Economic Outlook:
1st Quarter 2005

United States

Overview. Following a mild recession in 2001, the economic recovery that began in December 2001 is now in its fourth year. However, it is sometimes difficult to recognize this recovery when so many businesses continue to be skittish about adding to their payrolls, particularly in the manufacturing sector where employment is expected to remain sluggish throughout 2005.

In the third quarter of 2004, gross domestic product (GDP) increased by 4.0 percent. It is expected that the 2004 numbers will show an annual growth rate of 4.4 percent, the best since 1999. Major contributors to 2004 growth were personal spending on durable goods such as home appliances, automobiles, and housing; business spending on equipment and software, including information processing equipment; government spending on defense; and exports.

Consumer spending jumped 5.1 percent in the third quarter, with spending on durable goods increasing by a surprising 17.2 percent. Business spending on equipment and software rose 17.5 percent in the third quarter. One would expect a hefty rise in exports since there has been a substantial fall in the value of the U.S. dollar in recent months, but exports in the third quarter increased only 6.3 percent, just slightly above the 6.0 percent increase seen in imports. Another major factor contributing to economic growth in the third quarter was a 9.8 percent increase in national defense expenditures.

As of this writing, data for the fourth quarter of 2004 have not yet been released. Consumer spending is expected to have grown some in the fourth quarter, while business spending on equipment and software is expected to have increased approximately 10 percent. Business spending on computers and peripherals is likely to have grown very sharply in the fourth quarter, primarily because accelerated depreciation allowances ended in December 2004.

The Conference Board’s consumer confidence index jumped sharply in December, mainly due to improving labor markets. Housing markets also chalked up another record year in 2004. Nationwide, housing starts increased 10.9 percent in December, the biggest jump in almost seven years. Although the Federal Reserve has been gradually increasing short-term rates, mortgage rates have remained low and continue to fuel housing markets. The sales of both existing and new homes remain strong. Refinancing of existing mortgages, although down from previous years, has promoted consumer spending by providing additional disposable income.

Employment. December marked the sixteenth consecutive month of increased payroll employment. Each month in 2004 added an average of 186,000 jobs,
significantly more than the 2003 figures. For 2004, payrolls increased by 2.2 million, the best year for job growth since 1999 when the economy added almost 3.2 million to its payrolls, and a sharp contrast to 2003, when the economy experienced a net loss of 61,000 jobs. Despite the U.S. economy's solid growth in 2004, payroll employment is still short of optimum. People looking for work hope 2005 will be a good year for companies to add employees.

Manufacturing added only 96,000 jobs in 2004, accounting for approximately 4 percent of all new jobs. The nation's workers welcomed that 4 percent because this was the first time payrolls in manufacturing have shown an increase since 1997. This recovery has been the weakest in factory jobs among all past economic recoveries, including the so-called jobless recovery of 1991. Retailing employment also languished in 2004. Retail sales payrolls were notably weak in December. Where employers usually add jobs on a seasonal basis in December for the holidays, retailers actually shed 20,000 jobs in December 2004.

From 1998 to 2003, manufacturing industries have lost approximately 3.3 million jobs. Not since the great depression of 1930-32 has the industrial sector experienced a decline for three consecutive years. The economic news from the nation's industrial sector isn't all bad, however. The sector produced 4.1 percent more goods in 2004 than the previous year, even while employment held steady. Since industrials are expected to continue to grow in 2005, there is a high probability that some companies will start to add to their payrolls during the year.

There is a cautionary note here. Despite a projected production increase, manufacturers are reluctant to hire new workers. Some manufacturers are bearing a heavy burden of higher energy prices, and some industries, due to competition, have great difficulty passing higher production costs along to customers. Energy prices increased by 16.6 percent in 2004, the largest increase experienced since 1990, when energy prices surged by 18.1 percent when Iraq invaded Kuwait. Given these constraints, employment in manufacturing could remain sluggish.

Outlook. If energy prices stay at current levels or if increases continue, consumers' pocketbooks will feel the pinch. Particularly vulnerable are people at lower income levels. The cost of energy could hamper consumer spending for other items in 2005. Consumer prices rose by 3.3 percent in 2004 as the biggest increase in fuel prices in 14 years pushed up inflation at the fastest pace since 2000. However, excluding volatile energy and food prices, the so-called core inflation rate was only 1.1 percent. Without any major disruption in the oil supply, energy prices will decline in 2005. The overall inflation rate will average around 2.5 percent.

During the first half of the year, GDP is forecasted to grow at an average annualized rate of 3.7 percent, with a slight slowdown expected in the second half. By then both consumers and businesses will start to feel the effects of increasing interest rates. Short-term interest rates will continue to rise, with the Fed gradually nudging up the Fed Funds rate at each of its policy meetings. However, if energy prices or overall inflation continue at high levels, the Fed could ratchet up the rate much more rapidly. Business spending on equipment and software for the first half of the year is expected to increase by close to 9 percent, while spending on information processing equipment is forecasted to increase by slightly over 18 percent.

Housing markets, which have been very robust, perhaps peaked in 2004 and could experience a slight decline from year ago levels. Nevertheless, housing markets are not expected to decline quickly. They will remain strong at least through the first half of the year. Thirty-year fixed mortgage rates are forecasted to increase to around 6.5 percent by mid-year 2005. Nonresidential construction activity will also pick up in 2005, primarily in office and other commercial construction markets. Highway construction is expected to be strong in 2005. Unlike housing, commercial construction has been weak during the last three years. But with continuing economic growth, the commercial sector can see improvement in 2005.
Alabama Employment. Payroll employment in Alabama substantially improved during the second half of 2004, with both the durable manufacturing and services sectors showing considerable gains. From November 2003 to November 2004, the state added 21,500 new jobs. After losing payrolls for almost three consecutive years, manufacturing employment is now showing net gains. During the twelve month period ending in November 2004, manufacturing added 2,800 new jobs. Most of the gains were in durable goods manufacturing; nondurable manufacturing experienced a net loss of 2,200 jobs. Among nondurable goods producers, there were two groups that showed net employment gains—food processing (400 jobs), and plastics and rubber products manufacturing (1,200 jobs). Some food processors lost jobs, but there were 800 new jobs added in animal slaughtering and processing. Within durable goods manufacturing, most gains were in motor vehicle manufacturing and wood product manufacturing.

Service providers added 11,300 jobs between November 2003 and November 2004. Most notable gains were in retail trade (2,800—mostly in general merchandise stores) and professional and business services (5,500—mostly administrative support jobs). During the same period, educational and health services added 1,400 new jobs, which were mainly in health care and social assistance related businesses. Nursing and residential care facilities added 500 workers. The leisure and hospitality industry in the state also gained 1,500 new jobs, primarily in accommodation and food services.

However, both financial services and information industries continued to lose jobs. The information industry is plagued by excess capacity and lost 1,600 jobs, with 1,100 of those coming from telecommunications, including 700 jobs lost in wired telecommunications carriers businesses. Nationwide, since the most recent recession began in March 2001, about 300,000 telecommunications workers have lost their jobs.

Tax Revenues. The fiscal year ending in September 2004 was a good year for the state’s revenue collections. Good news is that receipts are expected to remain strong through most of the current fiscal year. During the first quarter of the current fiscal year (October through December, 2004), total tax revenues in the state increased by almost 10 percent, a gain of about $160
Individual income tax revenues increased from $572 million collected in the first quarter of the previous fiscal year to almost $623 million in the first quarter of the current fiscal year, a gain of 8.8 percent, or $51 million. Corporate income tax revenues totaled $103.9 million in the first quarter of the fiscal year, a significant increase over the first quarter of the previous fiscal year. With relatively strong consumer and business spending, sales tax receipts totaled $436.3 million, up by almost $11 million over the same period in the previous fiscal year. Appropriations made to the Alabama Education Trust Fund totaled $1.166 billion, up from $1.165 billion appropriated in the first quarter of the previous fiscal year.

However, the state’s General Fund is seeing a different side of the coin. Although the General Fund received almost $63.5 million more than in the same period of the previous fiscal year, the increase in collections needs to be larger to meet the demands on the Fund.

**Outlook.** The state’s economy is expected to grow by 3.3 percent in 2005. Although the first half of the year is expected to be strong, we could see a slight slowdown in the second half, caused mainly by weaker consumer spending and a small decline in construction activity. Within the manufacturing sector, automotive and other transportation related businesses will see continued growth, adding almost 4,000 new jobs. Wood product manufacturing is expected to remain strong. However, both textiles and apparel industries will continue to lose jobs. There is a good possibility that payroll losses in these two industries could even accelerate, particularly if the expiration of quotas in December 2004 is not offset by new tariffs on imports.

Payroll employment will grow a little faster in 2005 than it did in 2004. Nonagricultural payroll employment is forecasted to increase by 1.5 percent in 2005. Most of the job growth will be in construction and service industries, specifically in professional and business services and health services. These construction and services sectors will add approximately 9,000 new jobs in 2005. Although retailing is expected to have a good year, particularly in major metropolitan areas of the state, job gains will be moderate. Retailing statewide will add approximately 3,000 new jobs in 2005.

**Ahmad Ijaz**

aijaz@cba.ua.edu