THE ECONOMIC SITUATION

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The Saucer Economy

What Does GDP Tell Us?

Economy watchers were caught off guard one more time when second quarter GDP numbers arrived showing growth of 1.4%. A good many forecasters expected to see the economy dead in its tracks. First quarter's upward revision to 5.5% did little to comfort down-in-the-mouth forecasters who still don't believe in the Great American Bread Machine.

After all, Asian tremors seem more pronounced than ever, the GM strike was pretty heavy stuff, and there seemed hardly anyone left to join the labor force. These three factors surely made a difference, but their negative pull was more than offset by good old American consumers, who are out there buying, and businesses that just can't seem to get enough information machinery.

Consumer demand is strong, and shows little sign of weakening. And computers, networks, and internet? In 1997 investment in information machinery accounted for 35% of all non-residential investment. By the year 2020, the share is predicted to be a whopping 80%!

To be more specific, declining exports to Asia pulled about 2.9 percentage points from the second quarter GDP calculations. The GM strike cut another half percentage point. But strong growth in domestic demand added 6.3 percentage points to the calculation, more than enough to offset the weaker components.

Asia's problems form a two-edged sword. One edge cuts down on exports and reduces demand for manufactured products. The other edge reduces the prices of imports, freeing up consumer dollars to spend on other things, which increases demand.

But a drop in GDP growth from 5.5% to 1.4% is more than enough to define the slippery slope of a saucer. Or is it more like a soup

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bowl? This leaves some questions: Do we have farther to fall? How far is it to the opposite upward-sloping side?

What About the Future?

Heartened by the brighter economic news, the Blue Chip forecasters have raised, not lowered, the consensus estimate for this year's economic performance. They now expect to see 3% growth for the year, following 1997's almost 3.8%. Not bad for an Asian-hammered economy. This suggests we are now on the saucer's bottom and should be moving up the other side by this year's last quarter. The same group calls for 2.3% growth in 1999, the identical growth rate predicted by the WEFA group. By the way, WEFA is less optimistic about this year. They call for 2.8% growth for 1998.

Longer term forecasts are based on demographic considerations: How many workers will there be to work in the economy? Productivity growth is the other puzzle to solve. Then, predicting the U.S. share of the growing world market has to be factored in. U.S. population growth, even with net immigration running at close to 880,000 annually, is in the tank. The number looks like 0.8% per year. But employment participation, the share of the work-age population working, is still rising, and productivity improvements look very strong. Still, when factored together the supply side suggests long-term moderation in GDP growth.

The export side of the economy looks rather rosy for the longer term in spite of Asia's problems. First off, Asia's export market, while large, represents just 5% of world GDP. It turns out that Europe's recovery is offsetting Asia's weaknesses. Having an open trading system has much to recommend it. In 1997, U.S. international trade accounted for 25% of GDP. By the year 2020, forecasters predict the share will be 40%. World trade is the main future locomotive.

The Bottom Line

So what's the bottom line? We have slipped to the bottom of the saucer. Barring new shocks, economic activity should improve by the fourth quarter. The year ahead lacks the promise of 1998 and 1997, partly because of the exceptional boom in housing and autos that is not likely to be sustained and partly due to labor market constraints. Look for continued mild inflation and accompanying stable interest rates. While the economy travels across the saucer bottom, parts of the manufacturing sector will still feel the pain of Asian weakness. Recent data from the Midwest indicate that manufacturing there is already recovering, but data from Pennsylvania suggest otherwise. It is definitely a mixed bag.

South Carolina and the Region

The Short-Term Picture

Wake Forest University's analysis of the state economy shows remarkable strength in 1998's first quarter. S.C. employment grew 7.13%, exceeding by many fold the growth in other southeastern states. The state's unemployment rate was the lowest in the region. Most of the employment growth is found in construction, services, and trade. Manufacturing employment growth is at a standstill, partly because of the sheer absence of qualified workers. How about Asia? Less than 15% of S.C. exports head to that part of the world, while falling prices on Asian goods provide a boost for S.C. consumers. Strangely enough, the Asian tremors could be a mild positive for the state economy. With the current picture being rather strong, 1998 offers a bright prospect for S.C.

Looking at the Longer Run

Recent data from WEFA focusing on the next 10 years, tell us that employment and income growth for the nation should average 1.34% and 5.06% respectively. For the southeast, the numbers are 1.70% and 5.46%. The region is healthier than the nation. But South Carolina's numbers are weaker than the region's. The forecast calls for state employment to grow 1.23% with income growth of 5.25%. Again, the numbers relate to demographics—predicting the number and age of people leaving and entering the state. The S.C. population is growing, but a major part of the growth is in the over-65 category, which adds little to the labor force. Even with a strong senior citizen component, that share of the state's population is still less than the national average.

Among the major metro areas, WEFA's forecast shows Columbia recording the largest employment growth over the next 10 years, 1.58%, with Charleston at 1.32%. The Florence area is slated to see employment grow 1.18%, and the Greenville metro 1.09%. None of the major metro areas is expected to see meaningful growth in housing, having sustained a strong boom in recent years.

Stock Market Tremors. What's the Message?

When the Dow-Jones reached its recent zenith in mid-July, many investors were congratulating themselves for having stayed with the market in spite of warnings that the market was "overpriced." Then, when August 4th hammered markets worldwide, many of us licked our wounds and realized once again that we cannot outsmart the market. In the official jargon of market watchers, the major averages have now sustained an "adjustment," meaning that the composite averages have fallen by at least 10% from their recent highs. When these adjustments make us feel dumb rather than wise, we can seek comfort by saying "I am in it for the long term." So far, that response, when actually applied, has worked well.

In spite of it all, I am still in it for the long term, but I'm not saying how long the long term will have to be for recovery to July numbers. One bit of basic economic data may offer some guidance. The leading U.S. economic sectors are computers and office machines, electronic components, communications equipment, amusements, and telephone and telegraph services. Having followed a blazing path for several years, indicators suggest the trend is still powerfully positive, for the long term. Of course, identifying stronger sectors is just one of the first steps to take in finding attractive firms. Careful attention to fundamentals can help. Luck can help a lot too.

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