



Economic Indicators

Prepared by the Department of Finance • October 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:
<http://www.montgomerycountymd.gov>*

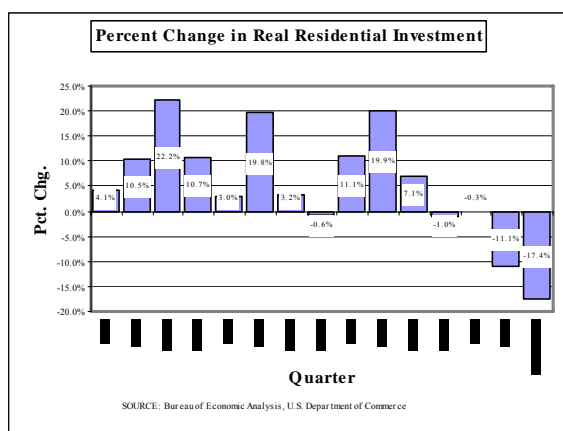
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ECONOMIC OVERVIEW

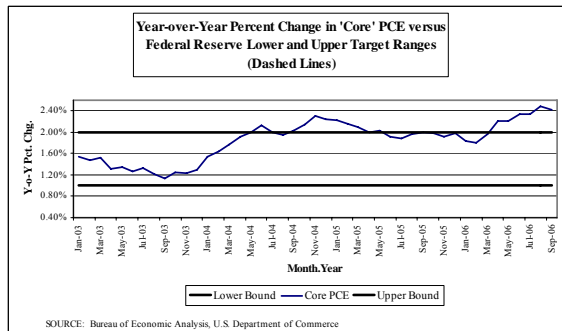
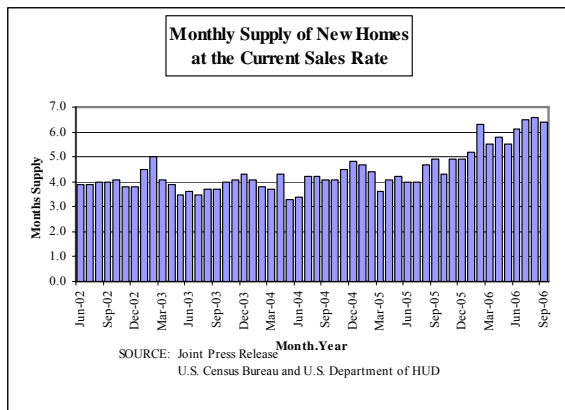
According to “advance” estimates from the Bureau of Economic Analysis (BEA), U.S. Department of Commerce, the U.S. economy grew at a 1.6 percent seasonally adjusted annual rate during the third quarter of 2006, its slowest pace in three years. That rate was well below the historic trend of 3.5 percent. Although the rate is based on incomplete data, the major contributors to the modest increase were investment in nonresidential structures (↑14.0%), personal consumption expenditures for services (↑3.1%), and nondefense federal spending (↑6.9%). The below-average growth was led by a further decline in residential investment. Real growth in home building declined 17.4 percent and follows declines of 1.0 percent (2005:IV), 0.3 percent (2006:I), and 11.1 percent (2006:II). According to Maury Harris of UBS, the drop in residential investment during the past two quarters subtracted 0.7 percentage point from real GDP for the second quarter and 1.1 percentage point from third quarter’s real GDP.



Based on the survey of fifty economists conducted by the *Wall Street Journal* (WSJ) and prior to the BEA release, the third quarter GDP was expected to grow by 2.3 percent and the fourth quarter GDP by 2.5 percent. Since the advance estimate is

subject to two more revisions, recent history has shown that the average adjustment between the advance and final number is +0.3 percentage points. Based on that average, the final third quarter GDP growth rate could be 1.9 percent but still well below the historical average.

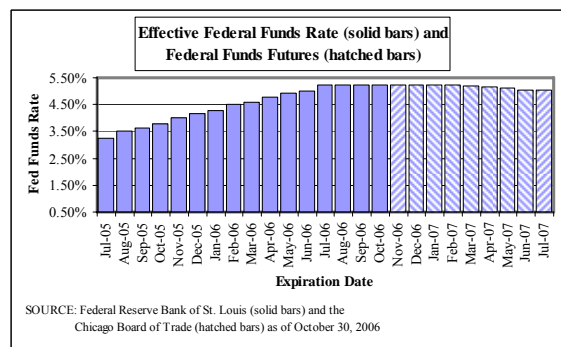
Sales of existing homes, a 6.180 million unit annual rate in September, were 1.9 percent below sales in August and 14.2 percent below September 2005. Median prices for existing homes also declined for the second consecutive month. After increasing 12.4 percent in 2005, prices in October dropped 2.2 percent compared to October 2005 — that decline follows the same drop between September 2005 and September 2006. According to Maury Harris of UBS, such year-over-year declines were the first since the third quarter of 1993. The National Association of Realtors’ Pending Home Sales Index increased 4.3 percent in August but was 14.1 percent below the index of August 2005, which confirms a significant slowdown in new and existing home sales. Sales of new single-family homes were up 5.3 percent in September compared to August’s sales but 14.2 percent below September 2005. Median prices of new home prices also showed signs of easing with the price of a new home decreasing from a high of \$257,000 in April to \$217,000 in September. The inventory of new homes for sale was up dramatically in September to a six month supply based on current sales rate. For the first nine months of this year, the average inventory of homes was also at a six month supply compared to a 4.3 month supply during the same period in 2005 and 3.9 month supply during the first half of 2004.



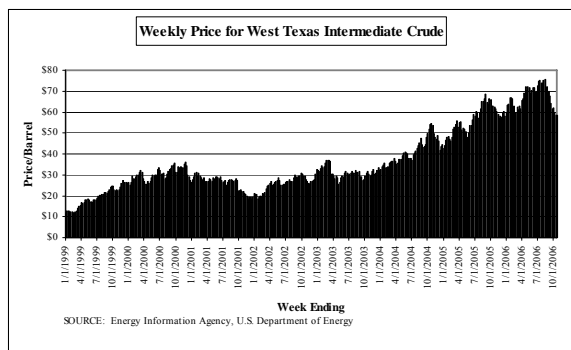
On October 25th, the Federal Open Market Committee (FOMC) of the Federal Reserve kept the target rate for federal funds at 5.25 percent. This was the third consecutive meeting in which the FOMC did not change the target rate. However, inflation remains the primary concern of the FOMC. In its press release, the FOMC stated that “readings on core inflation have been elevated, and the high level of resource utilization has the potential to sustain inflation pressures.” While the members of the Committee stated that inflation “seems likely to moderate over time”, they judged that some inflation risks remain.

As such the members of the FOMC await progress on inflation over the remainder of this year and into the first half of next year before the markets expect the decline in the target rate for federal funds. The Federal Funds Futures Market anticipates the next rate adjustment, most likely a 25 basis point cut in the target rate, no sooner than June of next year.

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 has remained above the Federal Reserve’s target range of 1.00-2.00 percent since April.



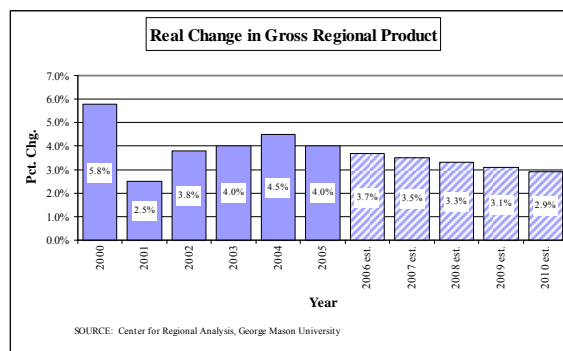
Because of the concerns expressed by the members of the FOMC about inflation and inflation expectations, their focus has been the pass through of energy costs into the core PCE. However, while oil prices averaged nearly \$73 a barrel during the peak summer period between Memorial Day and Labor Day weekends, the price for West Texas Intermediate (WTI) crude declined to \$59 a barrel for the week ending October 20 — a 19 percent decline. As such, the Energy Information Agency’s composite price of all grades of conventional gasoline decreased over 80 cents a gallon from its peak in early August to the week ending October 23rd.



As of October 27, the stock market experienced remarkable growth during the month. 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 of October 19, 1987. For the month, the DJIA was up 3.5 percent and 12.8 percent for the year, while the S&P 500 was up 3.1 percent for the month and 10.3 percent for the year. The NASDAQ experienced the biggest gain of the three indices for the month with an increase of 4.1 percent but up only 6.6 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 1.1 percent in August after increasing a modest 0.3 percent in July. For the twelve-month period ending in August, the leading index also declined 1.1 percent which suggests that the region’s economy is expected to experience a modest slowdown for the foreseeable future. “The Washington economy experienced a broad based decline that extended its slowing trend to a fourth month,” according to CRA. However, with energy prices declining, especially gasoline prices, and interest rates holding steady, consumers are expected to return to the market with stronger spending. With strong employment growth offsetting the uncertainty in the housing market, the

economy is expected to transition from one of expansion to one of (maturation) extending into 2007. As such, CRA expects the gross regional product to steadily decline from 3.7 percent in 2006 to 2.9 percent in 2010.

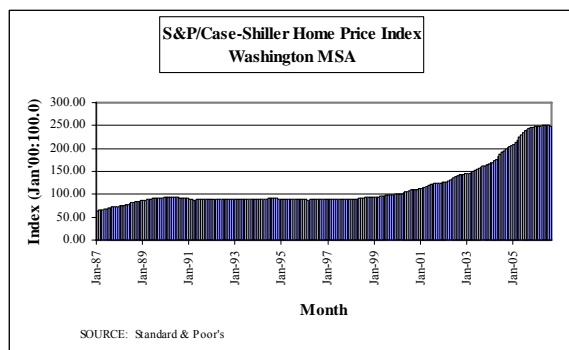


According to CRA, the region’s economy continued to generate new jobs in spite of rapidly rising energy prices and a slowdown in new home construction. The region added 72,200 jobs the past year (September 2005 over September 2006) and the unemployment rate stood at 3.0 percent in September.

For the twelve-month period ending in September, the Bethesda-Gaithersburg-Frederick metropolitan division added over 13,400 jobs during the same twelve-month period and experienced an unemployment rate of 2.7 percent in September, one of the lowest among the 34 most populous metropolitan divisions throughout the nation.

Home prices have weakened dramatically since August of last year. Based on the S&P/Case-Shiller® Home Price Index for the Washington region, prices in August decreased nearly 1.0 percent in one month. That decrease followed monthly declines of 0.3 in July and 0.1 percent in June. On a year-over-year basis, home prices increased only 2.5 percent, which was the smallest twelve-

month gain since May 1998, and the first time home prices declined three months in a row since December '96-February '97.



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 54.0 percent in PMI's fall 2006 report. The probability that home prices will decline in the B-G-F corridor is slightly more troubling at 54.6 percent. Both metropolitan divisions have a significantly greater probability compared to the Baltimore-Towson area which has a probability of 43.2 percent. *Note that PMI's percentage indicates the probability of a decline, not that prices will decline by 54 percent.*

MONTGOMERY COUNTY ECONOMIC INDICATORS

Montgomery County experienced mixed economic activity during the first nine months of this year. The primary reasons for the County's mixed performance were a continuation in the contraction of residential construction growth and in the decline of home sales.

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. Based on estimates derived by the Department of Finance, the County's businesses added 11,200 jobs to total payroll employment during the January-September period of this year. The County's unemployment rate of 2.7 percent remains one of the lowest in the State.

Residential construction activity in the County declined during the first nine months of 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 January-September period compared to the same period in 2005.

Home sales in the County declined nearly 24 percent during the January-September period compared to the same nine months in 2005. Although housing prices continued to increase, they have decelerated dramatically to a 6 percent increase compared to nearly 19 percent during the January-September 2005 period.

Employment Situation

Based on data derived by the Department of Finance, the County's total payroll employment grew by nearly 11,200 ($\uparrow 2.3\%$) during the first nine months of this year. 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 2.9 percent, or nearly 14,400, compared to the January-September period of 2005. With significant improvement in resident employment, the unemployment rate for the County remained well below the State's average. As of

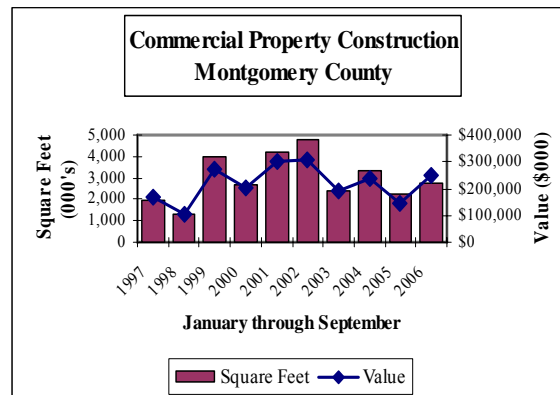
September, the County's rate at 2.7 percent was a full percentage point below the State's average of 3.7 percent and slightly below the region's 3.0 percent. The low unemployment rate also suggests that both the public and private sectors are providing a stable foundation against significant labor market volatility and that the County is close to full employment.

Construction Activity

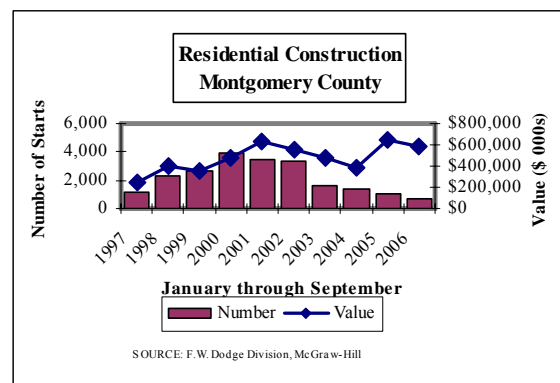
Construction activity in the County during the first nine months of this year was mixed. Construction of new homes continued to decline compared to January-September period in 2005. With home sales and homebuilding declining and price increases decelerating, the residential real estate market continued to experience a correction that began in September of last year.

While the number of non-residential construction projects was up 23.1 percent, the amount of square footage added through new construction decreased 14.0 percent during the first nine months of this year from 4.1 million square feet to 3.5 million square feet. The value of new construction also decreased by 4.6 percent.

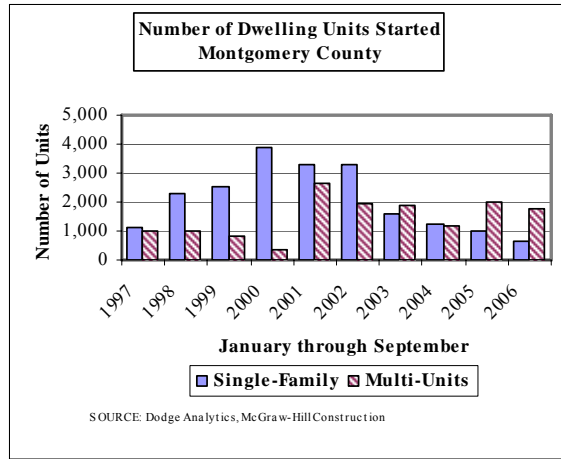
However, while overall non-residential activity declined during the January-September period, commercial construction, led by the office and banking sector, improved in 2006 to date. Additions of square footage were up nearly 24 percent and represented 79 percent (2.8 million square feet) of the added non-residential capacity. Office and bank building properties experienced the most dramatic turnaround in 2006. Additions to square footage were up over fifteen fold and the value added construction was up eight fold.



Because of the dramatic decline in existing home sales this year, construction of new residential properties decreased in response to the correction in the real estate market. Even with the mild fall weather, the number of new residential projects declined (↓32.7%) and the total value of new construction decreased over 10 percent.



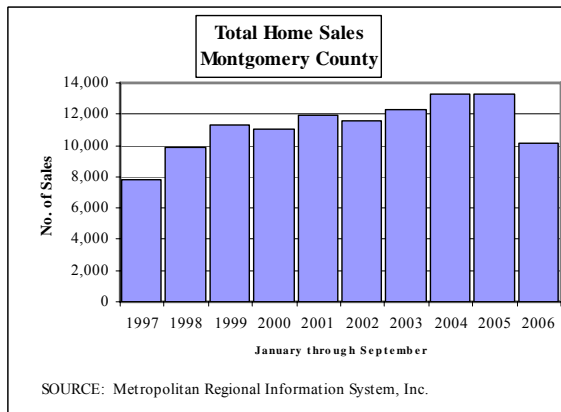
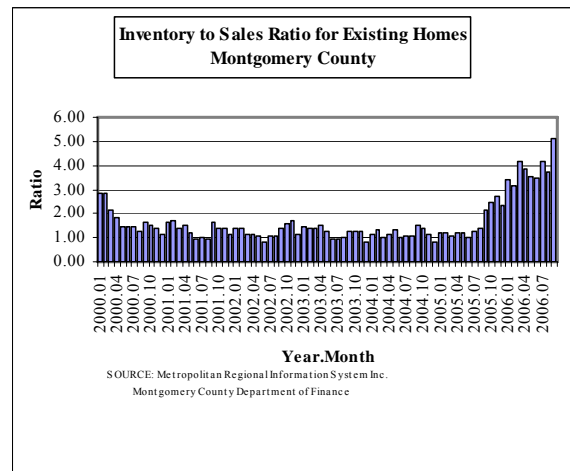
Based on data provided by McGraw-Hill Construction, the number of residential units built in the County totaled nearly 2,500, a decline of 18.7 percent from the January-September period of last year. The decline occurred in the construction of new single-family houses which dropped from 1,000 units during the first nine months of 2005 to 662 units during the same period this year, a decline of nearly 34 percent. The number of multi-family units also decreased from 2,018 units in 2005 to less than 1,800 units during the first nine months of this year (↓11.2%).



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 2004 and 2005. Such action may be attributed to an affordability issue or the potential buyer is anticipating a further deceleration or a decline in prices. As a result, even though thirty-year fixed rate mortgages have been below 6.5 percent since mid-August, potential home buyers are still anticipating further corrections in home prices and are sitting on the sidelines.

Residential Real Estate

The housing market in Montgomery County continued to experience a dramatic slowdown during the first nine months of this calendar year that began during the final quarter of 2005. During the January-September period, home sales declined 23.8 percent compared to the same period in 2005. However, average home prices were up 6.1 percent for the period compared to the first nine months of 2005.



Retail Sales

Using sales tax receipts as a measure of the level of retail sales for the County, sales of durable and nondurable goods were down 3.9 percent in August compared to August 2005 but up a meager 0.5 percent during the first eight 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 3.8 percent during this period while purchases of durable goods were down 4.9 percent.

The contraction in sales is reflected in the dramatic increase in inventory-to-sales ratio. Since August 2005, the ratio increased from 1.37 to 5.10 by September. This means that in August of 2005 for every home listed on the market, there was one buyer. By September of this year, for every

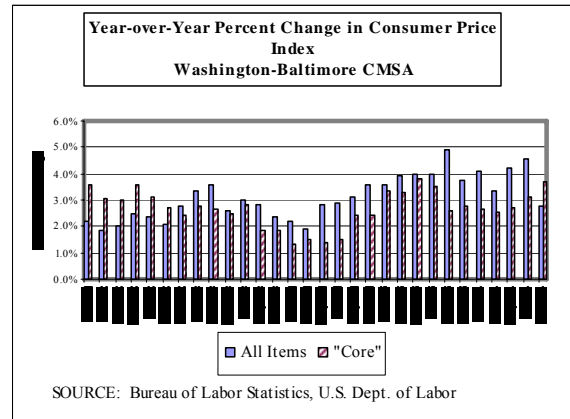
For the eight-month period, purchases of energy products (↑14.4%), apparel (↑3.7%), and general merchandise (↑2.8%) led sales

of nondurable goods. Purchases of building and industrial supplies (↑6.2%) were the only category of durable goods that experienced any significant increase during the eight-month period. Sales of furniture and appliances (↓21.2%) and hardware, machinery and equipment (↓0.5%) 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 2.8 percent over the twelve-month period ending in September. That rate was above the national average of 2.1 percent but the lowest year-over-year change since

March 2004. 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 2.9 percent for the nation.



SELECTED ECONOMIC INDICATORS	Reporting Period	Current Period	Prior Year's Period	Year To-Date		2005
				2006	2005	
Leading Indicators						
National	Sept	0.1%		1.5%		1.8%
Washington MSA	Aug	-1.1%		0.2%		-0.1%
Coincident Indicators						
National	Sept	0.0%		2.5%		1.5%
Washington MSA	Aug	-1.8%		0.1%		1.7%
Consumer Confidence Index						
National	Sept	4.3%		3.6%		1.1%
South Atlantic Region	Sept	1.7%		2.2%		2.7%
Consumer Sentiment (University of Michigan)	Aug	-3.2%		-7.2%		-5.8%
Consumer Price Index						
<u>All Items (nsa)</u>						
National	Sept	2.1%		3.7%		3.4%
Washington - Baltimore CMSA	Sept	2.8%		3.8%		4.0%
<u>Core CPI (nsa)</u>						
National	Sept	2.9%		2.5%		2.2%
Washington - Baltimore CMSA	Sept	3.7%		2.9%		3.2%
Retail Trade						
National (sales - nsa)	Sept	5.1%	7.2%	6.7%	7.2%	6.9%
Washington MSA (sales - nsa)	Aug	4.8%	9.1%	5.7%	6.5%	6.8%
Maryland (sales tax)	Aug	2.9%		6.3%		6.4%
Montgomery County (sales tax)	Aug	-0.8%		3.8%		5.0%
Employment						
National (labor force data - nsa)	Sept	145,010,000	142,579,000	143,973,000	141,401,000	141,730,000
- Percent Change		1.7%		1.8%		1.8%
Bethesda-Federick-Gaithersburg (establish.)	Sept	587,900	574,500	581,700	567,800	570,900
- Percent Change		2.3%		2.4%		0.9%
Montgomery County (labor force data)	Sept	508,521	494,129	505,591	490,115	491,801
- Percent Change		2.9%		3.2%		2.1%
Montgomery County (QCEW)	Mar	462,003	452,858	458,746	450,943	458,668
- Percent Change		2.0%		1.7%		2.2%
Unemployment						
National (nsa)	Sept	4.4%	4.8%	4.7%	5.2%	5.1%
Maryland (nsa)	Sept	3.7%	3.7%	3.9%	4.3%	4.1%
Montgomery County (nsa)	Sept	2.7%	2.8%	2.9%	3.2%	3.1%
Construction						
<u>Construction Starts - Montgomery County</u>						
Total (\$ thousands)	Sept	\$109,119	\$47,566	\$1,072,827	\$1,162,691	\$1,286,612
- Percent Change		129.4%		-7.7%		0.1%
Residential (\$ thousands)	Sept	\$74,271	\$42,676	\$585,548	\$651,836	\$742,279
- Percent Change		74.0%		-10.2%		9.6%
Non-Residential (\$ thousands)	Sept	\$34,848	\$4,890	\$487,279	\$510,855	\$544,333
- Percent Change		612.6%		-4.6%		-10.4%
<u>Building Permits (Residential)</u>						
National	Sept	133,636	191,304	1,476,897	1,655,520	2,147,617
- Percent Change		-30.1%		-10.8%		6.1%
Maryland	Sept	2,421	2,384	21,186	25,348	32,276
- Percent Change		1.6%		-16.4%		13.7%
Montgomery County	Sept	715	179	2,752	3,114	3,564
- Percent Change		299.4%		-11.6%		-6.2%
<u>Building Permits (Non-Residential)</u>						
Montgomery County	Sept	173	126	1,458	1,707	2,154
- Percent Change		37.3%		-14.6%		9.6%
Real Estate						
<u>National</u>						
Sales (saar)	Sept	6,180,000	7,200,000	6,580,000	7,100,000	7,075,000
- Percent Change		-14.2%		-7.3%		4.4%
Median Price	Sept	\$220,000	\$225,000	\$223,333	\$213,667	\$219,600
- Percent Change		-2.2%		4.5%		12.4%
<u>Montgomery County</u>						
Sales	Sept	996	1,415	10,104	13,253	17,011
- Percent Change		-29.6%		-23.8%		-4.2%
Average Price	Sept	\$517,823	\$510,053	\$530,029	\$504,910	\$507,340
- Percent Change		1.5%		5.0%		18.1%
Median Price	Sept	\$435,000	\$429,000	\$438,972	\$415,697	\$425,000
- Percent Change		1.4%		5.6%		19.7%
Average Days on the Market	Sept	67	27	52	25	25

NOTES:

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