Economic Outlook: 3rd Quarter 2008

Overview. The U.S. economy grew by 1.0 percent during the first quarter of 2008, slightly higher than the previous estimate of 0.9 percent. The increase in inflation-adjusted GDP was primarily due to positive contributions from consumer spending on services, as well as from exports and federal government spending. While consumer expenditures on nondurable goods were essentially flat, spending on durable goods and residential fixed investment (which includes both home construction and sales) experienced significant declines.

Overall inflation rates were also revised higher. The price index for gross domestic purchases, which measures prices paid by consumers, increased 3.6 percent in the first quarter. Inflation-adjusted total personal consumption expenditures, accounting for around two-thirds of the U.S. economy, rose 1.1 percent in the first quarter, compared to a 2.3 percent increase in the fourth quarter of 2007. However, consumer spending on durable goods declined by 6.0 percent. After falling 25.2 percent in the fourth quarter, residential fixed investment dropped at a 24.6 percent inflation-adjusted rate in the first quarter of 2008. Exports increased 5.4 percent in the first quarter, while real federal government expenditures and gross investment rose 4.3 percent. A 0.9 percent increase in real final sales of domestic product in the first quarter compares to a 2.4 percent gain in the fourth quarter of 2007.

Consumer Spending. Consumer confidence in the economy is hovering around recessionary levels. The Conference Board’s Consumer Confidence Index, which hit a 16-year low of 58.1 on May 27th, fell to 50.4 in early June. The survey found that consumers have not been this worried about future prospects for the economy since 1978, with a record proportion expecting their incomes to fall in 2008. The index measuring expectations for the economy six months ahead plunged to its lowest level since the Conference Board started conducting its consumer surveys in 1967. At the same time, the Reuters/University of Michigan’s Index of Consumer Sentiment dropped to a level last seen in 1980.

Rising commodity prices are not the only problem consumers are concerned about—other economic factors, including weakening labor markets, falling home prices, high energy costs, and a banking sector that remains cautious about lending, are weighing in on consumers’ pessimistic attitudes. Furthermore, a continued rise in prices could deepen these problems, and the U.S. economy could plunge into a prolonged recession.

Weak consumer spending was evident in the first quarter data—inflation-adjusted expenditures for durable goods dropped 6.0 percent, the first decline since 1990-91. Spending on new automobiles fell almost 16 percent, while expenditures for new light trucks declined by around 29 percent. Purchases of nondurable goods, including clothing, food, and gasoline, decreased by a slight 0.2 percent from the fourth quarter of 2007: spending on gasoline and oil actually dropped 3.6 percent. However, spending on services, such as household operations, transportation, and medical care, rose 3.1 percent in the first quarter. Expenditures by households on natural gas utility costs were up almost 27 percent and spending on electricity increased over 8 percent.

Housing. Housing markets remain the biggest drag on the economy. Although sales of existing single-family homes, which make up almost 85 percent of the housing market, increased 1.6 percent in May, housing sales overall were 15.0 percent below last year’s level. The increase in existing home sales is primarily due to falling prices—the median price of a single-family home was $206,700 in May 2008, 6.8 percent below May 2007. New home sales fell 2.5 percent in May 2008 from April and were 40.3 percent below their May 2007 level.

Residential construction fell 26.7 percent in the first quarter, the worst drop in nearly 27 years, while the number of vacant single-family homes climbed to a record 2.3 million. Home sales are now about 63 percent below their July 2005 annualized peak of 1.4 million, while starts are down by over 50 percent. Residential construction as a share of GDP is at a 15-year low of 3.8 percent, well below its more than 6 percent share during 2005 and 2006. New home inventories, which peaked at 573,000 in July 2006, stood at 482,000 at the end of first quarter 2008, equivalent to an...
According to the Standard & Poor’s/Case-Shiller home price index of 20 major metropolitan areas, prices of existing single-family homes declined by a record 15.3 percent from April 2007 to April 2008. Home prices across the nation, as measured by the OFHEO (Office of Federal Housing Enterprise Oversight) House Price Index, were down 4.6 percent in April from a year earlier. However, home prices were up slightly in the East South Central region, which includes Alabama, Kentucky, Mississippi, and Tennessee. While OFHEO tracks sales of existing homes financed by conventional mortgages and securitized by Freddie Mac and Fannie Mae, the Case-Shiller index tracks the prices of homes financed by all types of mortgages, including subprime and jumbo loans—a market where a significant drop in prices is being experienced. Still, both indices agree that prices are now falling at a much faster inflation-adjusted pace than six months ago and have further to fall.

Mortgage delinquency rates have doubled over the last 12 months. According to the Mortgage Bankers Association, delinquency rates rose by 53 basis points to 6.4 percent in the first quarter of 2008, the highest reading ever. Delinquency rates on prime loans were at 3.7 percent, while 18.8 percent of subprime loans were delinquent, both the highest readings ever.

**Employment.** Labor markets remain weak—the U.S. economy lost 49,000 jobs in May 2008, the fifth consecutive monthly decline and a sharp contrast to May 2007 when 162,000 jobs were added. The unemployment rate rose from 5.0 in April to 5.5 percent in May. Significant losses were seen in manufacturing, construction, and retailing. Still, the manufacturing loss of 26,000 jobs was less severe than the 46,000 jobs lost in April. The Institute for Supply Management’s manufacturing index rose to 50.2 in June 2008 after a 49.6 reading in May—a value over 50 represents expansion. The increase was largely due to export gains helped by the weak U.S. dollar. However, the employment component of the index declined to its lowest level in five years and, if domestic demand does not improve in the near future, we could see an acceleration in layoffs.

A persistent slowdown in construction caused the industry to shed 34,000 jobs in May alone and, although the drop was steepest in residential construction, nonresidential construction also lost workers. Given the weakness in consumer spending, retailers shed 27,000 workers in May. Some sectors of the economy showed significant job gains in May: healthcare added 34,000 workers; education 12,000; and food and drinking places 11,000. Employment in state and local government entities rose by 17,000, primarily in local education. If labor markets remain weak overall, though, that will certainly have a significant impact on consumers’ spending behavior in the coming months.

**Outlook.** The U.S. economy began the year better than was expected, with 1.0 percent growth in the first quarter and, most likely, slightly positive growth in the second quarter. The $107 billion fiscal stimulus package in the form of tax rebate checks should help the economy accelerate in the third quarter. However, the rate of growth is expected to slow again as the effect of the stimulus wears off. GDP growth is now expected to be around 1.5 percent for all of 2008, with the economy growing 1.7 percent in the third quarter and declining by 0.4 percent in the fourth quarter. Housing is no longer the only sector of the economy experiencing weakness; the slowdown is now much more widespread.

Consumers will continue to be squeezed by weak labor markets, falling home prices, rising food and energy prices, and tighter lending standards. Overall, consumer expenditures will increase by only 0.7 percent in the second quarter, followed by an approximately 2 percent gain in the third quarter, and a 1.5 percent decline in the fourth. Spending on durable goods is now estimated to have declined by 4.0 percent in the second quarter, with a gain of 5.5 percent expected in the third quarter, and a drop of about 10 percent forecast for the fourth quarter, as the stimulus effect of the tax rebate checks fades.

Residential fixed investment, including both home sales and construction, is not expected to begin to recover at least until the second or perhaps the third quarter of 2009. After dropping by 24.6 percent in the first quarter of 2008, it is forecasted to decline by 25.5 percent, 23.7 percent, and 20.4 percent over the remaining three quarters of 2008, respectively.

Faced with slower growth in consumer and housing demand, as well as tighter lending criteria, businesses are expected to remain cautious about capital investment spending. After a 0.2 percent gain in the first quarter, business spending on equipment and software is forecasted to decline by 3.2 percent and then 1.7 percent over the next two quarters, respectively. Business investment could possibly show an increase in the fourth quarter, as the bonus depreciation provisions of the economic stimulus near expiration.

Relatively strong spending by state and local governments has helped cushion the economy from the weaknesses in consumer spending and housing. However, with revenue growth slowing and lending institutions becoming more cautious, we can expect a significant drop in both construction projects and other state government outlays. Construction spending by state and local governments is forecasted to decline through the rest of 2008.

One of the biggest risks to the outlook is that food, energy, and other raw material prices will continue to increase for the remainder of 2008; this could send the economy into a more severe tailspin and even a prolonged recession. Furthermore, although the falling value of the U.S. dollar is creating a boon for U.S. exporters, it is bad news for U.S. consumers who will pay ever-increasing prices the farther the dollar drops.

**Alabama**

**Review.** In recent months, Alabama’s economy has performed considerably better than the U.S. economy and, despite the fallout in housing markets, average home prices in the state have continued to increase, albeit at a modest pace. The OFHEO state house price index for the year ending in the fourth quarter of 2007 ranked Alabama fifth with a positive gain

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of 4.5 percent. According to the Alabama Center for Real Estate, for the first five months of 2008, home sales posted a steady monthly increase, but were still down 21.0 percent compared to the same period in 2007. Slowing construction of new housing units will help bring the supply more in line with demand. From January through May 2008, building permits were issued for a total of 7,091 housing units across the state, a decline of almost 3,000 units, or 29.5 percent, from the number permitted during the first five months of 2007. The total included permits for 5,409 single-family homes—3,062 (-36.1 percent) fewer than for the same period a year ago. The state’s inventory to sales ratio stood at 10.8 months in May 2008, down from a peak of 13.9 months in January.

Alabama added 8,500 new jobs during the 12-month period ending in May 2008, significantly below the 30,300 jobs created during the comparable period last year. The state’s 28 metropolitan area counties gained 10,400 jobs, while the remaining 39 counties lost 1,900 jobs. The Huntsville metro area led the state with 4,600 new jobs, followed by Auburn-Opelika (1,400), Mobile (1,300), Montgomery (1,200), Florence-Muscle Shoals (1,000), Decatur (600), Tuscaloosa (500), Gadsden (200), and Birmingham-Hoover (100). The number of jobs in the Anniston-Oxford metro was unchanged from May 2007 to May 2008, while the Dothan area lost 500 jobs.

For the year ending in May 2008, Alabama’s government sector added the largest number of jobs (4,600), with 1,300 in state government and 3,600 at local government entities. Professional and business services created 4,400 jobs, including 2,300 in professional, scientific, and technical services and 2,100 in administrative, support, and waste management and remediation services. The leisure and hospitality industry added just 600 jobs—a sharp reduction from the 5,700 jobs created during the 12-month period ending in May 2007. Employment at food services and drinking places rose by 1,000 between May 2007 and May 2008. Full-service restaurants shed 1,100 workers, while limited-service eating places gained 1,200 jobs.

Educational and health services created 1,500 new jobs, most of which were in ambulatory health care services (1,100) and nursing and residential care facilities (600); the educational services area lost 100 jobs. While retailers added 500 workers overall to their payrolls during the 12-month period ending in May 2008, motor vehicle and parts dealers lost 100 jobs and department stores shed 900 positions. The financial activities sector had a net gain of 600 jobs, while the telecommunications industry added 100.

From May 2007 through May 2008, the state’s manufacturing sector experienced a net loss of 6,100 jobs, with durable goods producers down 2,400 workers and nondurable goods producers 3,700. Payroll losses were spread across almost every manufacturing industry. The majority of losses were concentrated in wood product manufacturing (-700), primary and fabricated metals (-600), motor vehicle parts manufacturing (-700), furniture and related products (-1,000), food manufacturing (-600), textile mills (-1,300), and textile product mills (-1,400). The only substantial employment gain was among aerospace products and parts manufacturers, which added 1,000 jobs during the year. Despite a slowdown in residential construction, Alabama’s construction sector gained 1,300 workers through May 2008.

Tax Receipts. After experiencing remarkable increases in recent years, growth in tax receipts slowed significantly during the first eight months of the current fiscal year. From October 2007 through May 2008, state tax revenues grew by 2.6 percent, or approximately $155 million, to over $6.1 billion. Weaker consumer and business spending had a significant impact on sales tax revenues, which only rose 0.3 percent to about $1.3 billion, up less than $4 million. Corporate income tax receipts totaled more than $341 million, an increase of almost 8.5 percent ($27 million) compared to the same period in the previous fiscal year. Individual income tax revenues grew 2.4 percent to approximately $2.5 billion, about $60 million higher. Appropriations to the Alabama Education Trust Fund were up about $8 million to approximately $3.9 billion, an increase of 0.2 percent. Appropriations made to the state’s General Fund rose by approximately $212 million, an increase of 21.3 percent, to total over $996 million.

Outlook. Although both commercial and residential construction are expected to remain weak at least through the end of 2008, industrial construction should continue fairly strong, with some very large projects in the pipeline. Overall, the state’s economy is estimated to grow at an inflation-adjusted rate of 1.0 to 1.5 percent, substantially below the rate of growth experienced in recent years. Payroll growth will be relatively weak compared to last year, with most manufacturing industries either cutting hours or continuing to layoff workers, despite the increase in export activity.

Higher prices for raw materials, food, and energy are just beginning to spill over to other sectors of the economy, resulting in even more weakness in both consumer and business spending. One of the major risks to the economy is that growth in demand for energy will continue to outstrip supply, putting further upward pressure on energy and other commodity prices, with a prolonged negative impact on consumer and business spending. Given lower tax revenues, state and local government spending is also forecasted to remain sluggish.

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Alabama Improves Technology Ranking

Alabama ranked 29th with an overall value of 49.99 on the State Technology and Science Index, released by the Milken Institute in June 2008. Strong improvement in the indicator for average yearly growth in high-tech industries contributed to the state moving up seven places since 2004. Among southeastern states, only Virginia, North Carolina, and Georgia came in ahead of Alabama.

Five component indexes are averaged to calculate the composite. Alabama earned its highest ranking (#25) on the Technology Concentration and Dynamism Index, a measure of the success of state efforts at developing high-tech industries. The study found 5.1 percent of employment and 8.2 percent of payroll across Alabama was in high-tech industries in 2006 (motor vehicle manufacturing was excluded from high tech).

Well above-average shares of civilian workers employed as electrical engineers, computer hardware engineers, computer and information scientists, systems analysts, and physicists contributed to a ranking of 26 on the Technology and Science Work Force Index. Federal R&D dollars, SBIR awards, and R&D spending in biomedical, life, and agricultural sciences led Alabama to a 27th place ranking on the Research and Development Inputs Index.

Alabama’s Risk Capital and Entrepreneurial Infrastructure Index ranked 43rd, influenced by a lack of entrepreneurship as measured by business starts, while the Human Capital Investment Index had a ranking of 37.

How Confident Is Alabama Business?

Covering six key financial measures, along with a topical issue each quarter, the Alabama Business Leaders Confidence Index (BLCI) sums up the expectations of hundreds of the state’s leading executive decision makers. The BLCI is a collaborative effort between Compass Bank and The University of Alabama’s Center for Business and Economic Research to provide local and relevant information to Alabama’s business leaders.

Please log on at www.blci.com/alabama and register to become a BLCI panelist. It only takes a few minutes and you’ll be notified by email when the next survey opens on September 1st.

With increased participation from business leaders like you, the BLCI will become a more valuable planning tool for the Alabama business community. Plus, when you participate, you receive an exclusive preview of survey results before they are released to the general public. Join today!

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Copies of this publication as well as other socioeconomic data resources are available on the Center website: http://cber.cba.ua.edu