Economic Outlook: 2nd Quarter 2006

United States

Overview. During 2005 the United States economy grew 3.5 percent. Current estimates put first quarter 2006 growth at a strong 4.5 percent. In the remainder of 2006, GDP gains should slow somewhat because of rising energy prices and interest rates. A 3.6 percent increase in GDP is forecasted for the second quarter, followed by 2.5 percent in both the third and fourth quarters of 2006.

Consumer spending, which in 2005 accounted for almost 71 percent of the growth in GDP, was also strong in the first quarter of 2006. After rising 3.5 percent in 2005, consumer expenditures rose 5.1 percent in the first quarter of 2006. Spending was particularly strong on big ticket items, climbing almost 17.5 percent compared to a 16.6 percent decline in the fourth quarter of 2005. This remarkable growth is primarily due to strong sales of light trucks, computers, furniture, and other household equipment. Expenditures made on nondurable goods and on services increased by 5.5 percent and 2.7 percent, respectively, in the first quarter.

Business spending on equipment and software also increased sharply in the first quarter. Spending on communications equipment jumped almost 47 percent, while expenditures for computers and peripherals increased about 9 percent. However, spending on industrial equipment was weak.

The manufacturing and construction sectors continued to expand in March, signaling a strong economy, despite emerging signs of inflation driven by higher oil prices. The Institute for Supply Management’s manufacturing index registered 55.2 in March, compared to 56.7 in February; an index of 50 or above indicates expansion. Raw materials and energy prices, which have risen sharply in recent months, are of great concern to the industrial sector. Significant productivity growth in the industrial sector should help these firms register about a 5.5 percent increase in output for the first quarter without much change in their payroll employment.

While housing continued to see strength in multifamily units, construction of new homes fell 7.8 percent in March, the fourth decline in the past six months. A weakening housing market is particularly noticeable in the new home segment, where developers are offering discounts and incentives to buyers. New home sales most probably peaked in July 2005 and the used home sales peak was probably in June 2005. Both categories have been slowly declining since then.

A big jump in gasoline prices pushed inflation up at both the wholesale and retail levels, but the core rate of inflation, which excludes food and energy, remained fairly tame. The core rate was 1.7 percent for the past 12 months. Sharp increases in costs for gasoline and other raw materials will continue to move prices higher during the remainder of 2006.

The U.S. trade deficit hit a record high of $725.8 billion in 2005, up 17.5 percent from the previous $617.6 billion record set in 2004, making it the fourth consecutive record-setting trade deficit. There were sharp increases in imports of both oil and consumer goods. The expiration of international quotas on textiles and apparel at the beginning of

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2005 and a 39.4 percent increase in oil imports are two primary reasons for the sharp increase in the trade deficit in 2005. Imports rose 12.9 percent to a new record of $2 trillion. The U.S. deficit with China rose to $201.6 billion in 2005—a 24.5 percent increase over the previous record deficit of $161.9 billion in 2004—and is the highest ever recorded with any country.

Good economic news is that payroll employment has risen solidly for five months. There are more jobs in construction, services, and government. Construction added significant numbers of employees over the winter, although employment gains slowed in March. Services added almost 178,000 jobs in March, with strong payroll increases in general merchandise stores, food services and drinking places (including restaurants), and professional and business services. Sizeable gains were also recorded in hotel employment and health care. Government jobs have also increased, primarily at the state and local levels.

Despite job gains in other sectors, there are fewer jobs in manufacturing. Manufacturing lost 5,000 jobs in March; the sector has lost almost 56,000 jobs in the last 12 months. Due to rapid growth in productivity, the manufacturing sector is not expected to experience any significant gains in payrolls. More than four years after the last recession ended in November 2001, the current economic expansion remains the weakest in about four decades in terms of payroll employment gains, even counting the jobless recovery of the early 1990s.

**Outlook.** Growth in U.S. Gross Domestic Product is forecasted to average 3.3 percent during 2006. Higher energy prices and increased borrowing costs for consumers will slow consumer spending to about 3 percent for the remainder of the year. Business spending is expected to remain strong. Expenditures on software, computers, and peripheral equipment will increase this year.

The Federal Reserve will most likely increase the federal funds rate to 5.0 percent in May, a 16th consecutive increase in less than two years. But if the economy, particularly the housing market, begins to show weakness, the Fed might consider pausing after the May increase. Rising interest rates will significantly affect housing markets and prices and make mortgage refinancing more difficult. The 10-year treasury yield is expected to rise from its current level of around 5 percent to about 5.5 percent by year end. The 30-year fixed mortgage rate is forecasted to be around 6.8 percent by the end of 2006.

The biggest risks include rising energy prices, a sharp increase in borrowing costs for both firms and consumers, and a rapid decline in housing markets and housing prices.

A rise in inflation, either due to energy costs or raw material prices, will definitely mean more interest rate hikes by the Fed. Rising energy prices can also start to derail industrial activity and, more importantly, consumer spending.

**Alabama**

**Review.** Alabama’s economy has showed strong payroll growth through most of 2005 and thus far in 2006. From February 2005 to February 2006, Alabama gained 48,800 new jobs.
mostly in service businesses (32,700 of the 48,800). Professional and business services added 10,300 jobs to their payrolls, primarily in administrative support and related occupations (8,100). Educational and health services also gained 5,700 jobs, mostly in health care and social assistance. Leisure and hospitality firms added 6,900 new workers to their payrolls, of which 4,700 were in food services and drinking places.

Counter to the nationwide trend of manufacturing job loss, the state gained 9,400 manufacturing jobs between February 2005 and February 2006. The gains were not even across all manufacturing industries. Durable goods producing industries added 10,900 jobs, while firms producing nondurable goods lost 1,500 jobs. Not surprisingly, the durable goods industry that added the most jobs was transportation equipment manufacturing (including both motor vehicle manufacturing and aerospace products and parts manufacturing) with a gain of 9,100 net new jobs. Other manufacturing industries that added jobs include primary and fabricated metals (1,500), computer and electronic product manufacturing (900), wood product manufacturing (500), and machinery manufacturing (300). Furniture manufacturing lost 900 jobs. Almost all nondurable goods producing industries, which include textiles and apparel, paper products, plastic and rubber products, and food manufacturing, saw losses in their payrolls.

Employment in information-related industries remained flat during the period. Wholesale trade added 1,600 to its payrolls, but retailers lost 200 jobs. Both food and beverage stores and department stores lost jobs. The government sector added 4,800 jobs, mainly in state and local government entities. Natural resources and mining gained 700, and construction employment increased by 6,000.

Of the 48,800 jobs added during the February 2005 to February 2006 period, 36,900 were located in the state’s metropolitan areas that comprise 27 Alabama counties. The other 40 counties saw their payrolls rise by 11,900. Metropolitan areas that added the most workers included Birmingham-Hoover (8,800); Huntsville (6,100); Mobile (5,800); and Montgomery (4,400).
**Tax Revenues.** Along with strong employment growth, Alabama has seen a significant increase in tax revenues. For the first six months of the current fiscal year, October 2005 to March 2006 inclusive, total state tax revenues are over $4 billion, 9.5 percent (about $350 million) higher than was received in the first six months of the previous fiscal year. Sales tax revenues are up 10.4 percent to $973 million, almost $92 million higher. Corporate income tax receipts totaled $205 million, an increase of 16.9 percent or $39 million. Individual income tax revenues have risen roughly 7.9 percent to almost $1.5 billion, $107 million higher than revenue for the same period last year. Appropriations made to the Alabama Education Trust Fund rose more than $168 million to $2.4 billion, an increase of 7.3 percent. Appropriations made to the state’s General Fund increased approximately $124 million, a little more than 18 percent, to $805 million.

**Outlook.** In 2006 Alabama’s economy is expected to grow roughly 3 to 3.5 percent. After a robust first half of the year, higher energy prices and gradually rising interest rates will begin to have an impact on consumers and businesses, particularly those in energy sensitive sectors. Payroll employment is expected to remain strong in automobile manufacturing. Within the services sector, most of the job gains will be in eating and drinking places, administrative assistant and related clerical occupations, professional and business services, and health care-related occupations.

The state’s manufacturing sector output is expected to grow about 5 percent, largely due to the automotive industry and aerospace and parts-related industries. Manufacturing industries in the state are forecasted to add almost 6,000 new jobs in 2006. Professional and business services firms will add nearly 8,000 workers to their payrolls; most of the new jobs will be in professional, scientific and technical services and in administrative support and related services. The leisure and hospitality sector is also expected to gain roughly 6,000 jobs, mainly in restaurants. Health care and social assistance services will also add about 5,000 jobs. As housing markets begin to cool, payroll gains in construction-related industries are expected to be far less than recorded for last year.

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