Economic Outlook: 2nd Quarter 2008

United States

Overview. The U.S. economy grew by 0.6 percent in the fourth quarter of 2007, a significant slowdown from the previous quarter when economic growth registered 4.9 percent. Overall, the economy expanded by a modest 2.2 percent in 2007, below its 2006 growth rate of 2.9 percent. The contraction in housing, high energy prices, stagnant job growth, the negative impact of the mortgage loan crisis on banks and other financial institutions, and tightening credit conditions all contributed to the weakening economy.

Consumer spending increased by 2.3 percent in the fourth quarter, while business spending declined 14.6 percent. For all of 2007, consumer spending rose 2.9 percent but business spending registered a 4.9 percent drop. Business profits, which were flat in the third quarter, fell by 3.3 percent in the fourth quarter. Growth in real exports slowed from 19.1 percent in the third quarter to 6.4 percent in the fourth. Imports declined 1.4 percent, following a 4.4 percent increase in the previous quarter. Domestic purchases of goods and services, a measure of domestic demand conditions, dropped 0.4 percent during the fourth quarter after increasing 3.3 percent in the third.

A mild recession is forecasted for the first half of 2008, with overall economic growth declining by 0.1 percent in the first quarter and 0.7 percent in the second. The unemployment rate, which averaged 4.6 percent in 2007 and was at 5.1 percent in March, will inch up to around 5.3 to 5.4 percent by the second quarter of 2008. Job losses totaled 80,000 in March with private employment declining by 98,000—payrolls have fallen by 232,000 during the last three months. Educational and health services, leisure and hospitality, and government were about the only sectors adding jobs in March. Manufacturing shed 48,000, including 24,000 in the motor vehicle industry. Professional and business services lost 35,000 jobs during the month. For 2008 as a whole, the economy is now expected to grow by 1.2 percent. The economic downturn is rapidly spreading to sectors beyond housing, as higher prices and tighter lending conditions squeeze both businesses and consumers.

Housing. Residential investment spending, which includes both home building and sales, declined by 25.2 percent in the fourth quarter—the biggest drop in 26 years and the eighth consecutive quarterly decline. Single family permits were almost 57 percent below their peak in September 2005 and are trending downward across every region. Even commercial real estate is now showing signs of sluggish growth. For the twelve-month period ending in February 2008, the construction sector lost 240,000 jobs, while single family housing starts dropped 62 percent from their peak in January 2006.

During the fourth quarter of 2007, the number of homes across the U.S. entering foreclosure rose to a record level, while, at 47.9 percent, homeowners’ share of equity in their homes declined to its lowest level since the World War II era. Home prices in January were down 10.7 percent from a year ago; prices have dropped at an annualized rate of 20 percent over the past three months. During the last housing recession in 1990-91, prices declined 2.8 percent. With the current 10.3 month backlog of unsold homes, prices will continue to drop at least for the first half of 2008 and most likely throughout the remainder of the year.

The homeownership rate, which had been around 64 to 65 percent for decades, increased to almost 70 percent in recent years. Many of these new homeowners were previously unable to qualify for financing but were offered mortgages through nontraditional lending practices, thus creating significant risk once those rates started to adjust higher. Foreclosures, which totaled 1.5 million in 2007, could top 2 million in 2008. Construction spending on commercial and state and local government projects helped negate some of the impact from declining housing markets, but this is slowing in the face of weak revenues and profits and sharply rising financing costs. Overall, residential fixed investment is forecasted to decline by 24 percent in 2008, following a 17 percent drop in 2007. Business spending on structures is expected to rise just 1.8 percent this year.

Consumer Spending. Consumer spending, which increased by 2.9 percent in 2007, slowed in the fourth quarter and is expected to be flat through at least the first half of 2008. Higher energy and food prices, together with falling home prices, are impacting spending, which in recent years has accounted for almost 70 percent of economic growth. The Conference Board’s monthly consumer confidence index fell 11.9 points to 64.5 in March.

Inside the BLCI: Businesses scale back, but cautiously optimistic amid economic uncertainty.
Consumer spending on durable goods, which rose 4.7 percent in 2007, saw growth slow to around 2 percent in the fourth quarter. Spending for durable goods is expected to decline 8.6 percent in the first quarter and another 7.0 percent in the second quarter of 2008, and wind up down 1.3 percent for the year as a whole. The $107 billion in tax rebate checks that will begin going out to consumers as early as May will help boost consumer spending on durable goods in the second half of 2008.

**Business Spending.** Business spending as a whole declined by 4.9 percent in 2007, with spending on equipment and software increasing only 1.3 percent. Tighter lending conditions will have a significant impact on the ability of businesses to secure financing for capital investment or expansion. Business spending is expected to drop 1.7 percent in the first quarter of 2008 and another 4.3 percent in the second quarter. For the year as a whole, total expenditures are estimated to increase by 1.7 percent. Spending on equipment and software will rise 1.6 percent in 2008, after a decline of 1.3 percent in the first half of the year. The $45 billion in tax stimulus for businesses is expected to have some impact on spending late in the year as the bonus depreciation nears expiration.

**Manufacturing.** Despite an increase in manufacturing exports, the sector continues to shed workers. During the first three months of 2008, manufacturing lost almost 80,000 jobs. The Institute for Supply Management (ISM) index for the manufacturing sector dropped to a five-year low of 48.3 in February and nudged up to just 48.6 in March. During the 2001 recession, the manufacturing index was below 45 for nine straight months. The new orders index continued to decline in March, while the employment index rose 3.2 points to 49.2, still below the neutral point of 50. The price index jumped 8 points, with its 15th consecutive monthly increase continuing to erode profit margins.

For all of 2007, U.S. manufacturing firms lost almost 350,000 jobs. Although job losses were concentrated in nondurable goods producers, most industries saw a decline. Modest employment gains were seen in food processing, machinery manufacturing, petroleum and coal products, and fabricated metals manufacturing. Employment across the manufacturing sector is expected to decline by 2.5 percent in 2008, with the loss of approximately 350,000 jobs. Despite declining employment, industrial production rose 1.9 percent in 2007 and is forecasted to increase 0.6 percent in 2008. Most of the increase in production will be among firms selling products in overseas markets, where the falling dollar makes them relatively more competitive. However, firms producing inputs for the construction sector will experience sluggish growth in 2008.

**Inflation.** The rise in food, medicine and energy costs pushed both consumer and wholesale prices to their highest levels in nearly 25 years; retail food prices recorded their biggest increase in approximately two decades. Although the relatively weak dollar benefits manufacturers who export their products, it has a significant negative effect on price levels in the domestic market. The relatively high demand for commodities in world markets and the flow of funds into commodities as a hedge against inflation are also contributing to price increases. Despite inflationary pressures, the Federal Reserve will continue to cut interest rates, perhaps lowering the federal funds rate to the 1.75 at their April 30th meeting.

Rising prices affect both consumer and business spending. Price levels, as measured by the consumer price index, will increase by 3.3 percent in 2008 while producer prices for finished goods are forecasted to rise 5.4 percent. Although we are in a period where both unemployment and inflation rates are on the rise—an economic condition known as stagflation—we are still far from the stagflation days of the 1973-75 recession when the unemployment rate was close to 11 percent and inflation was around 15 percent.

**Alabama**

**Exports.** In 2007 Alabama exports totaled $14.4 billion, up 3.9 percent from the previous year’s $13.8 billion. The state’s largest export market was Germany, followed by Canada, China, Mexico, the United Kingdom, and Japan. Exports to Germany, which consist mostly of automobiles, declined 8.8 percent from $3.6 billion in 2006 to $3.3 billion in 2007. While Alabama exports to Canada and China increased by 28.7 percent and 22 percent, respectively, exports to Mexico, the United Kingdom, and Japan declined. Exports to Mexico alone dropped almost 17 percent, from $960 million to approximately $800 million. In 2007 Alabama exports to Canada, China, the United Kingdom, and Japan totaled $2.9 billion, $808 million, $732 million, and $692 million, respectively.

Transportation equipment, the state’s largest export commodity, accounted for 41.1 percent of all exports and rose from $5.4 billion in 2006 to $5.9 billion in 2007, up 9.2 percent. Other major exports in 2007 included chemicals ($1.99 billion), machinery ($935 million), paper products ($899 million), and computers and electronic products ($707 million).

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Employment. While the U.S. economy shed jobs in February 2008, Alabama added 7,800, a gain of 0.4 percent. For the twelve-month period ending in February, total nonagricultural employment in the state increased by 18,000. Alabama’s 11 metropolitan areas, comprising 28 counties, gained 13,940 jobs, while the remaining 39 counties added 4,060. The Huntsville metro area led the state with 5,400 jobs, followed by Montgomery (3,500), Auburn-Opelika (2,200), and Florence-Muscle Shoals (800). Decatur added 600 jobs, while the Anniston-Oxford, Mobile, and Tuscaloosa metros each gained 500. The Birmingham-Hoover area netted just 200 jobs between February 2007 and February 2008. Jobs were flat in Gadsden, while the Dothan metro shed 200 jobs, with losses in manufacturing, professional and business services, and leisure and hospitality.

Job gains in the Huntsville metro area were spread across most sectors including retail trade (900 jobs), government entities (800), education and health services (800), professional and business services (700), information (700), and leisure and hospitality services (600); transportation equipment manufacturers lost 500 jobs. The Montgomery metro saw its largest payroll gains in retail trade (1,200), government (1,000), leisure and hospitality services (600), professional and business services (500), and financial activity (400), while manufacturing was down 200 jobs. Mobile added 600 workers in the transportation, warehousing, and utilities sector and in professional and business services during the year ending in February 2008.

However, the area’s natural resources, mining, and construction sector lost 700 jobs and leisure and hospitality jobs also declined by 700. Job gains in a number of sectors in the Birmingham-Hoover metro area, including education and health services (1,200), local government (800), and leisure and hospitality (600), were almost negated by sizeable losses in manufacturing (-1,100) and professional and business services (-1,200) over the last 12 months.

Statewide, manufacturing industries shed 5,800 jobs from February 2007 to February 2008; nondurable goods industries lost 3,400 workers while durable goods producers dropped 2,400. Within durable goods manufacturing, payroll losses were recorded in most industries—the worst declines were in electronic equipment, appliance, and component manufacturing (-1,300) and furniture and related products (-1,100). The bright spot was aerospace products and parts, which gained 900 jobs during the year. Among nondurable goods industries, only plastics and rubber products producers added jobs. The largest losses were in textiles and apparel (-3,000) and food manufacturing (-800).

Alabama’s service-providing firms added 21,800 jobs over the period. Sectors with sizeable gains included professional and business services (4,400), education and health services (2,400), and leisure and hospitality services (2,200). The state saw the net addition of 5,900 government jobs during the year ending in February, including 3,700 at local government entities and 2,600 in state government. Despite the loss of 600 department store jobs, the retailing industry added 4,500 new workers.

Tax Revenues. State tax revenues continue to show slower growth than for the same period of the previous fiscal year. For the first six months of the current fiscal year which ends in September, revenues totaled $4.4 billion, up 3.3 percent or about $139 million over the first six months of the previous fiscal year. For the same period a year ago, total tax revenues had risen 4.8 percent. Sales tax revenues are up just 0.2 percent (about $1.7 million) to $1.0 billion. At $271 million, corporate income tax receipts are 16.6 percent or $38.6 million higher than receipts in the first six months of last fiscal year. Individual income tax revenues have risen 3.2 percent or $50.6 million to over $1.6 billion.

For the first six months of the current fiscal year, appropriations to the Alabama Education Trust Fund increased by approximately $82 million or 3.1 percent to almost $2.7 billion, while those to the state’s General Fund were up about $201 million to approximately $980 billion, an increase of 25.9 percent.

Outlook. In 2008 Alabama’s economy is expected to grow by around 2.0 percent, while nonfarm employment will increase by about 0.7 percent, a significant slowdown from the previous year. However, some sectors of the state’s economy will continue to do well, including aerospace products and parts manufacturing, computer and electronic products manufacturing, motor vehicle and motor vehicle parts manufacturing, business and professional services, education and healthcare services, and leisure and hospitality services. Although the retailing sector is still forecasted to grow in 2008, the rate of growth will be somewhat lower than in recent years.

The state is expected to face the same challenges as the rest of the United States in 2008, albeit growing at a slightly higher rate than the nation. Slowdowns in both consumer and business spending, together with tighter lending conditions and the fallout in the housing sector will negatively impact segments of the state’s economy—in particular, manufacturing, retail and wholesale trade, and residential and commercial construction. The effects of higher energy prices are now spilling over to prices of other commodities, which can further slow consumer and business expenditures.

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Alabama’s Housing Market

Alabama house prices rose 4.45 percent from the fourth quarter of 2006 to the fourth quarter of 2007, according to the OFHEO House Price Index, which measures prices for home sales and refinancing appraisals. This compares to appreciation of 0.84 percent across the nation and ranks the state 13th.

There were 2,053 building permits for single family structures issued in Alabama in January and February 2008, a decrease of 35.2 percent from the 3,166 permits recorded during the first two months of 2007. However, the 849 multi-family units permitted during the first two months of 2008 was 1.5 percent above the number a year ago.

Mirroring national trends, Alabama foreclosure filings were up 57 percent in February 2008 compared to a year ago. Still, RealtyTrac notes that the rate of one filing for every 2,949 households compares to one in 557 nationally and ranks the state 39th.

The Alabama Center for Real Estate reports that 3,537 homes sold across Alabama in February 2008, down 13.6 percent from February 2007. The average selling price was virtually unchanged from a year ago, while average days on the market fell slightly. With 42,984 units for sale, Alabama had a 12.1 month supply of housing in February given the current sales pace—well above the 9.0 month supply a year ago.

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