

U.S. STATE MONITOR

May 2007

States in focus



Southeast region: North Carolina, South Carolina, Virginia, Georgia, Florida, Alabama

TABLE 1
Southeast business banking market outlook

Year-over-year % change in outstanding industry-wide balances

	2007		2008	
	U.S.	Southeast	U.S.	Southeast
Total business credit	5.1	<<=>	8.5	-
Short-term business credit	9.0	+	7.0	-
Commercial banks (C&I loans)	12.0	+	10.0	-
Long-term business credit	4.8	<<=>	8.6	-
Commercial mortgages	9.5	<<=>	10.0	-
Cash and chequable deposits	-60.0	<<=>	7.0	<<=>

Source: Federal Reserve Board, FDIC, RBC Economics Research

Southeast business banking market outlook

Many signs are pointing towards a healthy U.S. business banking market in 2007 and 2008. Lending opportunities are expected to grow at one of the fastest rates in years. A low economy-wide inventory-to-sales ratio and accelerating economic growth should be mutually reinforcing in terms of driving an expansion in net working capital financing requirements.

The upbeat outlook is in direct contrast with the recent experience in the U.S. economy which saw a significant decline in total net long-term product issuance. The dry-up in financing can be partly attributed to companies drawing down more heavily from their internal cash positions as opposed to looking outside for financing. While liquidity ratios still remain above-average, companies have recently started to redeploy some of that liquidity. The other contributing factor is the recent weakness in business investments in machinery and equipment and non-residential structures.

Overview of conditions in the southeast

The outlook for business lending conditions in the southeast region is expected to mimic closely the trends at the national level (Table 1). Growth in short-term lending — including commercial and industrial loans (C&I loans) — in the southeast is expected to come in slightly above the national average in 2007 (indicated by a "+") and at a mildly slower pace compared to the national average in 2008 (indicated by a "-"). Recent indicators show that an already-significant restocking of inventories in 2007 occurred across the southeast region compared to the overall national rate, which still has more upside inventory growth. Longer-term borrowing will get a boost from higher activity in commercial properties, which drives up overall long-term financing. While southeast long-term borrowing will still remain in a healthy growth range, we expect growth in longer-term credit throughout the southeast region to be lag slightly behind growth at the national level in 2008.

C&I loan growth to hover just below the national pace

Traditionally, there is a positive relationship between inventory investment and short-term borrowing requirements. The relationship suggests that, as companies work to bring inventory levels back up to more normal levels, their borrowing is likely to also increase. A comparison of inventory measures from the national ISM manufacturing survey with that of the Federal Reserve Bank of Richmond's manufacturing survey covering North Carolina, South Carolina, Virginia, Maryland, and the District of Columbia shows recent inventory trends. While this measure of inventory levels serves only as a proxy, it illustrates that the downward trend last year was more pronounced in the Richmond area compared to the national rate. And, more recently, it shows the recent reversal as inventories started to rebuild.

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1. "Outlook for North American business finances," RBC Economics Research, March 2007. [\(Click here for full report\)](#)

Inventories dropped sharply across the southeast through 2005 and bottomed out in the early part of 2006. As a result, last year we were looking for a significant replenishing of inventories to begin towards the end of 2006. As anticipated, the restocking appears to have taken hold. In the early part of 2007, inventories moved back up to higher levels at a faster pace than the recovery of inventories in the broader U.S. economy. We expect this trend to continue in 2007. Going forward in 2008, the national rate of inventory replenishing is likely to exceed the pace in the southeast as inventories catch up and return to more normal levels while inventories in the southeast level off. With softer inventory improvements expected after this year, the southeast will likely experience slightly more moderate growth in C&I loans compared to the national rate in 2008.

Relatively low vacancy rates still positive for commercial mortgage growth

The pace of commercial mortgage growth should be healthy in 2007 with momentum to pick up in 2008. Vacancy rates provide a signal of current capacity pressures on the commercial market. Although both industrial and office vacancy rates appear to be coming off their recent lows, they are still signalling some tightness in the market for commercial space.

National office vacancy rates continue to demonstrate sustained tightness. However, there are some notable regional variations in the southeast. Atlanta, Charlotte and Orlando are still indicating ongoing tightness in the demand for office space. National industrial vacancy rates are currently sitting below rates in the southeast, indicating some slack now in the industrial market. Industrial vacancy rates in Orlando and Atlanta have been rising in the past year.

Long-term business financing: soften in '07, pick-up in '08

The United States has experienced a sharp downturn in total net long-term product issuance in the last few years. The combination of recent weakness in business investments in both equipment and non-residential structures and the heavier draw-down on cash positions has hurt the long-term financing market. Since long-term borrowing is significantly affected by business investment, the expected moderation in investment in 2007 will restrain some activity this year. However, a gradual turnaround should begin in 2007, followed by a stronger pick-up in 2008 as the economy regains momentum. Long-term business lending prospects across the region are largely expected to follow the national trend in 2007 and lag slightly behind in 2008.

The economic climate for business investment is expected to improve with several current characteristics of the economy expected to contribute: high capacity utilization rates, rapid technological change that quickly makes capital obsolete, high levels of competition that force productivity-enhancing investments and ongoing labour shortages that cause a diversion towards capital to meet higher production needs. Furthermore, as the U.S. economy stabilizes and liquidity continues to decline from recent highs, growth in long-term issuance should benefit.

Mild deterioration in credit quality

Credit quality is expected to deteriorate marginally through 2007 before gradual improving in 2008. As the lagged effects of higher rates continue to filter through the economy, debt will continue to get repriced at higher rates and credit quality in the southeast region will be marginally squeezed. But the current environment still remains one of the better ones in decades for overall business credit quality. On balance, underlying economic strength should prove to be a support to financing conditions in the southeast. The regional outlook remains upbeat with strong in-migration, tight labour markets and rising incomes that all continue to support a healthy growth profile in the region.

CHART 2

Richmond area manufacturing survey - inventories

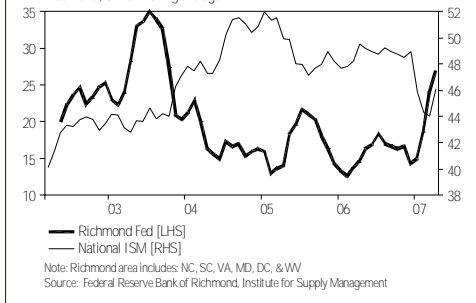


CHART 3

Industrial vacancy rates

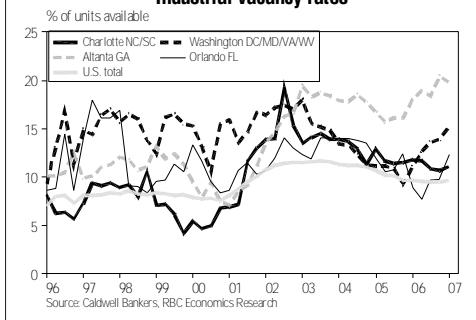


CHART 4

Office vacancy rates

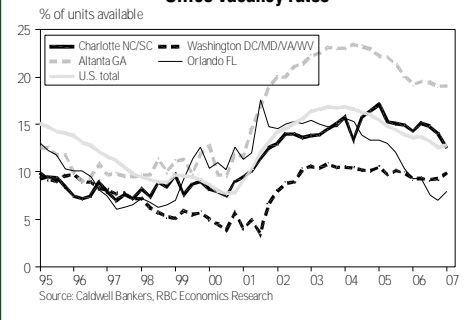
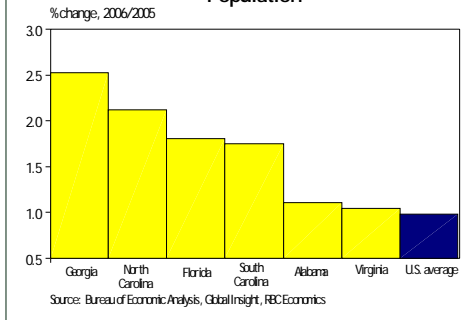


CHART 5

Population



U.S. southeast current economic indicators

REAL ESTATE PROFILE

		<u>North Carolina</u>	<u>South Carolina</u>	<u>Virginia</u>	<u>Georgia</u>	<u>Alabama</u>	<u>Florida</u>	<u>United States</u>
At seasonally adjusted annual rates, unless otherwise indicated								
Housing starts	March-07	95,884	43,499	36,738	88,680	27,344	133,984	1,518,000
Annual % change (3-month moving ave.)		-10.7%	-26.8%	-38.5%	-21.9%	-14.9%	-53.7%	-30.2%
Housing permits	March-07	102,648	44,784	44,520	88,440	24,696	146,424	1,648,800
Annual % change (3-month moving ave.)		-12.5%	-27.0%	-30.1%	-21.6%	-13.3%	-52.5%	-26.9%
Home prices (median)								
Existing homes	Q4 2006	\$135,620	\$120,281	\$228,705	\$141,937	\$108,921	\$210,500	\$219,000
Annual % change		7.3%	7.2%	6.6%	4.7%	7.2%	8.6%	-2.8%
New homes	Q4 2006	\$162,995	\$152,909	\$268,693	\$174,013	\$138,692	\$260,295	\$245,400
Annual % change		2.4%	3.2%	-3.3%	-0.8%	4.7%	-1.3%	0.7%
Home price index (weighted repeat sales)								
Annual % change	Q4 2006	8.2%	8.1%	7.5%	5.6%	8.1%	9.4%	5.9%
Existing single family home sales ¹	Q4 2006	\$225,600	\$102,400	\$125,600	\$243,600	\$119,200	\$337,600	\$6,263,000
Annual % change		-5.7%	-16.6%	-27.1%	-2.4%	-12.4%	-32.3%	-9.8%
Vacancy rates ²								
Industrial	Q1 2007	11.1%	n/a	15.2%	19.8%	n/a	8.7%	9.7%
Office	Q1 2007	12.5%	n/a	9.9%	19.0%	n/a	9.9%	12.8%

1. Including apartments, condominiums, and cooperatives

2. Charlotte-Gastonia-Rock Hill, NC; Washington, DC-MD-VA-WV; Atlanta, GA; Ave of major MSA's, FL for office and Jacksonville for industrial.

ECONOMIC PROFILE

		<u>North Carolina</u>	<u>South Carolina</u>	<u>Virginia</u>	<u>Georgia</u>	<u>Alabama</u>	<u>Florida</u>	<u>United States</u>
Employment	March-07	4,080,400	1,922,900	3,763,500	4,130,500	2,004,300	8,102,100	137,596,000
Annual % change (3-month moving ave.)		2.2%	1.3%	1.2%	1.4%	1.5%	1.4%	1.5%
Unemployment rate		4.5%	5.9%	3.0%	4.1%	3.4%	3.3%	4.4%
Labor force		4,520,971	2,163,552	4,059,327	4,836,285	2,239,608	9,193,678	152,979,000
Annual % change (3-month moving ave.)		2.4%	2.3%	2.2%	2.7%	3.1%	3.0%	1.7%
Personal income growth (annual % cl)	Q1 2007	5.9%	5.5%	5.3%	4.8%	5.7%	6.7%	5.5%

EMPLOYMENT PROFILE

		<u>North Carolina</u>	<u>South Carolina</u>	<u>Virginia</u>	<u>Georgia</u>	<u>Alabama</u>	<u>Florida</u>	<u>United States</u>
March-07								
Employment (non-agricultural)								
Annual % change [share of employment]								
Total		2.2	1.3	1.2	1.4	1.5	1.4	1.5
Government		1.0 17%	-0.4 18%	0.5 18%	1.9 16%	2.0 19%	1.9 14%	1.3 17%
Manufacturing		-0.9 13%	-3.6 13%	-1.4 8%	-2.2 11%	-1.4 15%	-2.4 5%	-0.8 10%
Professional & business services		4.2 12%	0.7 11%	2.6 17%	1.9 13%	3.8 11%	2.1 17%	2.4 13%
Education & health services		4.1 12%	6.6 11%	2.2 11%	2.9 11%	2.3 10%	2.6 12%	2.7 13%
Retail trade		2.3 11%	0.2 12%	0.9 11%	0.9 11%	0.9 12%	0.9 12%	0.3 11%
Wholesale trade		1.4 4%	4.2 4%	3.3 3%	1.0 5%	2.5 4%	1.9 4%	1.6 4%
Leisure & hospitality		3.5 9%	1.8 11%	2.0 9%	2.5 9%	3.6 9%	2.0 12%	3.3 10%
Transportation & utilities		-0.9 3%	1.6 3%	2.5 3%	1.9 4%	2.3 4%	-0.7 3%	2.0 3%
Construction		4.1 6%	3.3 7%	-1.5 6%	4.5 5%	2.7 6%	-0.9 8%	0.1 5%
Financial services		4.7 5%	3.9 5%	1.8 5%	1.4 6%	-1.0 5%	0.8 7%	1.6 6%
Unemployment rate (%)								
March-07		4.5	5.9	3.0	4.1	3.4	3.3	4.4
March-06		4.6	6.4	2.9	4.6	3.4	3.3	4.7
Labor force								
y/y % change		2.3	2.5	2.3	2.9	2.7	3.2	1.5

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