Economic Outlook: 3rd Quarter 2003

United States

Overview. Officially, the most recent recession ended in November 2001 and the U.S. economy is now actually in its second year of expansion. However, this jobless economic recovery has completely eluded some sectors of the economy, making the recovery seem very lackluster. Current economic conditions are similar to the post-1990-91 recession recovery when payroll employment did not begin to pick up for almost two years. Consumer spending and housing markets have remained strong throughout the downturn, but business spending and the manufacturing sector in general are still in the doldrums. Since the stock market started declining in early 2000, the U.S. economy has experienced an average annual growth rate of 1.7 to 1.8 percent, primarily due to low business confidence and declining payrolls.

In a typical recession, both housing markets and consumer spending decline, creating a pent-up demand when the recovery eventually arrives. However, in the latest downturn, both these sectors remained buoyant, reducing the expected postrecession pent-up demand for consumer goods and other manufactured products. This is one reason why the recovery has eluded the manufacturing sector. A second reason is that excess capacity brought on line in the late 1990s still has a great deal of overhang. Until this capacity is utilized, firms have little incentive to increase business spending or hire new workers. The Federal Reserve Bank has eased interest rates 13 times over the past 30 months by a total of 5.5 percentage points to the lowest level since 1958. The latest drop in June 2003 took the federal funds rate to 1.0 percent, and yet business capital spending has not revived. Manufacturing jobs have declined for 33 consecutive months. This sector accounts for almost 90 percent of the approximately 2.6 million jobs lost in the last 28 months.

For the first three months of 2003, the U.S. economy expanded at an annual rate of 1.4 percent. Consumer spending increased by two percent, a little better than the 1.7 percent growth in the previous quarter. Spending on nondurable goods grew 6.1 percent, following a 5.1 percent rise in the fourth quarter of 2002, while spending on durable goods fell further by 2.1 percent after an 8.2 percent decline in the last quarter of 2002. Fueled by low interest rates, sales of new homes increased by 12.5 percent to a record 1.2 million units in May. New housing construction reached a five-month high in June. However, spending on capital goods by businesses is still restrained. Spending on software and equipment dropped 4.8 percent in the first quarter, a reversal from the 6.2 percent increase in fourth quarter 2002; overall spending on capital goods declined by 5.3 percent. On a more positive note, corporate profits are showing signs of improvement after months of cost cutting through payroll reductions. Corporate profits rose 2.5 percent in the first quarter of 2003, following 4.1 percent growth in the previous quarter.

Although the economy continues to grow modestly, the first half of 2003 saw a rapid increase in layoffs. With uncertainty surrounding the war in Iraq lifted, it is more likely that economic growth will accelerate somewhat in the second half of the year. Evidence of this is showing in retail sales and increasing consumer spending. Consumer spending is expected to rise by 2.8 percent in second quarter 2003 and by about 3.6 percent in the second half of the year. The economy is expected to grow by 2.0 to 2.5 percent this year. Productivity increases will drive this growth, but will also constrain job gains. Payroll employ-
ment is expected to decline by 0.3 percent, a net loss of approximately 400,000 jobs. Only once since World War II has the economy lost jobs for three consecutive years during a downturn. The last time was in 1952 due to a steel industry strike. Government purchases grew by almost 7.5 percent last year and are expected to rise again this year. The federal government should remain one of the strongest sectors; its expenditures are expected to grow by almost seven percent in 2003. Severe budget shortfalls will cause state and local government sector spending to increase by just 0.1 percent.

Manufacturing. The Institute of Supply Management’s (ISM) index rose slightly in June. Orders are showing some postwar signs of improvement. Manufacturing has been one of the hardest hit sectors in recent years. Industrial machinery and electronics manufacturers and communications equipment producers are among those that have suffered the most. Productivity gains in recent years have contributed to the dismal employment situation in manufacturing. While generally positive over the long run because it leads to a higher standard of living, productivity improvement can adversely affect payroll employment in the short term. With productivity increasing faster than economic growth, firms are refraining from adding workers. The economy grew at a faster pace than productivity in previous economic recoveries. Globalization has also shipped some factory work overseas. The nation’s factories are running at 74.3 percent of capacity versus an average utilization rate of 82.7 percent five years before the recession began.

Manufacturing employment fell 5.5 percent in 2002 and is expected to decline by 3.4 percent, or almost 575,000 jobs, this year. Both durable and nondurable goods producing firms are expected to lose jobs. Durable goods manufacturers will fare worse, with nearly all industries within this category losing jobs. Any recovery in manufacturing will depend on capital and equipment investment, which in turn depends on demand conditions and profits. Even though the Conference Board’s index of leading indicators has indicated improving conditions in recent months, the lack of business confidence remains a concern. The gain in the index has been mainly due to the rising stock market, declining jobless claims, and rising consumer confidence.

Consumer Spending. After a slight slowing in the first quarter, consumer spending appears to be picking up again. For the first half of the year, consumer spending is expected to increase by 2.4 percent. Consumer attitudes in June were slightly less optimistic than in May; the University of Michigan’s confidence index fell to 89.7 from 92.1. The current conditions index rose, but the future expectations index deteriorated. Continuing layoffs and increasing unemployment are largely responsible for the movement in the indexes. Consumer spending on electronics, appliances and home furnishings, general merchandise, and apparel remained strong in the first half of the year, offsetting the declines experienced in automobile sales, travel, and recreation. Newly enacted federal income tax cuts are expected to boost disposable income, thus setting the stage for strong consumer spending in the second half of the year. The income tax cuts should increase household spending by 1.5 percent in the second half of 2003, or by approximately $120 billion annualized. The tax cuts will raise disposable income in 2004 by $190 billion and lead to an additional $130 billion in spending. After an increase of 2.4 percent in the first half, consumer spending is expected to rise 3.9 percent in the second half of this year, with strong growth in computer sales, motor vehicles (mostly light trucks), household furnishings and equipment, recreation, and medical services.

One cautionary note is that household debt is now in excess of 80 percent of U.S. gross domestic product (GDP), about 15 percentage points higher than in the early 1990s. Household debt grew 10 percent in the first quarter of 2003 compared to fourth quarter 2002, primarily driven by an 11.6 percent increase in mortgage debt, which now stands at $6.2 trillion. Overall consumer debt is up 25 percent in the last two years. Despite these high levels of debt, consumer spending will be strong so long as consumers feel they can service their debt payments. Consumer spending accounted for almost 80 percent of GDP growth in 2002 and should drive most of the economic growth in 2003.

Employment. More than two and a half million jobs have been lost since the start of the recession in March 2001; about 600,000 in just the first half of 2003. The number of discouraged workers, those who would like to work but have stopped looking, is around 9.2 million and part-time workers number about 4.8 million, up 46 percent from 2001. Nationally, employment is in its third
year of contraction. The unemployment rate climbed to 6.4 percent in June, the highest level in more than nine years, with businesses cutting 30,000 jobs from payrolls. Since March, the number of workers being laid off has increased by 93,000, with manufacturing accounting for 56,000. It should be noted that unemployment, a lagging indicator, always rises on the verge of recovery as the number of people looking for jobs increases. In June, optimistic expectations about the economy led over 600,000 more people to search for work. Improving conditions in manufacturing and services raises the likelihood for payroll loss deceleration in the second half of 2003. Significant improvement in manufacturing payrolls is not expected until 2004. Strength in residential construction has led to the addition of over 100,000 construction jobs since February. Almost 10,000 new services jobs were added in June, after a 54,000-job loss in May. Temporary employment also increased by 38,000 in June, after an increase of 44,000 in May. However, price pressures continue to force firms to lay off people in order to reduce costs.

**Outlook.** The U.S. economy will grow 2.0 to 2.5 percent in 2003. The second half of the year will post a much stronger gain fueled by both monetary and fiscal policies. Consumer price inflation is expected to remain subdued at about two percent, a slight increase over the 1.6 percent recorded in 2002. The 2003 tax package should boost consumer spending in the second half of this year and next year. Consumer spending is forecasted to increase by 2.7 percent this year, with almost five percent for durable goods and slightly over three percent for nondurable goods. Business capital spending will probably decline by one percent and put downward pressure on payrolls. The manufacturing sector will remain weak through the end of the year and the weaker dollar is not expected to help much due to overcapacity, weak global demand, and the yuan-dollar peg. Change in the exchange value of the U.S. dollar does not affect the U.S.-China trade imbalance.

**Alabama**

**Employment.** The state lost 15,800 jobs, mostly in manufacturing, from May 2002 to May 2003, a decline of about 0.8 percent. The loss of 11,000 manufacturing jobs was partially offset by a slight gain in construction jobs. Except for motor vehicle and related industries, almost all manufacturing industries lost jobs. Fabricated metals lost 1,800 jobs, electrical and nonelectrical machinery manufacturing (1,400), transportation equipment excluding motor vehicles (1,500), food manufacturing and processing (1,800), and apparel manufacturing and textile mills (1,800). Payroll losses were also fairly widespread in service producing industries. Substantial declines were experienced in financial activity employment (1,400) and wholesale and retail trade (4,300), with food and beverage stores losing almost half of these. However, educational and health services added almost 2,000 new jobs to their payrolls. The government sector also added 2,300 new jobs.
Job gains in motor vehicle production and related industries have negated some of the payroll declines experienced in other sectors. The automotive industry continues to expand production capacity in the state.

**Tax Revenues.** Most states have experienced substantial budget shortfalls. Thirty-seven states have cut $14.5 billion off current year budgets and 29 states have proposed a total of $17.5 billion in new taxes. Most of the decline in tax receipts has been due to the substantial fall in business spending and capital gains. Upward spiraling health care costs have added to states’ woes, with some health care-related costs rising by as much as 18 percent over the previous year. For the first nine months of the current fiscal year, Alabama state tax revenues are up 2.3 percent, or $105 million, to $4.6 billion. Sales and individual income tax revenues have risen 2.4 percent to $1,182 million and $1,882 million, respectively. Corporate income taxes are down 7.5 percent. Legislative appropriations to the General Fund are up almost 20 percent, or $157 million, compared to the same period in the previous fiscal year, to $957.6 million. Appropriations to the Education Trust Fund are up by 2.1 percent, or $63 million, to a total of $3,083 million.

**Outlook.** The Alabama economy will grow by about two percent in 2003, with employment falling 0.5 percent, a loss of almost 10,000 jobs. Most of the economic growth will be in services, specifically health care and government. Job gains in motor vehicle production and related industries will continue. Lack of capital spending and excess manufacturing capacity will continue to constrain new payroll jobs.

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