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The economic situation

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THE ECONOMIC SITUATION

A Strom Thurmond Institute and
College of Business & Public Affairs Report

Bruce Yandle

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A quarterly report on economic trends.

SUMMER 1999

- Asia recovers and the economy roars.
 - South Carolina leads the pack.
 - The new “have it your way” economy.
 - A note on the BMW Optimism Index
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The Saucer-Shaped National Economy

The 1999 economy continues to show remarkable strength and good prospects for continued expansion. In fact, the consensus forecast for the year's final few months indicates things will accelerate a bit. Here's the picture. Second quarter GDP data formed the slope of a saucer-shaped growth profile. The 2Q1999 growth rate of 2.3% followed the first quarter's 4.3%. The consensus among the Blue Chip forecasters calls for 3Q1999 GDP growth to hit 3.1% and 4Q1999 to yield 3.4%. Trace it out. A saucer is born.

The August report on manufacturing from the Federal Reserve Bank of Philadelphia shows a sharp increase in new orders, rising optimism about expanding new hires, and, believe it or not, a bit of relief from rising input prices. More evidence of the U.S. saucer economy.

Strong consumer buying continues to be the economy's lead locomotive, followed by expanding shipments of producers' durable goods and a strong construction sector. Asia's rapid recovery brightens the overall picture. U.S. exports rose 4.3% in this year's second quarter after tumbling 5.1% in the first quarter. Practically everything in the consumer goods category is enjoying record-breaking sales, including apparel, shoes, and services. Indeed, apparel shipments reached a pace that reduced inventories well below normal levels.

The continued roar of the bull market provides one source of consumer wealth that translates to increased demand. But old-fashioned wage gains, coupled with high levels of employment, offer the more reliable explanation. Since 1994, nonfarm wages have grown at a faster clip than the GDP deflator. At the end of 1998, inflation was running a bit more than 1.0% annually and had been falling for six years. Wage in-

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creases were rising at 4.0% a year and had been increasing for six years. We could hardly ask for a better national landscape on which to develop a S.C. economy.

The S.C. Economy

The S.C. economy continues to perform at a strong level. Data now available for 1998 show the state expanded employment to yield an all-time high number of new jobs. Some 32,000 new jobs were added along with the highest amount of capital investment in a year. Construction continues to be the state's strong economic sector with that activity booming across the board. In spite of difficult global competition felt in some industries, S.C. businesses increased exports in 1998. In 1999's first quarter, the state had the nation's sixth highest employment growth rate, 3.0% compared to a national rate of 2.2%.

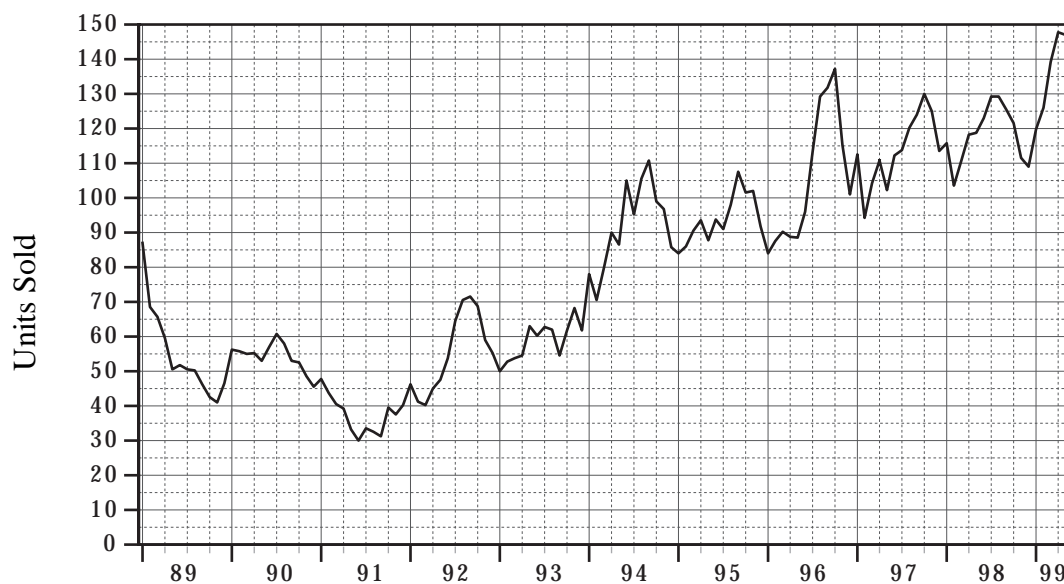
What's the picture for the region? The economic consulting firm WEFA examined employment growth data for the southeast region for the years 1995 through 1998 and provided a forecast to the year 2002. The employment growth profile rises sharply in 1996 and slowly declines until 2001, hitting roughly 1% growth at that time. Then, employment recovers to 2%. WEFA's forecast for South Carolina calls for a similar pattern of employment growth.

Is this the Garden of Eden or What?

We've heard it countless times. The information revolution affects everything we do from the way we search for cars and mortgages to how manufacturers manage global inventories. The cost of new computers has fallen 18.7% annually since 1950, while the

S.C. BMW Sales

1/1989 - 5/1999



————— 3-month Running Average

cost of computer storage locations has fallen 25-30% per year. Investment in information technology and labor productivity has risen systematically together. But what has it done to the Great American Bread Machine? Is GDP growth at a higher level? Has all this computer capability made us measurably richer?

The good folks at the Federal Reserve Bank of Dallas did a lot of digging to answer these questions. What they found and reported is really staggering. Low cost information has contributed to a veritable revolution in what is made available for consumers. The revolution has more to do with the quality and variety of goods than with a sheer increase in the volume of goods produced. Think of it as a shift away from mass production of limited choice goods to high-volume tailor-made goods. The range of choices has almost exploded. The Dallas Fed calls it the move to mass customization. Other voices might say "Have it your way."

To illustrate: In the 1970s, there were 17 OTC pain relievers. Today there are 141. There were 267 movie releases compared to 458, and 160 breakfast cereals compared to 340. Supermarkets carried four kinds of milk. Today, they have 19. In the 1970s consumers could choose from 140 car models. Now? The number is 260 and rising. To illustrate, Ford Motor Company is introducing custom ordering so that consumers can specify exactly what they want. The firm's internet site shows six Explorer models, with 2.5 million possible combinations of features for the vehicle. In 1980 there were 12 brands of laundry soap and 79

pasta dishes sold in grocery stores. Today there are 48 kinds of laundry soap and 561 pasta offerings.

Are we better off? Think about this mental experiment. Compare two people, one from 1999, the other from the 1970s. Both with the same real income, the same aspirations, and living in the same region. Greater variety and more information to assist in choosing must surely make life better in 1999.

No. We don't live in the Garden of Eden, but we are a bit closer than we were in the 1970s. At least on this score.

The BMW Index

Last quarter's Economic Situation called attention to the BMW Index of S.C. Optimism. Readers will recall that the index is simply S.C. monthly sales of new BMW autos. When comparing 1999's first few months with the 1997-1998 pattern, I found 1999 looking rather tentative. Sales were just not spiking upward. It turns out that the data provided through the Department of Revenue were not complete. As shown in the accompanying chart, the new and more complete data provide a very different picture. Much like the U.S. and S.C. economies, BMW unit sales are spiking upward.

My BMW Optimism Index is sending stronger signals than the broader Index of National Consumer Sentiment maintained by the University of Michigan. The Michigan Index says 1999 looks about like 1998. I will place my bets on the BMW index.

Economists and Weathermen

There's an old saw that says economists are especially thankful for weathermen. Their forecast can make the economists look pretty good. But now it seems economists are faced with a serious challenge. They must forecast the weather if they are to forecast economic activity with accuracy. This year's winter was the mildest since records were started in 1895. Construction boomed, in all sectors. Housing, businesses, and highways. Housing starts may be as much as 50% higher. The mild winter added as much as a half percentage point to 4Q1999 GDP growth, and that's not small potatoes.

Last quarter's report mentioned the work on global warming done by Hoover Institution economist, Thomas Gale Moore. You may recall, that Tom assembled a raft of data on economic activity and pronounced global warming to be a good thing, at least for the United States.

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