THE ECONOMIC SITUATION

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The Spring Economy

The 1999 spring economy has two striking features. Consumer spending shows no sign of letting up, and the long bull market continues to outdo the dreams of even the most optimistic forecasters. Obviously, these two features are connected. What's going on?

First off, we should celebrate the extraordinary GDP growth registered for 4Q1998 and 1Q1999. GDP growth roared to the tune of 6.1% as the year ended and moved ahead at 4.5% in the first quarter. GDP growth for 1998 was 3.9%, the same as for 1997. And get this, according to some economists, these levels are just too good. In their view, the government ought to do something to slow things down. Is it fear of flying and all that? Partly. There is also concern about the source of the growth.

Consumer spending, the main locomotive pulling the economy, is now growing at almost the same rate as consumer income. The savings rate is close to zero. A moment's reflection tells us this happy outcome occurs only when credit expands or financial assets decline. Short of getting manna from heaven, to sustain our shopping frenzy, we consumers can either pass the plastic more often, cash out of stock and bonds, or do a little more of both. From all indications, the great bull market is funding America's shopping spree. And a powerful combination of falling interest rates and strong corporate earnings has been fundamental to making the market boom. Will it continue? Most likely not. (Sorry, we just can't say when or how long the bull will run.)

There is constant shuffling of economic engines. If and when the market slows to catch its breath, consumers will pull back, and the economy will slow a bit. Then, if we are lucky, Asia may be on the mend, exports will be on the rise again, and the economy will have a new engine.

But there is another part to the puzzle. Interest rates. If interest rate movements reverse themselves and begin to point north, consumer spending and business investment could head south. To get a handle on these prospects, we need to consider the linkage between inflation and interest rates.

Inflation, Down but Not Out

Back in 1976 I took part in the Ford administration's effort to Whip Inflation Now. I think I still have one of those WIN buttons. At the time, inflation measured by the CPI was running at an annual rate of 5 to 6 percent. Inflation accelerated. By the time Mr. Carter was in office, the price level was rising at an annual rate of 13%. Since then, of course, inflation has been tamed. Indeed, with the weak Asian economies, the number for 1998 came in at 1.6%. We hardly talk about inflation any more. But inflation still matters, especially in determining interest rates.

We see this when the U.S. Treasury's TIPS bonds, which are "inflation protected," are compared with the ordinary Treasury issue that is not adjusted to inflation. The yield differential gives an indication of inflation, and vice versa. Here's the disturbing news. In April 1999, The St. Louis Fed reported that the difference in yield jumped more than

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one-half a percentage point between Jan. 1, 1999, and March 5, 1999. Then, because of expected Fed action, June interest rates are predicted to be up by a quarter of a point. And what lies beyond June 1999? From all indications, slightly higher interest rates, something on the order of one-half to three-quarters of a point on the 30-year bond. The reasons? The rebirth of inflationary forces generated by a flash flood of money entering the economy and the recovery of major elements of the world economy.

The Picture for the Second Half

So what's the picture for the rest of 1999? A 1999 saucer-shaped economy seems to have already been generated. Consumers have been doing their part. Now, data for April show a marked turnaround for the manufacturing sector. There is a sharp increase in new orders, an expansion of orders unfilled, and an increase in delivery times. Manufacturing employment is nudging up again. And in the face of increased demand for goods and workers, we find new upward pressures on input prices. Survey data say manufacturers expect to see an improving economy across the next six months.

What about South Carolina?

The last two years have been good for the S.C. economy. Consider the southeastern states and employment opportunities. South Carolina stands out from the crowd in both years, ranking second to Florida in 1998.

Employment growth is one thing; income growth is something else. (See accompanying table.) The record here is not as good. For 1997 and 1998, state total personal income growth exceeded that of North Carolina and Alabama and for 1997 nudged above the U.S. growth rate. According to Wake Forest forecaster Gary Shoesmith, income growth should continue apace in 1999 and 2000.

The lagging growth in total personal income is explained partly by which employment sectors are growing faster. With a 1997/1998 gain of 24,300 workers, Services, which has widely varying wages, is the top growth sector. Wholesale and Retail Trade is second with 22,100 workers gained. Construction, with 10,100 workers added, ranks third. By comparison, Manufacturing, which generally has higher average wages than trade, gained just 700 workers. Within that sector, employment in textiles and apparel has fallen by more than 5,000 workers.

Employment Growth: 1997, 1998

	1997	1998
Alabama	2.05	2.18
Florida	3.72	4.09
Georgia	2.44	3.47
North Carolina	3.32	3.03
South Carolina	2.59	3.88
Tennessee	1.95	2.11
Virginia	3.03	2.41
U.S.	2.58	2.56

Source: Gary Shoesmith, Quarterly Review, Spring 1999, Wake Forest University.

Economists generally predict that wages for similar skilled workers will be the same in competitive labor markets. Consider this: the average wage for workers in broadwoven fabric mills, $10.29 per hour, is very close to the average wage in the durable goods sector, $10.46, and higher than the average in electronics and furniture.

State Freedom Index

For several years now, researchers at various think tanks have produced indexes of economic freedom for the major nations of the world. The measures are typically based on the presence of markets versus government dictates, sound money, the ability of people and goods to move across borders, and low risk of property confiscation. A 1995 ranking of 115 countries prepared by the Fraser Institute placed Hong Kong as king of freedom mountain and Algeria at the bottom of the heap. The United States was fourth. Interestingly, Brazil was ranked 98, just above Zimbabwe and well below China, which was 81st.

In March, an economic freedom index for America's 50 states was produced by researchers at Clemson's Center for Policy & Legal Studies. This index is built from five components—fiscal, regulatory, judicial, government size, and welfare spending. Data for 144 variables for each state were gathered and processed statistically. Idaho ranks first in economic freedom, followed in order by Virginia, Utah, Wyoming, and South Dakota. South Carolina is 16th on the list, ranking just above North Carolina, but somewhat

lower than statistical modeling conducted by the researchers, population in-migration was positively associated with economic freedom, as was value added in manufacturing. Should this be a surprise?

The Rational Livability Ranking

While on the topic of indexes, we might consider the results of a study by Howard J. Wall of the St. Louis Fed. Using data for 1990-97, Wall built indexes of net domestic migration to the 59 largest U.S. cities. He called his index the Rational Livability Ranking, since it was based on actual movement of people. Number One? Las Vegas. Number Two? Atlanta. As shown here, 10 southeastern cities ranked in the top 20 cities. Oh yes, and at the bottom? Los Angeles, which ranked just below New York.

Thinking about these rankings and indications that people tend to move to warmer locations reminds me of research on global warming recently reported by Hoover Institution's Thomas Gale Moore. Doing something unheard of, Moore took estimates of global warming used by those who support the theory and considered the benefits and costs of global warming for the United States. Guess what? The benefits exceed the costs. People are healthier in warmer regions; life expectancy goes up. Food production rises, as does GDP. Other studies suggest that China and Russia would be net beneficiaries of global warming while some Pacific island countries would definitely not gain. Obviously, there is more to the story, but it helps to consider all the pros and the cons in different ways.

Top 20 Rational Livability Cities

1. Las Vegas
2. **Atlanta**
3. Phoenix-Mesa
4. Austin-San Marcos
5. **Raleigh-Durham-Chapel Hill**
6. **West Palm Beach-Boca Raton**
7. **Orlando**
8. **Fort Lauderdale**
9. Portland-Vancouver
10. **Charlotte-Gastonia-Rock Hill**
11. **Nashville**
12. Denver
13. **Jacksonville**
14. Monmouth-Ocean, NJ
15. **Tampa-St. Petersburg-Clearwater**
16. Cincinnatti-Hamilton
17. **Greensboro-Winston Salem-High Pt**
18. Riverside
19. Dallas-Fort Worth
20. Salt Lake City-Ogden

Return on Investment in a College Education

Clemson economist Curtis Simon has just completed a major project that estimates the financial return to investment in college education in South Carolina, North Carolina, and Georgia. By focusing on the three states and including estimates for gains from high school as well as two-years and four-years of college, Simon was able to offer interesting comparisons.

Does it pay? On average, a South Carolina young person can expect to earn a 10% return on investment in two years of college, 10.8% on four years of college versus a high school education, and an 11.2% return on investment in four years of college versus two years. Simon's report is available on the Strom Thurmond Institute website (http://www.strom.clemson.edu) and can be obtained by contacting Clemson's Center for Policy & Legal Studies (864.656.1346).

Final Thoughts

From time to time, I freshen my data set on new BMWs purchased in South Carolina. The monthly data, which I smooth by using a 3-month moving average, provide an interesting snapshot of cutting-edge decisions made across our state by people in a variety of circumstances. Most likely, none of the purchases would be called an absolute necessity. In short, my BMW index is a measure of optimism about the future. The tall monthly bars that describe 1997 and 1998 are almost identical in height and position. The similarity is almost uncanny. Remember, GDP growth for the two years was identical.

The picture being formed for 1999 is decidedly different. Instead of building a rising mountain, the smaller monthly sales are bouncing at about the same level and appear tentative. One of three things can happen. The data for the rest of the year will be flat, like those in the first quarter. The data may rise markedly. Or the data may fall. Based on what I am seeing now in the economy, I believe the data will take a positive move. But remember, I am an optimist.

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