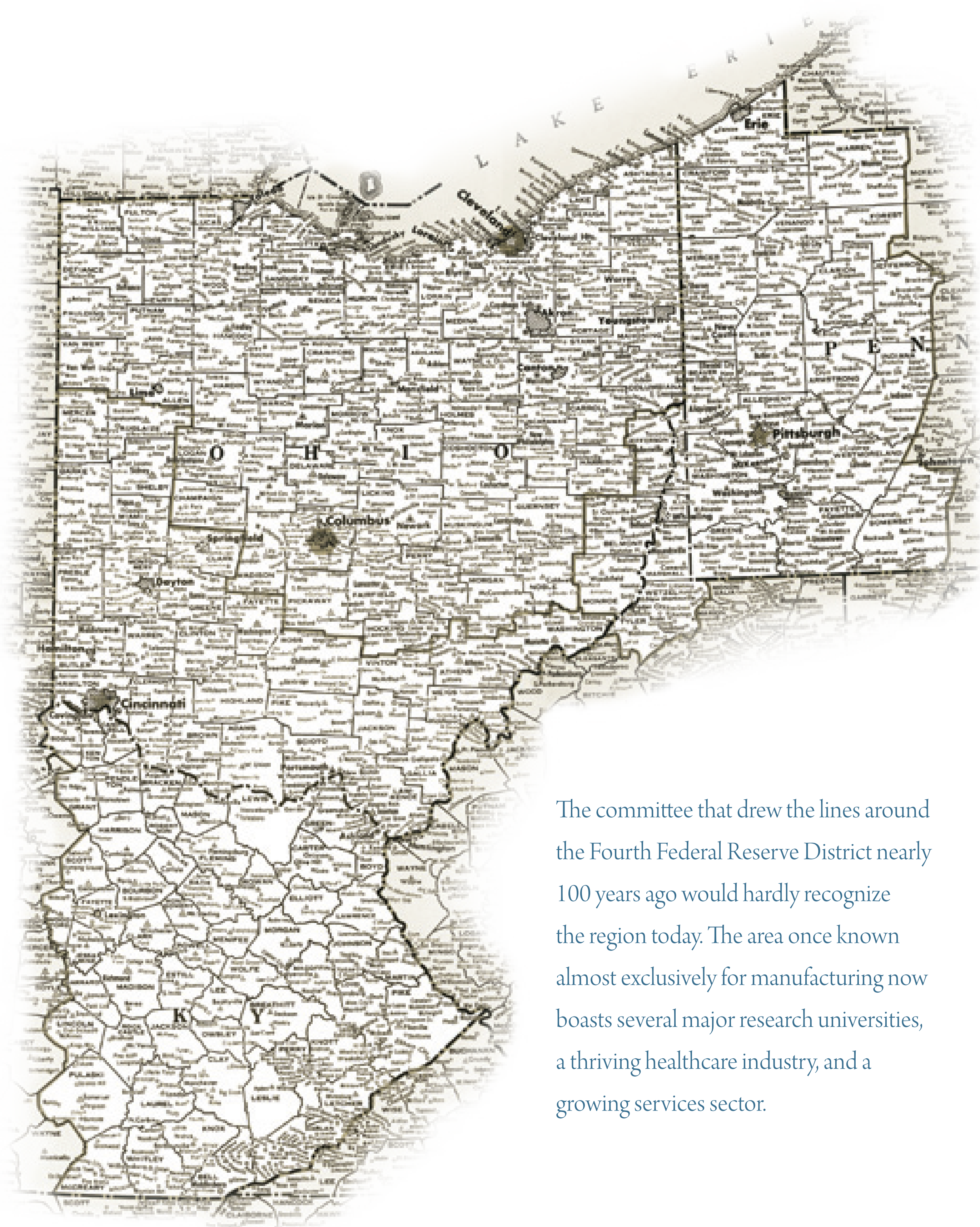



The committee that drew the lines around the Fourth Federal Reserve District nearly 100 years ago would hardly recognize the region today. The area once known almost exclusively for manufacturing now boasts several major research universities, a thriving healthcare industry, and a growing services sector.

# State of the **Fourth District**

**KEY POINTS**

The Fourth District's economy has tracked national trends fairly closely.

Some of the region's labor markets are doing well—especially in Pittsburgh and Columbus.

Most of the region's sectors should see continued growth in 2013.

The US economy expanded at a very modest pace in 2012. Output grew by 2.2 percent, unemployment declined by 0.7 percentage points to 7.8 percent, and inflation held slightly below 2 percent on a year-over-year basis. This was an uneven performance. In short, 2012 continued the stop-and-go progress of the country's economy since the Great Recession ended in 2009.

The Fourth District's post-recession progress looks a lot like the broader national recovery, with declines in unemployment, modest jobs growth, and an increase in real per capita income. Employment reports suggest that economic growth in the Fourth District slowed in the second half of the year, but some sectors did show strength. In fact, some Fourth District metropolitan areas outperformed the nation.

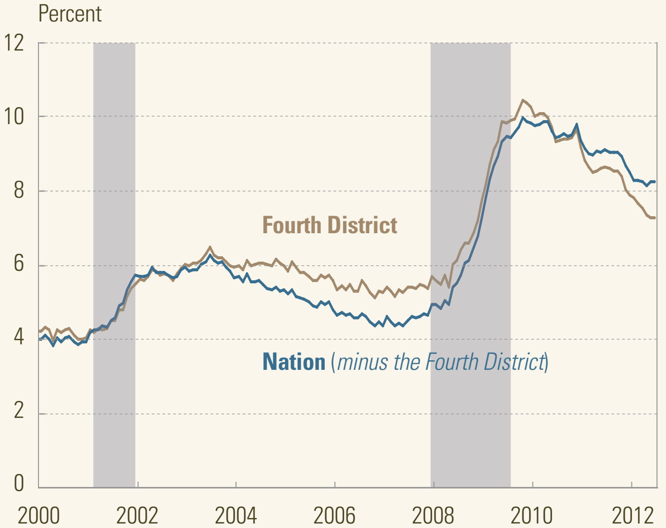
Our overall outlook as we head further into 2013 remains cautious. The Fourth District's economy continues to have the same stop-and-go feel as the nation's.

## Employment

The Fourth District's labor markets continued to make slow but steady progress during the recovery and in 2012. The unemployment rate was 7.2 percent at the end of 2012, a decline of 3 percentage points from its peak just after the end of the Great Recession. Notably, the region's unemployment rate declined more sharply than the nation's (see figure 1). At the same time, the region's employment growth throughout the recovery is slightly below that of the nation as a whole.

One place where the region's jobs market has especially underperformed the nation's is labor force growth. Among the 12 Federal Reserve districts, the Fourth District posted the second-weakest labor force growth in the recovery. In fact, the region's labor force has actually contracted since 2009, a trend especially evident in Ohio. The anemic labor force growth partly explains why the Fourth District's unemployment rates fell faster than the nation's, although the District's overall employment growth was modest. The District just hasn't needed to generate a high number of jobs in order to lower its unemployment rate because the flow of new workers and re-entrants into the labor force has not put significant upward pressure on the unemployment pool. The decline in the labor force is not present across all areas of the District; Pennsylvania and Kentucky have reported increases.

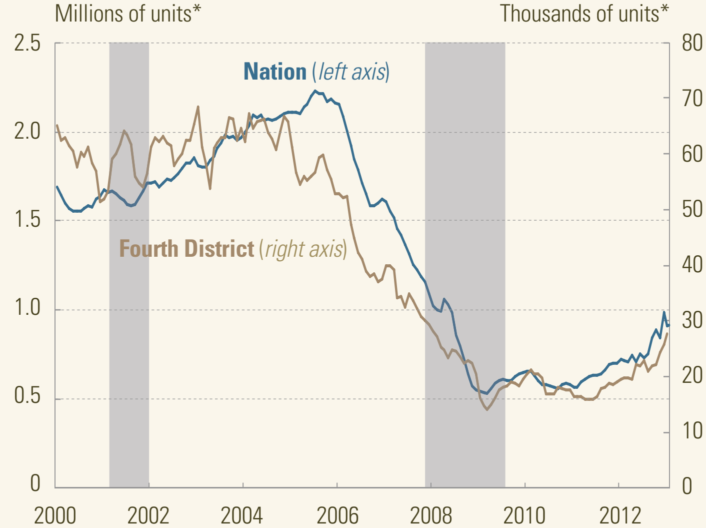
Figure 1. **The region's unemployment rate declined more sharply than the nation's...**




Source: Bureau of Labor Statistics.

Shaded bars in figures 1 and 2 indicate recessions.

Figure 2. **...and private-building permits saw an uptick on a year-over-year basis.**




*Seasonally adjusted annual rate.

Source: Census Bureau.

Over all, labor market performance varies widely across the District. The metropolitan areas of Columbus, Lexington, and Pittsburgh have outpaced the US as a whole in employment growth. Columbus and Pittsburgh rank in the top half of the 50 largest metropolitan areas in the country for employment growth since 2007. This pattern is not new—Columbus and Pittsburgh, university towns with strong service sectors and ample supplies of highly skilled labor, had seen relatively strong growth before the recession, and these trends appear to have been re-established during the recovery.

At the same time, the northeast Ohio metro areas of Akron, Cleveland, and Youngstown have reported slower-than-average employment growth. Their employment numbers remain between 3 percent and 6 percent below their pre-recession peaks. In part, this reflects the slower recovery of manufacturing employment in these manufacturing-heavy cities, which also affects nonmanufacturing-sector firms that provide services to manufacturers and their employees.

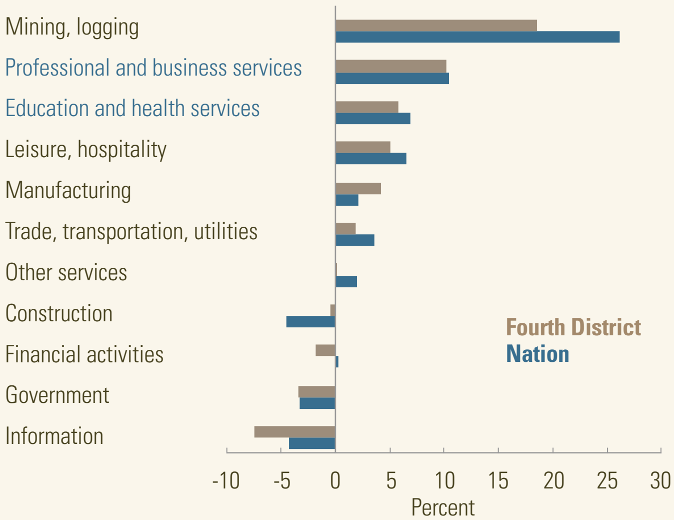
## Housing

The Fourth District's housing market began moving in a positive direction toward the latter half of 2012. Prices firmed, and many cities saw increased construction activity. Building permits finally saw an uptick on a year-over-year basis, the first in several years for many locales in the District, although the pace of improvement trails that of the nation overall (see figure 2).

Still, context is important. Building activity had been treading water at very low levels since 2009, nationally and in the Fourth District. The gains we are beginning to see remain modest, and hiring in the sector is sluggish.

Certainly, the short-term trends are moving in the right direction, buoyed by low interest rates. Household formation picked up, after declining sharply during the Great Recession, and income growth has been solid. That said, many Ohio locales are working through significant foreclosure backlogs, which are likely to dampen new construction activity in these markets.

Figure 3. **The region's services industries have grown markedly since the recovery...**




Note: Aggregate of Fourth District states' payrolls; growth from June 2009 to December 2012.

Source: Bureau of Labor Statistics.

Figure 4. **...and its educational attainment rate for 25- to 34-year-olds ranks seventh of 12 Fed districts.**


Source: American Community Survey (five year).

## Industry Developments

The Fourth District remains strong in manufacturing, even though manufacturing jobs grew only modestly in 2012. Pennsylvania showed slight employment expansions, while Ohio and especially Kentucky had stronger growth due primarily to gains in transportation equipment industries.

Today, the services industries make up the largest share of employment. Professional and business services, along with education and health services, have been key contributors to strength in local labor markets (see figure 3). In Columbus, for example, education and health care services have grown by almost 20 percent—or nearly 20,000 jobs—since the end of the recession, accounting for 40 percent of Columbus' employment growth over the recovery period. We also saw solid growth in education and health services in Pittsburgh, Lexington, and Cleveland.

Regional energy production has risen sharply higher in recent years, boosted by exploration and development of the Marcellus and Utica shale gas resources. Western Pennsylvania posted strong growth in natural resource employment. Ohio, whose shale gas activity is in an earlier stage than Pennsylvania's, has felt a less direct impact so far, but exploration and development are rising. The open question is how much more employment growth we can expect from shale gas developments. Analysts remain quite divided on the future economic impacts; the size of the employment spillovers will depend critically on whether oil- and gas-related industries will locate in the Fourth District and how much of the income created remains in local economies.

## The State of Human Capital

Growth prospects for any region depend heavily on workforce quality. On that front, the Fourth District faces some short-term challenges. Its human capital, as measured by the bachelor's degree attainment rate of its adult population, is relatively low; it ranks second-to-last of the 12 Reserve Bank Districts. Not surprisingly, the First (Boston) and Second (New York) Districts have the highest share of adults with four-year college degrees.

However, it's important to note that the differences across Districts reflect a range of factors that may not tell the whole story.

For example, the Fourth District fares a bit better in the educational attainment rate for younger working adults, those aged 25–34 (see figure 4). If a region's human capital is improving, we would expect to see larger impacts on its younger working cohort. In the Fourth District, we see highly skilled, younger workforces in metropolitan areas like Columbus and Pittsburgh. Indeed, the educational attainment of Pittsburgh's young working cohort ranks twelfth among the 100 largest US metropolitan areas. Such improvements in human capital bode well for longer-term growth in these areas—assuming they can retain their skilled workforces.

## The Year Ahead

The Fourth District's economy, like the nation's, is not yet hitting on all cylinders. The specter of uncertainty continues to threaten as we move through 2013. The Federal Reserve Bank of Cleveland's business contacts cite uncertainty over the US fiscal situation and global economic conditions as reasons for their diminished optimism about hiring plans compared with this time last year.

That said, the majority of our contacts still plan to expand their payrolls, or at least maintain their current employment levels, in 2013. In addition, improvements in local housing markets, the continued repair of Fourth District households' balanced sheets, and solid growth in real per capita income should support continued expansion of the Fourth District's economy in 2013.