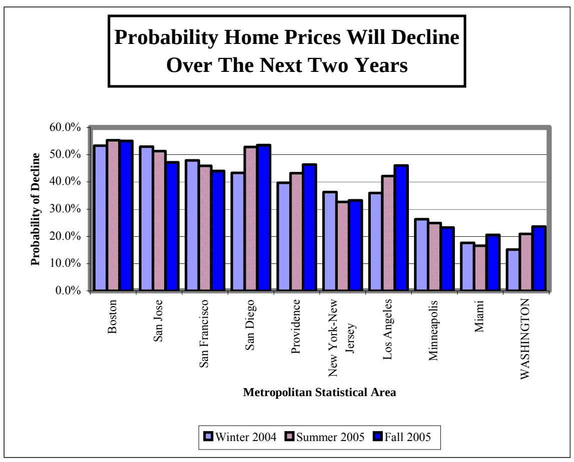
The hallmark of the region's economy is its ability to create jobs. For the twelve-month period ending in September, the regional economy generated nearly 80,000 jobs and has led the nation in job creation. According to the Center for Regional Analysis (CRA), the types of new jobs "continue to reflect a disproportional gain in higher wage jobs." Professional and business service jobs experienced the largest growth.



According to the recent discussion of the current state of the region's economy by CRA, the region has come under increasing pressures as a result of higher energy prices. Higher energy prices have cut into consumer spending particularly for durable goods. With home mortgage refinancing slowing as interest rates rise and with energy costs up significantly the past year, many consumers have reached their spending limit unless earnings from their employment can offset their borrowing for the purchase of durable goods. Hence, CRA forecasts a slowdown in consumer spending in 2006.

With the leading index moderating in recent months, CRA points to slower future growth in the region's economy. With higher energy costs, higher interest rates, and growing concerns among consumers above the vitality of the housing market, a slowdown is inevitable.

Concern about the vitality of the housing market 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 15.1 percent last winter to nearly 24 percent in PMI's fall report. Compared to nine other metropolitan areas with either the same or higher percentages that change in the probability was the largest except for San Diego and Los Angeles.



The report also stated that the residential real estate in the metropolitan region was overvalued by 18 percent. That value was 5 percentage points above the average of a sample of 17 other metropolitan areas.

MONTGOMERY COUNTY ECONOMIC INDICATORS

The County's economy during the first three quarters of 2005 generally experienced significant improvement compared to the same period in 2004. Employment grew significantly during the January-September period, residential construction rebounded during the first three quarters of 2005 compared to the January-September period last year, and housing prices continued to increase significantly.

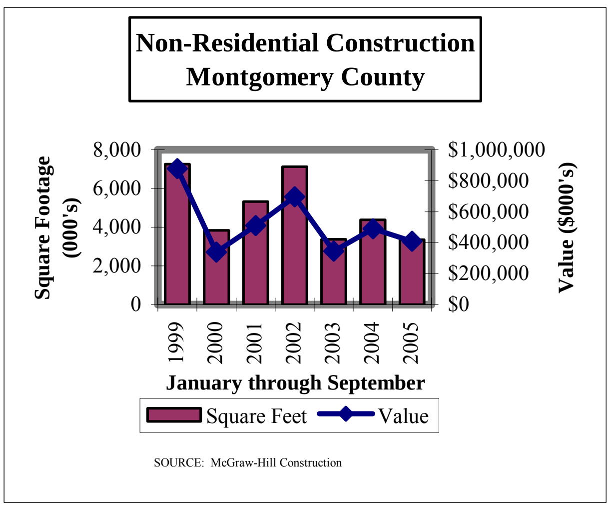
Employment Situation

The employment situation in Montgomery County experienced significant improvement during the January-September period. Data from the Bureau of Labor Statistics, U.S. Department of Labor, showed that employment in the Bethesda-Frederick-Gaithersburg metropolitan division increased 2.3 percent over the twelve-month period ending in September. Over the January-September period this year, employment grew 1.9 percent compared to the same period in 2004. To date, employment growth in the metropolitan division should exceed the 0.7 percent increase experienced in 2004. Employment for the County increased 2.3 percent over the twelve-month period ending in September. On a year-to-date basis (January-September 2005), the County's payroll employment increased 1.9 percent compared to a 0.4 percent rate during the same period last year.

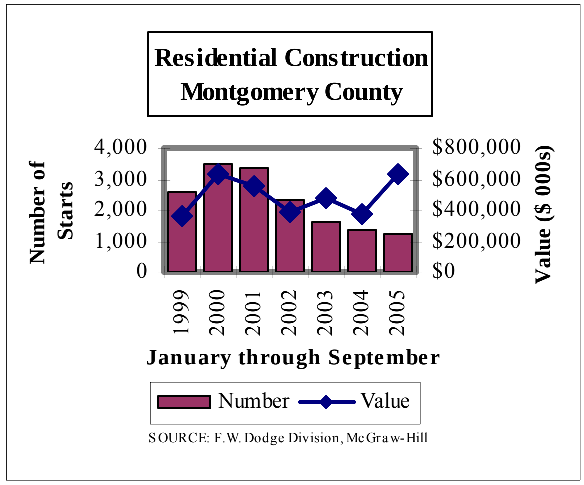
Data from the labor force series reported that employment based on place of residence grew 2.9 percent over the twelve-month period ending in September. On a year-to-date period (January-September), resident employment grew 1.8 percent compared to no grow during the same January-September period last year. With significant improvement in resident employment, the unemployment rate for the County continues to remain one of the lowest in the State with a rate of 2.8 percent in September and a nine-month average of 3.3 percent compared to the 4.3 percent statewide and 5.2 percent for the nation.

Construction Activity

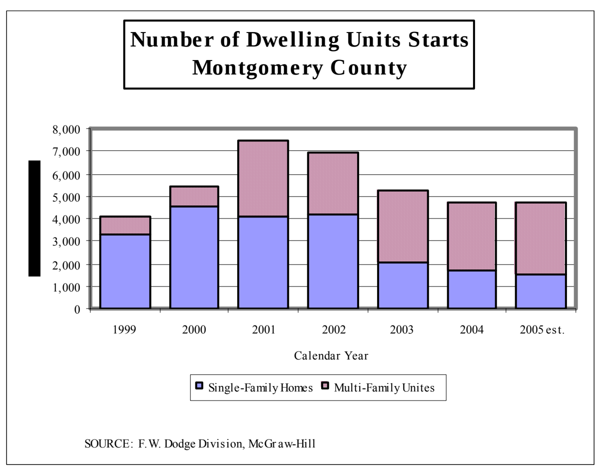
During the first three quarters of 2005, construction activity in the County experienced two different cycles. Non-residential construction starts, which consist of commercial (stores and food service, warehouses, office and bank buildings, garages and service stations, and hotels and motels), manufacturing, education and science, dormitories, medical, and other buildings were down 16.2 percent in total value during the January-September period compared to the same period last year. This rate follows a 41.5 percent increase during the same period in 2004. The amount of square footage added to the County's non-residential property base declined significantly during the January-September period (↓23.3%) compared to the first half of 2004.



Unlike non-residential activity, residential construction experienced a construction boom during the first three quarters of 2005, which was a reversal of 2004. During the first nine months of this year, the number of building permits (↑13.6%) and the value of construction starts (↑66.0%) were up compared to 2004.

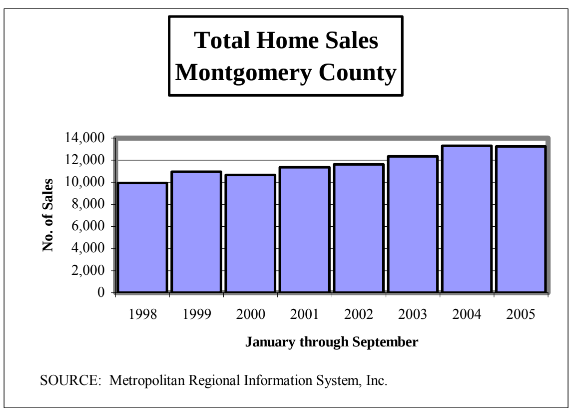


Led by the growing demand for condominiums, construction of multi-unit housing accelerated in the past two years. With the prices of single-family detached units beyond the reach of many new households, the construction of multi-family units has increased from 1,190 units during the January-September period of 2004 to over 1,800 units during the same period this year — an increase of 51.3 percent. At that rate, the total number of multi-family units under construction in the County could reach over 3,200 units by the end of the year, which would be slightly higher than the 3,000 units in 2004 but match the 3,200 units constructed in 2003.

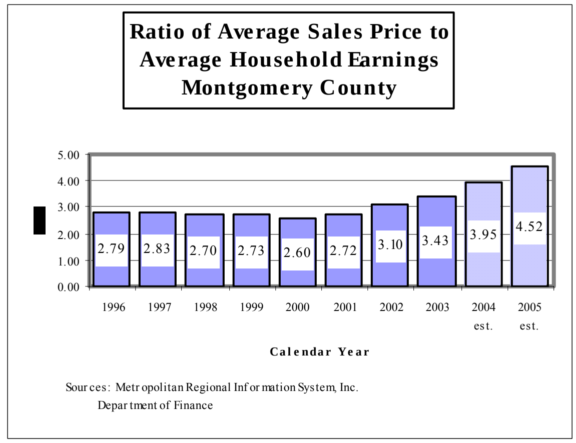


Residential Real Estate

Existing homes sales in the County decreased at a modest rate of 0.3 percent during the first three quarters of 2005 compared to the same period in 2004. Even with the insignificant decrease in home sales this year compared to last year, sales of nearly 13,300 units to date exceeded the annual sales for the six years prior to 2004. Average home prices have risen 18.6 percent during the first three quarters of the year compared to the same period as last year, and median prices accelerated nearly 20 percent during the same period. With an average home price of nearly $510,000, home values have doubled over the past four years. As such, it is expected that the strong growth in property values will be reflected in exceptionally high reassessment rates this year similar last year.



However, in contrast to the dramatic rise in house prices, personal income by County residents has not kept pace. Based on the latest income data from the Bureau of Economic Analysis, U.S. Department of Commerce, personal income increased only 3.5 percent per year between 2000 and 2003 and earnings increased 4.1 percent per year over the same period. While at the same time, home prices increased at an average annual rate of nearly 12 percent or three times the rate of growth in earnings. As such the ratio of average earnings per household received by County residents to average home prices accelerated from 2.60 in 2000 to 3.43 in 2003.

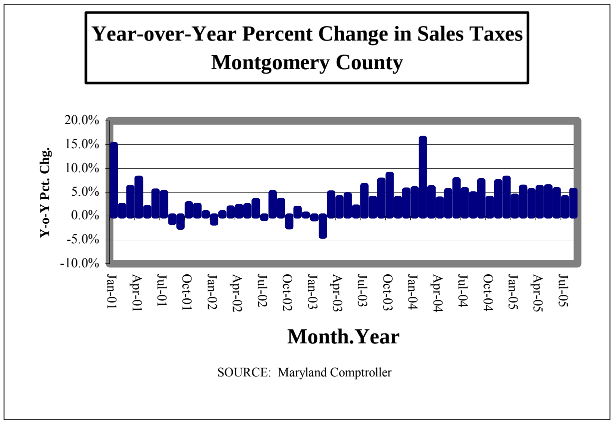


Based on the projected average sales prices and earnings for 2005, that ratio could reach an astonishing 4.52 — a significant level compared to the late 1990s and early 2000s. The increase in the ratio means that Montgomery County households, particularly first-time home buyers, are stretching their incomes to the maximum in order to meet rising real estate prices. Coupled with innovative mortgage financing instruments, there is the possibility that new homebuyers are at risk if home prices decline or moderate significantly in the near term.

Retail Sales

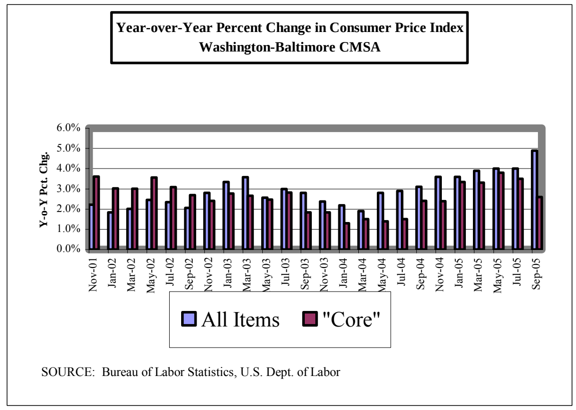
Led by purchases of nondurable goods, retail sales in the County, as measured by sales tax receipts, increased 5.5 percent in August compared to August of last year. On a year-to-date basis, retail sales were up 5.2 percent compared to 6.7 percent for all of 2004. The slowdown in retail sales was attributed to a slowdown in purchases of durable goods, which were up only 4.2 percent on a year-to-date basis compared to 9.7 percent for 2004.

For the year (January-September), sales of food (↑7.9%) and general merchandise (↑7.3%) led purchases of durable goods. Sales of building and industrial supplies (↑11.9%) and furniture and appliances (↑2.7%) led purchases of durable goods. Sales of hardware, machinery and equipment were off 15.2 percent compared to the January-September period for 2004.



Consumer Prices and Inflation

Led by surging energy prices, the overall Consumer Price Index for the Washington-Baltimore Consolidated Metropolitan Statistical Area (CMSA) increased 4.9 over the twelve-month period ending in September. That increase was the largest year-over-year increase since the index was developed in 1996. However, "core" inflation, which is the overall CPI excluding food and energy, was up only 2.6 percent which was the lowest twelve-month increase since November of last year.



SELECTED ECONOMIC INDICATORS	Reporting Period	Current Period	Prior Year's Period	Year To-Date 2005	Year To-Date 2004	2004
Leading Indicators						
National	Sept	-0.7%		(not available)		1.3%
Washington MSA	Aug	0.5%		0.8%		2.1%
Coincident Indicators						
National	Sept	-0.1%		(not available)		3.5%
Washington MSA	Aug	0.2%		6.6%		7.1%
Consumer Confidence Index						
National	Oct	-2.9%		4.5%		8.3%
South Atlantic Region	Oct	0.6%		5.2%		11.4%
Consumer Sentiment (University of Michigan)	Oct	-2.0%		-6.5%		4.9%
Consumer Price Index						
All Items (nsa)						
National	Sept	4.7%		3.3%		2.7%
Washington - Baltimore CMSA	Sept	4.9%		4.0%		2.8%
Core CPI (nsa)						
National	Sept	2.0%		2.2%		1.7%
Washington - Baltimore CMSA	Sept	2.6%		3.4%		1.8%
Retail Trade						
National (sales - nsa)	Sept	7.1%		7.6%		7.6%
Washington MSA (sales - nsa)	Aug	9.1%		6.3%		7.4%
Maryland (sales tax)	Aug	6.2%		6.2%		9.1%
Montgomery County (sales tax)	Aug	5.5%		5.2%		6.7%
Employment						
National (labor force data - nsa)	Sept	142,579,000	139,641,000	141,281,000	138,857,000	139,252,000
- Percent Change		2.1%		1.7%		1.1%
Bethesda-Federick-Gaithersburg (establish.)	Sept	572,000	559,000	565,700	555,400	557,700
- Percent Change		2.3%		1.9%		0.7%
Montgomery County (labor force data)	Sept	494,219	480,187	489,497	480,894	481,555
- Percent Change		2.9%		1.8%		n.,m.
Montgomery County (adjusted)	Mar	452,858	445,758	450,943	441,503	444,591
- Percent Change		1.6%		2.1%		0.9%
Unemployment						
National (nsa)	Sept	4.8%	5.1%	5.2%	5.6%	6.0%
Maryland (nsa)	Sept	3.9%	3.9%	4.3%	4.3%	4.2%
Bethesda-Federick-Gaithersburg (nsa)	Aug	3.2%	3.1%	3.3%	3.3%	3.2%
Montgomery County (nsa)	Sept	2.8%	2.8%	3.3%	3.2%	3.1%
Construction						
Construction Starts - Montgomery County						
Total ($ thousand)	Sept	$62,472	$44,038	$1,038,292	$867,666	$1,134,582
- Percent Change		41.9%		19.7%		-31.6%
Residential ($ thousand)	Sept	$57,882	$34,489	$628,732	$378,733	$676,613
- Percent Change		67.8%		66.0%		-15.7%
Non-Residential ($ thousand)	Sept	$4,590	$9,549	$409,560	$488,933	$457,969
- Percent Change		-51.9%		-16.2%		-46.5%
Building Permits (Residential)						
National	Sept	191,304	172,865	1,655,520	1,545,402	2,024,211
- Percent Change		10.7%		7.1%		8.7%
Maryland	Sept	2,384	2,573	25,348	21,208	28,384
- Percent Change		-7.3%		19.5%		-5.8%
Montgomery County	Sept	179	310	3,114	2,742	3,798
- Percent Change		-42.3%		13.6%		-17.3%
Building Permits (Non-Residential)						
Montgomery County	Sept	126	150	1,707	1,472	1,966
- Percent Change		-16.0%		16.0%		9.3%
Real Estate						
National						
Sales (saar)	Sept	7,280,000	6,790,000	7,100,000	6,670,000	6,784,000
- Percent Change		7.2%		6.4%		9.7%
Median Price	Sept	$212,000	$187,000	$205,222	$182,222	$185,200
- Percent Change		13.4%		12.6%		9.3%
Montgomery County						
Sales	Sept	1,415	1,480	13,253	13,293	17,753
- Percent Change		-4.4%		-0.3%		7.4%
Average Price	Sept	$510,053	$423,766	$504,910	$425,886	$429,480
- Percent Change		20.4%		18.6%		18.3%
Median Price	Sept	$429,000	$359,975	$415,697	$347,124	$355,000
- Percent Change		19.2%		19.8%		20.1%
Average Days on the Market	Sept	27	29	25	25	26

NOTES:

(nsa): not seasonally adjusted
(adjusted): ES-202 series adjusted for noneconomic coding revisions by DLLR
(saar): seasonally adjusted at annual rates