United States

Overview. Despite a slight slowdown in the first quarter, national economic fundamentals remain on solid footing. Increased business spending, together with improving payroll employment, will continue to drive the economic recovery. Although a recovery in the industrial sector still has a long way to go, services are doing better. In spite of a decline in June, the ISM (Institute for Supply Management) nonmanufacturing index is still indicating a strong expansion. The orders and employment indexes increased significantly and the employment index value is the highest it has been since the survey began seven years ago.

Increased energy prices will affect both business costs and consumer spending. But higher fuel prices do not necessarily indicate a stalled economic recovery. Economic fundamentals for the second half of 2004 point toward relatively strong growth, even though in the first half of the year there was some weakness in payroll employment and consumer spending. For the second half of the year, the economy is expected to grow in the 4.5 to 5.0 percent range, higher than the 3.9 percent experienced in the first half. For the year as a whole, the economy is expected to grow at 4.6 percent, which would be one of the fastest rates of growth experienced in nearly 20 years.

Consumer Spending. Retail sales dropped by 1.1 percent in June, the largest decline experienced since February 2003, primarily due to a decline in automobile sales. Excluding autos, overall sales remained about even. Auto sales dropped from 17.8 million units in May to 15.4 million units in June, one of the slowest months since August 1998. Despite their recent reluctance to buy cars and trucks, consumers continue to spend, more on nondurable than durable goods. Helped by tax cuts, low interest rates, and improving payroll employment, consumer spending is growing at a very strong pace. However, the effects from tax cuts are about to wane.

Fundamentals for strong consumer spending in the second half still look promising. The Conference Board’s consumer confidence index rose in June, giving the strongest reading in nearly two years. The index tracking expectations for the next six months also increased in June. During first quarter 2004, consumer spending, which accounts for almost two-thirds of the economy, increased by 3.8 percent, compared to 3.2 percent in the fourth quarter of 2003. Although higher energy prices in both 2003 and this year have cost consumers about 40 billion additional dollars, these prices have had only a marginal effect on spending levels. Consumer spending increased in the first half of 2004 by about 3 percent, and as payrolls and the economy continue to
improve, spending in the second half is forecasted to increase by 3.9 to 4.0 percent.

With improving employment conditions, spending on durable goods is also expected to accelerate in the second half, increasing by almost 9 percent, compared to the decline we noticed in the first half of 2004. The biggest risk to consumer spending is a rapid increase in interest rates. If interest rates on consumer installment credit rise relatively rapidly, that additional burden would affect spending. The portion of disposable income that is used to pay off debts is at a record high. An increase in interest rates would further squeeze consumer discretionary income.

Employment. After an increase in payroll employment of 248,000 in May, payroll employment increased again in June by an unexpectedly lower 112,000. The economy has added nearly 1.3 million jobs in the first six months of 2004. The biggest risk to consumer spending is a rapid increase in interest rates. If interest rates on consumer installment credit rise relatively rapidly, that additional burden would affect spending. The portion of disposable income that is used to pay off debts is at a record high. An increase in interest rates would further squeeze consumer discretionary income.

Outlook. Although the economy has shown some signs of a slowdown, it remains fundamentally strong. After a long run of bad news, the manufacturing sector overall has finally turned around and continues to improve, even though not every manufacturing industry is doing well. The second half of the year is expected to see increases in both consumer spending and payroll employment. Business spending will also be a key factor in coming months. Pent up demand, inventory rebuilding, and increased hiring should help business spending grow by over 15 percent in the second half of 2004. Furthermore, depreciation allowances expire at the end of the year, and these expirations should provide extra incentives for businesses to increase their spending now.

The U.S. economy is expected to grow by 4.6 percent in 2004, the fastest growth experienced since 1984. For 2005 economic growth should be about 3.9 percent. The fixed 30-year mortgage rate is expected to be slightly above 6 percent, and could inch up to close to 7 percent next year. The 10-year Treasury note yield is expected to rise to around 4.6 percent this year and move close to 5.5 percent in 2005. After declining for three straight years, payroll employment is forecasted to increase by over 1 percent in 2004. The unemployment rate is also expected to decline, falling to 5.3 or 5.4 percent by the year’s end. The federal funds rate is forecasted to reach 2.0 percent, stabilizing economic growth.

Alabama

Employment. In keeping with the national trend, payroll layoffs in Alabama have shown a significant slowdown in recent months. Contrary to the national trend, automobile manufacturing in the state has performed exceptionally well, with the industry being the only part of the manufacturing sector
that has added any significant number of jobs. Alabama’s strong automotive sector has helped negate some of the effects of layoffs in other manufacturing industries.

During the 12-month period ending in June 2004, the state gained almost 2,500 new jobs. The state’s manufacturing sector lost about 5,700 jobs in that same period, but other sectors of the economy took up the slack. While durable goods manufacturers gained about 600 net jobs, the nondurable sector lost 6,300 jobs. Net new jobs in durable goods manufacturing bode well for state tax revenues, since durable goods manufacturing includes many capital-intensive industries with high productivity and wages. Manufacturing industries that are not increasing their payrolls are notable.

In the 12 months to June 2004, the state’s steel industry lost almost 2,300 jobs; textile mills, textile products and apparel lost 3,300; paper manufacturing lost another 400; and electronic components and products manufacturing, including computer and appliance manufacturers, lost 800 jobs. Information and telecommunications industries continued to shed jobs—1,200 in the 12 months to June 2004.

The services sector gained 6,000 jobs between June 2003 and June 2004. Leisure and hospitality gained 1,200, split between eating and drinking places and accommodation and food services. The retail sector, after losing a significant number of jobs since 2001, added almost 5,400. Most of the new jobs have been in the major metropolitan areas of the state—1,000 were in the Huntsville metropolitan area. Healthcare and social assistance services also added 900 new jobs. Employment has improved over the prior three-year period, indicating that the Alabama economy is indeed showing a sustained recovery. However, really significant additions to payrolls are not expected until the second half of 2004 or maybe even 2005.

Tax revenues. After one of the worst fiscal years in decades, the first three quarters of the current fiscal year (FY2004) recorded significant improvement. The state tax structure faces long-term struc-
tural problems, but revenues for the current fiscal year will easily surpass the previous fiscal year’s, as business spending and payrolls improve and consumer spending remains strong. For the first three quarters of the current fiscal year, total tax receipts are up 8.5 percent over the same period of the previous fiscal year.

For the first three quarters of FY2004, the appropriations for the Alabama Education Trust Fund totaled approximately $3.4 billion, an increase of about $337.8 million over the previous fiscal year. However, appropriations made to the General Fund declined by almost 14.7 percent, or $141.5 million, to slightly more than $822 million.

Outlook. The rebound in the manufacturing sector and continued strength in consumer spending will help the state grow at an average annual rate of 3.5 to 4.0 percent in 2004 with payroll employment rising 0.3 to 0.5 percent, adding 6,500 to 8,000 net new jobs. Most of these job gains will be in services and residential construction. The automotive industry in the state, including the suppliers associated with major manufacturers, will add a significant number of jobs in both 2004 and 2005. The services and retailing sectors of the economy are expected to grow by slightly more than 4 percent in 2004, while financial activity is forecasted to grow by approximately 4 percent or better. With interest rates already increasing, refinancing activity in the housing markets will slow down soon. However, housing sales should remain strong as consumers, in anticipation of rising interest rates, try to lock in rates at their present levels.

Ahmad Ijaz can be reached at aijaz@cba.ua.edu