THE ECONOMIC SITUATION

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Bruce Yandle

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〈 The National Economy: Shifting from Roll to Stroll
〈 Interest Rates and the Year Ahead
〈 South Carolina: The Auto Economy Reacts
〈 Election Uncertainties

The National Economy Strolls into 2001

This time last year, the world's party-goers were poised to celebrate a new millennium, and after preparing for more than a year, the nerds among us were hoping against hope that Y2K would not bring a gigantic meltdown. While party poopers watched, the party-goers got their wish, and Y2K slipped into place without even blowing a fuse.

The economy's entry to the year 2000 was lifted by Y2K expenditures, and perhaps by an extra shot of purchases associated with all the fireworks and parties. Real GDP growth for 1999 came in at 4.2%, and was strongest in the year's last half, making the overall shape of GDP growth for the year look like a lazy J with the hook showing up at year end. This year, by contrast, reverses the lazy J image. 1999 started with a bang and is ending with a hum.

Three major forces explain the slowdown: 1) Mr. Greenspan has tightened credit continually since June 1999; 2) Rising oil and energy prices have soaked up purchasing power and taken a half percentage point away from the pace of economic growth; and 3) the pin-pricked stock market has stopped creating quick and easy wealth, causing consumers to be a bit more cautious than they were during boom times. By the way, the stock market boom may have added as much as one percentage point to post-1994 GDP growth. When added to the effects of rising fuel costs, this gives a loss of 1.5 percentage points in GDP growth.

The pace of the nation's economy is shifting from a high-paced roll to a more sedate stroll. If we subtract the 1.5% just mentioned from the 5.2% growth experienced over the most recent 12 months, we have 3.7%, which is pretty close to the ball-park estimates for growth in the year 2001, but well above the 3.3% 30-year average. (In November, the Blue Chip Consensus Forecast called for 3.3% GDP growth in the new year. WEFA, another major forecasting organization, called for 3.4%.)

Is This the Soft Landing?

Now that "soft landing" has replaced "rosy scenario" in our daily lexicon, we must ask: Have we arrived? Is this the year of the soft landing? Or should we steel ourselves for another dose of credit-crunch medicine?

The Fed-induced interest rate run-up and accompanying tighter lending standards have yielded a predictable outcome: Home and auto sales have swooned, retail sales are weaker and employment growth has fallen to lower levels. Of these important indicators, employment growth seems to be most important when the Fed assesses its efforts to slow the economy. In

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their view, if unchastened, tighter labor markets will eventually translate into higher wages that outstrip productivity growth. Yikes! Inflation will rise again.

So how do things look on the labor front? Yearly wage increases are up 4.1% since last year, an amount that is covered by 4.5% in productivity increases. But the cost of fringe benefits has risen 6%, and that cost has to be borne by employers too, or passed along to consumers.

A quick review of employment growth since 1997, including year-to-date (YTD) through October, shows a Fed-encouraging trend.

Average Monthly Change
(1000 employees)

1997	280
1998	251
1999	229
YTD	177

Is this soft? A quick calculation of the year-to-year changes in gains shows the most recent decline is the largest. The monthly gain in the labor force has fallen from 229,000 to 177,000, a change of 52,000 workers in one year. The decline is accelerating. This doesn't seem so soft!

A closer look at the employment data shows that most of the employment gain since 1997 has occurred in the service-producing activities, as opposed to goods-producing. In fact, manufacturing employment has actually fallen every year since 1997 with most of the loss occurring in the nondurable goods industries. And this has special significance to South Carolina, a topic to be addressed later.

Personal income growth offers another way to assess soft landings. When viewed on the basis of 12-month moving averages, since 1995, yearly changes in wage and salary increased across 1996 and 1997, and then peaked in November 1998. Wage and salary increases then became smaller through most of 1999; they have now leveled out. This looks more like a soft landing!

Leading Indicators and Consumer Confidence

Well, all this soft landing talk may seem pretty good for now. But what about next year? The December Conference Board leading indicator report showed a decline for October, no change in September, and a decline in August. Since January, the index has declined for five month and been flat for four, which is clearly consistent with a slower pace of future economic growth. A more negative picture is given by the Economic Cycle Research Institute (EPCRI) Weekly Leading Index. It has been declining unsteadily since September with a sharp fall recorded at the end of November. EPCRI does not forecast a recession, but they do speak of a rough, not a soft landing.

The latest readings from two measures of consumer confidence paint a somewhat placid picture for the economy. One measure, maintained by the Conference Board, is heavy on business data. The University of Michigan's consumer sentiment index is more heavily weighted with consumer data. The Conference Board's confidence index fell in October and November to the lowest level since October 1999. The University of Michigan index took its big hit in October but rose a bit in November. Overall, these two indicators reflect a soft landing, a strolling, not a rapidly growing, economy.

Will Interest Rates Soften?

Thus far, Mr. Greenspan has relaxed a bit from the credit-crunching course he set back in June of 1999. While short-term interest rates are still high, and credit approvals are more difficult to get, long-term rates, like those for 30-year mortgages, have fallen from the peaks of a few months ago. Once again, housing sales are picking up a bit, even though housing start data are not.

But what actions will Mr. Greenspan and his colleagues take in the next few months when they see more soft landing evidence? Of course, no one

knows, but everyone tries to guess. Investors who purchase credit market futures contracts are among the most serious forecasters. Unlike most of us, they pay when their interest rate forecasts are wrong. Futures contracts currently reflect even odds that the Fed will cut rates in the second quarter of next year. This is consistent with a slow-growth economy, and a completed soft landing.

My 10-year bond, PPI analysis is also signaling a bit of softness, which is to say the growth rate of inflation does not quite support the current 10-year bond interest rate. Taken together, these two tea leaves suggest we will see lower rates in 2001.

South Carolina: Looking through the Magnifying Glass

The assessment of the national economy can serve as a lens for examining South Carolina. At a national level, we see a slowing economy that is being braked by manufacturing. Within manufacturing, nondurable goods industries are taking on the chin. Within the somewhat stronger, but still weak, durable goods industries, auto and auto parts are hard hit.

South Carolina's economy is more manufacturing-intense than the national economy. Our services sector, which is the strongest national sector, is smaller. Within manufacturing, South Carolina is heavy in nondurable goods, and within durables, the economy is heavy in autos and auto components. The weakness in the national economy is magnified in South Carolina. For example, from October 1999 to October 2000, state payrolls grew by 37 thousand workers, almost exactly 2.0%. During that period, manufacturing showed an absolute decline of 2,300 workers, even though producers of durable goods added 2,700. Nondurables declined by 5,000 workers. Recent data suggest the decline in nondurables is bottoming out at a time when auto–related manufacturing is weakening. This should put manufacturing in the no-growth column, while the state's services and construction sectors should continue to show moderate to strong growth.

Since January, South Carolina's leading economic index has shown weakness, with the monthly index falling in seven out of nine months. Data for September, the most recent available, show a bottoming out, another indication of a soft landing.

The South Carolina economy continues to have a strong pulse beat. Even though new building permits have fallen to the cellar, initial claims for unemployment have fallen a bit, and construction employment continues to boom. Tourism activity, as reflected accommodations tax collection, has been weak along the coast, while state retail sales continue to grow at a healthy pace.

The Emerging Picture

When all is said and done, what's the bottom line? A soft landing has occurred, and the economic engine is trying to accelerate. The three forces affecting the national economy—the Fed, oil prices, and a declining stock market—are joined by a fourth, a heavy dose of political uncertainty. Three of the four will soon pass. The Fed will relax, oil prices will get better, and the political uncertainty will end by January. Only an uncertain stock market remains. Most likely, when things improve for the other three, things will also look better on Wall Street.

When given half a chance, markets work. Pass the word.

THE ECONOMIC SITUATION
The Strom Thurmond Institute
Clemson University
Perimeter Road
Clemson, SC 29634-0125

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Telephone—(864)656-0215;
FAX— (864)656-4780;
e-mail—**publications@strom.clemson.edu**

Bruce Yandle is a Senior Fellow in the Strom Thurmond Institute of Government and Public Affairs at Clemson University. He is also a Professor of Economics Emeritus.

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