THE ECONOMIC SITUATION

Bruce Yandle
Interim Dean, College of Business & Behavioral Science, Clemson University
Director, Strom Thurmond Institute Economic Outlook Project
yandle@clemson.edu

October 2004

- From Goldilocks to the soft patch.
- Looking at the regional patterns.
- South Carolina has rising wages and rising income, but not much employment growth.
- A bit late catching the economic expansion express, South Carolina is finally moving ahead.
- The oil hobgoblin rides again

Moving from Goldilocks to the soft patch

My July newsletter began with a discussion of the Goldilocks economy, that wonderful time when everything is just right. I made no claim that Goldilocks was tripping in from the woods and all was well. But I did suggest that South Carolina's economy might not feel just right until sometime in 2005. Perhaps I should have said 2006.

Well, that was before Mr. Greenspan began to talk about the soft patch, an economic diversion that seemed to be gumming up the works, just temporarily. His talk was based on facts. Indeed, several facts. First, the stimulus of the early Bush tax cuts is wearing out. Then, there is a war that is interrupting and destroying lives. There is Sarbane-Oxley, a troublesome set of regulatory constraints that is affecting the efficiency of capital markets. Add to this a wholesale increase in regulations generally and a growing government that is eating more private dollars. And on top of this, add a hurricane season and a mountain of political factors that together have bottled up oil supplies just at the time the world economy is beginning a synchronous expansion.

This sounds like the makings of a modern Halloween story, but this time the goblins are real.

In spite of the soft patch, the nation's economy is perking along pretty well. It is downright incredible what a market-based economy can do.

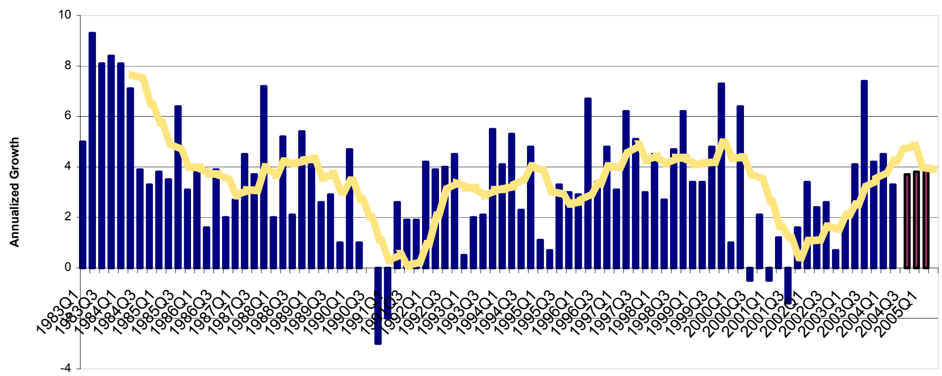
Second quarter GDP growth was revised up.

Consider second quarter GDP growth. The preliminary estimate set real growth at 2.8%. Then, the revised estimate was raised, not lowered, to 3.3%. As shown in the accompanying chart, the revision still suggests weakness. But there are some strong sectors flexing their muscles. Construction is hot again. Vehicle production is up. And business firms are back in the information technology market.

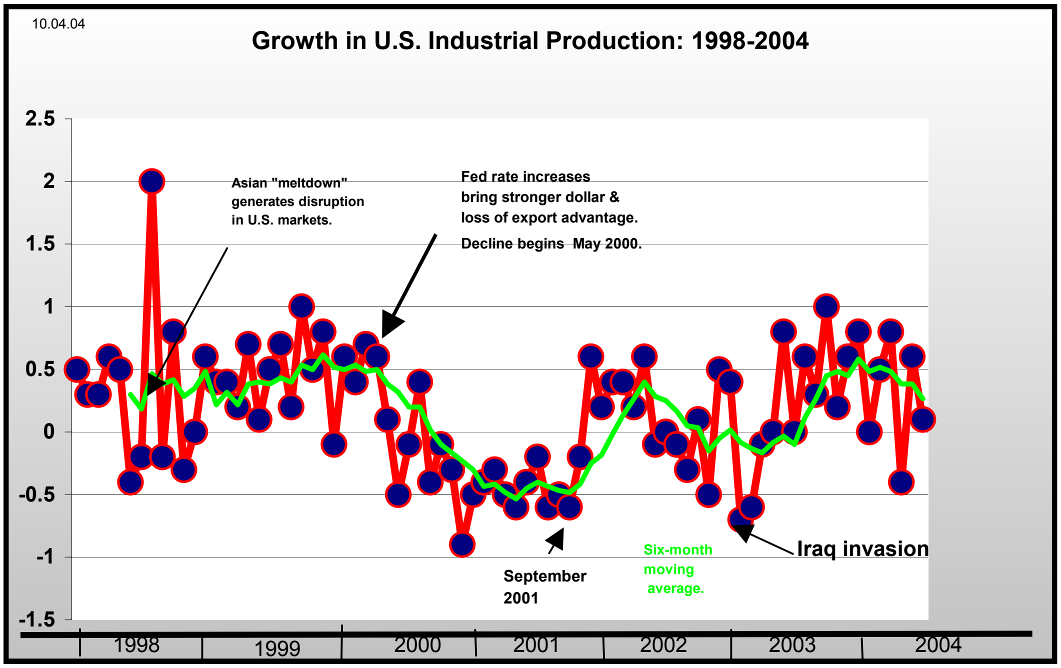
In short, everything but employment growth in manufacturing is looking pretty good.

100304

Real GDP Growth: 1Q1983-1Q2004
Estimates through 1Q2005
(with 6-quarter running average)



The weakness in manufacturing employment can be traced partly to industrial production. And it is here that we see evidence of the soft patch economy. The chart below shows monthly growth rates for the nation's factories, mines, and utilities. Along about mid-2003, things looked good for Goldilocks. But then, oil prices began to rise and consumers cut back a bit on the purchase of durable goods. Industrial production growth softened. The data point for August barely registered a positive number.

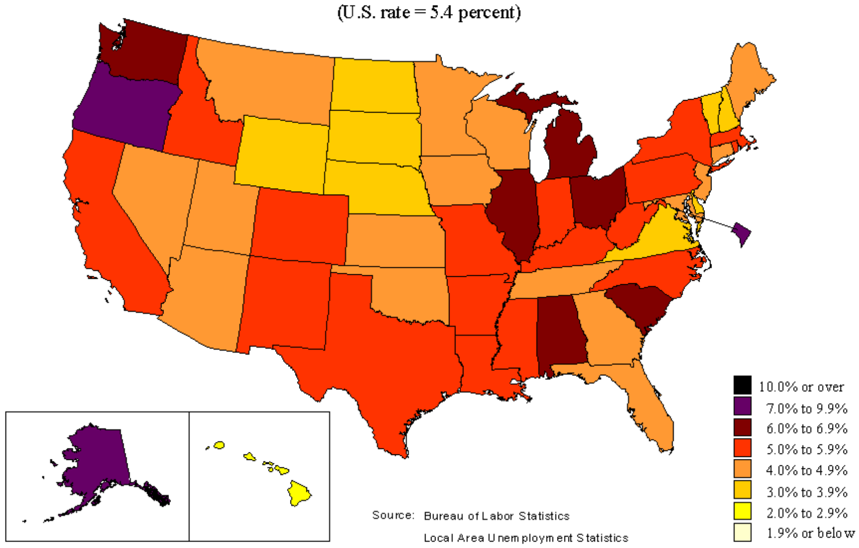


But there is more to weak employment growth than a manufacturing slowdown. The fringe benefit costs of hiring another worker continue to rise, even when wages are fairly stable. Consider this. Since 1948, the share of national income going to labor, including fringe benefit costs, has held about constant at 70%.
But the share of national income going to wages and salaries has fallen from a peak of 60% in 1968 to roughly 55% now. Fringe benefits, which must be paid out of production, are eating away at wages and salaries…, and hiring.

Where Goldilocks is leaving her mark.

There are some bright spots out there. Plenty of them. But the effects of the dot.com adjustment and recovery from the manufacturing recession are seen vividly in unemployment numbers across the states. Washington, Oregon, South Carolina, Michigan, Wisconsin, and Alabama are the laggards.

Unemployment rates by state,
seasonally adjusted, August 2004
(U.S. rate = 5.4 percent)



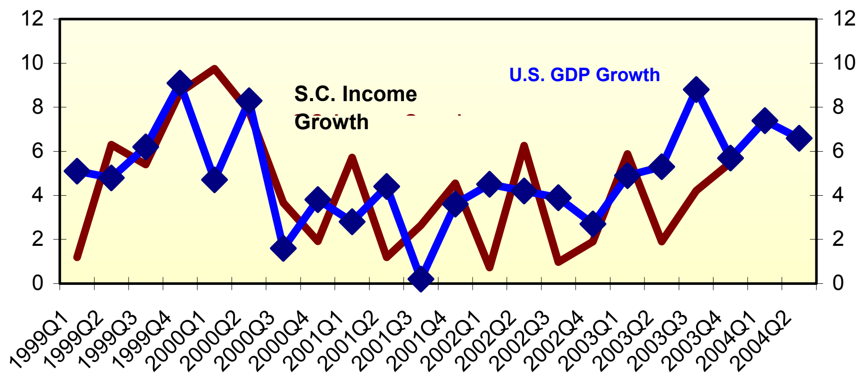
The unemployment rate is just one measure of economic performance, and an important one, but there is still more to the story.

What about South Carolina?

An interesting relationship is seen when the economic pulse of the nation is compared to South Carolina's. The accompanying chart reports the story from 1999 forward. Notice how South Carolina's income growth connects to the nation, at least until 2003. The manufacturing recession took a large bite from the relationship. But notice the good news in the data. South Carolina total personal income growth is now locked on the growth of nominal GDP for the nation.

The chart also provides a basis for making a forecast. More data points for GDP are available than for S.C. income growth. A naïve forecast suggests there are brighter days ahead for the home team.

S.C. and the Nation
Nominal Income and GDP Growth
1999-2003/04



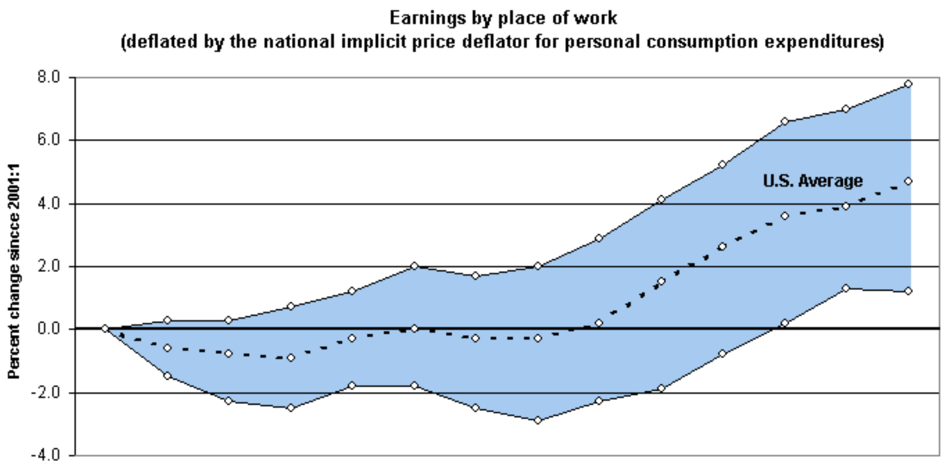
South Carolina accelerates

While still lagging the nation in employment, South Carolina is taking the lead in income growth. What might appear as an anomaly is partly explained by the larger than average state retirement community, which has earnings that are not employment related. As shown in the next table, South Carolina income growth looks pretty good, and now ranks 17th in the nation for growth between 2004:I and 2004:II.

Southeast Total Personal Income Growth						
State	2003:II	2003:III	2003:IV	2004:I	2004:II	Rank: I-II Growth
Alabama	1.0	1.0	1.8	0.9	1.2	41
Arkansas	1.4	1.2	1.9	1.5	1.8	8
Florida	1.1	1.1	1.2	1.6	1.8	5
Georgia	1.0	1.0	1.5	1.7	1.6	23
Kentucky	1.2	1.2	1.5	0.7	1.1	45
Louisiana	1.3	1.1	1.3	1.5	0.9	48
Mississippi	0.8	1.2	1.4	1.4	1.5	27
N. Carolina	0.6	1.5	1.9	0.8	1.5	28
S. Carolina	0.6	1.0	1.7	0.7	1.6	17
Tennessee	1.0	1.3	1.7	1.2	1.3	37
Virginia	1.1	1.1	1.7	1.8	1.6	18
W. Virginia	0.8	0.7	1.2	1.4	1.6	24

Data on S.C. wage growth also look positive.

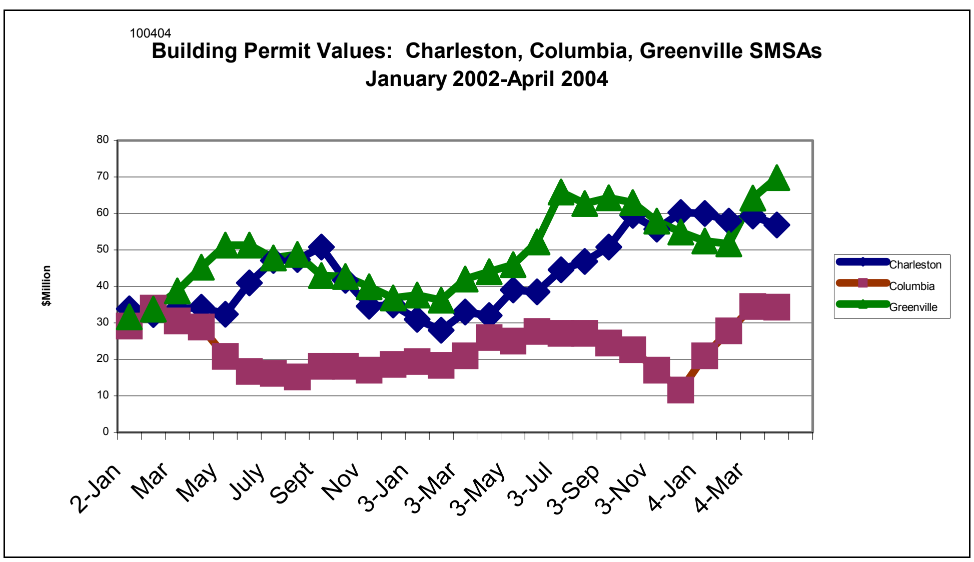
The differential effects of economic growth and change are seen in the accompanying chart that plots place-of-work earnings based on Department of Commerce data for eight U.S. regions. The widened band that separates the slowest growth regions from the fastest region shows how the Southeast acceleration is setting a faster relative pace for the nation.



Note -- The shaded area represents the range of growth rates of the eight BEA regions; the upper bound represents the Southeast region and the lower bound represents New England.

While the state is recovering overall, state regions present a mixed bag.

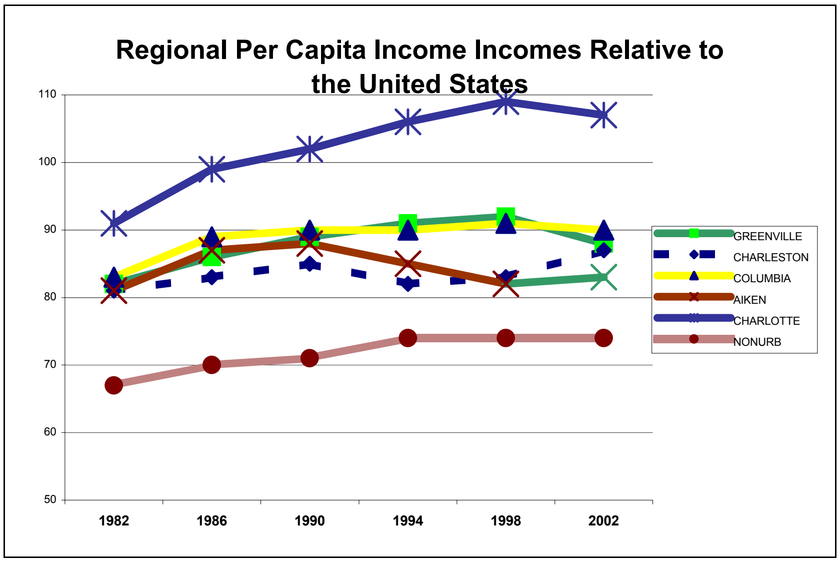
Consider housing. Data on housing permit values for the state's major metro regions show a bottoming out in March 2003 and a sharp recovery since then. The Central Midlands, which marches to a different beat, has not done so well.



A similar mixed bag is seen when per capita income relative to the nation is examined for major state regions.

The accompanying chart gives the comparison for a series of years beginning in 1982. At the time, the Charlotte metro area, which includes a portion of South Carolina, enjoyed a per capita income that was about 90% of the nation's. The Charlotte region gained on the nation until 1998. After that, the differential effects of the manufacturing recession took some of the edge off Charlotte's income growth.

And gains relative to the nation show a mixed bag too.



The Columbia and Greenville metro areas were neck-and-neck in 1982, with per capita incomes that were about 80% of the national per capita level. The Greenville economy gained a bit on Columbia, until 1998. After that, the manufacturing recession took a larger bite out of Greenville's surge. The Charleston metro region followed the path of Greenville and Columbia until the base closings intervened. The pace in Charleston picked up after 1998. In 2002, per capita incomes for the state's three major state regions were locked together.

One final array of points in the income chart deserves some attention. Notice the path followed by South Carolina's nonurban areas. Per capita income for that large conglomerate of places was less than 70% of the nation's in 1982. The move has been positive ever since. In 2002, per capita income stood at about 73% of the nation's. The pace has been slow, but it has been positive.

And now that oil price goblin

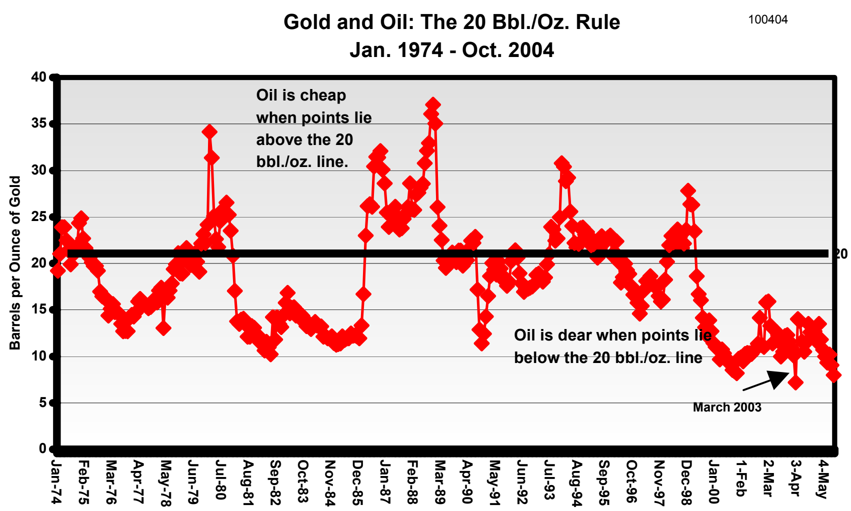
When the price of crude oil ran through the $50 mark a few days ago, analysts began to list all the things that have gone wrong. It was worse than the return of the three bears. Yes, the Middle East cutback was expected. We did that one to ourselves, perhaps hoping that Russia would open the valves and take in the cash, which they often do when the price is right. But Mr. Putin has jailed the CEO of Russia's largest oil producer and is putting the firm on the block. Uncertainty is closing the valves.

What about the incentive effect of rising prices? We normally expect producers in other parts of the world to begin to take up the slack. Not this time. The South American producers are caught up in political intrigue, Nigeria almost faces civil war, and three hurricanes in a row have shuttered the offshore producers in the Gulf of Mexico.

Put it all together and we get $50 oil.

We see the result in our old familiar oil/gold chart. Once again, I have mapped the price of oil in terms of gold and compared the result to the 20 barrels for an ounce of gold relationship. Recall, there is a golden rule that says Arab traders normally give 20 barrels of oil for an ounce of gold. Notice the word "normally" in the sentence.

As seen in the chart, the gold price of oil has risen skyward. An ounce of gold will barely buy seven barrels of oil. Indeed, the array of price points since the March Iraq invasion forms a high cost frontier that exceeds anything seen since 1974



The high price of energy is taking a toll on the economy. Some analysts suggest that as much as a half a percentage point is shaved from GDP growth. More than that may be shaved away from state revenues that rely on sales taxes. In South Carolina, gasoline bears no sales tax. When consumers divert spending from other items at retail, state revenues suffer.

Interns and jobs for MBAs.

In my July newsletter, I asked for assistance in lining up summer internship opportunities for MBA and other Clemson masters students. The appeal was for real jobs with real pay. The response was heartening. We now have 61 prospective internship opportunities for summer 2005.

I thank you for the tremendous response.

Guess what? Now I am going for 100. Just 39 more to go and we will have it. Indeed, I would like for every Clemson masters student to have an internship prior to hitting the job market. Of course, internships are a way to make early identification of good employees.

Talking about employment opportunities brings to mind this year's crop of MBA and MS students. We have a strong offering coming through our programs. Some have engineering backgrounds. Others worked as accountants before entering the programs. Still others are deep into information technology. And then there's an interesting array of psychology masters students who are focusing on employment and workplace management.

If you want to know more, please send an email to Meredith Mims (mmims@clemson.edu).

Still looking for heroes.

Innovation is a hot topic, as well it should be. When we learned that Clemson professor David Bodde's book *The Intentional Entrepreneur* had been added to the Wall Street Journal's "startup journal website," I was reminded of a hero of mine.

Ludwig von Mises was an Austrian economist who immigrated to the United States in 1940 to escape Hitler's terror. Mises focused on entrepreneurship long before it was cool. A scholar to the marrow of his bones, he celebrated free markets, individualism, and the power of the capitalist engine to lift human well-being.

In his book, *Theory and History*, he talks about the individual and celebrates the American spirit. Here's what he said:

Most people are common men. They have no thoughts of their own; they are only receptive. They do not create new ideas; they repeat what they have heard and imitate wheat they have seen. If the world were populated only by such as these, there would not be any change and any history. What produces change is new ideas and actions guided by them. What distinguishes one group from another is the effect of such innovations. What makes the American people different from any other people is the joint effect produced by the thoughts and actions of innumerable uncommon Americans.

The Great American Bread Machine still works. Pass the word.