Economic Outlook: 1st Quarter 2004

United States

Overview. The nation’s gross domestic product grew at an astounding 8.2 percent annual rate in the third quarter of 2003, the strongest pace seen since the first quarter of 1984. Nevertheless, this overall recovery has been one of the slowest, with no significant employment gains. The lack of pent-up demand in both housing and consumer markets, above average productivity gains, and excess capacity (or underutilized capacity) in manufacturing are some of the reasons why the current recovery has been a jobless one. In some areas, particularly the industrial sector, it does not even seem like a recovery.

Despite slow going, the U.S. economy is showing signs that recovery is underway. Even the labor markets are on the verge of a turnaround. From September to December 2003, the number of people filing for state unemployment benefits dropped by 500,000. The second half of 2003 also brought significant improvements in business spending and profitability. Consumer spending on durable goods increased by over seven percent in 2003, while spending on computers and software rose more than 30 percent and 13 percent, respectively. After declining for six straight quarters, capital spending by businesses increased more than 8.5 percent during the last three quarters of 2003.

Inflation. A rebound in the economy is generally accompanied by an increase in both inflation and interest rates, but not this time. In November the inflation rate fell to its lowest level in 40 years. Even with industrial production improving and housing markets strengthening, the consumer price index dropped 0.2 percent, bringing the annual rate of inflation to 1.8 percent for 2003. The core rate of inflation, excluding food and energy, dropped by 0.1 percent, the first decline seen in the core rate since 1982. One reason for this behavior could be that both ample capacity in manufacturing and unemployment are putting downward pressure on prices. Inflation may have bottomed out and it should remain subdued in the near term. Consumer prices could rise about 1.3 percent in the first half of 2004. Then as employment begins to improve in the second half of the year, we could see another increase in prices.
Industrial Production. Manufacturing activity surged in December, showing significant gains on new orders and employment. The Institute of Supply Management’s index of manufacturing rose to 66.2, versus the November reading of 62.8. This was the largest increase in nearly 20 years. An index value of over 50.0 indicates an expansion in manufacturing activity. The index for new orders increased to 77.6 from 73.7 in November, the highest level since July, 1950. Over the last four years, the country’s manufacturing sector has been plagued by numerous difficulties—foreign competition, lack of pricing power, a deflationary economic environment, and excess capacity. In the long term, manufacturing will continue to lose jobs, particularly in labor intensive industries, and the sector will account for a smaller share of the nation’s output.

Business spending showed signs of improvement in the second half of 2003, and is expected to continue on a gradual path to recovery. We could possibly see a business spending increase of nine to ten percent in 2004. Technology related industries, which have laid off workers during the last four years, are also beginning to show some signs of a revival. Industrial activity is expected to increase at an over five percent annualized rate during the first half of 2004.

Employment. After five months of consecutive increases in employment, payrolls grew by only 1,000 in December. However, the unemployment rate dropped from 5.9 percent to 5.7 percent. The decline in the unemployment rate was not because of increased employment, but rather because of a decline of 309,000 people in the civilian labor force. Payroll employment growth has been slow in part because retailers have let people go. In particular, retailers hired far fewer workers during the 2003 Christmas season than they usually do.

While retailers cut jobs, service producing industries had an overall employment increase, even though individual components behaved differently. Temporary health services added jobs in December whereas professional and administrative services lost jobs. Manufacturing lost 26,000 further jobs in December, the 41st straight month of decline. In general, payroll employment should post a recovery this year. The relatively weaker dollar and improvement in world economies should also benefit manufacturers who are involved in export markets.

Outlook. Consumer confidence remained strong in January with the prospects of improving payroll employment. Interest rates, presently at their 45-year lows, are expected to stay low, at least through the first half of the year. Strong profits are expected to fuel an increase in capital spending. However, consumer demand may slow down because of the diminishing effects of tax cuts and gradually rising interest rates, particularly mortgage rates. The U.S. economy in the first half of 2004 is expected to grow by around 4.5 percent and perhaps by 5.0 percent in the second half.

Alabama

Employment. During the twelve month period ending in November 2003, the state lost 14,200 jobs. The hardest hit sector was manufacturing, losing 11,200 jobs, with losses spread across every manufacturing industry except motor vehicle production. Although the media has focused in recent years on the loss of apparel jobs, during 2003 the industries producing durable goods actually lost more jobs than those producing non-durable goods such as apparel. Both excess capacity and stiff competition continue to hurt Alabama’s manufacturers. Some large payroll losses were seen in textiles (2,200), apparel (1,000), primary and fabricated metals production (2,200), and computer
and electronic product manufacturing (1,800). However, the rate of job loss has slowed considerably and, in the last two months, the state’s economy has added jobs in some service related businesses.

Within the service-producing sector, the hardest hit industries have been professional and business services and retailing. Decline in demand, excess capacity, and competition plague both these industries. During the twelve month period ending in November 2003, retailers shed nearly 600 jobs, while administrative and support services declined by 2,000 jobs. Most jobs lost in retailing were in motor vehicle and parts dealers (700), food and beverage stores (1,000), and clothing and accessory stores (300). However, as the economy improves, payrolls in service industries will also improve.

**Tax revenues.** After one of the worst fiscal years in decades, the first quarter of the current fiscal year (FY2004) showed a significant improvement. The tax system in the state faces long-term structural problems but, with improving business spending and payrolls, tax collections in the current fiscal year could easily surpass last year’s collections. During the first three months of the current fiscal year, total tax receipts increased by 9.5 percent over the first quarter of the previous fiscal year, from $1.4 billion to slightly over $1.5 billion. Individual income tax receipts were up 7.3 percent.

Collections increased from $533 million during the first quarter of the previous fiscal year to $572 million in the current fiscal year. Corporate income tax revenues rose from $38.6 million to $70.8 million, an increase of approximately 83 percent. A significant improvement was also seen in sales tax collections, with tax receipts up from $385 million to almost $425 million, an average annual increase of over ten percent.

During the first quarter of FY2004, the Alabama Education Trust Fund received approximately $1.2 billion, an increase of close to $202 million over the collections during the first quarter of the previous fiscal year. However, General Fund collections declined by almost $46 million over
Budget woes continue to haunt Alabama. Although improving business spending and payroll employment are expected to cushion some of the shock from devastating declines in tax revenues experienced last year, spiraling health care costs will continue to pose a challenge. Increases in tax collections will largely depend on improved payroll employment. If, as expected, labor markets do not improve until the second half of the year, overall tax revenues are expected to increase by only about $100 million in FY2004.

Outlook. The state’s economy is expected to grow by 3.8 percent in 2004; however, the outlook for payroll employment does not appear especially bright. Although service producing industries will begin to add jobs as the economy improves, most manufacturing industries will languish. An exception will be in automotive production-related industries, one of the strongest industries in the state, with employment increasing by over four percent. Both services and retailing sectors of the economy are expected to see employment gains of around five percent in 2004, while jobs in financial activity are estimated to grow by over three percent.

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