Economic Outlook:
2nd Quarter 2003

*United States*

**Overview.** In the last two quarters, the economy has weakened somewhat. The growth of real gross domestic product (GDP) in the fourth quarter of 2002 was down significantly from the previous quarter. Consumer spending on services and nondurable goods accounted for almost 85 percent of what growth there was. Spending on durable goods, or big-ticket items, actually declined by 8.2 percent, a sharp drop when compared to the almost 23 percent increase for the third quarter. A fall in exports also contributed to the decline in GDP. The strong residential sector and federal government spending offset some of the negative effects of these declines. For all of 2002, the U.S. economy grew 2.4 percent. Despite the growth in output, employment fell 0.9 percent, a loss of about 1.2 million jobs.

Lack of business investment spending has been a major hurdle to the current economic recovery. However, after eight straight quarters of cutting capital spending, businesses increased their spending by a modest 2.3 percent in the fourth quarter, a good indication that the economy could accelerate somewhat in 2003. For all of 2002, business spending on structures, equipment, and software dropped by almost $72 billion.

Housing is one of the strongest sectors. Investment spending on homes rose 9.4 percent in fourth quarter 2002. A record 5.7 million existing homes sold in 2002, beating the 2001 record of 5.3 million. Construction of new homes and apartments rose to a 16-year high in January 2003. One major reason for the strong housing sector is people’s perception of housing as a good investment alternative to stocks, especially given the recent significant losses in financial markets. Home values have been steadily increasing in recent years and interest rates, at around 5.61 percent, are at their lowest levels in nearly 41 years. Record low interest rates give consumers the opportunity to either refinance their existing mortgages or borrow against equity in their homes. This has raised disposable income and helps to explain the stable and high consumer spending level throughout the current slow economic environment.

Supply Management’s (ISM) index fell from 50.5 in February to 47.9. An index below 50.0 indicates contraction in industrial activity. War jitters may have contributed to the drop in the index; the cutoff date for the survey is the 10th of the month but the war with Iraq did not start until the 19th. The production component of the index showed the sharpest decline, falling to 46.2 after 15 consecutive months of growth. Overcapacity and the lack of demand continue to plague the sector. Right now, manufacturing firms can add to capacity without adding workers, reducing the chances of a strong revival in industrial capital spending. Capital spending is usually a response to increases in demand, but demand remains weak throughout the global economy.

Consumer spending continues to be strong despite the weak economy, although spending on durable goods has declined somewhat. Consumer spending increased by 1.8 percent in 2002. Real incomes are rising even though jobs have been lost. Low inflationary conditions and cash-out
home mortgage refinancing are providing some relief to consumers. A Blue Chip Economic Indicators survey expects consumers to tap into $88 billion worth of home equity this year, compared to $170 billion in 2002. The University of Michigan’s March consumer sentiment index fell to the lowest level since August 1993, primarily due to uncertainty about the war with Iraq, higher oil prices, weak financial markets, and a lack of any significant job growth. However, the index rose in April after the conclusion of the short war and the subsequent decline in oil prices.

The Conference Board’s current condition index, which reflects consumers’ perception of their financial situation and whether it is a good time to buy big-ticket items, fell in February to the lowest level since October 1992. The expectations index fell in February to the lowest reading since September 1993.

The U.S. economy has lost almost two million jobs since the recession began in March 2001. Manufacturing alone has lost 2.1 million jobs since August 2000, the start of the industrial sector downturn. Manufacturing job losses do not seem to be abating, as 36,000 jobs were lost in March. Also in March, the services sector lost 94,000 jobs, following a 256,000-job loss in February. Most cuts were in retailing. Significant excess capacity will have to be used up before manufacturing and retailing start hiring again; short term prospects do not look bright. The government sector also lost 40,000 jobs, mainly in local education due to severe budget problems facing most states.

Outlook. Despite aggressive monetary and fiscal policies, the U.S. economy has had a hard time rebounding. An anemic global economy, declining profits, and poorly performing financial markets are affecting both consumer and firm spending behavior and patterns. The economy struggled in the first quarter because of war-created uncertainty and lack of job growth. However, we anticipate that consumer spending, and to some extent business spending, will begin to revive in the second half of 2003 and into 2004. The economic recovery will gain some momentum over the summer and fall. Overall, the economy is expected to grow about 2.7 percent in 2003, mainly fueled by consumer and federal government spending. Overcapacity and employment cuts should keep inflation about 2 percent. The housing sector will remain strong as long as the mortgage rates are low and financial markets stay depressed. Business spending, which has declined for two straight years, is forecasted to grow by 2.5 percent, particularly because of spending on equipment and software. Spending on structures and industrial equipment is not expected to increase significantly until 2004. Employment is expected to increase by 0.3 percent.

Alabama

Overview. The state economy grew 1.6 percent in 2002. Employment fell 0.9 percent (approximately 17,400 jobs); the state unemployment rate equaled the nation’s at 5.7 percent. Services grew fastest, around 2 percent, while manufacturing and retailing had the most job losses. The telecommunications industry suffered losses in sales and employment.

Employment. Of the 17,400 job losses statewide in 2002, manufacturing accounted for 11,125 jobs. Transportation, which includes both motor vehicle-related production and certain defense-related industries, remains one of the fastest growing segments of the state economy and was the only industrial sector to add to its payroll, with almost 2,600 jobs gained. The steel industry lost approximately 2,300 jobs and industrial and other machinery manufacturers lost about 3,100 jobs. Job losses were even more pronounced in nondurable goods producing industries; apparel lost 3,300 and paper products and related industries shed 850.
The most recent data show that the jobs losses may be abating somewhat. However, manufacturing industries, mainly primary and fabricated metal, machinery manufacturing, and textiles and apparel continue employment declines. A pleasant surprise is that apparel, which has experienced the largest payroll losses among the state’s industries in recent years, only lost 300 jobs from February 2002 to February 2003.

**Tax Revenues.** Most states are facing the biggest tax shortfall in post-World War II history, with almost 36 states reporting severe budget shortfalls. Tax receipts are falling short due to lack of business spending and sales, which in some cases accounts for almost half of the states’ sales tax revenues. States are also facing sharply rising Medicaid costs. Alabama’s situation is not as dire as many states, particularly those that passed tax cuts during the booming 1990s.

Over the first two quarters of the current fiscal year, Alabama tax revenues are up by 5.6 percent (almost $157 million) to $2,961 million, compared to a decline of 0.4 percent during the same period in the last fiscal year. Individual income tax receipts have increased approximately $78 million to $1,165 million, a 7.2 percent rise and much better than the 2.5 percent decline recorded for the same period last fiscal year. However, corporate income tax collections have fallen 5.3 percent to $100 million. Sales tax collections, which depend on both consumer and business spending, are up by 2.3 percent to $778 million, an approximately $17 million increase, mainly due to consumer spending. Sales tax collections were up 1.3 percent during first two quarters of the previous fiscal year.

Legislative appropriations made to the state’s General Fund during the first two quarters of the current fiscal year
are up almost $108 million over the same period in the previous fiscal year. Appropriations to the General Fund totaled $627.8 million, an almost 21 percent increase. State appropriations to the Education Trust Fund were up 3.2 percent ($64 million) over the first two quarters of the previous fiscal year to a total of $2,023 million.

**Outlook.** The state economy is expected to grow about 2.5 percent in 2003, with an employment gain of 0.3 to 0.5 percent. That would be about 6,000 to slightly over 9,000 jobs. With many new automotive-related plants in the pipeline associated with Hyundai and the expansion of the Honda plant in Lincoln, the state could see a significant increase in automotive-related payrolls over the next two or three years. No large increases in payrolls are expected particularly for the steel, electrical and nonelectrical machinery, and telecommunications industries.

Most job growth this year will be in services-related businesses. The state unemployment rate is expected to remain around 5.7 to 5.8 percent through year.

*Ahmad Ijaz*