Economic Outlook—Quarterly Update

January 2003

United States

Overview. After growing at an average annualized rate of 4.0 percent in the third quarter of 2002, the U.S. economy slowed significantly in the fourth quarter. Although the economy continues to show signs of gradual improvement, the recovery is likely to be jobless—similar to the experience after the 1990-91 recession. This also has been one of the weakest economic recoveries in the post World War II period, but the recent recession was also one of the mildest in terms of its duration and the decline in growth of gross domestic product (GDP). The first four quarters of all previous recoveries averaged annualized GDP growth rates of over 7 percent. For the first three quarters of 2002, GDP grew at an annualized rate of 3.5 percent, roughly half the rate of previous recoveries. A significant slowdown in fourth quarter 2002 forced the Federal Reserve to cut the fed funds rate to 1.25 percent, the lowest level in over four decades.

In the first three quarters of 2002, consumer expenditures on durable goods increased by 5.5 percent, while residential investment, one of the strongest segments of the economy, increased by 6.2 percent. Compared to previous economic recoveries, growth in both consumer spending and residential investment seems low, but these two sectors of the economy never really experienced a downturn during the three quarters of recession in 2001 so no pent up demand developed. Cutbacks in business investment spending are the main reason why the pace of the current economic recovery seems tepid. Business investment usually increases by over 8 percent in the first year of recoveries but it has declined by more than 5 percent in this recovery. Businesses continue to suffer from excesses of capital investment made in the late 1990s and thus the recovery will remain fairly modest as indicated by most economic statistics. The index of leading economic indicators rose 0.5 percent in November and 0.1 percent in December. Together with the widening spread between long term and short term interest rates, these indicate improving economic conditions six to nine months into 2003. GDP growth is expected to be around 2.6 percent for first quarter 2003 and slightly over 3 percent for the entire year.

The Institute for Supply Management’s factory index increased to 54.7 in December from 49.2 the previous month, the first increase since August and the highest since June 2002; an index reading of above 50.0 indicates expansion in manufacturing. The new orders index, accounting for about a third of the total index, increased to 63.3 from 49.9 in November—the highest rate since March 2002. However, most of manufacturing still remains generally weak in terms of both exports and domestic demand. The industrial production index declined 0.2 percent in December. Industrial production grew...
by less than 1.0 percent for 2002, resulting in the slowest rate of growth in any three-year period since 1983. In 2003 industrial production is expected to increase by around 2.5 percent mainly due to high levels of productivity rather than significant job increases. Industrial machinery and equipment manufacturing is expected to remain weak.

New housing sales are also expected to continue strong, at least in the short term. Housing starts surged 5.0 percent in December to their highest level since mid-1986, with sales increasing by 5.7 percent; starts on single-family homes were at their highest levels since 1978. At 5.85 percent, mortgage rates, which have dipped to the lowest level since 1965, may have contributed to this surge. In the last two years, the average cashout during refinancing has been over $26,000 and is partially responsible for the high consumer spending levels through the recession and current recovery. The strong housing market has also improved households’ net worth and cushioned some of the shock from declines experienced in the stock market.

One of the strongest sectors of the economy this year will be defense-related capital goods. Federal government spending is expected to increase by over 10 percent in 2003, while gains in consumer spending are forecasted to dip slightly from 3.0 percent in 2002 to around 2.8 percent. Major downside risks to the forecast include the possibility of war with Iraq, its impact on energy prices, and reluctance of businesses to increase investment spending on capital goods.

**Employment.** U.S. payrolls unexpectedly fell by 101,000 in December with the unemployment rate remaining unchanged at 6.0 percent. This is the largest drop in nearly 10 months. The economy has lost 1.6 million jobs in the last two years, the largest decline in overall employment since World War II; the only other consecutive two-year employment dip was in 1957-58. Retailers lost almost 104,000 jobs in December, after losing 40,000 the previous month, while manufacturing jobs declined by 65,000. The employment situation is expected to remain generally weak in 2003, with payroll employment increasing by just 0.7 percent, following a decline of approximately 1 percent in 2002. After dropping by over 5 percent in 2002, manufacturing employment will decline further by around 2.5 percent in 2003. The only sector that could see significant job growth will be services, primarily health and business services. The unemployment rate will inch upward with a probable peak at 6.2 to 6.3 percent in the middle of the year.

**Alabama**

**Overview.** From November 2001 to November 2002, the state lost 14,300 jobs. The manufacturing sector lost 7,000 jobs overall but there were gains of almost 2,500 jobs in transportation equipment-related manufacturing, specifically motor vehicle and related production. Almost all other manufacturing industries lost jobs. The most notable job losses were in the steel industry (1,800 jobs), industrial and other machinery manufacturers (1,700 jobs), and apparel (2,800 jobs). Manufacturing continues to remain weak, faced with excess capacity and lack of demand growth, and is not expected to see a turnaround until the second half of 2003 or perhaps 2004. Lack of business investment in capital equipment is adversely affecting both industrial and other machinery manufacturing in the state. However, it is important to note that job losses in manufacturing have slowed significantly; 2002 saw about half the losses of 2001. Manufacturing sector output is expected to grow by over 5 percent in 2003, with automobile and related production accounting for most of the growth.

One of the strongest sectors of the state economy has been residential construction, primarily in the state’s metro areas. Construction gained almost
1,300 jobs from November 2001 to November 2002, compared to a loss of 1,000 jobs in the November 2000 to November 2001 period. The sector in turn also helped the lumber and wood products industry to gain about 100 new jobs. Overall construction expenditures increased by almost 17 percent from October 2001 to October 2002; expenditures on single-family homes increased by slightly over 25 percent. Expansion of both the Honda plant in Talladega County and the Mercedes plant in Tuscaloosa County contributed immensely to new industrial construction in the state. Housing construction is expected to remain strong throughout the year and together with ground breaking for the Hyundai plant in Montgomery County, overall construction is expected to grow at approximately 3 percent.

Alabama gross state product is expected to grow 2.8 percent in 2003, with output in the motor vehicle industry increasing by approximately 11 percent. Output of the combined wholesale and retail trade sector should grow by slightly over 2 percent. In general, employment will remain sluggish with only services-related businesses and motor vehicle-related manufacturing showing any notable improvement in payrolls. Unless there is a significant upturn in capital spending, employment is only expected to increase by 0.6 percent during 2003.

**Tax Revenues.** For the first quarter of the current fiscal year, which is actually the fourth quarter of the calendar year, total tax revenues were up a very
significant 4.8 percent ($64 million) to $1,387 million, much better than the 1.4 percent decline for the same period in the previous year. Individual and corporate income tax receipts rose sharply, 8.6 percent ($42 million) and 28.8 percent ($9 million), respectively. However, a generally slow economy in the fourth quarter of 2002, resulting in one of the most sluggish retailing seasons in recent history, led to a 1.2 percent ($4 million) decline in sales tax receipts to $385 million. Appropriations made to the state’s General fund were up by almost $78 million, an increase of about 33 percent to $314 million. State appropriations to the Education Trust fund were up by 3.2 percent, increasing from $934 million to $963 million.

For the current fiscal year, total tax revenues are expected to increase by 2.5 percent or $152 million to $6,216 million. Income tax receipts (combined individual and corporate) are estimated to rise 3.4 percent or $92 million to $2,796 million. Sales tax receipts, which are heavily dependent on consumer and business spending, will grow 2.7 percent (approximately $42 million) to total $1,592 million.

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