

THE ECONOMIC SITUATION

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Spring 2002

The recession ends: a post-mortem.
South Carolina: the good news just turned bad.
The Fed and money. Is inflation on the way?
What about GDP?
Making markets work for the environment.

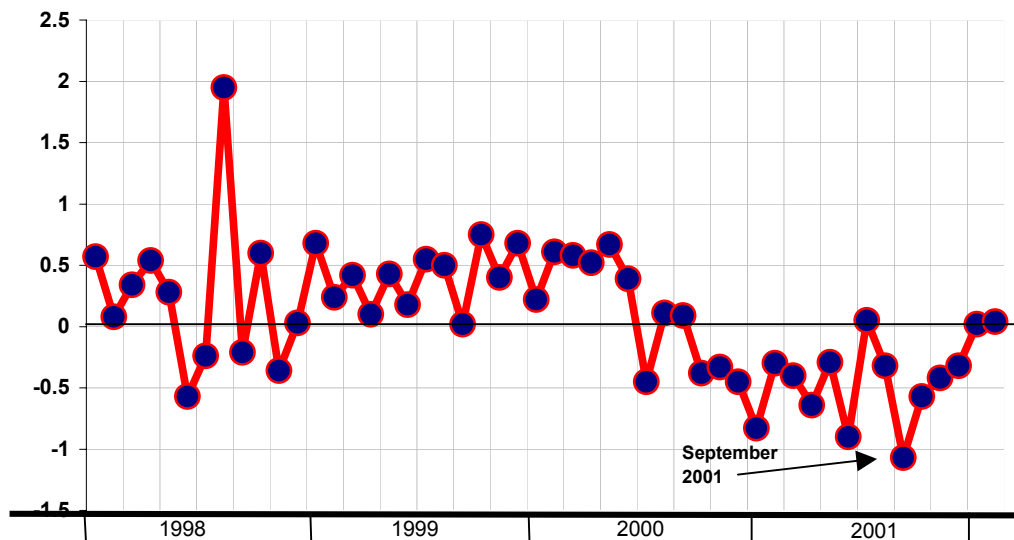
Mr. Greenspan says it's over.

And that should make it official! On the same week that Congress finally passed its "stop-the-recession" stimulus package, Mr. Greenspan, in testimony before that august body, announced the beginning of the recovery. The dip lasted exactly 11 months, which is the average length of all post-World War II recessions. The timing of the congressional action and Mr. Greenspan's announcement were purely coincidental, of course. After all, the effects of the stimulus package were minor compared with what the Greenspan Fed had already done, and corporate tax rebates, not tax cuts, made up a major part of the package. This was a textbook case of political delays that make action when it finally comes almost meaningless.

Strong evidence of the recession's end is seen in February's Industrial Production data shown in the accompanying chart. Close inspection of the January and February 2002 data point reveals the signal. Growth in factory output is positive again.

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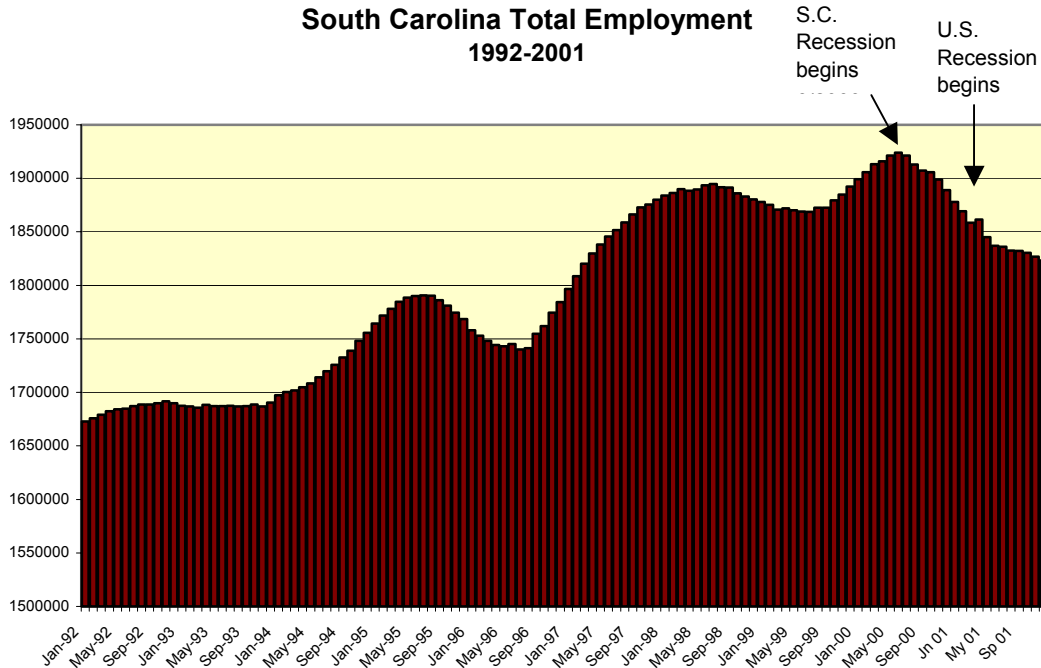
Growth in U.S. Industrial Production: 1998-2002



The chart gives a mapping of industrial production growth that begins in January 1998. The data show the remarkable period that began in late 1998 and continued until May 2000. It was then that the cumulative effects of Fed interest rate increases finally stopped the Great American Bread Machine. A bad case of tremors is seen in the summer of 2000. This is when the manufacturing recession grabs and shakes the U.S. and South Carolina's manufacturing economy. The official full-economy recession, which began in March 2001, is now over.

It may be over the nation, but not for South Carolina.

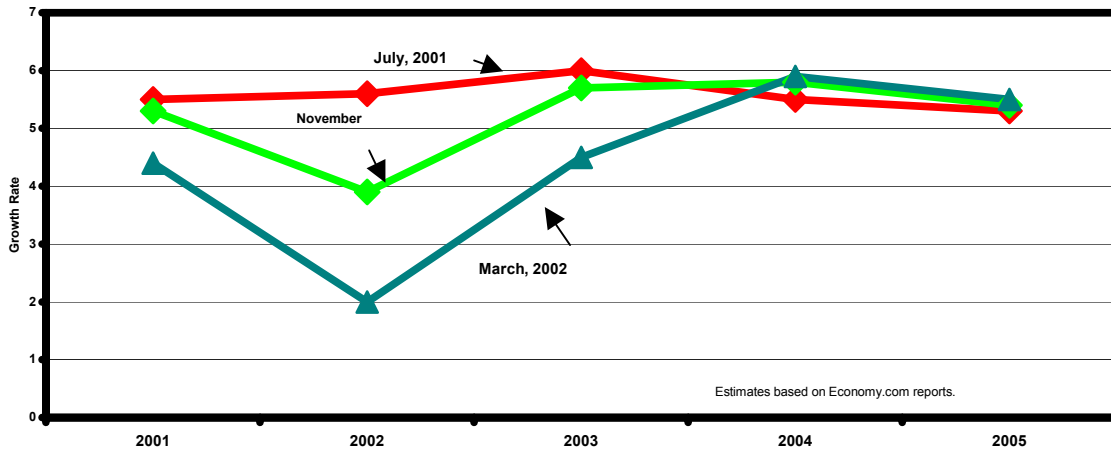
The South Carolina economy still feels the lingering effects of the manufacturing recession and the heavy adjustments taking place in the textile/apparel economy. Recent revisions of employment data provided by the U.S. Department of Labor put a decidedly negative spin on the state's current economic fortunes. What had been relative strong employment growth going into the recession was revised downward. We are left with a picture of a weaker economy that will not be fully recovered until around 2004.



The effects of the revised data on forecasts of state economic activity are shown in the next chart, which gives a mapping of three forecasts for growth in total personal income. The first forecast arrived before September 11. The second is dated November 2001, and the third was produced in March 2002. The November forecast takes account of the terrorist shock. The March forecast delivers the Department of Labor shock.

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S.C. INCOME GROWTH (Nominal Dollars)

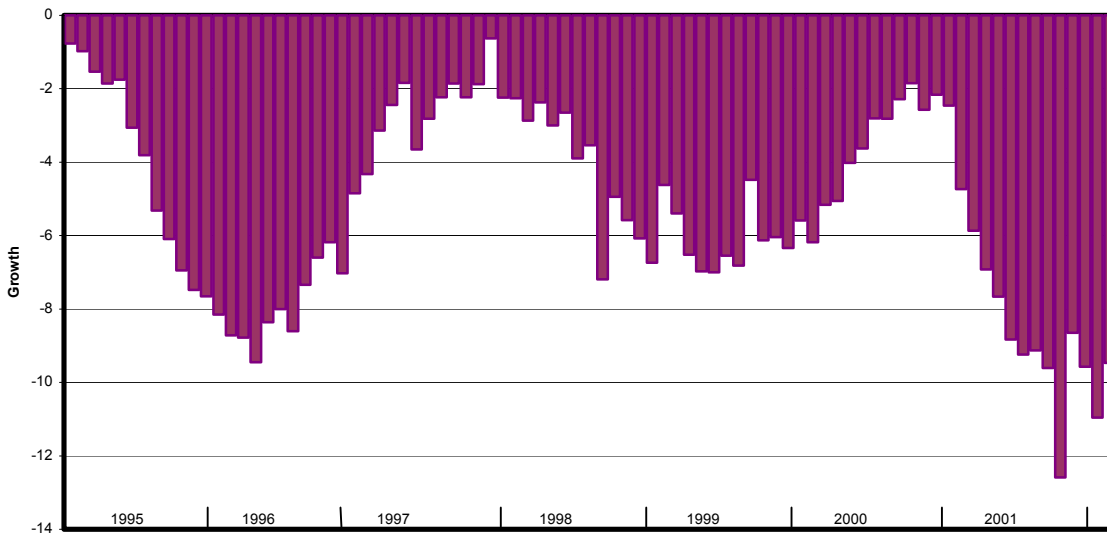


The textiles transition.

The dramatic economic transition occurring in textiles and apparel was accelerated by 911 and past efforts by the Fed to slow the American economy.

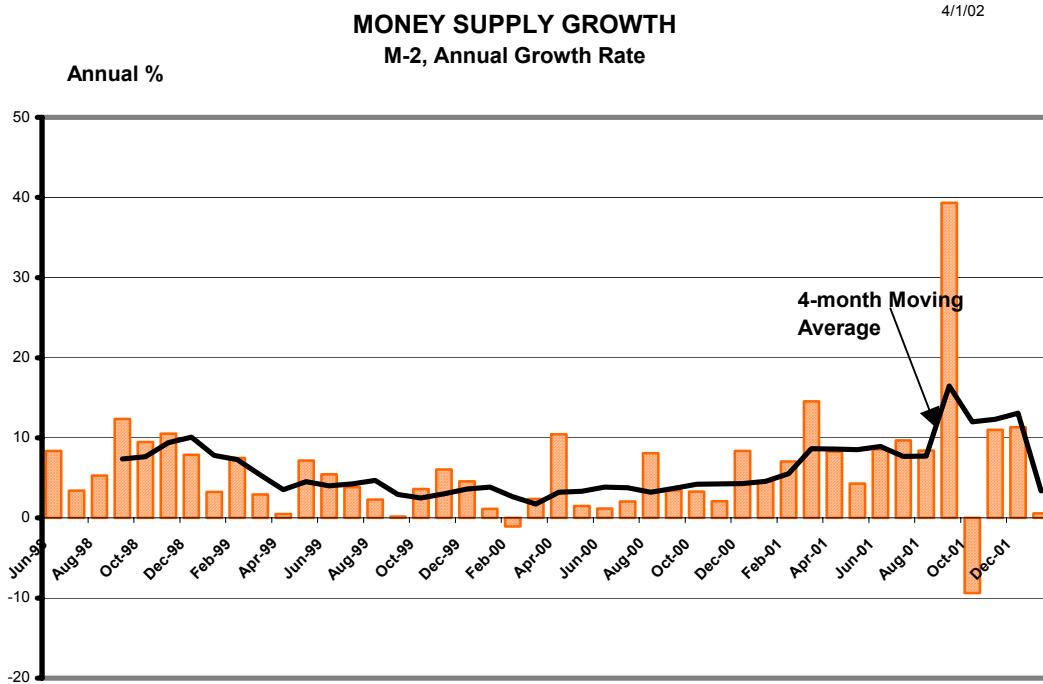
Monetary actions taken by the Fed to slow the economy led to higher interest rates and a stronger dollar. Domestic textile producers faced even more severe global competition. The results of the transition and Fed action are shown in the next chart that reports growth in total employment in the South Carolina textile industry. Note the word "growth." There has been no growth. Every observation in the chart lies below zero. The chart shows distinct period when things were tough and then not so tough. The most recent period is one of the toughest of all.

South Carolina Textile Mill Employment Growth: Jan. 1995--Jan. 2002



The Fed and the money machine

After the 911 outpouring of money, the Fed did some mopping up, but apparently not enough to avoid signs of inflation. As indicated in the next chart, the Federal Reserve Board fully opened the money valves in September and closed them a bit in the months that have followed. Still,



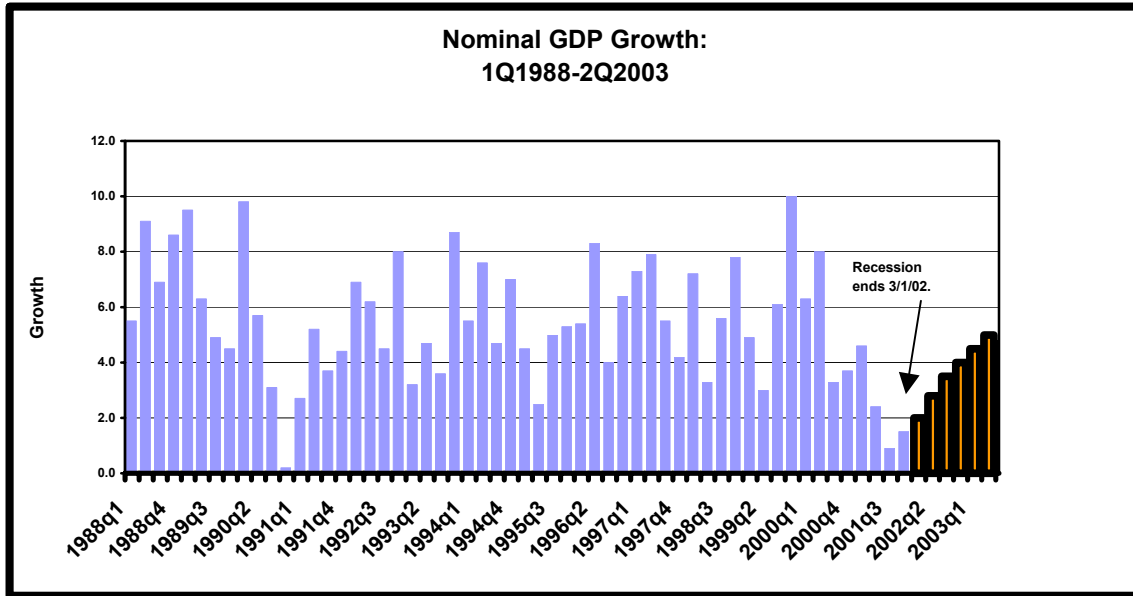
there's a good bit of money washing through the economy, as evidenced by the very low interest rates being charged on overnight bank loans. Already, there is more than a whiff of inflation in the air, with commodity prices showing an upward tilt. The higher price of crude oil stemming from the sad Middle East disturbances contributes to the price inflation.

With the economy picking up and inflation in the air, all bets on the table are calling for a tighter stance to be taken by the Fed in late summer. If we are going to borrow, sooner is preferred to later.

The good news: GDP growth.

The shape and character of the economic recovery became apparent with the March 28 release of final data for 2001Q4 GDP growth. In a nutshell, the data got better. Instead of 1.2% nominal growth, the final number came in at 1.5% (1.7% real), giving a more positive tilt to future projections. Two major forces are driving the numbers. Spurred by interest rate cuts and increases in real wages, consumer spending is surging. Driven by anti-terrorist actions and war, government spending is on the rise. Business spending on new capital equipment is still in the tank, and will remain there for the rest of the year. There are huge amounts of excess capacity in the economy, particularly in communications.

The GDP growth picture and forecast are shown in the final chart.



Making markets work for the environment.

The U.S. environmental revolution began about 30 years ago. It was in 1972 that the Federal Water Pollution Control Act was passed. Clean air legislation came a bit earlier, in 1970. The two major blueprints for environmental protection were based on command-and-control regulation that reflected a general distrust, if not dislike, of American capitalism. Indeed, there were some who felt that capitalism was a major cause of environmental destruction.

After three decades, the tables have turned. The collapse of the wall and glimpses inside the Soviet system convinced many that capitalism was not the enemy. If the environment was to flourish, incentives and property rights had to be harnessed, not muffled. Now, leading environmentalist and eminent biologist Edward O. Wilson is calling for market solutions. Writing in the spring issue of *The Nature Conservancy*, Wilson put it this way:

Make conservation profitable. There are many ways to derive income from noninvasive use of natural areas, turning local people into guardians instead of destroyers. That, biologists and economists agree, is the only certain way to save the vast biological resources of the developing world.

The market works. Pass the word.

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