

# THE NORTH CAROLINA ECONOMIC OUTLOOK

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## DEALING WITH EXCESSES AND SHORTAGES: CAN WE MANAGE?

Two major economic challenges emerged for North Carolina in 2007. The first, shared with most of the nation, was the excess supply which developed in the housing market and the consequent reductions in house price appreciation and new residential construction. House price appreciation, measured through repeat sales, fell to the low single digit rates, and residential construction, measured by permits, dropped almost 17% in 2007. Because the real estate and construction sectors are so large – including not only firms building and selling homes but also supportive activities in the finance, textile, machinery, furniture, and lumber markets – a retreat this large led to wider economy-wide weakness. All the major economic indicators for the state, including total employment, retail sales, and real wages, are expected to post noticeably poorer results in 2007 compared to 2006 (Table 1).

The second major economic challenge to North Carolina in 2007 was drought. The state experienced the largest rainfall deficit in recorded history, with most of the state's counties being in the most severe (exceptional) category of dryness. Estimates of losses to agricultural and green industry firms alone topped \$500 million. However, with conditions not improved by year's end, the adverse impacts spread to other sectors, and in some regions this condition could bring further curtailment of new construction and other economic activity.

Therefore, the economic forecasts for 2008 are downbeat. Economic activity is expected to be slower and unemployment is projected to rise. One bright spot is the forecasted milder reduction in residential construction. It's thought the housing market will move toward balance in 2008, and by the end of the year the sector should be positively contributing to economic growth.

But weather may be the most important focus for North Carolina in the new year. If the drought persists through the spring, leaving reservoirs and wells unfilled and stream flows low, more drastic conservation practices will need to be imposed. It's difficult to ascertain the economic impact of such a dire situation because these conditions have not prevailed in recent memory. Suffice it to say all the 2008 forecasts would be more negative, and the state would likely fall into a localized recession.

The economic transformation that has been on-going in the state will continue in 2008. Jobs continue to be shifted out of manufacturing to other sectors. Still, the state's manufacturing output has trended upward this decade due to the tremendous improvements in worker productivity. Fastest job growth will continue to be on the two ends of the education/wage scale – for high education/high wage professional positions, and for low education/low wage service positions. At the same time, middle income jobs are a declining share of the total employment market.

**TABLE 1. NORTH CAROLINA FORECASTS**

	2006	<b>2007 forecast</b>	<b>2008 forecast</b>
Employment, % change	3.4%	<b>1.0%</b>	<b>0.8%</b>
Unemploy. rt., Chg in % pts.	-0.4	<b>0.0</b>	<b>+0.3</b>
Real Retail Sales, % chg.	5.0%	<b>1.4%</b>	<b>1.2%</b>
Real Wages per Employ, % chg.	1.4%	<b>0.9%</b>	<b>0.7%</b>
Housing Permits, % chg.	2.1%	<b>-16.9%</b>	<b>-10.0%</b>

(see notes at end for definitions of the measures)

**REGIONAL FORECASTS**

**Advantage West** (Alleghany, Ashe, Avery, Buncombe, Burke, Caldwell, Cherokee, Clay, Graham, Haywood, Henderson, Jackson, McDowell, Macon, Madison, Mitchell, Polk, Rutherford, Swain, Transylvania, Watauga, Wilkes, and Yancey counties)

**TABLE 2. ADVANTAGE WEST FORECASTS**

	2006	<b>2007 forecast</b>	<b>2008 forecast</b>
Employment, % change	2.1%	<b>0.7%</b>	<b>0.6%</b>
Unemploy. rt., Chg in % pts.	-0.4	<b>-0.1</b>	<b>+0.2</b>
Real Retail Sales, % chg.	8.8%	<b>9.0%</b>	<b>4.0%</b>
Real Wages per Employ, % chg.	0.5%	<b>0.2%</b>	<b>0.2%</b>
Housing Permits, % chg.	1.7%	<b>-5.7%</b>	<b>-4.5%</b>

Led by robust retail sales growth, the Advantage West economy performed reasonably well in 2007 given the turbulence prevailing in the nation and state. The 9% increase in real retail sales was the strongest of any region and is reflective of the area's continuing strength as a vacation, retirement, and second home destination. The modest contraction in the housing market (the second smallest contraction among the regions) also contributed to the region's relatively good economic performance. Still, employment growth in 2007 was only one-third the rate of 2006.

Looking ahead to 2008, the region should post similar numbers with the exception of slower retail sales activity. However, sluggish job growth will catch up to the region and result in a rise in the Advantage West unemployment rate. Wisely, the region will continue efforts to diversify its economic base to include more technology and light manufacturing firms. Of course, to accomplish this goal will require greater access to higher education opportunities for the area's residents.

**Charlotte Region** (Alexander, Anson, Cabarrus, Catawba, Cleveland, Gaston, Iredell, Lincoln, Mecklenburg, Rowan, Stanley, and Union counties)

**TABLE 3: CHARLOTTE REGION FORECASTS**

	2006	2007 forecast	2008 forecast
Employment, % change	4.3%	<b>1.8%</b>	<b>2.0%</b>
Unemploy. rt., Chg in % pts.	-0.5	<b>+0.1</b>	<b>-0.2</b>
Real Retail Sales, % chg.	1.6%	<b>1.9%</b>	<b>2.3%</b>
Real Wages per Employ, % chg.	1.2%	<b>0.9%</b>	<b>1.0%</b>
Housing Permits, % chg.	14.2%	<b>-14.8%</b>	<b>-3.0%</b>

The housing crunch came to the Charlotte region in 2007. The area has had one of the strongest residential markets in the nation – as reflected by the 14% gain in residential construction in 2006. But in 2007, housing went in reverse, with residential permits declining almost 15%. As a result, the year's employment gains, while good for many regions at almost 2%, were sub-par for the Charlotte economy. Real wage growth was also lower in 2007 than in 2006.

But bucking the national trend, a modest rebound for the Charlotte regional economy is forecasted for 2008. The housing market should stabilize, real wage growth should improve, and hiring related to the region's growing biotech and health care sectors will put 2008's job growth rate slightly above 2007's level. On the negative side are

possible employment reductions in finance and associated fields related to rebalancing in the credit market. Long-run, the region retains many locational advantages for both households and firms, and the addition of a major biotechnology sector to the economy will broaden the local economic vitality. Public infrastructure and resource (water, energy) constraints will be the greatest future challenges.

**Piedmont Triad** (Alamance, Caswell, Davidson, Davie, Forsyth, Guilford, Montgomery, Randolph, Rockingham, Stokes, Surry, and Yadkin counties)

**TABLE 4. PIEDMONT TRIAD FORECASTS**

	2006	<b>2007 forecast</b>	<b>2008 forecast</b>
Employment, % change	2.3%	<b>0.8%</b>	<b>0.6%</b>
Unemploy. rt., Chg in % pts.	-0.4	<b>0.0</b>	<b>+0.2</b>
Real Retail Sales, % chg.	0.3%	<b>1.3%</b>	<b>1.1%</b>
Real Wages per Employ, % chg.	1.5%	<b>0.6%</b>	<b>0.4%</b>
Housing Permits, % chg.	-1.0%	<b>-20.3%</b>	<b>-6.5%</b>

With the exception of retail sales, economic activity was slower in the Piedmont Triad region in 2007. The most noticeable change was a 20% reduction in residential construction. Employment gains were under 1%, no improvement was made in the unemployment rate, and real wages increased at less than half their pace in 2006. One positive note was a slight rise in real retail sales growth.

The numbers are expected to be slightly more subdued in 2008. Jobs will be added, but not enough to keep pace with growth in the labor pool, so the unemployment rate will edge up. Real retail sales and real wages will both increase at low rates. And, the contraction in the housing market will continue, but – on the good news side – the declines will be at a much lower level.

Looking into the future, leaders in the Piedmont Triad region realize that to be successful, their economy needs to be remade. More than the other metropolitan area in the state, the Piedmont Triad economy developed around the traditional manufacturing sectors of tobacco, furniture, and textiles. With those industries now downsizing, the region is trying to retool with “new economy” sectors like technology manufacturing and air transportation. Access to higher education facilities, proximity to interstate highways, and a lower relative cost of doing business are the advantages the region is using to make this transition.

**Research Triangle** (Chatham, Durham, Franklin, Granville, Harnett, Johnston, Lee, Moore, Orange, Person, Vance, Wake, and Warren counties)

**TABLE 5. RESEARCH TRIANGLE FORECASTS**

	2006	<b>2007 forecast</b>	<b>2008 forecast</b>
Employment, % change	4.6%	<b>2.0%</b>	<b>1.9%</b>
Unemploy. rt., Chg in % pts.	-0.4	<b>-0.2</b>	<b>0.0</b>
Real Retail Sales, % chg.	6.1%	<b>5.6%</b>	<b>5.0%</b>
Real Wages per Employ, % chg.	2.4%	<b>1.1%</b>	<b>1.0%</b>
Housing Permits, % chg.	16.2%	<b>-7.3%</b>	<b>-6.5%</b>

The Research Triangle region had an “off” year in 2007. Job growth, the reduction in the unemployment rate, and real wage growth all came in at half of 2006’s numbers. The results in 2007 were still good, but they weren’t up to the region’s usual robust standards.

As in most regions, a big reason for the change was the decline in the housing market. For the first time in five years, regional residential construction took a dip. Granted, the reduction was modest by national standards, but the pullback was significant because – by one measure – the real estate and construction sector is the leading industry in the Research Triangle region.

The economic numbers should be similar in 2008, with enough growth to hold the unemployment rate steady. Residential housing will still slump, with most of the contraction occurring in the first half of the year. A big unknown is the effects of the drought, especially if it worsens in 2008. A severe reduction in water availability, leading to a widespread curtailment of work effort and reduced incomes, would deteriorate the economic projections for 2008 and potentially send the area into a regional recession.

**Southeast** (Bladen, Brunswick, Columbus, Cumberland, Hoke, New Hanover, Pender, Richmond, Robeson, Sampson, and Scotland counties)

**TABLE 6. SOUTHEAST FORECASTS**

	2006	<b>2007 forecast</b>	<b>2008 forecast</b>
Employment, % change	3.3%	<b>1.8%</b>	<b>1.3%</b>
Unemploy. rt., Chg in % pts.	-0.3	<b>-0.1</b>	<b>0.0</b>
Real Retail Sales, % chg.	7.2%	<b>-0.2%</b>	<b>0.5%</b>
Real Wages per Employ, % chg.	-0.2%	<b>0.8%</b>	<b>0.4%</b>
Housing Permits, % chg.	-22.8%	<b>-19.1%</b>	<b>-15.0%</b>

The Southeast regional economy has been rocked by the pullback in the residential housing sector. For the second year in a row, residential construction was down almost 20% in 2007. The housing crunch has taken its toll on the regional economy, with economic performance well below the norm for this traditional fast-growing area.

Unfortunately, more of the same is forecasted for 2008. The region enjoyed a booming housing market, particularly in 2003-2005, with big gains in construction and large run-ups in prices. Now the retreat is occurring, and it will persist for another year. Consequently, the economic numbers look modest for the upcoming year. One consolation is that the reduction in construction will moderate, signifying the beginning of balance returning to the market.

Despite these recent setbacks, the region's longer run outlook appears upbeat. The Southeast region will continue to attract retirees and second home buyers. But like its regional cousin in the west (Advantage West), local leaders would like to diversify the services-oriented job market by attracting targeted manufacturing and technology firms. To accomplish this goal will require a greater role for the University of North Carolina at Wilmington and the regional campuses of the Community College System.

**Eastern** (Carteret, Craven, Duplin, Edgecombe, Greene, Jones, Lenoir, Nash, Onslow, Pamlico, Pitt, Wayne, and Wilson counties)

**TABLE 7. EASTERN FORECASTS**

	2006	<b>2007 forecast</b>	<b>2008 forecast</b>
Employment, % change	2.9%	<b>1.8%</b>	<b>1.5%</b>
Unemploy. rt., Chg in % pts.	-0.5	<b>-0.2</b>	<b>0.2</b>
Real Retail Sales, % chg.	-2.7%	<b>1.5%</b>	<b>1.3%</b>
Real Wages per Employ, % chg.	-0.2%	<b>0.3%</b>	<b>0.7%</b>
Housing Permits, % chg.	-9.6%	<b>-3.1%</b>	<b>-2.5%</b>

Although economic growth in the Eastern regional economy moderated in 2007, the slowdown was much less pronounced than in the rest of North Carolina. One reason was the very slight dip in housing market activity. Housing permits fell only 3% during the year, after being off almost 10% in 2006. As a result, regional employment grew at the second fastest pace among the state’s regions, and the drop in the unemployment rate was tied for first for the regions.

2008 will see a slight step backwards in economic growth, with jobs growing less than 2007’s rate and the regional unemployment rate edging upward. However, the housing market will be virtually stable, and there will be stronger than average gains in real wages. Future growth will depend on using the region’s transportation, educational, and cost-competitive assets to upgrade workforce skills and attract “new economy” firms.

**Northeast** (Beaufort, Bertie, Camden, Chowan, Currituck, Dare, Gates, Halifax, Hertford, Hyde, Martin, Northampton, Pasquotank, Perquimans, Tyrrell, and Washington counties)

**TABLE 8. NORTHEAST FORECASTS**

	2006	<b>2007 forecast</b>	<b>2008 forecast</b>
Employment, % change	1.0%	<b>0.0%</b>	<b>-0.3%</b>
Unemploy. rt., Chg in % pts.	-0.2	<b>0.0</b>	<b>0.3</b>
Real Retail Sales, % chg.	5.4%	<b>2.3%</b>	<b>1.5%</b>
Real Wages per Employ, % chg.	0.3%	<b>0.7%</b>	<b>0.5%</b>
Housing Permits, % chg.	-29.4%	<b>-38.5%</b>	<b>-20.0%</b>

More than any other North Carolina region, the slump in the housing market has adversely affected the Northeast economy. After being off almost 30% in 2006, housing permits are expected to be down close to 40% in 2007. It should be no surprise, therefore, that the Northeast regional economy really struggled in 2007. In fact, no net employment occurred in the region during the year.

Unfortunately, more of the same is expected for 2008. There will be another 20% drop in housing permits. Employment will actually fall during the year, leading to an increase in the regional unemployment rate. Small gains will occur in real retail sales and real wages.

Nevertheless, the region still has attractive assets in its natural beauty, miles of oceanfront and freshwater shores, access to mid-Atlantic metropolitan markets, and room for development – especially in its inner banks areas. The housing market will eventually rebound, and with it so will the region. Regional leaders are also looking to build on relatively new industries, such as in the aviation sector.

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Measures and Sources

Employment: percentage change in household employment, from the Employment Security Commission of North Carolina

Unemployment rate: change in the regional unemployment rate (percentage points) from the Employment Security Commission of North Carolina

Real retail sales: percentage change in taxable retail sales, adjusted for retail inflation, from the North Carolina Department of Revenue and the U.S. Bureau of Labor Statistics

Real wages per employee: percentage change in wages per employee, adjusted for retail inflation, from the Employment Security Commission of North Carolina and the U.S. Bureau of Labor Statistics.

Housing permits: percentage change in residential housing permits from the U.S. Department of Commerce.