

# Alabama Business

Center for Business and Economic Research, Culverhouse College of Commerce, The University of Alabama

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## Economic Outlook: 3rd Quarter 2004

### United States

**Overview.** Despite a slight slowdown in the first quarter, national economic fundamentals remain on solid footing. Increased business spending, together with improving payroll employment, will continue to drive the economic recovery. Although a recovery in the industrial sector still has a long way to go, services are doing better. In spite of a decline in June, the ISM (Institute for Supply Management) nonmanufacturing index is still indicating a strong expansion. The orders and employment indexes increased significantly and the employment index value is the highest it has been since the survey began seven years ago.

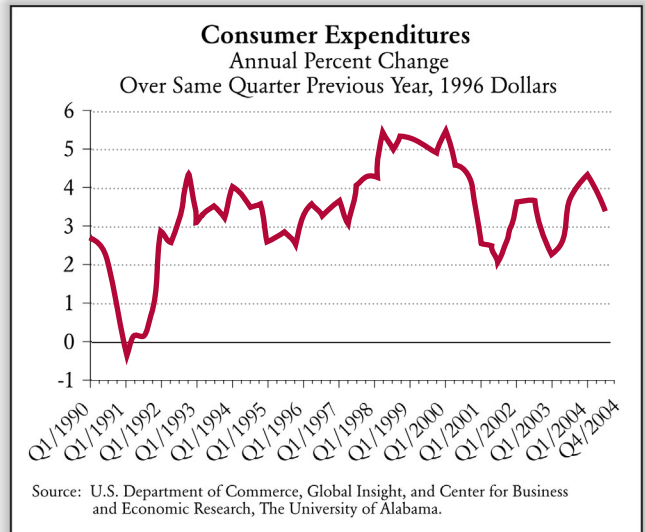
Increased energy prices will affect both business costs and consumer spending. But higher fuel prices do not necessarily indicate a stalled economic recovery. Economic fundamentals for the second

half of 2004 point toward relatively strong growth, even though in the first half of the year there was some weakness in payroll employment and consumer spending. For the second half of the year, the economy is expected to grow in the 4.5 to 5.0 percent range, higher than the 3.9 percent experienced in the first half. For the year as a whole, the economy is expected to grow at 4.6 percent, which would be one of the fastest rates of growth experienced in nearly 20 years.

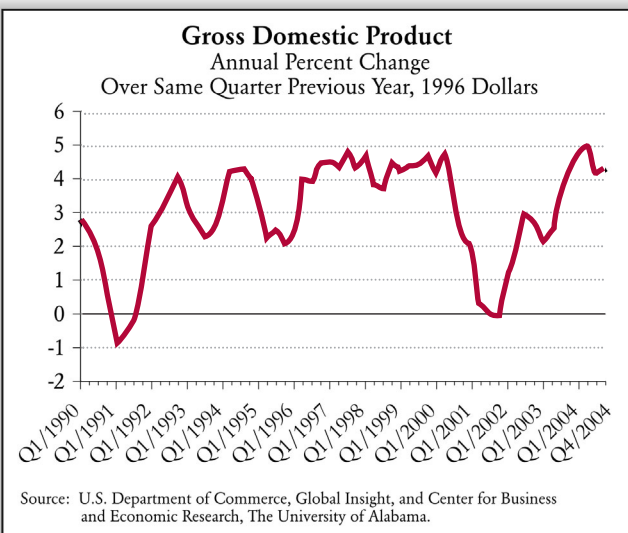
**Consumer Spending.** Retail sales dropped by 1.1 percent in June, the largest decline experienced since February 2003, primarily due to a decline in automobile sales. Excluding autos, overall sales remained about even. Auto sales dropped from 17.8 million units in May to 15.4 million units in June, one of the slowest months since August 1998. Despite their recent reluctance to buy cars and trucks, consumers continue to spend, more on nondurable than

durable goods. Helped by tax cuts, low interest rates, and improving payroll employment, consumer spending is growing at a very strong pace. However, the effects from tax cuts are about to wane.

Fundamentals for strong consumer spending in the second half still look promising. The Conference Board's consumer confidence index rose in June, giving the strongest

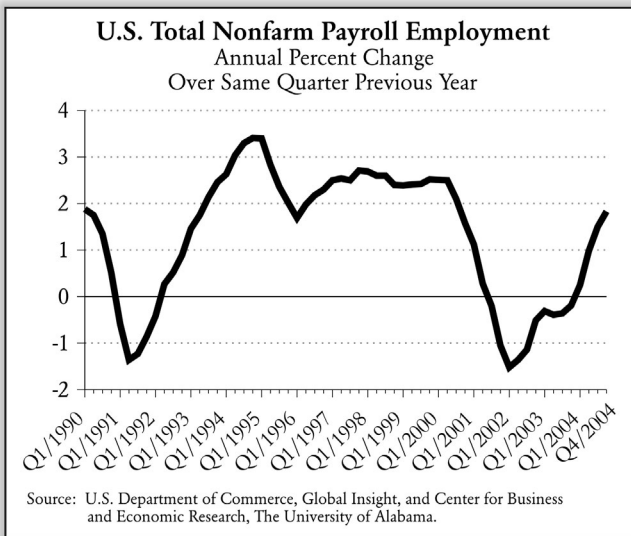


reading in nearly two years. The index tracking expectations for the next six months also increased in June. During first quarter 2004, consumer spending, which accounts for almost two-thirds of the economy, increased by 3.8 percent, compared to 3.2 percent in the fourth quarter of 2003. Although higher energy prices in both 2003 and this year have cost consumers about 40 billion additional dollars, these prices have had only a marginal effect on spending levels. Consumer spending increased in the first half of 2004 by about 3 percent, and as payrolls and the economy continue to



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improve, spending in the second half is forecasted to increase by 3.9 to 4.0 percent.

With improving employment conditions, spending on durable goods is also expected to accelerate in the second half, increasing by almost 9 percent, compared to the decline we noticed in the first half of 2004. The biggest risk to consumer spending is a rapid increase in interest rates. If interest rates on consumer installment credit rise relatively rapidly, that additional burden would affect spending. The portion of disposable income that is used to pay off debts is at a record high. An increase in interest rates would further squeeze consumer discretionary income.

**Employment.** After an increase in payroll employment of 248,000 in May, payrolls increased again in June by an unexpectedly lower 112,000. The economy has added nearly 1.3 million jobs in the first six months of 2004. That's good news, but the economy will have to gain an additional 1.2 million jobs to offset the number of jobs lost since the most recent recession began in March 2001. In June, employment in services increased by almost 122,000, following an increase of 176,000 in May. However, payrolls in goods producing industries declined by about 10,000. Payroll employment gains are expected to remain solid for the remainder of the year. By fourth quarter 2004, the economy is expected to add approximately 2.5 million new jobs over the previous year,

which should bring the unemployment rate down to around 5.2 or 5.3 percent.

**Manufacturing.** After peaking in 1979, employment in manufacturing has been on a long declining trend and is currently at levels approximately 5 to 6 million below the peak. For the first time in 44 months, manufacturing employment in May did not experience a decline. In fact, in May

manufacturing added 32,000 new jobs, the biggest gain in six years. However, the gains could not be sustained; manufacturing lost 11,000 jobs again in June. Over the last 44 months, manufacturing has lost almost 3 million jobs.

For the second half of the year, industrial production will increase by 5 or 6 percent, and for all of 2004 industrial production is forecasted to rise by 5.5 percent, compared to 0.3 percent in 2003. Although industrial production declined in June after increasing in May, most of that decline was due to a cutback in automobile production. With high levels of inventory, automobile manufacturers decreased their production by 10.4 percent in the second quarter. Automobile manufacturers are currently utilizing only 77.6 percent of their capacity.

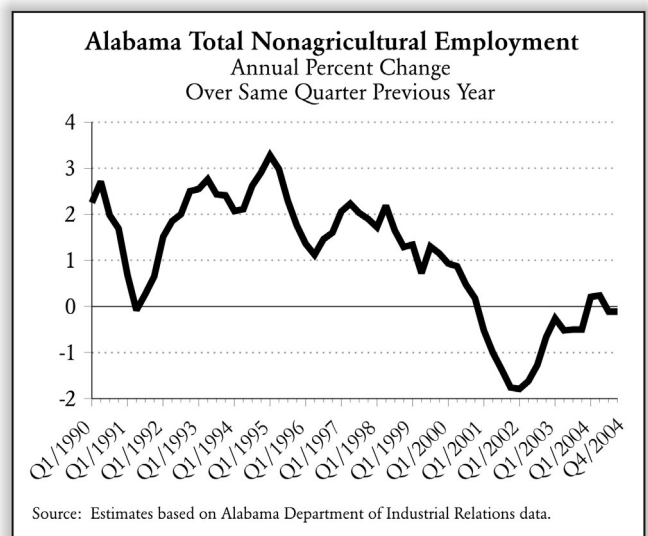
**Outlook.** Although the economy has shown some signs of a slowdown, it remains fundamentally strong. After a long run of bad news, the manufacturing sector overall has finally turned around and continues to improve, even though not every manufacturing industry is doing well. The second half of the year is expected to see increases in both consumer spending and payroll employment. Business spending will

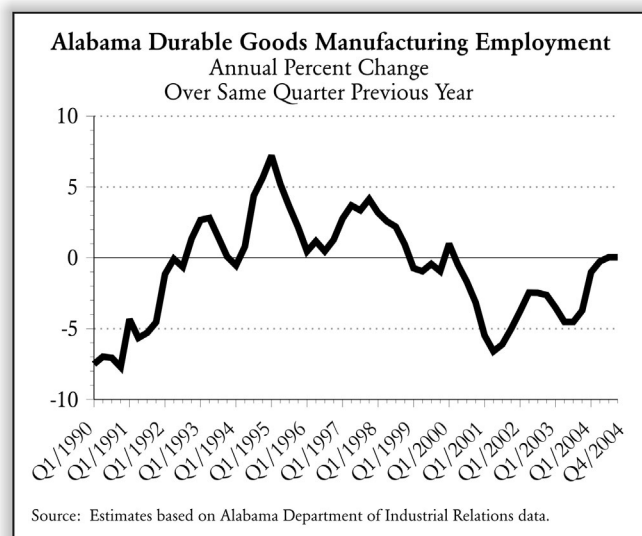
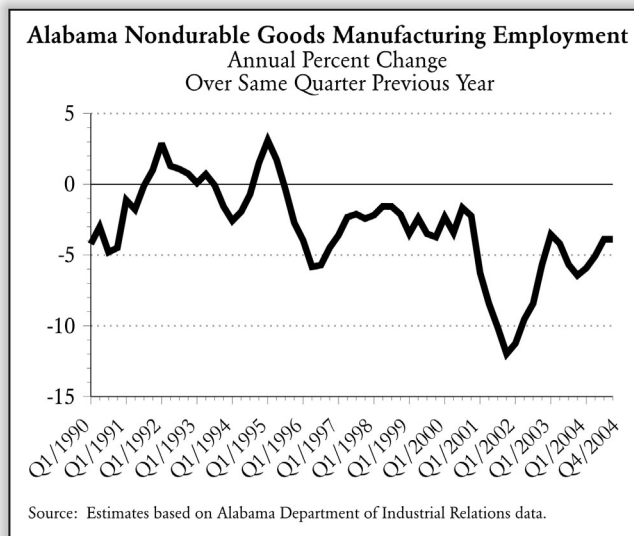
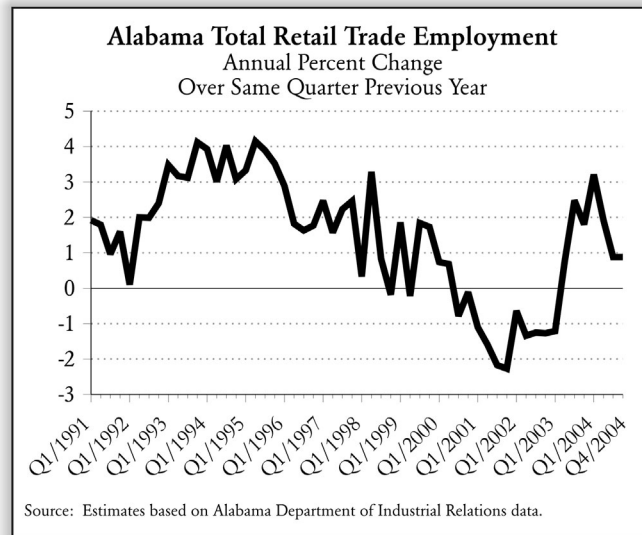
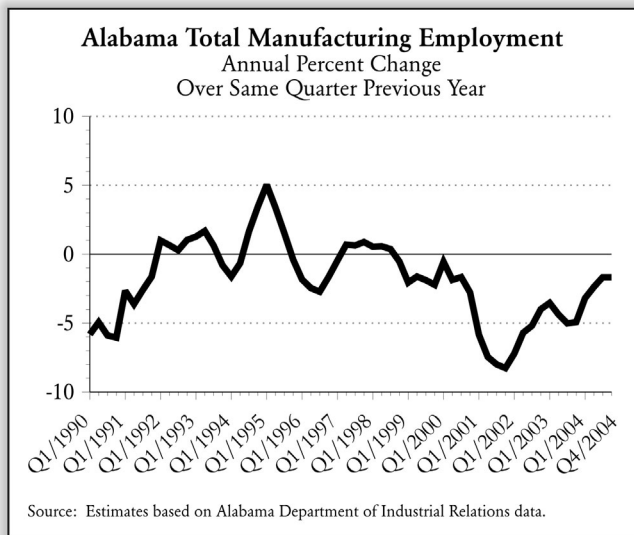
also be a key factor in coming months. Pent up demand, inventory rebuilding, and increased hiring should help business spending grow by over 15 percent in the second half of 2004. Furthermore, depreciation allowances expire at the end of the year, and these expirations should provide extra incentives for businesses to increase their spending now.

The U.S. economy is expected to grow by 4.6 percent in 2004, the fastest growth experienced since 1984. For 2005 economic growth should be about 3.9 percent. The fixed 30-year mortgage rate is expected to be slightly above 6 percent, and could inch up to close to 7 percent next year. The 10-year Treasury note yield is expected to rise to around 4.6 percent this year and move close to 5.5 percent in 2005. After declining for three straight years, payroll employment is forecasted to increase by over 1 percent in 2004. The unemployment rate is also expected to decline, falling to 5.3 or 5.4 percent by the year's end. The federal funds rate is forecasted to reach 2.0 percent, stabilizing economic growth.

## *Alabama*

**Employment.** In keeping with the national trend, payroll layoffs in Alabama have shown a significant slowdown in recent months. Contrary to the national trend, automobile manufacturing in the state has performed exceptionally well, with the industry being the only part of the manufacturing sector





that has added any significant number of jobs. Alabama's strong automotive sector has helped negate some of the effects of layoffs in other manufacturing industries.

During the 12-month period ending in June 2004, the state gained almost 2,500 new jobs. The state's manufacturing sector lost about 5,700 jobs in that same period, but other sectors of the economy took up the slack. While durable goods manufacturers gained about 600 net jobs, the nondurable sector lost 6,300 jobs. Net new jobs in durable goods manufacturing bode well for state tax revenues, since durable goods manufacturing includes many capital-intensive industries with high productivity and wages. Manufacturing industries that are not increasing their payrolls are notable.

In the 12 months to June 2004, the state's steel industry lost almost 2,300 jobs; textile mills, textile products and apparel lost 3,300; paper manufacturing lost another 400; and electronic components and products manufacturing, including computer and appliance manufacturers, lost 800 jobs. Information and telecommunications industries continued to shed jobs—1,200 in the 12 months to June 2004.

The services sector gained 6,000 jobs between June 2003 and June 2004. Leisure and hospitality gained 1,200, split between eating and drinking places and accommodation and food services. An increasing hospitality and tourism component to Alabama's economy is welcome, although these jobs have generally lower wages compared to manufac-

turing. The retail sector, after losing a significant number of jobs since 2001, added almost 5,400. Most of the new jobs have been in the major metropolitan areas of the state—1,000 were in the Huntsville metropolitan area. Health-care and social assistance services also added 900 new jobs. Employment has improved over the prior three-year period, indicating that the Alabama economy is indeed showing a sustained recovery. However, really significant additions to payrolls are not expected until the second half of 2004 or maybe even 2005.

**Tax revenues.** After one of the worst fiscal years in decades, the first three quarters of the current fiscal year (FY2004) recorded significant improvement. The state tax structure faces long-term struc-

### *Alabama Nonagricultural Employment Change in Number of Jobs*

	June 2003 to June 2004
Total Nonagricultural	2,500
Natural Resources and Mining	-100
Construction	2,300
Manufacturing	-5,700
Durable Goods Manufacturing	600
Wood Products Manufacturing	500
Primary Metal Manufacturing	-600
Fabricated Metal Product Manufacturing	-1,700
Machinery Manufacturing	400
Computers and Electronic Products Manufacturing	-700
Electrical Equipment, Appliance and Component Mfg.	-100
Transportation Equipment Manufacturing	2,400
Motor Vehicle Manufacturing	1,100
Furniture and Related Products	400
Nondurable Goods Manufacturing	-6,300
Food Manufacturing	-300
Textile Mills	-1,200
Textile Product Mills	-200
Apparel Manufacturing	-1,900
Paper Manufacturing	-400
Plastics and Rubber Product Manufacturing	100
Trade, Transportation and Utilities	5,500
Wholesale Trade	100
Retail Trade	5,400
Transportation, Warehousing and Utilities	0
Information	-1,200
Telecommunications	-400
Financial Activity	-400
Professional and Business Services	1,400
Educational and Health Services	600
Leisure and Hospitality	1,200
Other Services	-1,300
Government	200
Federal Government	-100
State Government	200
State Education	0
Local Government	100

Source: Alabama Department of Industrial Relations.



year, from \$4.8 billion to over \$5.2 billion. Individual income tax receipts are 9.5 percent higher, increasing from \$1.8 billion to almost \$2.1 billion. Corporate income tax revenues, at \$237.5 million, are approximately 37 percent higher than the previous fiscal year's \$173.3 million. Sales tax collections totaled almost \$1.3 billion, compared to approximately \$1.2 billion collected during the first three quarters of the

previous fiscal year.

For the first three quarters of FY2004, the appropriations for the Alabama Education Trust Fund totaled approximately \$3.4 billion, an increase of about \$337.8 million over the previous fiscal year. However, appropriations made to

the General Fund declined by almost 14.7 percent, or \$141.5 million, to slightly more than \$822 million.

**Outlook.** The rebound in the manufacturing sector and continued strength in consumer spending will help the state grow at an average annual rate of 3.5 to 4.0 percent in 2004 with payroll employment rising 0.3 to 0.5 percent, adding 6,500 to 8,000 net new jobs. Most of these job gains will be in services and residential construction. The automotive industry in the state, including the suppliers associated with major manufacturers, will add a significant number of jobs in both 2004 and 2005. The services and retailing sectors of the economy are expected to grow by slightly more than 4 percent in 2004, while financial activity is forecasted to grow by approximately 4 percent or better. With interest rates already increasing, refinancing activity in the housing markets will slow down soon. However, housing sales should remain strong as consumers, in anticipation of rising interest rates, try to lock in rates at their present levels.

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tural problems, but revenues for the current fiscal year will easily surpass the previous fiscal year's, as business spending and payrolls improve and consumer spending remains strong. For the first three quarters of the current fiscal year, total tax receipts are up 8.5 percent over the same period of the previous fiscal

*Alabama Business* is a quarterly publication of the Center for Business and Economic Research, Culverhouse College of Commerce and Business Administration, The University of Alabama. Articles reflect the opinions of the authors, but not necessarily

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