

SOUTHEAST VIRGINIA MARKET OUTLOOK

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JOB SITUATION

Southeast Virginia’s economy, which includes the Virginia Beach-Norfolk-Newport News metro area, is adding jobs at a modest pace (Chart 1). The region is getting back on its feet after Hurricane Matthew damaged more than 2,200 buildings in October 2016. Overall trade through the civilian port is rising, despite a large decrease in coal shipments, and this is benefitting rail and trucking businesses in the area. A number of current investments in port infrastructure will enable the region to stay competitive in attracting the Post-Panamax ships that are passing through the expanded Panama Canal. Finally, healthcare and financial services have been important job generators. By the end of 2016, payroll jobs were just shy of their pre-recession peak.

There are soft spots, however. Federal government employment is volatile while the local government’s budget problems are resulting in spending cuts. Total public sector payrolls, which account for 1 in 5 jobs in the region, are now down by about 6,200 from early 2012. Moreover, retail, leisure and hospitality shed jobs in the second half of 2016 and manufacturing continued its 10th consecutive quarter of job loss.

INCOME

Wage growth will likely rise a bit in 2017 as the unemployment rate declines to a cycle low of 4.4 percent and the labor market tightens. Nevertheless, over the next couple of years a number of challenges will keep income growth more subdued in Southeast Virginia than nationwide (Chart 2). The President’s proposed increase in defense spending would be good for local shipbuilders and naval personnel. However, federal government hiring and wages are unlikely to rise much. Another challenge is that manufacturing employment has been falling since 2014 and a major turnaround is unlikely soon, weakening a key source of high-wage employment. Also, even with moderate job growth in the area, much of the drive will come from tourism-related industries. Their low value-added nature will prevent a stronger rebound in wages and salaries. Longer-term, civilian

Chart 1
Job Growth, (% change, year ago)
& Unemployment Rate, (% SA)

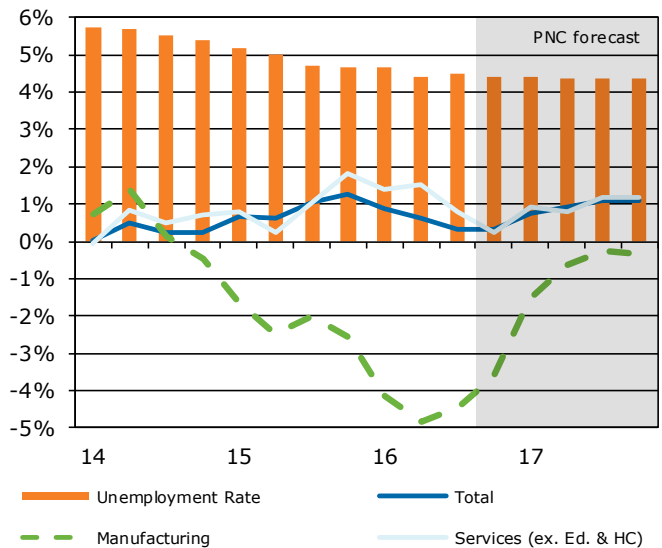


Chart sources: Bureau of Labor Statistics; The PNC Financial Services Group

Chart 2
Median Household Income (Ths. \$, SA)

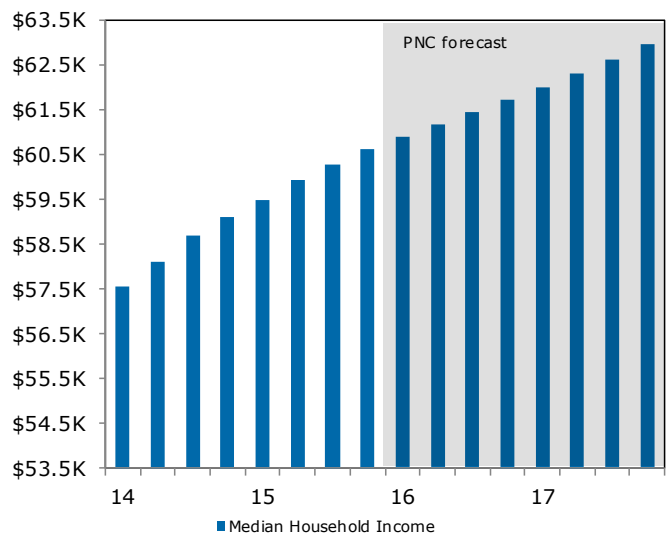


Chart sources: Bureau of Census; Moody’s Analytics; The PNC Financial Services Group



port activity will be an important income generator. Yet without well-paying cyclical industries such as high-tech firms that will support long-run jobs and income gains, the area will struggle to match the nation's rate of income growth. Weak long-run population growth will also be an impediment to attracting investment to the area. For now, both per capita income and living costs are about even with the U.S. The region's median household income is higher than the nation's but given the weaker long-term economic outlook, Southeast Virginia's advantage could diminish.

HOUSING

Both home prices and sales will rise moderately in 2017 (Chart 3). Housing is very affordable by historic comparisons and will likely remain so in the foreseeable future. Along with easier access to credit and low mortgage rates, this will encourage new housing demand. A key risk to the housing outlook is that the inventory of foreclosed properties will take longer to diminish than expected. Foreclosures have been declining more slowly than in the rest of Virginia or the U.S. Home price increases could disappoint if the foreclosure pipeline takes even longer than expected to clear. Looking further ahead, house price appreciation is likely to trail the U.S. average in the absence of a major economic or demographic spark.

DEMOGRAPHICS

Southeast Virginia's population growth lies close to the national average but could be driven lower by slow economic growth compared with larger metro areas that are less dependent on government employment (Chart 4). This would, in turn, erode the rate of economic growth generated by consumers in retail trade, healthcare, and leisure services. On average, younger military personnel and their families tend to be deployed and this cuts into the age bracket that drives population growth and consumption in the local economy. In recent years, in-migration from abroad has filled the deficit left by domestic out-migrants, but its sustainability depends on continued opportunities in low-wage industries that service the drivers of local growth such as government, trade, healthcare and education. In the medium-to-long term, household and population growth will follow government spending priorities and demand for tourism as the national economy continues to expand.

Chart 3
Home Sales (Ths., SAAR)
& Price Growth, (% change, year ago)

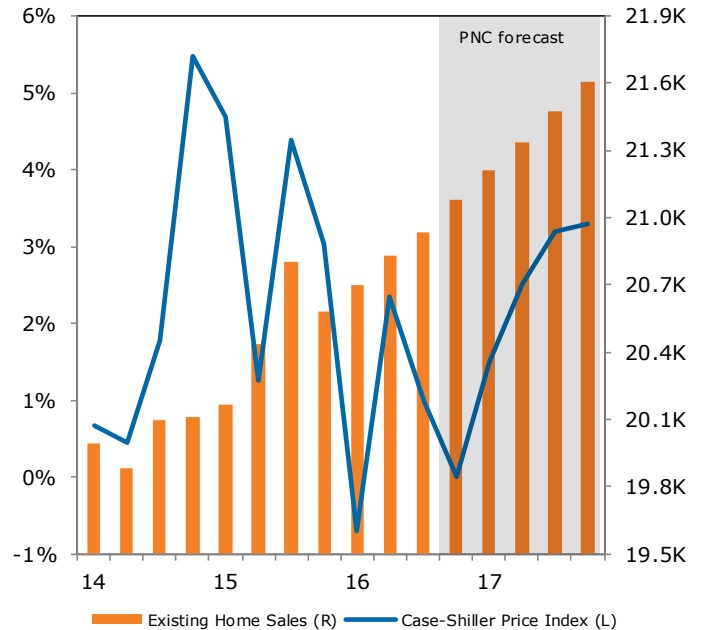


Chart sources: National Association of Realtors; Fiserv, Inc.; The PNC Financial Services Group

Chart 4
Demographic Growth, (% change, year ago)
& Net Migration, (Ths., SA)

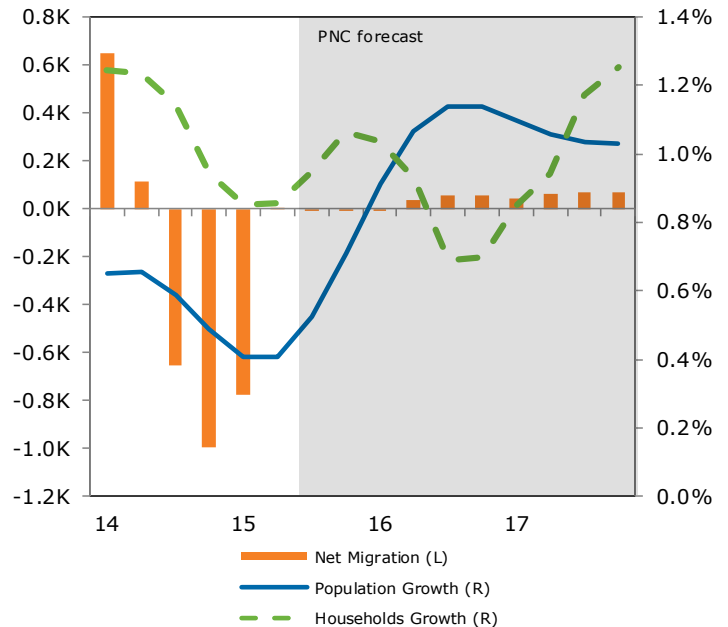


Chart sources: Bureau of Census; Bureau of Economic Analysis; Moody's Analytics; The PNC Financial Services Group

OUTLOOK SUMMARY

Southeast Virginia's economy will grow steadily and moderately. The worst of federal government austerity has passed but the outlook for spending is not yet clear. Defense spending is likely to increase and this would benefit local shipbuilders and defense personnel, especially the Navy (the branch with the largest presence in Southeast Virginia). However, civilian federal government employment or wages may not increase much as the White House and Congress attempt to offset increased defense outlays. This is a critical risk to the economic outlook, given that nearly one-half of all of Southeast Virginia output is tied to government spending. The private sector will likely fare better. Rising port activity will boost the region's logistics industry and support regional jobs and income growth. The U.S. economy's continued expansion and rising disposable income nationwide will support tourism, retail trade, leisure and hospitality services. Moderate increases in home prices will support household wealth and spending. One upside potential for the private sector is that infrastructure spending at the national level could increase over the next several years. This could boost demand for metallurgical coal, a key input of steel production and an important commodity that passes through Southeast Virginia's ports.

Over the long term, Southeast Virginia is likely to grow slower than the U.S. economy because of its weak population growth and a dearth of core industries that respond strongly to the macro business cycle. Manufacturing employment that had risen between 2011 and mid-2014 has since been contracting and will likely continue to do so over the long term. Construction, healthcare, professional and business services are likely to grow slowly. Trade and transportation are the bright spots in the long-term outlook. Container trade and transportation—demonstrated by the benefits from trade diverted from New York and New Jersey due to Hurricane Sandy in 2012—offer upside potential to the region's outlook, especially now that the expanded Panama Canal has become operational. Above all, fiscal sustainability is likely to become a priority in the future and an era of restrained growth in local and federal government employment could dull the local economy if it fails to diversify.

FORECAST TABLE

	U.S.			Southeast VA		
	2015	2016E	2017F	2015	2016E	2017F
Employment Growth, (% change)	2.1	1.8	1.5	0.9	0.5	1.0
Unemployment Rate, (%)	5.3	4.9	4.5	4.9	4.5	4.4
Median Household Income, (Ths. \$)	55.8	57.1	58.2	60.1	61.3	62.5
House Prices, (% change)	4.6	5.2	4.6	3.3	0.6	2.6
Single-Family Permits* (% change)	10.2	10.0	8.2	6.9	1.8	8.5
Multifamily Permits* (% change)	11.5	-0.9	6.6	38.4	12.5	-0.1

*E = Full year estimate, F = PNC forecast, *U.S. starts*

	U.S.		Southeast VA	
	2007-2012†	2012-2017†	2007-2012†	2012-2017†
Employment Growth, (% change)	-0.6	1.8	-0.7	0.8
Unemployment Rate, (%)	7.7	6.0	6.0	5.4
Median Household Income, (Ths. \$)	50.8	54.7	56.9	59.5
House Prices, (% change)	-4.8	6.1	-4.7	2.4
Single-Family Permits* (% change)	-12.3	9.6	-5.8	4.7
Multifamily Permits* (% change)	-4.2	11.1	3.5	10.4

*E = Full year estimate, F = PNC forecast, *U.S. starts, †per annum*

LONG-RUN EMPLOYMENT TRENDS

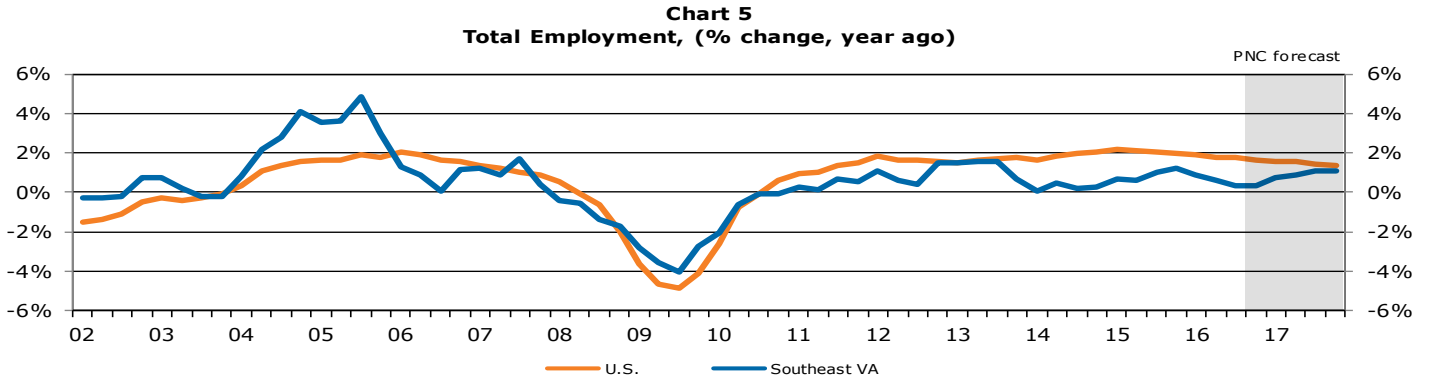


Chart sources: Bureau of Labor Statistics; The PNC Financial Services Group

LONG-RUN DEMOGRAPHIC TRENDS

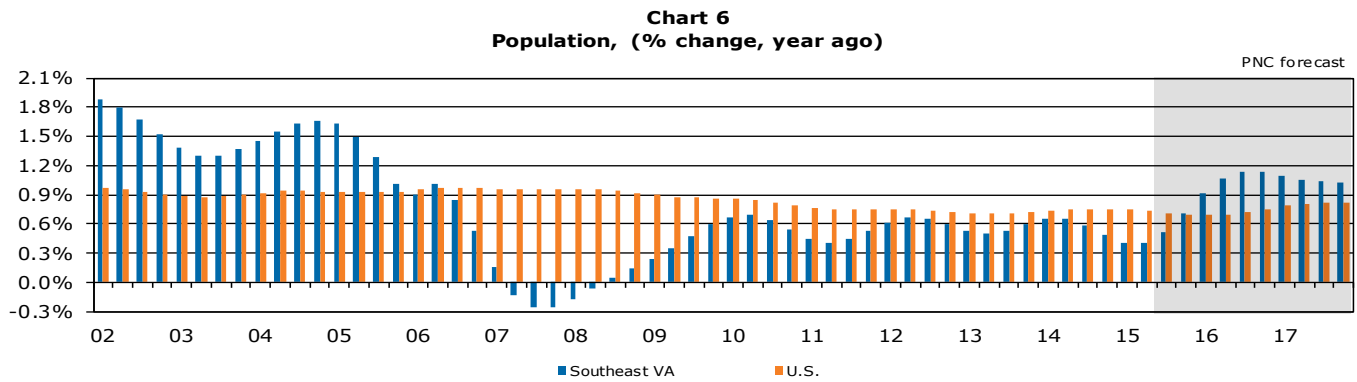


Chart sources: Bureau of Census; Moody's Analytics; The PNC Financial Services Group

LONG-RUN HOUSE-PRICE TRENDS

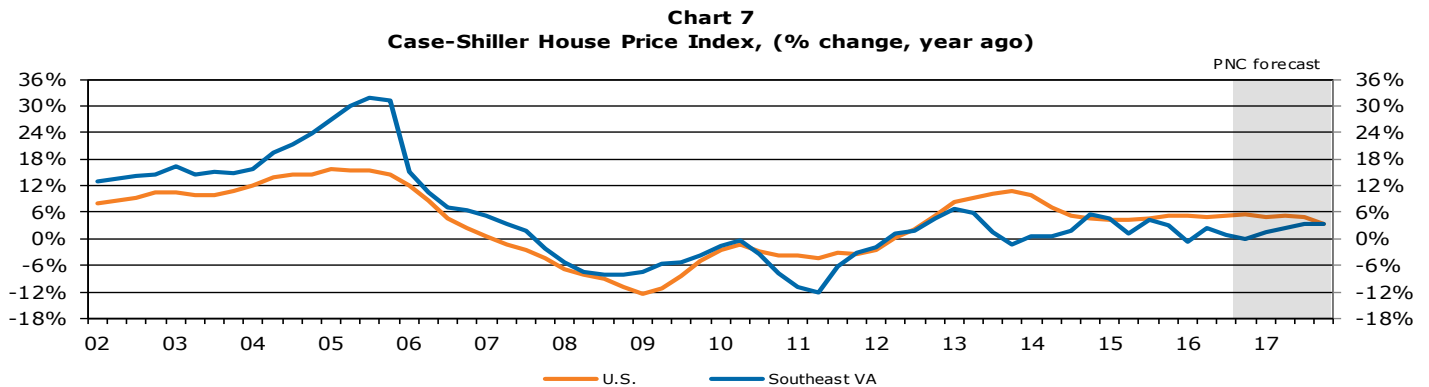


Chart source: National Association of Realtors; Fiserv, Inc.; The PNC Financial Services Group

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