Alabama Business

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

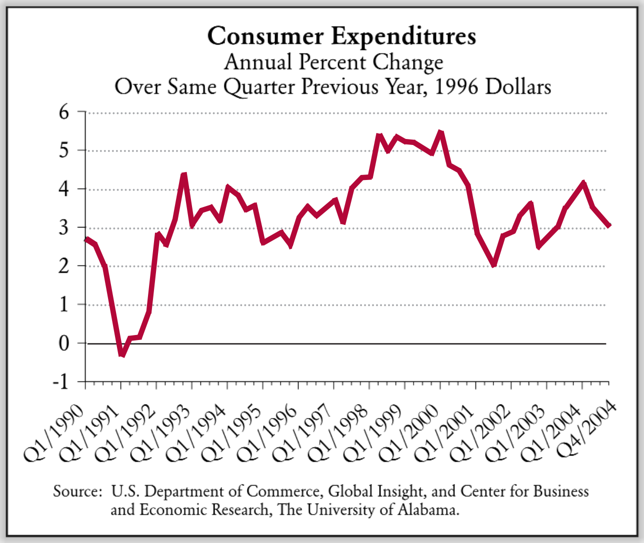
Volume 73, Number 4 *Fourth Quarter 2004*

Economic Outlook: 4th Quarter 2004

United States

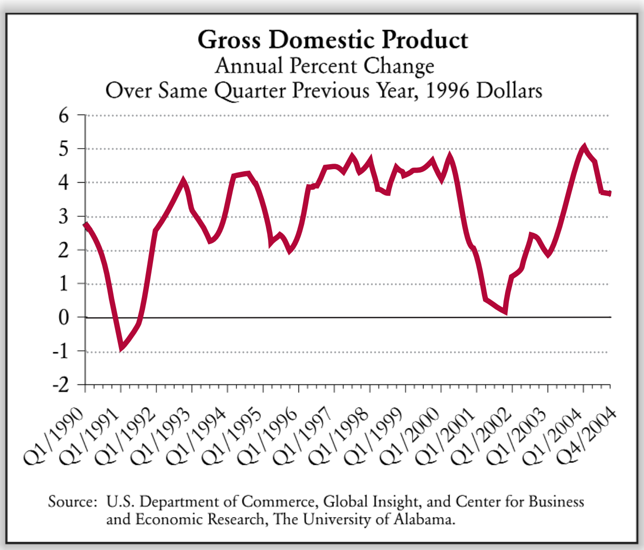
Overview. During the first two quarters of 2004, the U.S. economy grew at average annual rates of 4.5 and 3.3 percent, respectively. The slower growth rate during the second quarter was mainly due to deceleration in personal consumption expenditures on durable goods, primarily motor vehicles, and a decline in private inventories. However, that slowdown on the consumer side of the economy was offset by a strong showing on the business side. Business spending on fixed investments increased 4.5 percent in first quarter 2004 and almost 14 percent in the second quarter. Growth in spending on equipment and software increased from 8 percent to slightly over 14 percent, a sixth consecutive quarterly gain after over two years of decline. Some of the acceleration in business spending may be due to upcoming expirations of depreciation allowances at the end of the year.

September 2004 marked the 35th month of recovery in the U.S. economy. During the first 35 months of all previous economic recoveries, both employment and income growth far exceeded the gains made during this recovery. And we do not expect employment to rise sharply in the near future. The high rate of industrial productivity that has kept labor costs down is beginning to ebb. As productivity declines, unit labor costs will rise. Higher labor costs could hamper any increase in payroll employment during the second half of this year and into next year.



Source: U.S. Department of Commerce, Global Insight, and Center for Business and Economic Research, The University of Alabama.

One significant risk for today's economy is the price of oil. According to a study produced by Global Insight Inc., a $10 increase in the price of oil per barrel subtracts approximately 0.3 percent from GDP growth. The fact that oil is hovering above $50 a barrel could have a significant impact on both business and consumer spending in the second half of the year. Even at these levels, in current dollar prices and adjusted for inflation, the price of oil per barrel is still below the memorably high 1981 and 1990 levels. Oil cost around $79 per barrel in 1981 and $60 in 1990, if adjusted to current price levels. Both these historic spikes in oil prices caused the U.S. economy to dip into a recession. However, chances of recession are very slim this time around, as energy consumption in the United States as a share of total gross domestic product (GDP) continues to decline.



Source: U.S. Department of Commerce, Global Insight, and Center for Business and Economic Research, The University of Alabama.

Consumer Spending. Consumer spending accounts for almost two-thirds of GDP, and in some recent years it has accounted for almost 80 to 90 percent of the growth in the economy. For the first half of this year, consumer spending increased at an average annualized rate of 2.9 percent. Spending on durable goods, which includes motor vehicles, increased by less than 1 percent, while spending on nondurable goods increased by 3.4 percent. A decline in spending on gasoline, fuel oil, and other energy goods, together with a significant decline in spending on motor vehicles, meant growth in overall consumer expenditures

In this issue:

U.S. Total Nonfarm Payroll Employment
Annual Percent Change
Over Same Quarter Previous Year

Source: U.S. Department of Commerce, Global Insight, and Center for Business and Economic Research, The University of Alabama.

declined from 2.9 percent in first quarter 2004 to 1.1 percent in the second quarter. However, the slowdown in consumer spending is expected to be only a temporary phenomenon, as the fundamentals in the economy still look strong.

There has been a significant increase in housing market values, and low interest rates have resulted in a boom in new and existing home sales. New home sales soared in August; the biggest gain experienced since the end of 2000. Total outstanding mortgage debt has increased from $1.5 trillion in 1985 to approximately $7 trillion today. According to a Federal Reserve Bank of New York study, U.S. consumers have taken out $662 billion in home equity loans and refinancing since 2001. This refinancing results in more disposable income for consumers, and they have been very aggressive spenders in recent years. After a slight slowdown in the first half, spending in this year's second half is strengthening. Computers, software, home furnishings, and health care performed well in the third quarter of 2004.

Employment. Payroll employment has been increasing, but not very rapidly. Most of the jobs gained in September were in the services producing sector, with professional and business services adding almost 34,000 jobs. Surprisingly, retailing lost almost 15,000 jobs, mainly due to weakness in consumer spending. Despite slower new job creation, during the first nine months of the year there were almost 1.6 million new jobs added. Some sectors of the economy are still lagging in adding new jobs; manufacturing dropped almost 18,000 jobs in September. After peaking in 1979, manufacturing has since lost more than five million jobs. This includes almost three million over the last 46 months. Other than the 36,000 jobs added in May and August 2004, manufacturing employment has declined for almost four years. Although the sector has been reducing its payroll, according to the Institute of Supply Management Index, manufacturing activity grew for the 15th consecutive month in September. Thus far manufacturers have been able to increase production without adding more workers. Because that cannot continue forever, it will be only a matter of time before we see some gains in manufacturing employment.

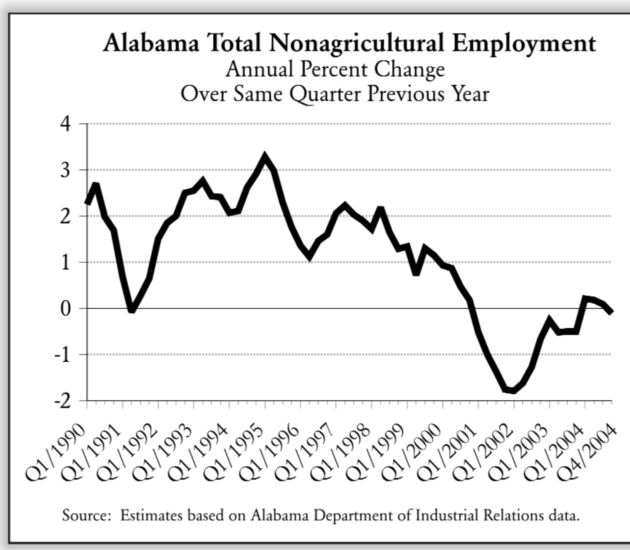
Health care related industries have seen strong employment growth. The sector added almost 97,000 jobs just in the second quarter of 2004 and is estimated to add another 80,000 jobs in the third quarter. Business and professional services are also increasing employment. After adding almost 215,000 jobs in the second quarter, these services will add another 115,000 jobs in the current quarter.

Outlook. The outlook for the remainder of the year assumes that the recent surge in oil prices, which is the biggest risk associated with the forecast, is only a temporary phenomenon and that oil prices will begin to decline toward $35 or $40 per barrel sometime in 2005. However, oil prices are expected to remain a drag on the economy, perhaps for as long as six months or even a year. The forecast also assumes that the Fed will continue to tighten interest rates gradually, in which case housing markets could remain strong for another three to six months. Clean-up and rebuilding after the four hurricanes will also provide some boost to the economy.

The U.S. economy should have an average annual growth rate of 4.4 percent for 2004 as a whole and 3.4 percent in 2005. Despite a run-up in oil prices, inflation is forecasted to be only around 2.6 percent in 2004, followed by 1.8 percent in 2005. After increasing by 5.7 percent in the first half of 2004, industrial production is estimated to increase by 4.2 percent in the second half of the year. Some of the slowdown in the industrial sector will be due to higher energy prices, which are affecting industrial demand across the world. Consumer expenditures are forecasted to remain strong, despite gradually increasing interest rates and high energy prices. If employment improves, consumer spending may increase by 3.5 percent in the second half of 2004, followed by an increase of 3.0 percent in 2005.

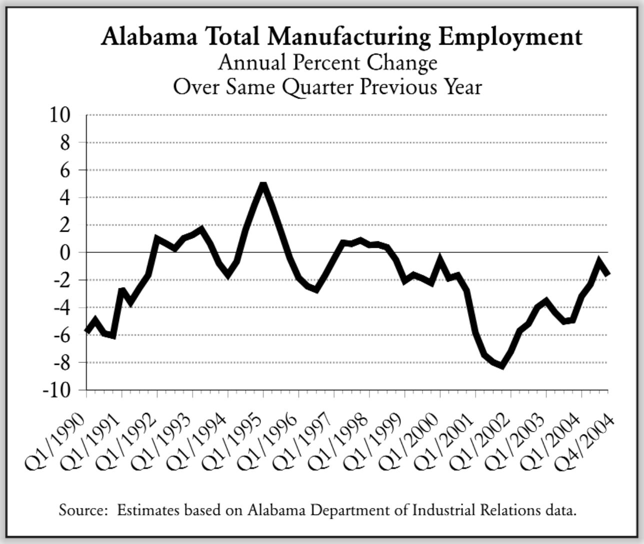
For the year as a whole, payrolls are expected to grow by 1.5 percent in 2004, followed by a 1.7 percent increase in 2005. The sector that will record the fastest growth in workers is services—professional and business services and educational and health services.

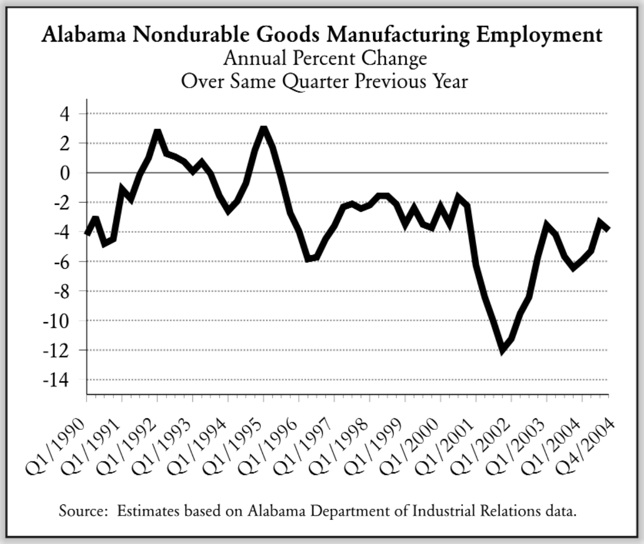
Temporary employment services will be in strong demand, as firms find it advantageous to hire more employees on a

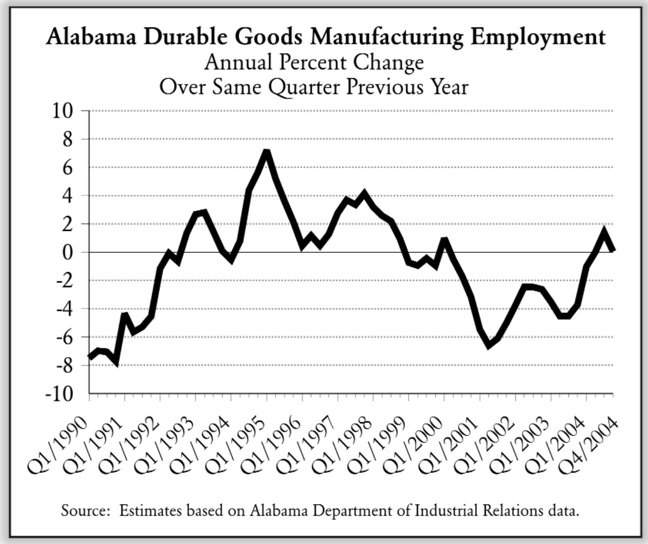


Alabama Total Nonagricultural Employment
Annual Percent Change
Over Same Quarter Previous Year

Source: Estimates based on Alabama Department of Industrial Relations data.







temporary basis. Despite relatively strong consumer spending, employment in retailing will remain muted at least through the rest of this year and well into the first half of next year.

Alabama

Employment. From August 2003 to August 2004, the state gained 7,800 new nonagricultural jobs–6,400 in services producing industries and 1,400 in goods producing sectors. While payroll employment in mining and natural resources industries remained flat, construction added 2,900 new jobs.

Manufacturing lost 1,500 jobs. However, within the manufacturing sector, some industries gained employment while others lost. The durable goods sector added 2,800 net new jobs, 2,200 of which were in transportation equipment manufacturing, including motor vehicle manufacturing (1,200). The automotive industry is Alabama manufacturing's bright spot. The number of jobs being added in the state's automotive sector has helped mitigate payroll declines in other manufacturing industries.

Industries that lost jobs included steel (1,000 jobs); computer and electronic product manufacturing; and electrical equipment, appliance and component manufacturing (another 1,000 jobs). The job losses in nondurable manufacturing were even more noticeable. This sector lost 4,300 jobs during the most recent twelve-month period, of which 2,200 were in textiles and apparel.

Although labor markets seem to be improving, most jobs being created are in services, with relatively less pay and benefits than are usually offered in manufacturing. Within the services producing sector, in the 12 months to August 2004, payroll employment increased by 0.4 percent, adding 6,400 new jobs. Most of the jobs were in retailing (2,900), professional and business services (2,300, mostly in Huntsville), and educational and health services (1,800). Huntsville, Mobile, Montgomery, and Tuscaloosa accounted for almost 97 percent of the total retailing jobs added. Birmingham lost 700 retailing jobs.

The information sector in the state lost 1,200 jobs and the financial activities sector dropped 1,200 jobs, most of them (1,100) among insurance carriers and related activities. The information sector, which includes technology, is still saddled with a great deal of excess capacity brought online in the late 1990s. Until that excess capacity is worked out,

Alabama Nonagricultural Employment Change in Number of Jobs

	August 2003 to August 2004
Total Nonagricultural	7,800
Natural Resources and Mining	0
Construction	2,900
Manufacturing	-1,500
Durable Goods Manufacturing	2,800
Wood Products Manufacturing	900
Primary Metal Manufacturing	-100
Fabricated Metal Product Manufacturing	-900
Machinery Manufacturing	300
Computers and Electronic Products Manufacturing	-600
Electrical Equipment, Appliance and Component Mfg.	-400
Transportation Equipment Manufacturing	2,200
Motor Vehicle Manufacturing	1,200
Furniture and Related Products	1,200
Nondurable Goods Manufacturing	-4,300
Food Manufacturing	-300
Textile Mills	-500
Textile Product Mills	-100
Apparel Manufacturing	-1,600
Paper Manufacturing	-300
Plastics and Rubber Product Manufacturing	300
Trade, Transportation and Utilities	3,800
Wholesale Trade	500
Retail Trade	2,900
Transportation, Warehousing and Utilities	400
Information	-1,200
Telecommunications	-600
Financial Activity	-1,200
Professional and Business Services	2,300
Educational and Health Services	1,800
Leisure and Hospitality	200
Other Services	-600
Government	1,300
Federal Government	-100
State Government	200
State Education	-100
Local Government	1,600

Source: Alabama Department of Industrial Relations.

any net job gains are unlikely. During the twelve-month period between August 2003 and August 2004, every metro area in the state lost jobs in information and technology. The Birmingham metro area lost almost 600 jobs, 400 of which were in telecommunications.

Tax revenues. After one of the worst fiscal years in decades for almost every state in the nation, fiscal year 2003-2004 (FY2004) saw a significant improvement in state tax receipts. For FY2004, total tax receipts increased by 8.2 percent over the previous fiscal year, from $6.353 billion to $6.872 billion. Individual income tax receipts were up by almost 8 percent, increasing from approximately $2.5 billion to almost $2.7 billion. Corporate income tax revenues totaled $299.7 million, up by almost 25 percent over the previous fiscal year. Because of increased business spending, sales taxes were up by slightly over 8 percent, increasing from almost $1.6 billion in FY2003 to over $1.7 billion. For FY2004 the appropriations for the Alabama Education Trust Fund totaled approximately $4.45 billion, an increase of about $206 million over the previous fiscal year. However, appropriations made to the General Fund declined by almost 1.3 percent, or about $16.5 million.

Outlook. Even though energy prices are acting as a drag, the state's economy is in a much better position in third quarter 2004 than it was in the first half of the year. Both a decline in initial benefit claims for unemployment and fewer mass layoff announcements clearly show an improving economy. For the year as a whole, the state's economy is estimated to grow at an average annual rate of 3.7 percent, with employment increasing 0.3 percent, adding approximately 5,000 net new jobs.

However, neither wage nor payroll growth is yet strong enough to carry all sectors of the economy. The fastest growing sectors are expected to be professional and business services, health care services, and in the industrial sector, automotive related firms. Other industries expected to show a clear improvement will be rubber and plastics manufacturers, wood products related industries, machinery manufacturing, and construction related industries.

Direct investment in the industrial sector, primarily in the automotive industry, is expected to stay robust during the remainder of the year and well into 2005. Business spending, which has improved significantly this year, is also forecasted to continue strong for the remainder of 2004, growing at an average annual rate of close to 8 percent.

Ahmad Ijaz