Economic Outlook: 2nd Quarter 2005

United States

Overview. Although the U.S. economy signaled a slight slowdown toward the end of 2004, it grew 4.4 percent for the year as a whole—the highest rate of growth since 1999. The economy relied heavily on consumer spending for nearly three years after the most recent recession ended in November 2001. However, business spending is also showing healthy growth now, which should generally lead to improvement in payroll employment. After rising 17.5 percent in the third quarter of 2004, business spending on equipment and software climbed 18.4 percent in the fourth. Despite a significant drop in the value of the U.S. dollar over the past three years, exports increased by just 3.2 percent in the fourth quarter while imports rose 11.4 percent. Surprisingly, defense related government spending declined by a slight 0.6 percent, after showing healthy gains earlier in the year. Almost all of the economic growth in 2004 was due to consumer spending and improving business spending, primarily on equipment and software.

Consumer spending contributed to the 4.4 percent GDP growth seen in 2004, posting a 3.8 percent increase with consumption of durable goods or big-ticket items rising 6.7 percent. Business spending on equipment and software grew 13.6 percent, while spending on information processing equipment rose 16.2 percent. Purchases of computers and peripherals also remained strong with an almost 27 percent jump in 2004. After three straight years of decline, business spending and investment in structures increased by a slight 1.4 percent. Recent data show that business outlays for new equipment grew in the second half of last year at the fastest two-quarter pace since 1997. Strong business outlays imply a continuation of job growth in 2005 that should generate healthy increases in income to help support consumer spending.

A major reason for the economic slowdown toward the end of 2004 was a sharp increase in the trade deficit that, at approximately $660 billion, subtracted about 1.4 percent off fourth quarter growth. This record 2004 deficit was more than 25 percent higher than the previous record deficit of $531 billion set in 2003. The deficit, as a percentage of GDP, climbed to 5.7 percent, up from 4.8 percent in 2003. The U.S. surplus in services shrank to $48.4 billion, down from $51 billion in 2003.

The fall in the value of the U.S. dollar over the past few years has not benefited exports significantly as had been anticipated by exporters, particularly within the manufacturing industry. The trade deficit is expected to balloon in 2005, with imports rising much faster than exports. The U.S. dollar’s exchange value is not the only determining factor for exports. For exports to rise significantly, the economies of trading partners also have to grow at a healthy pace,

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which is currently not the case. Consumer spending on imported goods will also have to decline substantially for the trade deficit to decline. Currently the U.S. is borrowing over $2 billion a day to finance the trade deficit, and instead of those funds being used to finance investment in productive assets, they are fueling housing purchases and imported consumer goods. Foreign investors have also increased their purchases of property and mortgage-backed securities, which is further fueling home sales by keeping interest rates at historically low levels.

Many foreign central banks have been covering the difference when private lending falls short of the $2 billion a day the U.S. currently borrows. In the first three quarters of 2004, almost 50 percent of the U.S. current account deficit was financed by foreign central banks, with Japan and China being the lead lenders. The end of global quotas on textile shipments boosted the deficit with China. Imports of foreign cars and auto parts and consumer goods also set records with imports of capital goods, including such items as computers, airplane parts, etc., rising to the highest level in more than four years. The largest deficit with a single country was recorded with China, which in January alone was $15.3 billion.

**Employment.** During its fourth year of economic recovery after the recession in 1990-91, the U.S. economy was adding almost 300,000 jobs each month. That is not the case in this fourth year after the last recession; substantial productivity gains seen in the late 1990s and more recently could be contributing to weaker job gains. With much higher levels of productivity and technological improvements compared to what the economy experienced during the early 1990s, it will be difficult for businesses to generate new jobs at the same pace as they did after previous recessions. However, the economy managed to add almost 2.4 million jobs in 2004, the most since 1999. Job gains have been registered monthly since June 2003 and enough jobs have now been added to regain all the jobs that were lost since February 2001, the month that preceded the eight-month recession. The pace of job growth in manufacturing is still lagging the rest of the sectors. In 2004, overall manufacturing employment declined by just over 1 percent. The fastest job growth was experienced in construction and in services producing industries, particularly healthcare and social assistance; administrative support; educational services; and employment services.

**Outlook.** Economic activity is expected to slow slightly from 2004 levels. GDP is expected to rise 4.0 percent in the first half of 2005 and approximately 3 percent in the second half for an overall rate of 3.7 percent. Consumer spending will grow at an annualized rate of 3.0 percent in the first half, followed by 2.6 percent in the second. Business spending growth is forecasted to exceed 11 percent in 2005, with spending on equipment and software rising by about 14 percent and expenditures on computers and peripherals jumping almost 30 percent. The 30-year fixed mortgage rate is expected to rise from its current level of around 5.8 percent to 6.8 percent by year’s end. Both the 3-month Treasury bill rate and 10-year Treasury note rate are also expected to increase gradually over the course of the year. Consumer price inflation is estimated to decline from its current level of over 3 percent to around 2.6 percent by the end of the year. With general commodity prices and oil prices rising sharply in the first
half of 2005, the U.S. trade deficit is expected to reach $750 billion in 2005.

**Alabama**

**Employment.** During the twelve-month period ending in February 2005, Alabama added 38,900 net new jobs, a 2.1 percent increase. Approximately 70 percent of these jobs or 27,200 were located in the state’s metropolitan areas. The Mobile metro area added around 6,800 jobs, followed by 4,500 for Huntsville and 4,400 in Birmingham. Job growth in the Mobile metro area was to some extent distorted by a one-time surge in jobs due to Hurricane Ivan. Payroll employment in the state improved significantly toward the end of 2004 and will continue to do well in 2005. Among the state’s goods producing sectors, construction added 4,500 new jobs while manufacturing added 5,900. Durable goods manufacturing accounted for 6,500 new jobs, mostly in transportation equipment manufacturing (3,400); fabricated and primary metals (1,000); wood product manufacturing (500); and furniture and related products (800). Nondurable manufacturing on the other hand lost 600 jobs; most of these losses were associated with textile mills.

From February 2004 to February 2005, Alabama’s services producing industries added 27,900 net new jobs. Professional and business services added 12,700, almost 46 percent of the total services producing industries’ job gains. Strong business and consumer spending helped retailers gain 3,600 net new jobs in the twelve-month period. The financial sector, which includes depository institutions, insurance carriers and real estate, lost 1,100 jobs. Job gains in the leisure and hospitality sector improved substantially, adding 3,200 new jobs. Educational and healthcare related businesses added 6,000 jobs. The telecommunications industry continues to be haunted by competition and excess capacity; wired telecommunication carriers lost 300 workers.

**Tax Revenues.** Total tax receipts for the first two quarters of the current fiscal year have risen by almost 10 percent to $3.691 billion, an increase of about $334 million over the same period in the previous fiscal year. Tax receipts are expected to continue strong for the remainder of the fiscal year. Individual income tax revenue totaling $1.351 billion is up by
slightly more than $125 million, a 10.2 percent increase. Corporate income tax receipts have risen 27.8 percent or about $38 million to almost $176 million. At close to $882 million, sales tax receipts are up by about $44 million or 5.2 percent.

Appropriations made to the Alabama Education Trust Fund totaled $2.280 billion, up from $2.081 billion for the first two quarters of the previous fiscal year. A significant improvement was also made in appropriations to the state’s General Fund, which at $681 million is $98 million above last fiscal year.

Outlook. The state’s economy is expected to grow approximately 3.5 percent in 2005, with a more rapid pace in the first half of the year than in the second. Payroll employment is expected to continue to improve throughout the year. Within the manufacturing sector, transportation equipment manufacturing, which includes automotive production, is forecasted to add about 4,000 to 4,500 new jobs in 2005. Despite some improvements in both textile and apparel manufacturing employment early in 2005, these industries could lose a significant number of jobs.

With expiration of the Multi-Fiber agreement and import quotas effective January 1, 2005, there is a high probability that the state’s textile and apparel industry could face yet another adverse year. Furthermore, if CAFTA (Central America Free Trade Agreement) passes in spite of its slim chances, it will accelerate job losses in other labor intensive industries in the state.

Overall, payroll employment will grow at a slightly higher pace than in 2004. The current forecast calls for an increase of 1.6 percent in 2005, with healthcare related businesses, retailing, leisure and hospitality related business, and professional and business services adding the bulk of the new jobs. The services producing businesses in the state are expected to add approximately 20,000 new jobs in 2005.

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