

THE ECONOMIC SITUATION

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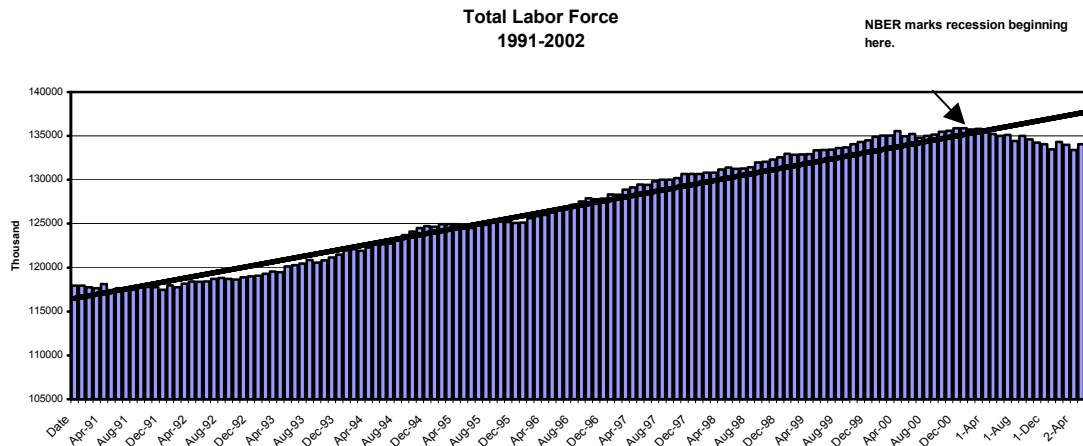
The nation's economy: rough road or a double-dipped recession?
Will growth in salary and wages sustain beleaguered consumers?
The Fed: easing or tightening?

And what about GDP?
The South Carolina economy, lagging the nation, claws ahead.
Oil, gold, and Middle East turmoil.

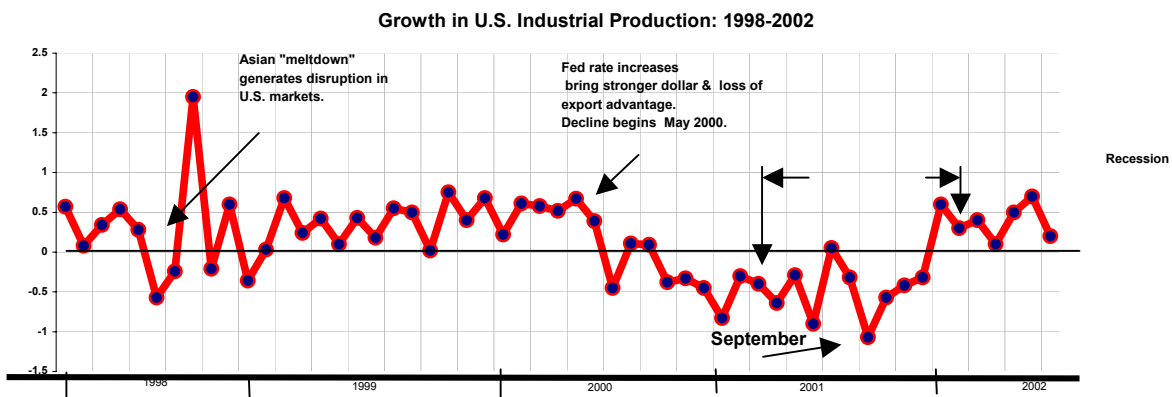
The Nation: Rough road or double-dip?

In recent weeks, soothsayers and forecasters alike have been troubled by data and guesses that suggest the recent recession is coming back to haunt us. The optimists proclaim that the good news is that bad news lies behind us. The pessimists say, don't look back, something bad is gaining on us.

One way to resolve the matter, at least partly, is to examine some data. Consider the chart below. It shows monthly data for the total U.S. labor force from 1991 to the present. The trend line fit to the data provides a benchmark for determining good times and not-so-good times. Notice the wonderful months of the late 1990s where the tall bars rise above trend. Then, after months of Fed tightening induced a slow economy, the recession's beginning point, March 2001, is seen as the beginning of a large wedge of lost jobs. Close examination of the wedge suggests that the number of people in the labor force has stabilized. But if the labor force is to grow, something good will have to happen in manufacturing.



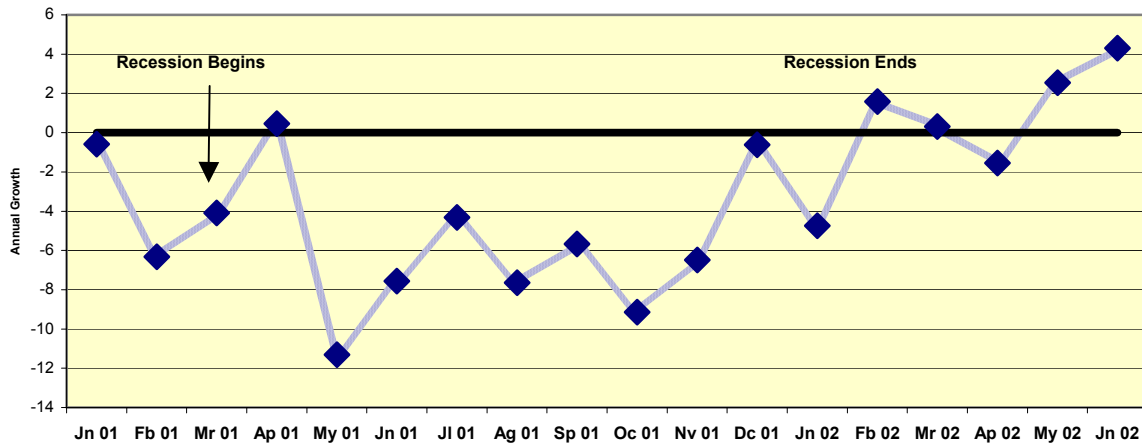
Fortunately, the data on manufacturing are beginning to look downright promising, another piece of evidence supporting the ghosts of recessions past will stay put. As the next chart shows, output from the nation's factories, mines, and mills is once again expanding. We now have seven consecutive months of positive growth. Yes, it's not real pretty. Sort of bumpy and weak, but the growth is positive.



How about those hearty consumers?

Consumer spending generates some 80% of economic activity. With huge amounts of excess manufacturing capacity and little promise of surging business investment, the pulse beat of the recovery will be determined largely by consumer action. Plummeting interest rates have caused consumers to refinance mortgages, putting more money on the line for spending. With little promise of capital gains from soaring stock prices, the only other source of spending money will come from salary and wages. The next chart shows growth in salary and wages from January 2001 to the present. The trend since May 2001 is enough to make a pessimist smile, if that's possible.

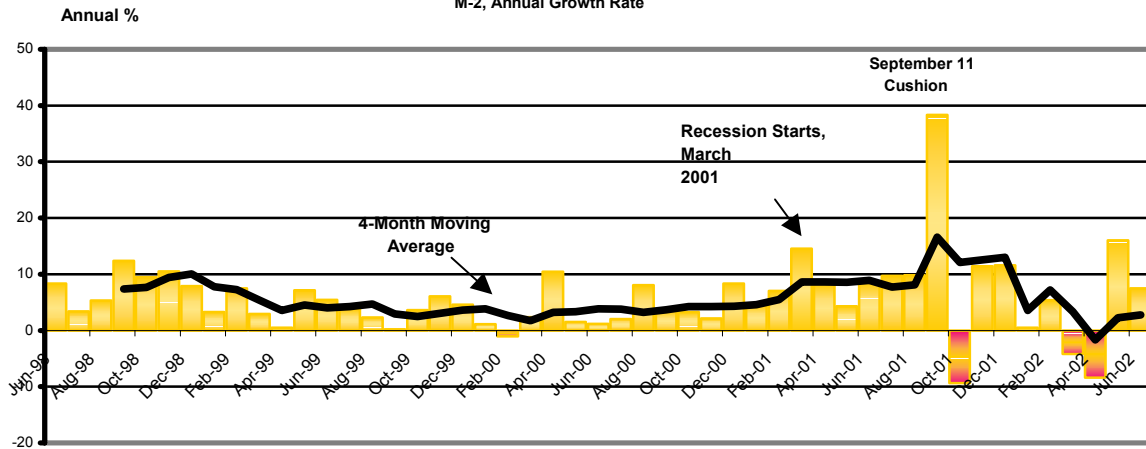
U.S. Salary & Wages Growth
July 1999 - June 2002



The Fed and money: tight or stingy?

Monetary action forms another important part of the forecast puzzle. Is the Fed loosening or tightening? Following 9/11, the Fed took quick and dramatic action to pump money into the economy. The economic shock was severe; there was every reason for the Fed to provide a credit cushion. After things settled down, the Fed took offsetting action. A lot of money that had been pumped into the economy was withdrawn, all through the quiet action of Fed open market operations. The question before us now is rather simple. Is the Fed opening the money valves to accelerate the recovery? Or is the Fed being a bit stingy? The next chart provides a partial answer to the questions. The 4-month average for money growth tells a tale of slow growth, and no inflation. There is no evidence of a generous Fed.

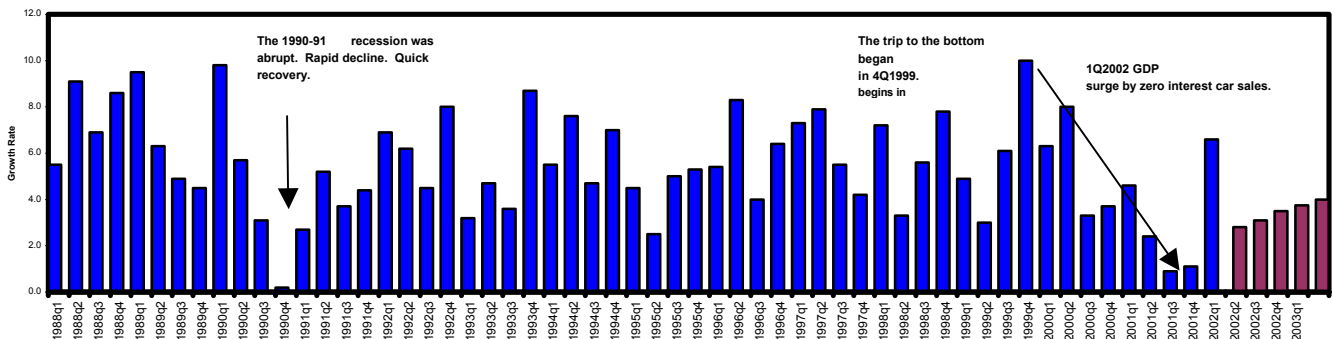
Money Supply Growth
M-2, Annual Growth Rate



And so what does all this say about GDP?

The pattern of employment, production, and growth in salary and wages suggests positive growth for GDP lies ahead. The Fed's tight money policy implies the growth will come with low inflation, and low interest rates. GDP record and forecast shown here calls for moderate growth ahead, with hardly any of the tall timber seen in late 1990s.

Nominal GDP Growth: 1Q1988-2Q2003

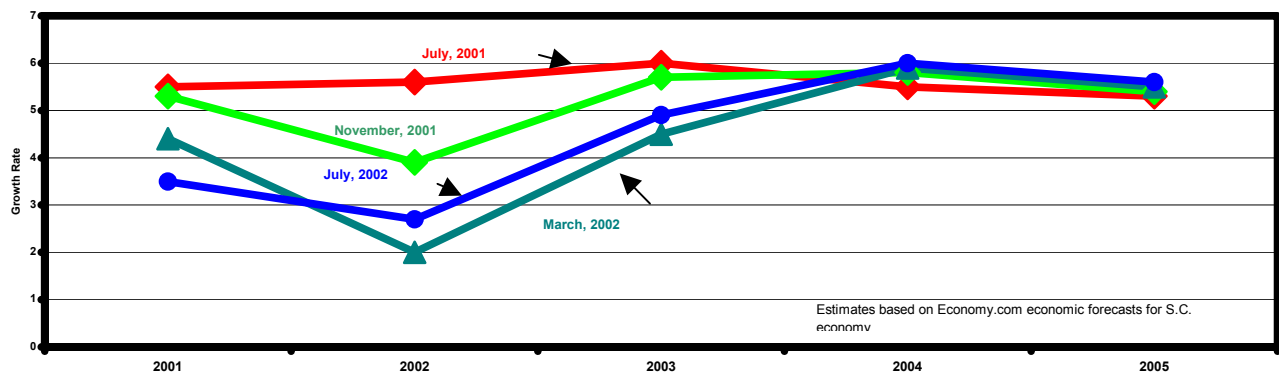


South Carolina: Lagging the nation.

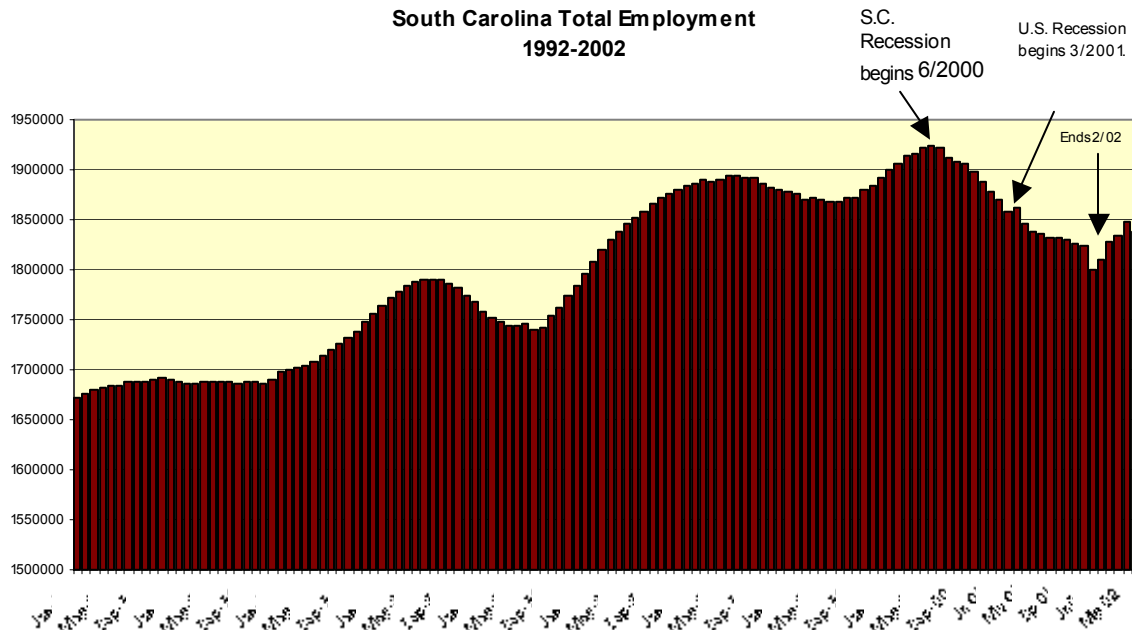
The evidence for the national economy suggests a bumpy road ahead, but no recurring recession. What about South Carolina? Will the state once again lay down a record that exceeds that of the nation? Hardly. So far, this is not in the cards. But before getting to the details, consider a series of forecasts for state total personal income provided at different times in the last year by economy.com. The chart below shows the dated forecasts. The first is made in July, 2001, which is of course before 9/11. The second comes in November, after 9/11. Then, there are two subsequent forecasts, the most recent being July 2002. The July 2001 forecast shows a steady-state growth rate that averages a bit less than 5%. At the time, forecasters expected the Fed to continue tightening interest rates, but not to force the economy into a recession. The November 2001 forecast shows how a horrible shock affects a rather calm forecast. By the time the March 2002 forecast emerges, the nation is suffering from a manufacturing recession, and South Carolina is getting it in spades. Then, the July 2002 forecast contains revised information that says the state's economy has improved. But, notice the forecast intersection points that occur around 2004. It is then, 2004, that the state economy has recovered to its pre-9/11 path.

The effects of the manufacturing recession on South Carolina are shown rather dramatically in state employment data. The next chart marks the beginning and end of the S.C. recession and illustrates how much ground has been lost since June of 2000. But in spite of the losses, there is evidence that the economy is clawing its way back toward pre-recession employment. It's a long road.

**S.C. Income growth: Comparing Forecasts
(Nominal Dollars)**



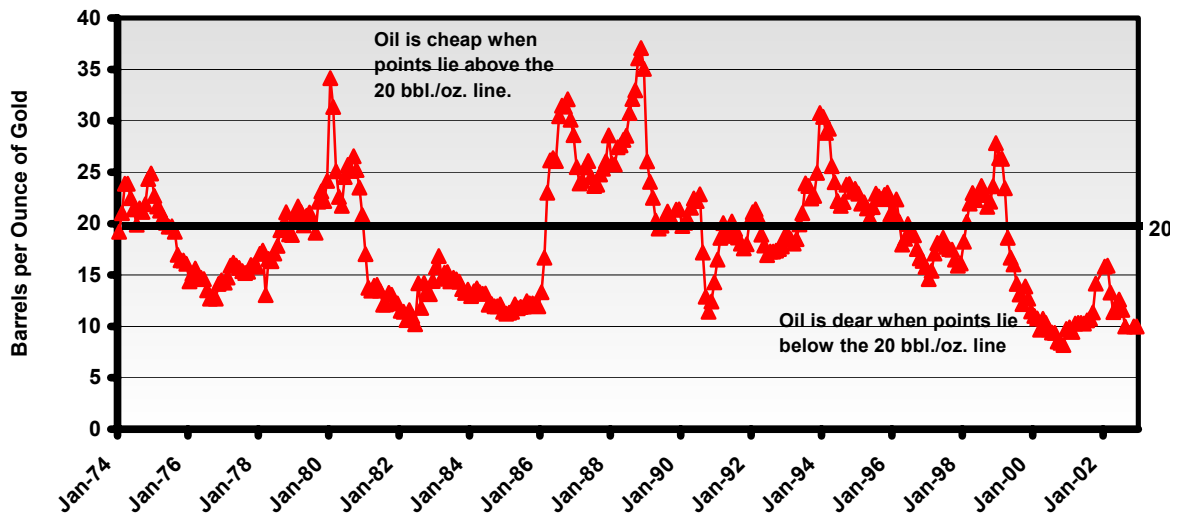
**South Carolina Total Employment
1992-2002**



Of oil, gold, and uncertainty.

With all the Middle East uncertainty and turmoil, it is time again to examine the relationship between the price of crude oil and the price of gold. Regular readers will recall the "golden rule," the one about oil. The rule says that Arab traders think in terms of gold and seek historically to obtain an ounce of gold for 20 barrels of oil. By dividing the dollar price of a barrel of crude oil into the dollar price of an ounce of gold, we obtain the number of barrels obtained for an ounce. The final chart in this quarter's report shows the relationship.

Gold and Oil: The 20 Bbl./Oz. Rule



Notice the way the chart is constructed. When the price of oil is “too high,” relative to the 20 barrel rule, the data will lie below the 20 barrel line. When oil’s price is “too low,” the observations will lie above the 20 barrel line. The plot of points oscillates nicely around the 20 barrel line, with major exceptions shown for the 1970s Arab embargoes and the Gulf War.

In just the last few days, the price of oil has risen to a 30-year high mark, where an ounce of gold barely fetches 10 barrel of oil. Indeed, the current picture looks as serious as the 1970s’ embargo days, at least when stated in gold.

The oil/gold picture raises a major concern for forecasters. Will the Iraq sword rattling create energy scarcity that conjures up the ghost of the recession just past? Or will other oil producing nations, seeing this as an opportunity to earn some much needed revenues, open their valves and ship crude oil into world markets?

The report ends with these unanswered questions. For now, the national and state economies are clawing ahead. The key to recovery lies in avoiding serious shocks to an already bruised economy.