THE ECONOMIC SITUATION

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Is this the shortest recession ever? Or what?
Employment recovery will take a while.
South Carolina will most likely lag the national recovery.
Habits of the heart. Do they matter?

What happened to 4Q2001 GDP and the recession?

There's an old rule of thumb that defines a recession as two consecutive quarters of negative growth in real GDP. Guess what? We saw negative growth in 3Q2001, when the final figure for real GDP growth came in at minus 1.3%. Meanwhile, the National Bureau of Economic Research (NBER), the keeper of the great recession scorecard, marked this recession as beginning in March 2001. But lo and behold, 4Q2001 GDP growth rattled in with a positive 0.2%. There goes the old rule of thumb!

In their response to this unhappy event, the NBER says it "does not define a recession in terms of two consecutive quarters of decline in real GNP. Rather, a recession is a period of significant decline in total output, income, employment, and trade, usually lasting six months to a year, and marked by widespread contractions in many sectors of the economy." Whew!

Now that we have the official definition, let's plug in another reminder: Recessions start at the peak of a business cycle and end at the trough. When the NBER dated the beginning of the current recession as March 2001, they were saying that was the high point for a 120-month expansion that had started in March 1991.

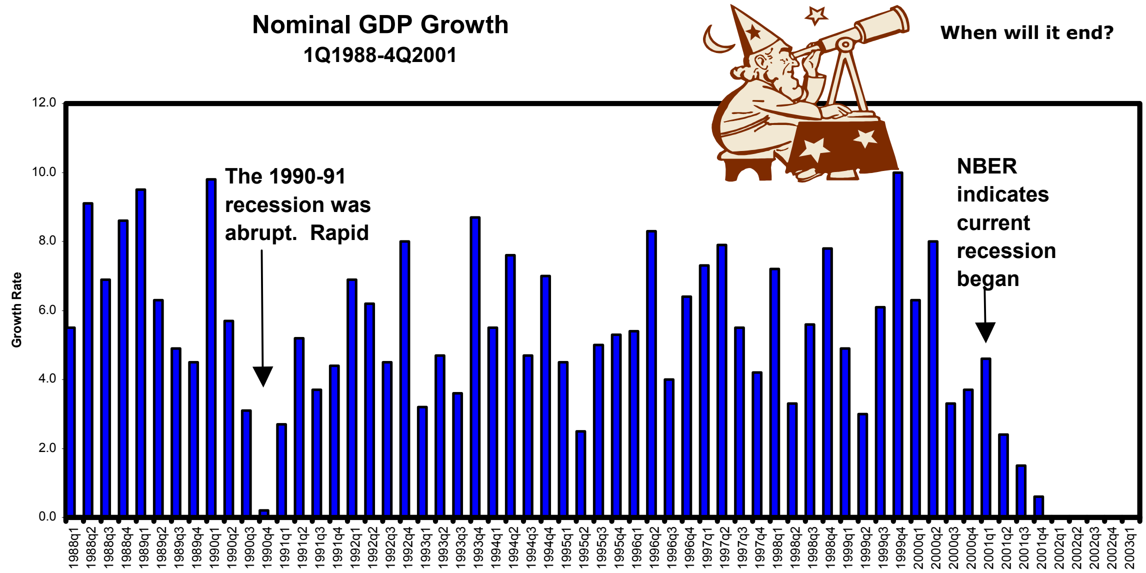
Enough definitions. Why the quick turnaround seen in the 4Q2001 data? Does this mean the recession has ended?

First, let's remember the data we are discussing are part of the first GDP estimate, which is termed the advanced report. There will be two revisions. In any case, buried deep in the 4Q2001 advanced GDP report are amazing consumer purchases of durable goods. Well, we might as well call it automobiles, because that's what it was. Those zero interest rates attracted a huge following. Auto sales skyrocketed in the last quarter of the year. But there was more. Consumers generally kept on buying, this in spite of 911 and the war. In fact, consumer spending was large enough to bring down excess inventories in the economy, and to hasten the day when re-stocking orders are placed by retailers. Add to this the 5.4% increase in major retailer sales in January, and we have more than just a feeling that the recession is hitting bottom about now, the end of February. If that turns out to be the case, this 2001-2002 recession will have lasted 11 months, which happens to be the average length of all recessions since 1945. Even though we may be bottoming, this is not the shortest recession ever. It is average. And it is a recession.

But, when will we see meaningful growth?

A lot of soothsayers and economists are asking the big question. When will we see expansion again? The chart below poses the question and suggests an answer. But first, let's take a quick look at the 1990-91 recession shown in the chart. It may give some clues about the current one.

The 1990-91 drop-off, came quick, went deep, and returned quickly. Compare that pattern with the current one. This slowdown has taken a while to get here, doesn't seem to be a deep, and therefore will not likely generate as much bounce on the way to recovery.

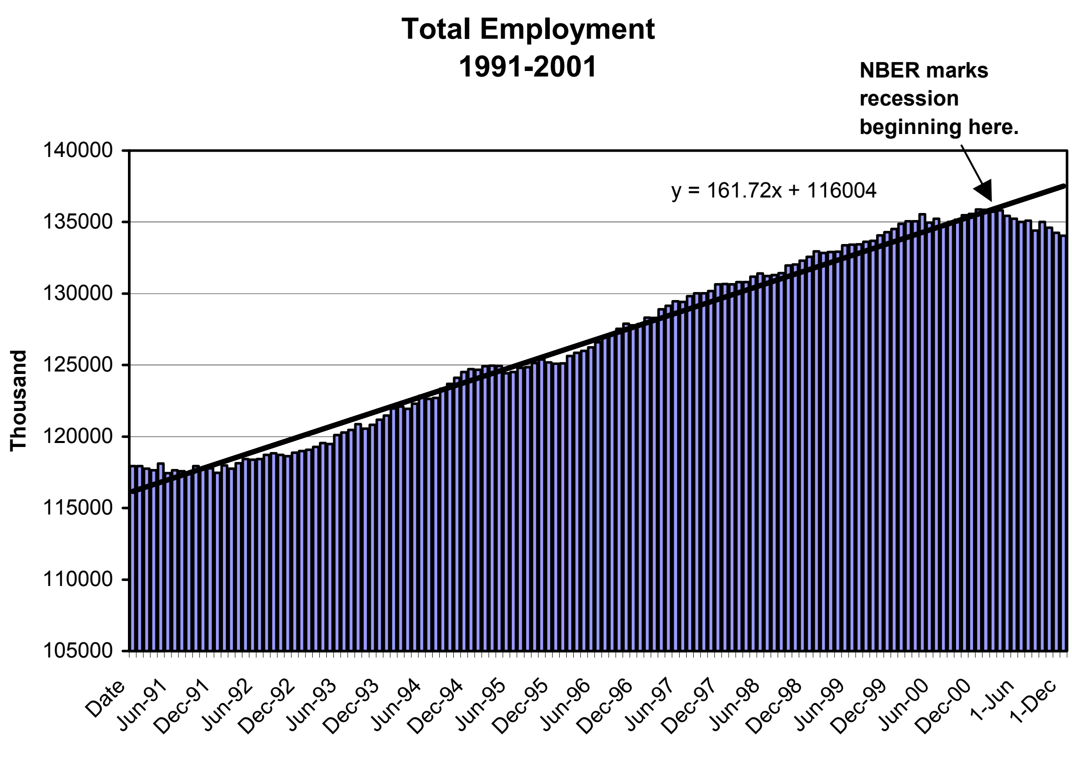


With the Fed's accommodating interest rate cuts already in the recipe for this year's economy, we can safely assume that the recovery pattern will look a lot like the reverse of the decline. Just imagine a set of recovery bars that mirror those showing the decline. On that score, we should see some "normal" economic growth in 1Q2003, with weak, but meaningful growth coming before that.

If the recession is bottoming, will employment recover too?

Consider the accompanying chart that shows monthly data for total U.S. employment, starting in 1990 and ending in December 2001. Notice the chart's trend-line, which reflects the average level of total employment for the 11 years of data.

Two things deserve attention. First, the date the current recession began, March 2001, coincides exactly with the point where employment fell below the trend.



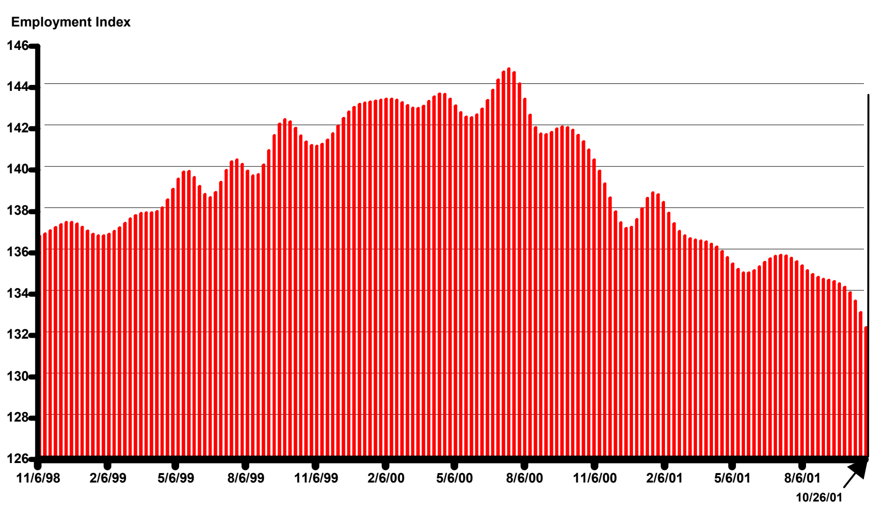
The second interesting observation relates to the long period from January 1996 to December 2000 when the level of employment was well above the trend line. This was a period of extraordinary job creation when the economy was chugging, in spite of efforts by the Federal Reserve Board to rein in the horses. Eventually, of course, the Fed was successful in killing the economic engine.

Finally, the shape of the job recession seen in the figure suggests that total employment will not recover to March 2001 levels until well into the fall of 2002. Employment growth will lag the recovery of GDP.

How the manufacturing recession looks to one industry.

It is one thing to identify the recession in terms of the nation's total employment, but quite another to look at how the recession looks to one major industry that is important to South Carolina. The next chart shows total U.S. employment, as measured by an index, for the rubber and plastics industry. Tire and rubber production are included in the data, of course. The data run from November 1999 to October 2001.

U.S. Employment, Rubber & Plastics



Industry employment peaked in August 2000, well ahead of the NBER date for the onset of the current recession. Then, employment has fallen sharply and quickly, so that in late October 2001, employment was well below 1998 levels.

Here, we see the difference between the manufacturing recession that has posed such difficulties and the nation's recession, which by comparison is relatively mild. While the nation has been lifted by a strong services and trade economy, manufacturing, hurt by high interest rates and the resulting strong dollar, has been languishing in the basement.

Low current interest rates and depleted inventories are combining now to give manufacturing a nudge. The January manufacturing survey of the Federal Reserve Bank of Philadelphia shows marked improvement, with the current activity index moving into positive ground for the first time in more than a year. The six-month forecast of manufacturing activity was even brighter. Some 64% of the firms responding to the survey predict growth in overall business during the coming six months. Just 11 percent expect business to deteriorate.

How does this optimism translate into jobs? Just 24% of the firms expect to add workers in the first half of 2002, and 14% predict further reductions in employment in their firms. The recession's low point may have been reached, but, as indicated before, it will be a while before employment recovers in manufacturing.

When will South Carolina's economy kick in?

A comparison of pre- and post-September estimates for S.C. income growth gives one answer to how the South Carolina economy was affected by 911 and when the economy should be on track gain. Prior to 911, forecasters expected South Carolina nominal income to grow at about 5.5% across 2002, eventually hitting 6.0% growth and then declining a bit in 2003-04. After 911, the revised forecasts show total personal income growth, again in nominal terms, falling to 4.0% this year and then recovering to 5.5% in 2003 and holding at that level on through 2004. In other words, the 911 event and its after effects first knocks the economy to the basement and then accelerates growth to a higher level than was predicted before 911. There is one last observation to make about these estimates. South Carolina's recovery is lagging the nation. We can look forward to better times toward the end of this year, but the truly better times will be seen in 2003-04.

Habits of the heart. Do they matter?

In 1831, Alexis de Tocqueville came to American officially to investigate prisons for the French government, but unofficially to answer his own burning questions about democracy and whether it could actually work. He traveled for nine months, covering a large amount of territory across the 24 states. During the southern leg of his trip, Tocqueville visited New Orleans, Mobile, Montgomery, Macon and Milledgeville in Georgia, and Columbia, SC. At the time, the population of Richland County was less than 16 thousand people. Charleston was a bustling city of 88,000. Tocqueville was simply overwhelmed by the way ordinary Americans formed societies, associations, and clubs. Everywhere he looked he found that

> *Americans make associations to give entertainments, to found seminaries, to build inns, to construct churches, to diffuse books, to send missionaries to the antipodes; in this manner they found hospitals, prisons, and schools. If it is proposed to inculcate some truth or to foster some feeling by the encouragement of a great example, they form a society. Wherever at the head of some new undertaking you see the government in France, or a man of rank in England, in the United States you will be sure to find an association.*

Tocqueville was amazed at how American communities addressed their own problems, generally without calling on some arm of organized government. As he sought to understand why these Americans were so effective at solving their problems, and seemed to enjoy it, too boot, Tocqueville identified two key factors. First, the Americans were free. They were pursuing their own fortunes; they were doing what they wanted to do in their own communities.

Underlying the pursuit of their fortunes was something else. It was what Tocqueville called "habits of the heart." As he saw it, there was a common understanding of what was good, beneficial to communities, and right. And this common understanding formed habits of the heart that were nurtured by churches, synagogues, and temples.

Tocqueville was optimistic about this country. He believed that democracy would work, and that ordinary people following habits of the heart would build a great nation.

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