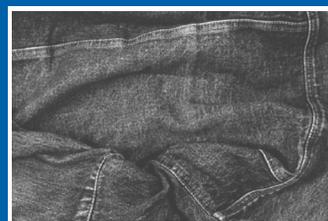


Economy Builds Steam in 2003

June 2003

THE THOMAS JEFFERSON INSTITUTE FOR PUBLIC POLICY
Virginia Economic Forecast:
2003-2004



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FOREWORD

The Thomas Jefferson Institute for Public Policy is proud to present its fourth annual report on the economy of the United States and Virginia. It is part of the foundation's efforts to offer well-researched studies for our leaders to assist them in better preparing for the future.

“Virginia Economic Forecast: 2003 – 2004” is made available to our state's elected leaders, business leaders and the media in order to assist them in better understanding the economic reality facing our state. This year's edition, titled *“Economy Builds Steam in 2003,”* suggests the country is no longer in recession and that Virginia will continue to slowly dig out of the economic downturn.

Last year's *Economic Forecast* predicted that the economy would slowly grow out of the recent recession. However, that slow growth has continued longer than predicted due to the uncertainties in the War on Terrorism and the recent military action in Iraq.

This year seems to be putting the recession behind us. And this year's *“Virginia Economic Forecast: 2003-2004”* believes that the second half of 2003 will see continued economic growth and that this will set the stage for continue growth during 2004.

This annual Economic Forecast is researched and written by Dr. Christine Chmura and her team of top-notch economists at Chmura Economics & Analytics in Richmond. Dr. Chmura opened this firm after serving as Chief Economist at Crestar Bank. This company has grown into a leading member of its industry. Twenty five years of experience is housed in this specialized economic consulting firm specializing in quantitative research, traditional economics and workforce and economic development.

We once again thank SunTrust for “sponsoring” this year's *“Virginia Economic Forecast: 2003 – 2004.”* Nothing in this report should be construed as supporting or opposing any legislation and is the opinion of the authors and not necessarily that of the Thomas Jefferson Institute, its Board of Directors, or SunTrust as the sponsor of this report.

Michael W. Thompson
Chairman and President
Thomas Jefferson Institute for Public Policy
June 2003

EXECUTIVE SUMMARY

Virginia Economic Forecast 2003-2004

Economy Builds Steam in 2003

In the Nation...

- The economic recovery building steam at the beginning of 2002 slowed to a crawl by the first quarter of 2003 as uncertainties about war in Iraq and threats for terrorist attacks in the United States gave businesses and consumers reasons to delay purchases. Now that the war in Iraq is essentially over, reduced uncertainties should hasten economic growth.
- The domestic economy is expected to slowly improve in the second half of 2003 before experiencing strong growth in 2004. Chmura Economics & Analytics' (CEA) 'most likely' forecast calls for modest real gross domestic product (GDP) growth of 2.0% in 2003 as uncertainties related to the war in Iraq dampen activity during the first two quarters of the year. Real consumer spending is expected to grow 1.8% in 2003, which increases to 2.7% growth in 2004.
- The Federal Open Market Committee (FOMC), the policy-making body of the Federal Reserve Board, continued implementing expansionary monetary policies in 2002 in an attempt to stimulate growth. As of May 2003, the federal funds rate target stood at 1.25%. The FOMC has indicated that it may resort to other monetary tools, such as pushing long-term interest rates lower if the economy remains sluggish in 2003.

In Virginia...

- Nonfarm employment, the broadest indicator of regional growth, fell slightly faster in Virginia than in the nation for the twelve months ending with February 2003. Virginia employment declined 0.3% over the last twelve months or by 11,536 jobs. National employment contracted by 0.2% over the same period.
- The contraction in Virginia's high-tech industries that began with the 2001 recession continued into 2002.
- From a regional perspective, the Lynchburg metropolitan area experienced a 2.3% employment decline in 2002 for the largest drop in Virginia. Contraction in employment in 2002 also occurred in the metro areas of Roanoke (-1.4%), Charlottesville (-1.3%), Danville (-1.2%), Northern Virginia (-0.6%), and Richmond-Petersburg (-0.5%). Hampton Roads, which grew 0.8%, was the only metro area to expand in 2002.
- The outlook for the Virginia economy over the next two years is in line with the national forecast, which anticipates modest growth in 2003 that builds into stronger growth during 2004. CEA expects nonfarm employment in Virginia to expand 0.9% in 2003 and 1.7% in 2004.

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Economy Builds Steam in 2003

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NATIONAL ECONOMY

The economic recovery building steam at the beginning of 2002 cooled to a crawl by the first quarter of 2003 as uncertainties about war in Iraq and the continued threats for terrorist attacks in the United States gave businesses and consumers reasons to delay purchases. Now that the war in Iraq is essentially over, the reduced uncertainty should promote economic growth. As indicated in the forecast below, however, risks remain on the side of slower-than-expected growth.

Emerging From Recession

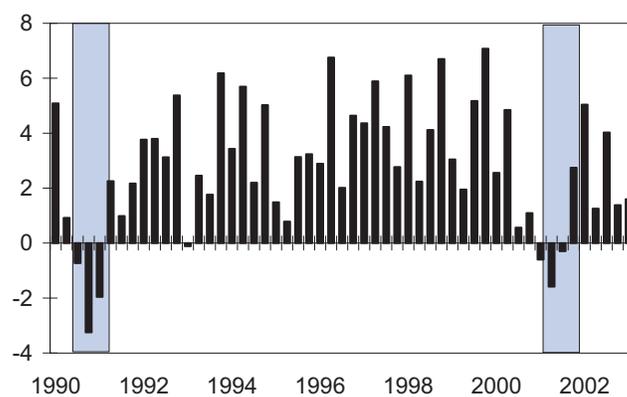
The U.S. economy entered into a recession in March 2001 according to the National Bureau of Economic Research (NBER), the official arbiter of recessions. Using the standard definition of recession, whereby real gross domestic product (GDP) is less than zero for at least two consecutive quarters, the recession ended after the third quarter of 2001. However, the NBER announced in April 2003 that it is not yet prepared to identify the end date of the recession. The NBER is delaying the announcement of the trough date for the following reasons:

According to the most recent data, the U.S. economy continues to experience growth in output and income without growth in employment. Though employment grew in January after several months' downturn, it declined substantially in February and March. Because of the behavior of employment, it remains our conclusion that additional time is needed to interpret the movements of the economy last year and this year. The NBER's Business Cycle Dating Committee will determine the date of a trough in activity when it concludes that a hypothetical subsequent downturn would be a separate recession, not a continuation of the past one. The trough date will mark the end of the recession. The committee will not issue any judgment about whether the economy has reached a trough until it makes its formal decision on this point. The com-

mittee waits for many months after an apparent trough to make its decision, because of data revisions and the possibility that the contraction would resume.¹

A Prolonged Recession?

Real Gross Domestic Product Quarterly Annualized Growth Rate



Source: U.S. Bureau of Economic Analysis. Recessions are shaded.

Real GDP contracted in each of the first three quarters of 2001 before resuming positive growth. Although quarterly data support assertions that the recession ended around October 2001, the NBER relies on monthly indicators such as employment, industrial production, personal income, and retail sales to determine the start and end dates of recessions. Absence of employment growth since late 2001 is one factor suggesting the recession may have continued. The recent decline in industrial production also supports contentions of a prolonged recession. In contrast, consumer spending and income growth suggest the recession ended in 2001.

In addition to employment, several sectors of the economy continue to contract, but at a slower rate than during the recession of 2001. Infla-

¹ <http://www.nber.org/cycles/recessions.html>, as of May 2003.

tion-adjusted business spending on investment in buildings, capital equipment, and software declined in the first quarter of 2003. It is not unusual for spending on expensive capital goods to remain sluggish for a few quarters after a recession ended. Recently, however, the reduction in business investment was compounded by the uncertainty associated with the escalation of events in Iraq and the eventual war between the United States and Iraq.

Over the last few years, consumer spending provided a consistent boost to the domestic economy while businesses were refusing to spend. Although the war in Iraq lowered measures in consumer confidence, the quick resolution to the Iraqi conflict minimized the affect of the war on consumer spending. The housing market was particularly strong as low mortgage rates supported home sales at a record pace in 2002.

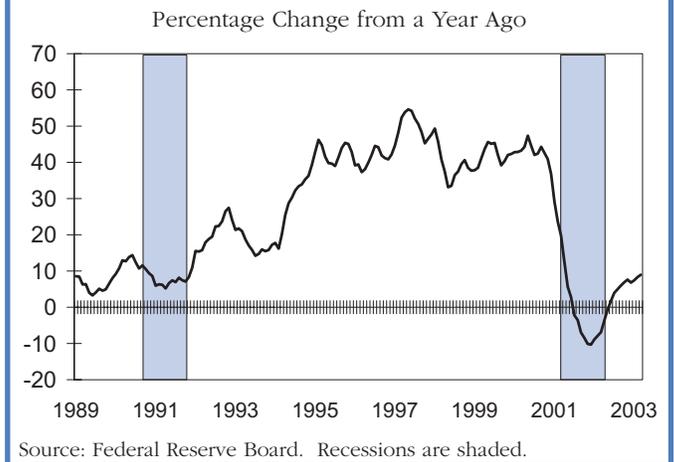
The Role of Technology

Spending on technology contributed to the depth and duration of the 2001 recession as well as its sluggish rebound. During the second half of the 1990s, high-tech consistently outperformed the rest of the economy. For example, the production of computers, communication equipment, and semiconductors expanded at a year-over-year pace of about 45% from 1995 through 1999. The tremendous growth exhibited by the technology sector preceded a dramatic decline in the second half of 2000.

Demand for technology equipment began to plummet just before the January 2001 start date of the last recession. At its lowest point in December 2001, the technology industry contracted at a year-over-year rate of 10.3%.

As the chart depicts, demand for technology equipment improved recently, and the industry expanded 9.0% in the twelve months ending with March 2003. Within the technology sector, production of communications equipment lagged overall growth with output contracting at a year-over-year rate of 9.6% in March 2003.

Production of Computers, Communications Equipment, and Semiconductors



Looking Ahead

With the war in Iraq coming to a swift conclusion, the domestic economy is expected to slowly improve in the second half of 2003 before experiencing strong growth in 2004. Our 'most likely' forecast for 2003 calls for 1.8% growth in real consumer spending in 2003, which is supported in the second half of the year by tax cuts.

Real residential investment spending looks to post strong 6.0% growth in 2003 as low interest rates and the lack of attractive alternative investments provide demand for new homes. Further, when viewing residential activity as the number of single-family homes built, it is evident that housing peaked in December 2002 when a record 1.076 MUAR (million units annualized rate) new homes were sold. Although the housing market remains strong in early 2003, the high level of sales is expected to show a modest 2.6% growth over the year.

Real GDP is forecast to grow a modest 2.0% in 2003 as uncertainties related to the war in Iraq dampen growth during the first two quarters of the year. Real GDP is expected to advance at a 2.5% annualized pace in the third quarter and 3.6% in the fourth quarter.

Although second quarter data for real GDP will not be released until July, the advance release for the first quarter of 2003 estimates that real GDP grew at an annualized rate of 1.6%. With

war worries on their minds, consumers spent less on expensive durable goods, causing real personal consumption expenditures to grow at a modest 1.4% annualized rate. The uncertainty surrounding the war in Iraq continued to show up in business investment decisions. The advance figures for first quarter also indicate real non-residential investment declined at a 4.2% annualized pace. Further deceleration in investment spending is expected to dampen GDP in the second quarter of 2003. By the second half of the year, however, consumers and businesses are expected to loosen their purse strings.

Monetary Policy

The Federal Open Market Committee (FOMC), the policy-making body of the Federal Reserve Board, continued implementing expansionary monetary policies in 2002 in an attempt to stimulate growth. The FOMC lowered the targeted federal funds rate by 50 basis points (half a percentage point) over the course of the year. As of

May 2003, the federal funds rate target stood at 1.25%.

With the federal funds target at such a low rate, the FOMC does not have much more leeway in using this instrument to stimulate the economy. Experience abroad suggests that the federal funds rate cannot drop below 0.25% before impairing the functioning of money markets and the banking system. For that reason, the FOMC has indicated that it may resort to other monetary tools, such as pushing long-term interest rates lower if the economy remains sluggish in 2003.

The Possibility of a Double Dip

History indicates that an economy is susceptible to dipping back into recession during its recovery stage.² Consumer spending, the strong leg of the economy throughout the last recession,

² The recovery stage of a business cycle encompasses the period after the recession ends through the time it takes to grow back to the level when the recession started.

National Forecast Summary

| | Actual | Forecast: | | | Forecast: | | |
|--|--|-----------|--------|-------------|-----------|------------|--------|
| | 2000 | 2001 | 2002 | Most Likely | 2004 | Double-Dip | 2004 |
| | Change From a Year Ago (%) | | | | | | |
| Real Gross Domestic Product | 4.1 | 0.3 | 2.5 | 2.0 | 3.5 | 1.0 | 2.4 |
| Consumption Expenditures | 4.8 | 2.5 | 3.1 | 1.8 | 2.7 | 1.0 | 2.1 |
| Residential Investment | 0.8 | 0.3 | 3.9 | 6.0 | 2.6 | 5.1 | 1.7 |
| Nonresidential Investment | 9.9 | -5.2 | -5.7 | -0.6 | 11.2 | -2.8 | 5.1 |
| Equipment and Software | 11.1 | -6.4 | -1.7 | 2.2 | 11.8 | 0.6 | 8.0 |
| Government Expenditures | 2.7 | 3.7 | 4.4 | 3.3 | 2.1 | 3.3 | 2.1 |
| | Trade Deficit (Billions of Dollars) | | | | | | |
| Net Exports, Goods & Services | -398.6 | -415.3 | -487.8 | -490.7 | -514.4 | -486.6 | -505.1 |
| | Change From a Year Ago (%) | | | | | | |
| Consumer Price Index | 3.4 | 1.9 | 2.2 | 2.4 | 2.1 | 2.7 | 1.9 |
| | Yields (%) | | | | | | |
| Federal Funds Rate | 6.2 | 3.9 | 1.7 | 1.7 | 2.4 | 1.6 | 1.9 |
| Prime Rate | 9.2 | 6.9 | 4.7 | 4.7 | 5.4 | 4.6 | 4.9 |
| 10-Year Treasury | 6.0 | 5.0 | 4.6 | 4.1 | 5.5 | 3.9 | 4.8 |
| 30-Year Conventional Mortgage | 8.1 | 7.0 | 6.5 | 6.1 | 6.7 | 5.9 | 5.9 |

VIRGINIA ECONOMY

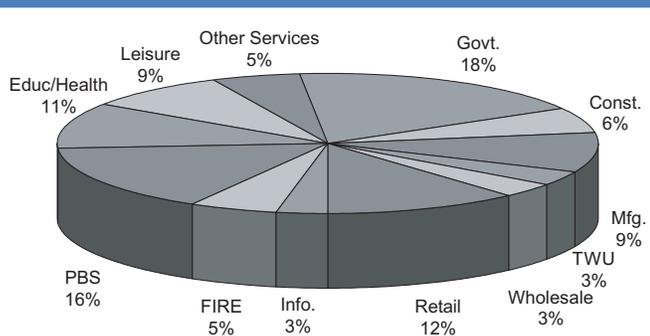
Virginia is an economically diverse state. High-tech services dominate Northern Virginia's economy; financial services lead the way in Richmond-Petersburg; the defense industry differentiates Hampton Roads; traditional manufacturing characterizes the western regions of Roanoke, Lynchburg, Danville, and Bristol; and Charlottesville is concentrated in state government jobs (University of Virginia).

Historically, Virginia's employment mix has resembled that of the nation with several significant differences. However, a brief knowledge gap characterizes any comparison between employment in Virginia and the nation until mid-2003. The reasons for the gap involve the U.S. Department of Labor processes for transitioning the reporting of economic data from the Standard Industrial Classification (SIC) system to the North American Industrial Classification System (NAICS). As of May 2003, Virginia's employment data are accessible by the new NAICS codes, but employment for the United States is only available by the former SIC codes.

The previous chart shows Virginia's employment composition under the new classification structure. With Virginia's proximity to the nation's capital, it is not surprising that the government sector, including state, local, and federal employees, accounts for the greatest percentage of employment in the state. Next to the government sector, professional business services (PBS) and retail trade employ the most workers.

The December 2002 employment breakdown by SIC industries for the state is also presented to demonstrate some of the changes resulting from the data conversion. One of the most noticeable changes in the classification of industries occurs in services. Under SIC codes, the services sector accounted for 33 % of the total employment in the state. NAICS separates the old services sector into eight new sectors. In Virginia, professional and business services (16%), education and health (11%), and leisure (9%) are all splinter groupings of the SIC services industry.

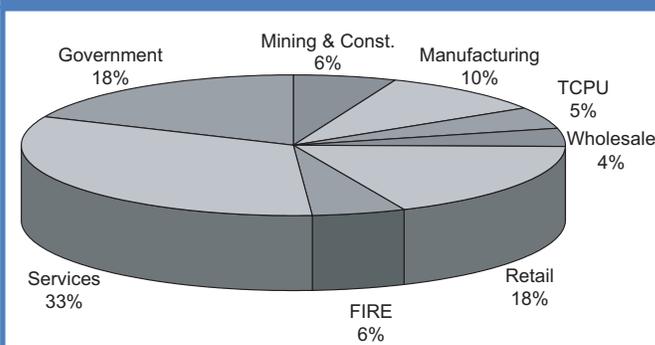
Virginia Nonfarm Employment Under NAICS, February 2003



Source: Virginia Employment Commission.

Upon completion of industry classification conversions, NAICS will allow enhanced analysis of the national and state economy. Under NAICS, industries are defined using a consistent production-based philosophy while greater representation is given to the growing number of businesses engaged in service-producing fields.

Virginia Employment Under SIC December 2002



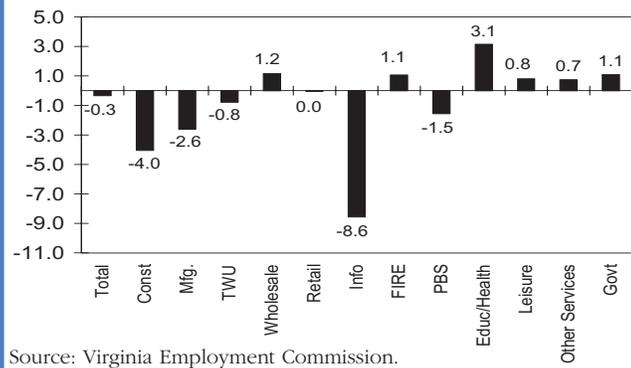
Source: Virginia Employment Commission.

Last Year's Growth

Nonfarm employment, the broadest indicator of regional growth, fell slightly faster in Virginia than in the nation for the twelve months ending with

February 2003. Virginia employment declined 0.3% over the last twelve months or by 11,536 jobs. National employment contracted by 0.2% over the same period.

Virginia Employment Growth by Sector Percentage Change From a Year Ago February 2003



With the transition to NAICS, Virginia employment is now classified under 12 major industries, versus 10 major industries under the previous classification system. Employment growth in Virginia was mixed last year with six of the twelve major sectors expanding, four contracting, and one experiencing no change in employment. Here again, as a result of the conversion to NAICS, industry-specific information is not currently available for comparisons to the nation.

The new information sector accounted for the largest employment decline in Virginia in terms of both percentage change and in the number of jobs lost. Information employment¹ fell 8.6%, or by 9,413 jobs, over the twelve months ending with February 2003. Within the information sector, the telecommunications industry accounted for roughly two-thirds of the jobs lost. In addition, over 8,000 of the information sector job losses were in Northern Virginia.

Other industries afflicted by substantial reductions in employment over the year ending with February 2003 include construction (-4.0%); manufacturing (-2.6%); professional and business services

(PBS, -1.5%); and transportation, warehousing and utilities (TWU, -0.8%). The largest job loss among these industries occurred in construction, which contracted by 8,707 workers for the year ending February 2003. Although the losses in construction were widespread throughout the state, the largest number of layoffs occurred in Northern Virginia. (About 37% of the state's construction workers are located in Northern Virginia.) The manufacturing sector and the professional and business services sector each registered job declines in excess of 8,000.

Of the six sectors that experienced positive employment growth over the past year, the education and health sector saw the largest gain. Education and health grew by 11,271 jobs or 3.1% for the twelve months ending with February 2003. Combined, the metro areas of Northern Virginia, Hampton Roads, and Richmond-Petersburg accounted for 84% of this sector's employment growth.

Sectors exhibiting modest employment growth were wholesale trade; finance, insurance, and real

Top 20 Employers, Third Quarter 2002 Greater Than 5,000 Employees

1. U.S. Department of Defense
2. WalMart Associates, Inc.
3. Fairfax County Public Schools
4. Food Lion, Inc.
5. Newport News Shipbuilding, Inc.
6. U.S. Postal Service
7. County of Fairfax
8. Sentara Health System
9. Capital One Service, Inc.
10. City of Virginia Beach School Board
11. Virginia Department of Transportation
12. INOVA Health System
13. University of Virginia
14. Science Applicants International Corp.
15. Prince William County School Board
16. Virginia Polytechnic Institute & State University
17. First Union National Bank
18. Southland Corporation
19. Bank of America
20. Chesterfield County School Board

¹ The information sector is comprised of companies engaged in the following processes: producing and distributing information and cultural products, providing the means to transmit or distribute these products as well as data or communications, and processing data.

estate (FIRE); and government. The government sector added nearly 7,000 jobs to its payrolls, with most of the jobs appearing at the local government level.

Technology in Virginia

The contraction in Virginia's high-tech industries that began with the 2001 recession continued into 2002. The high-tech sector, which is composed of manufacturing, services, and communications² firms shown in the table below, performed far worse than total employment in Virginia. High-tech employment fell an alarming

8.1% in the state during the four quarters ending with the third quarter of 2002 while overall employment in the state fell only 1.9%.

The computer and data processing industry (SIC 737) is the largest high-tech employer in the state. Employment in this industry fell by 8.1%, or by 11,481 jobs, for the four quarters ending with September 2002. Substantial employment losses also occurred in industries manufacturing

² The data used to calculate high-tech employment have not yet been converted from SIC to NAICS codes. Under the SIC system, manufacturing firms begin with a 2 or 3 SIC code, services firms begin with a 7 or 8 SIC, and communications firms begin with a 4 SIC. SIC 283, for example, represents the manufacture of drugs while SIC 737 denotes services related to computer and data processing.

High-Technology Growth in Virginia

| SIC | Industry | Employment | | | | Wages and Salaries Thousands of Dollars* | | | |
|---|--|------------------|------------------|----------------|-------------|---|------------------|-----------------|-------------|
| | | 2001Q3 | 2002Q3 | Change | % Change | 2001Q3 | 2002Q3 | Change | % Change |
| Total Employment ** | | 3,429,848 | 3,363,664 | -66,184 | -1.9 | 30,265 | 30,924 | 659 | 2.2 |
| Total High Technology | | 327,273 | 300,806 | -26,467 | -8.1 | 5,345 | 4,968 | -376 | -7.0 |
| 131 | Crude petroleum and natural gas | 245 | 208 | -37 | -15.0 | 4,131 | 3,839 | -292 | -7.1 |
| 281 | Industrial inorganic chemicals | 686 | 607 | -79 | -11.6 | 9,629 | 8,520 | -1,109 | -11.5 |
| 282 | Plastic materials and synthetics | 8,673 | 8,270 | -403 | -4.6 | 117,912 | 112,832 | -5,079 | -4.3 |
| 285 | Paint and allied products | 899 | 846 | -53 | -5.9 | 9,586 | 9,585 | -1 | 0.0 |
| 287 | Agricultural chemicals | 380 | 369 | -11 | -2.9 | 2,689 | 2,824 | 135 | 5.0 |
| 289 | Miscellaneous chemical products | 2,496 | 2,365 | -131 | -5.2 | 29,051 | 28,274 | -777 | -2.7 |
| 291 | Petroleum refining | 210 | 235 | 25 | 11.7 | 4,253 | 5,639 | 1,385 | 32.6 |
| 348 | Ordnance and accessories | N.A. | N.A. | N.A. | N.A. | N.A. | N.A. | N.A. | N.A. |
| 351 | Engines and turbines | 792 | 811 | 19 | 2.4 | 13,746 | 14,098 | 352 | 2.6 |
| 355 | Special industrial machinery | 2,700 | 2,428 | -272 | -10.1 | 27,055 | 25,976 | -1,079 | -4.0 |
| 356 | General industrial machinery | 3,014 | 2,811 | -203 | -6.7 | 30,181 | 32,302 | 2,120 | 7.0 |
| 361 | Electric distribution equipment | 2,184 | 2,049 | -135 | -6.2 | 21,590 | 20,427 | -1,163 | -5.4 |
| 362 | Electrical industrial apparatus | 3,505 | 3,461 | -44 | -1.3 | 41,622 | 39,554 | -2,068 | -5.0 |
| 365 | Household audio and video equipment | 1,165 | 1,509 | 344 | 29.6 | 7,713 | 9,412 | 1,699 | 22.0 |
| 369 | Miscellaneous electrical machinery | 530 | 535 | 5 | 0.9 | 3,712 | 3,842 | 130 | 3.5 |
| 384 | Medical equipment, instruments, and supplies | 2,141 | 1,801 | -340 | -15.9 | 17,028 | 15,068 | -1,960 | -11.5 |
| 481 | Telephone communications | 47,409 | 38,808 | -8,601 | -18.1 | 786,076 | 650,742 | -135,333 | -17.2 |
| 871 | Engineering and architectural services | 52,148 | 52,426 | 278 | 0.5 | 725,781 | 791,099 | 65,318 | 9.0 |
| High-Technology Intensive Subgroup | | 198,043 | 181,191 | -16,852 | -8.5 | 3,492,608 | 3,193,672 | -298,936 | -8.6 |
| 283 | Drugs | 3,803 | 3,918 | 115 | 3.0 | 55,283 | 54,471 | -812 | -1.5 |
| 286 | Industrial organic chemicals | 1,266 | 1,253 | -13 | -1.0 | 19,355 | 19,177 | -178 | -0.9 |
| 357 | Computers and office equipment | 4,461 | 2,888 | -1,573 | -35.3 | 40,423 | 31,001 | -9,422 | -23.3 |
| 366 | Communications equipment | 5,086 | 3,013 | -2,073 | -40.8 | 70,425 | 40,821 | -29,604 | -42.0 |
| 367 | Electronic components and accessories | 8,897 | 6,761 | -2,136 | -24.0 | 104,528 | 77,313 | -27,215 | -26.0 |
| 372 | Aerospace | 1,999 | 1,977 | -22 | -1.1 | 28,056 | 29,583 | 1,527 | 5.4 |
| 376 | Guided missiles, space vehicles, parts | 2,583 | 2,500 | -83 | -3.2 | 36,187 | 40,080 | 3,893 | 10.8 |
| 381 | Search and navigation equipment | 3,601 | 3,516 | -85 | -2.4 | 52,345 | 52,731 | 386 | 0.7 |
| 382 | Measuring and controlling devices | 3,616 | 3,500 | -116 | -3.2 | 45,231 | 48,638 | 3,407 | 7.5 |
| 386 | Photographic equipment and supplies | 557 | 476 | -81 | -14.6 | 3,954 | 3,746 | -208 | -5.3 |
| 737 | Computer and data processing services | 142,577 | 131,096 | -11,481 | -8.1 | 2,741,801 | 2,475,522 | -266,278 | -9.7 |
| 873 | Research, development, and testing services | 19,598 | 20,293 | 695 | 3.5 | 295,020 | 320,590 | 25,570 | 8.7 |

Source: Chmura Economics & Analytics and Virginia Employment Commission.

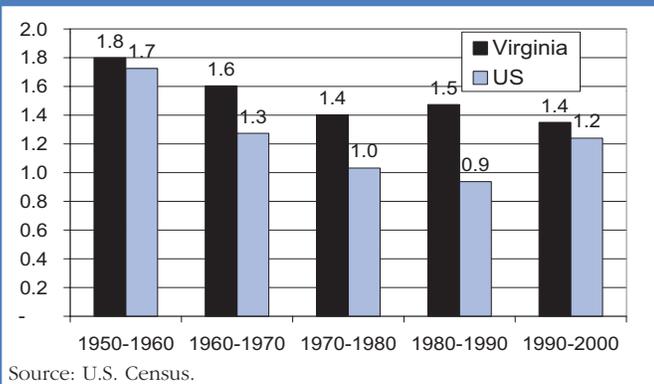
* Includes some stock options that were exercised. ** Includes farms, forestry, and fisheries.

communications equipment (-40.8%) and computers and office equipment (-35.3%).

Population and Demographics

The 2000 Census indicates that Virginia's population totaled 7,078,515 on April 1, 2000 and increased 14% since the 1990 Census. It grew at an annual average pace of 1.4% in the 1990s compared with 1.2% in the nation. According to the latest figures, Virginia is the twelfth most populous state, just ahead of Massachusetts and behind North Carolina. Virginia's growth rate ranked it as the sixteenth fastest growing state over the 1990s. Nevada grew the fastest, with a 66.2% increase.

Population Growth Annual Average Percentage Change



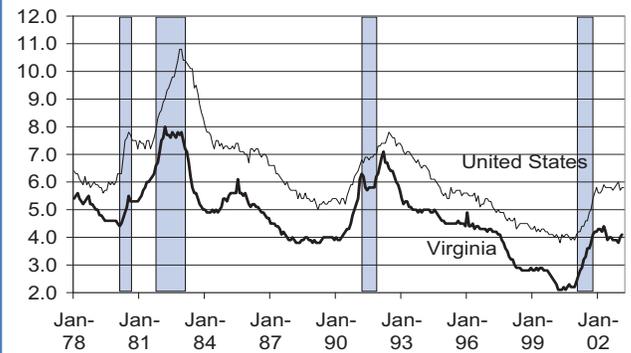
The state's age distribution of population is also favorable and closely resembles that of the nation. About 11.6% of the population for Virginia fell in the 18 through 24 year-old range which windows individuals entering the labor force and compares with 10.8% for the nation. The state's age distribution is expected to continue to resemble the nation over the next decade. The 55 to 64 age group is expected to grow 55.4% between 2000 and 2010 as the baby-boom generation (those born between 1946 and 1964) starts reaching retirement age in 2011.

Labor Market

The unemployment rate in Virginia remained low in 2002 and continued to trend beneath the na-

tional average. As of February 2003, the unemployment rate in the state stood at 4.1% compared to 5.8% for the nation.

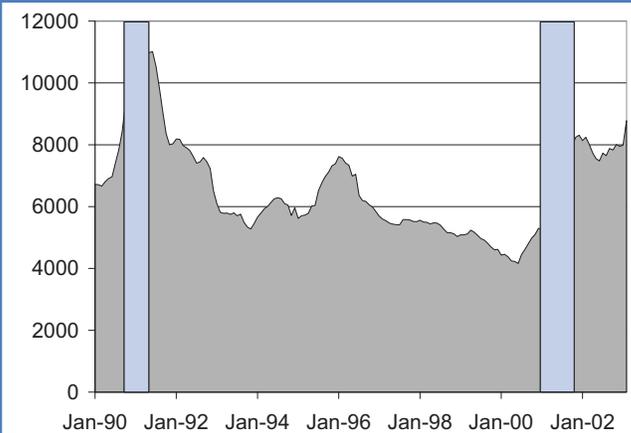
Unemployment Rate



Source: U.S. Department of Labor and Virginia Employment Commission. Recessions are shaded.

The labor market in the state and the nation has been relatively stagnant in the latter half of 2002 and early 2003. Uncertainty surrounding the war in Iraq has restrained new business investment. As a result, new job opportunities have been scarce. As the war in Iraq continues to come to a successful close, business optimism and labor market conditions should improve.

Virginia: Initial Unemployment Claims Weekly Average Per Month, 6-Month Moving Average



Source: Virginia Employment Commission. Recessions are shaded.

Despite lifting uncertainties accompanying ending U.S. military conflicts in Iraq, trends for initial unemployment claims in the state continue to point toward near-term weakness in labor markets. In February 2003, claims rose 6.5% from

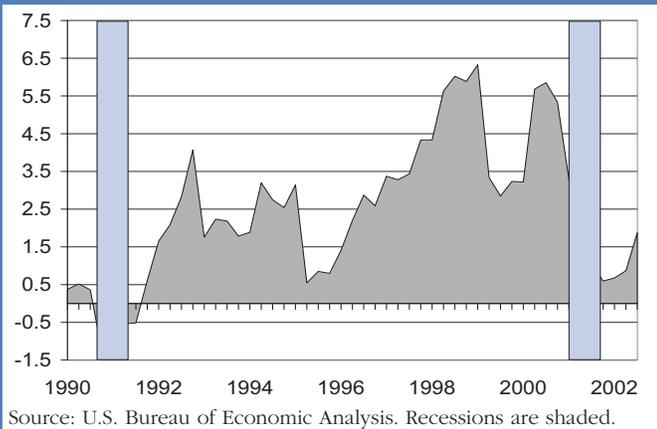
a year ago to 8,781—its highest level in over ten years. The monthly totals are 6-month moving averages of monthly claims, applied to smooth the high month-to-month variation in this series.

Income

Virginia's real personal income growth accelerated with the end of the recession in 2001. Year-over-year changes in personal income did not contract during the last recession in Virginia as it did in the 1991 recession. However, real personal income slowed to a 0.6% rate in the fourth quarter of 2001. By the third quarter of 2002, the year-over-year growth rate of real personal income improved to 1.9%.

With the apparent end of the recent recession in October 2001, growth in real personal income bounced back in the state. Rising real income is indicative of both increasing earnings and growth in employment. After the recession, employment growth resumed to some extent and helped push up incomes of Virginia residents. Although the latest data available suggests an upward trend, more recent employment figures indicate that growth in real income will decelerate once again in the first quarter of 2003.

Virginia: Real Personal Income Percentage Change From a Year Ago



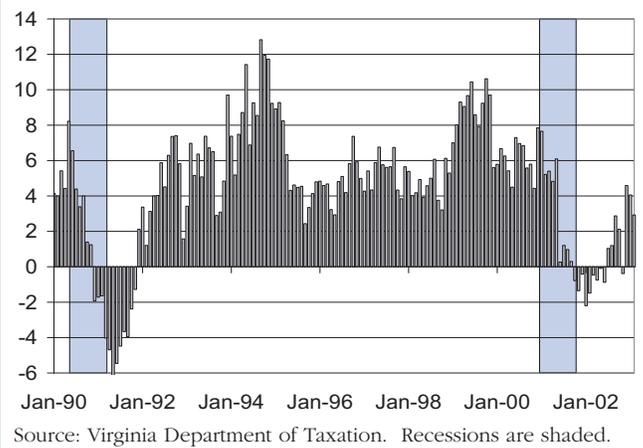
Net earnings, comprised of wage and salary disbursements, other labor income, and proprietor's income, made up 72.0% of real personal income in Virginia at the end of the third quarter 2002. For the year ending with the second quarter of 2002, the growth rate of real personal income

had outpaced the growth of net earnings. Over this period, real personal income in Virginia grew as much as 0.8% faster than net earnings. Only recently was this trend reversed when net earnings grew by 1.4% and real personal income advanced 1.0% in the third quarter of 2002.

Retail Sales

Retail sales in Virginia increased 2.9% over the twelve months ending with February 2003, the last month for which data are available. Growth in retail sales has been trending upwards since July 2002 when retail sales were growing 1.0% when compared to a year earlier. Since then, retail sales growth fluctuated between a slight decline and as much as 4.6% growth. Aside from indicating consumer willingness to spend, retail sales represent trends in taxes that constitute a substantial portion of state revenues. In 2003, for example, sales and use taxes are expected to account for roughly 22% of total revenue in the state.

Virginia: Retail Sales Percentage Change From a Year Ago 6-Month Moving Average

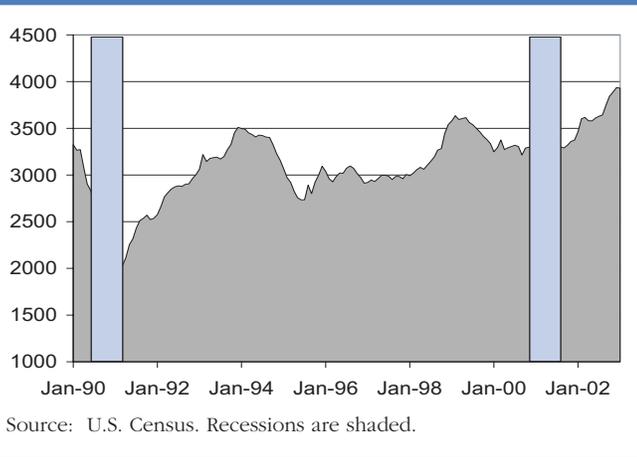


Housing and Auto Sales

Similar to the nation, the housing market in Virginia demonstrated remarkable strength in 2002 and early in 2003. Induced by record low mortgage rates, consumers have continued to drive new home sales upward.

For the twelve months ending with February 2003, building permits in Virginia advanced 7.4%. Permits have been steadily growing in the state since October 2001, and the longevity of the growth exhibited in the housing market has been surprising. Looking ahead to the second half of 2003, the housing market is expected to cool off as economic growth in other sectors accelerates and interest rates start to rise.

Virginia: Single-Family Building Permits 6-Month Moving Average



Auto sales were also strong in Virginia and in the nation for most of 2002. Low interest rates and generous incentives were keeping auto sales elevated. However, the pace of auto sales has since trailed off since many incentives were lifted.

Looking Ahead

With relatively poor economic performance in 2002, questions continue to surround the duration of our most recent recession. As noted earlier, the NBER recently stated that the recession, which began in March 2001, still might not have drawn to a close.

In Virginia, the employment trends lend some support to the possibility of a prolonged recession. Based on data through the third quarter of 2002, the 0.0% growth in employment in 2001 is expected to turn into a contraction of 0.6% in 2002. The employment situation should begin to improve in 2003 by growing 0.9% for the year. Employment in the state in 2004 is expected to increase by 1.7%.

With the national economy adjusting from its recent recession, uncertainty leading up to the war in Iraq dampened recovery efforts in 2003. Businesses across the country and in Virginia have been reluctant to invest in new projects, and have consequently implemented more layoffs than hires. The Northern Virginia information sector, in particular, was hit hard with job losses. However, the quick resolution to the Iraqi conflict is likely to have a stimulating effect on Virginia's economy.

In 2002, growth in wages and salaries decelerated sharply in Virginia compared with the previous two years. In 2000, wages and salaries grew almost 10% as stock options that were exercised pushed wages and salaries higher. In contrast, wages and salaries grew only 0.5% in 2002 as the sluggish recovery continued to put pressure on corporations to hold down costs.

From a regional perspective, most of the swing in the state's wages and salaries is attributed to Northern Virginia. In 2002 only two regions—Northern Virginia and Lynchburg—experienced contractions in wages and salaries. Forecasts for 2003 indicate Northern Virginia's wages and salaries will increase by 3.4%, and the state's wages and salaries will grow by 3.9%.

Inflation-adjusted consumer spending³ contracted 2.0% during 2001, which encompassed the recession, and fell another 0.2% in 2002. Looking ahead, retail sales in Virginia are expected to grow 2.1% in 2003 and 3.9% 2004.

Metropolitan Areas

CEA forecasts indicate that the seven largest metropolitan areas in Virginia, except Roanoke, will rebound in 2003. After contracting by 1.2% in 2002, employment in the Danville metropolitan area is forecast to experience the highest growth rate of the metro areas at 2.9% in 2003 as efforts to reduce the region's reliance on manufacturing are supporting employment growth. The Charlottesville and Richmond-Petersburg metro

³ Automobile sales are not included in consumer spending for Virginia.

areas will follow Danville, with employment expanding 2.1% and 2.0%, respectively.

Modest gains in employment can be expected from the other metro areas as the national economy continues to accelerate through the year. Employment in Northern Virginia is forecast to grow 1.7% in 2003. Employment in Lynchburg and Hampton Roads are expected to grow 1.9% and 1.0%, respectively, in 2003.

Roanoke, with declining employment in retail trade and manufacturing, is the only metro area in the state forecast to contract an additional 0.4% in 2003. Employment in the rest of the state is forecast to decline 2.1% during 2003. Continued increases in international competition as well as productivity gains are some of the reasons employment is expected to decline in the rural areas where traditional manufacturing activity is concentrated.

Wages and salaries are forecast to increase for all metropolitan areas, except Hampton Roads. Charlottesville will be leading the pack with wages and salaries expected to increase 7.2% in 2003. Following closely behind are Danville (+6.9%) and Roanoke (+6.3%). Charlottesville is also expected to have the highest rate of wage and salaries growth in 2004.

Virginia's metro areas were mixed with regard to real retail sales in 2002. Three metro areas experienced growth in retail sales, while four saw retail sales slip over the course of the year. Retail sales are forecast to improve in 2003 with five of the seven metro areas experiencing increases. Retail sales growth will be highest in Northern Virginia (5.0%), and will also increase in Hampton Roads, Richmond-Petersburg, Lynchburg, and Charlottesville.

The housing market helped buffer Virginia against a more severe contraction in 2001 as the low cost of borrowing induced many consumers to purchase homes. As interest rates have fallen and mortgages have reached record lows, the housing market reached record sales levels and continued to support economic growth. Relatively high levels of single-family housing permits are expected to slow somewhat across most metro areas in the second half of 2003.

Building permits in Northern Virginia are forecast to rise 14.2% in 2003 and then drop off to 12.2% in 2004. Richmond-Petersburg and Charlottesville are also forecast to maintain relatively strong housing markets in 2003 before slowing in 2004.

| Virginia Forecast Summary | | | | | |
|----------------------------------|-----------------------------------|-------|----------|-------|-------|
| | Percentage Change From A Year Ago | | | | |
| | Actual | | Forecast | | |
| | 2000 | 2001 | 2002 | 2003 | 2004 |
| Northern Virginia | | | | | |
| Total Nonagricultural Employment | 5.7% | 3.4% | -0.6% | 1.7% | 3.0% |
| Wages and Salaries* | 14.7% | 6.8% | -1.7% | 3.4% | 3.8% |
| Real Retail Sales | 8.5% | -2.9% | -0.6% | 5.0% | 6.0% |
| Building Permits | 3.3% | -5.7% | 11.0% | 14.2% | 12.2% |
| Hampton Roads | | | | | |
| Total Nonagricultural Employment | 1.6% | 2.1% | 0.8% | 1.0% | 0.4% |
| Wages and Salaries* | 6.0% | 6.2% | 4.5% | 4.3% | 4.0% |
| Real Retail Sales | 1.6% | 0.0% | 1.9% | 0.5% | 1.6% |
| Building Permits | -13.7% | 7.8% | 8.6% | 9.0% | -0.8% |
| Richmond Petersburg | | | | | |
| Total Nonagricultural Employment | 2.0% | 2.6% | -0.5% | 2.0% | 1.2% |
| Wages and Salaries* | 6.7% | 4.6% | 1.5% | 2.9% | 3.8% |
| Real Retail Sales | 4.3% | -3.0% | -2.0% | 1.7% | 3.7% |
| Building Permits | -12.7% | 13.9% | 6.7% | 10.1% | 9.0% |
| Roanoke | | | | | |
| Total Nonagricultural Employment | 1.8% | 1.0% | -1.4% | -0.4% | 0.7% |
| Wages and Salaries* | 4.9% | 4.5% | 3.6% | 6.3% | 5.4% |
| Real Retail Sales | -0.6% | -2.4% | -0.9% | -0.4% | 1.6% |
| Building Permits | 0.8% | 0.7% | 6.7% | 6.0% | 8.0% |
| Lynchburg | | | | | |
| Total Nonagricultural Employment | 1.9% | -1.2% | -2.3% | 1.9% | 1.7% |
| Wages and Salaries* | 4.7% | 0.6% | -0.9% | 5.7% | 4.6% |
| Real Retail Sales | 2.9% | 2.7% | -7.8% | 1.5% | 5.8% |
| Building Permits | -13.5% | 11.0% | 14.6% | 11.1% | 0.1% |
| Charlottesville | | | | | |
| Total Nonagricultural Employment | 3.1% | -0.1% | -1.3% | 2.1% | 1.8% |
| Wages and Salaries* | 9.3% | 4.5% | 4.5% | 7.2% | 6.4% |
| Real Retail Sales | 3.9% | -1.4% | 1.0% | 1.8% | 4.2% |
| Building Permits | -3.0% | 1.3% | 15.1% | 16.0% | 15.0% |
| Danville | | | | | |
| Total Nonagricultural Employment | 1.9% | -1.4% | -1.2% | 2.9% | 2.0% |
| Wages and Salaries* | 3.6% | -1.1% | 2.8% | 6.9% | 4.0% |
| Real Retail Sales | 2.1% | -4.3% | 0.4% | -0.8% | 1.8% |
| Building Permits | -2.5% | -2.3% | 14.1% | 1.1% | -9.9% |
| Non-MSAs | | | | | |
| Total Nonagricultural Employment | 1.4% | -9.2% | -1.6% | -2.1% | 1.5% |
| Wages and Salaries* | 6.5% | -0.7% | 0.4% | 4.5% | 5.0% |
| Real Retail Sales | 1.6% | -1.5% | 1.3% | -1.6% | 1.8% |
| Building Permits | -7.9% | 12.4% | 22.6% | 11.2% | 8.9% |
| VA-Totals | | | | | |
| Total Nonagricultural Employment | 3.0% | 0.0% | -0.6% | 0.9% | 1.7% |
| Wages and Salaries* | 9.8% | 4.8% | 0.5% | 3.9% | 4.1% |
| Real Retail Sales | 4.6% | -2.0% | -0.2% | 2.1% | 3.9% |
| Building Permits | -4.7% | 3.0% | 12.1% | 13.2% | 8.7% |

Source of Forecasts: Chmura Economics & Analytics. *Wages and salaries include some options that were exercised. Actual data are for wages and salaries through third quarter 2002.

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“... a wise and frugal government, which shall restrain men from injuring one another, shall leave them otherwise free to regulate their own pursuits of industry and improvement, and shall not take from the mouth of labor the bread it has earned. This is the sum of good government, and this is necessary to close the circle of our felicities.”

Thomas Jefferson

1801