

THE ECONOMIC SITUATION

Bruce Yandle

Interim Dean, College of Business & Behavioral Science, Clemson University

Director, Strom Thurmond Institute Economic Outlook Project

yandle@clemson.edu

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- Taking stock and looking ahead.
- The Bread Machine responds to Katrina.
- South Carolina's case of the slows.
- Where is the knowledge economy?
- The human capital challenge

The record and the 2006 forecast

December brings a time of reckoning when promises made are compared with what was delivered. It is also a time to look ahead and offer projections for December 2006. The next chart shows the record and the forecast. The columns contain the record for 2004, the forecast I made for 2005 this time last year, the record at mid-December, and my preliminary forecast for the coming year. I emphasize the word "preliminary." I will give my final numbers in early January when we know more about the actual 2005 numbers.

A comparison of the December 2005 forecast with actual December data, shows that lady luck smiled on me, at least for part of the data. (You will see that I put my better numbers at the top of the chart!) Rising energy prices and other disturbances played havoc with other parts of the data. I simply say that I hope I do as well in the year ahead.

The Year Past & Ahead

	2004	2005	Forecasts	
	Actual	Year Ahead	December 2005	2006 Year Ahead
GDP Growth	4.4%	3.7%	3.7%	3.9%
Inflation (Core)	2.2%	2.5%	2.0%	2.5%
30-yr. Mort.	5.19%	6.25%	6.26%	6.80%
Unemploy	5.4%	5.0%	5.0%	4.8%
Prime Rate	5.25%	6.00%	6.75%	7.70%
Dow-Jones	10,600	11,200	10,900	11,500
Employ Gain	150M/mo.	150M/mo.	198M/mo.	200M/mo.
Oil	\$45	\$40	\$54	\$50
Gold	\$422	\$400	\$500	\$480

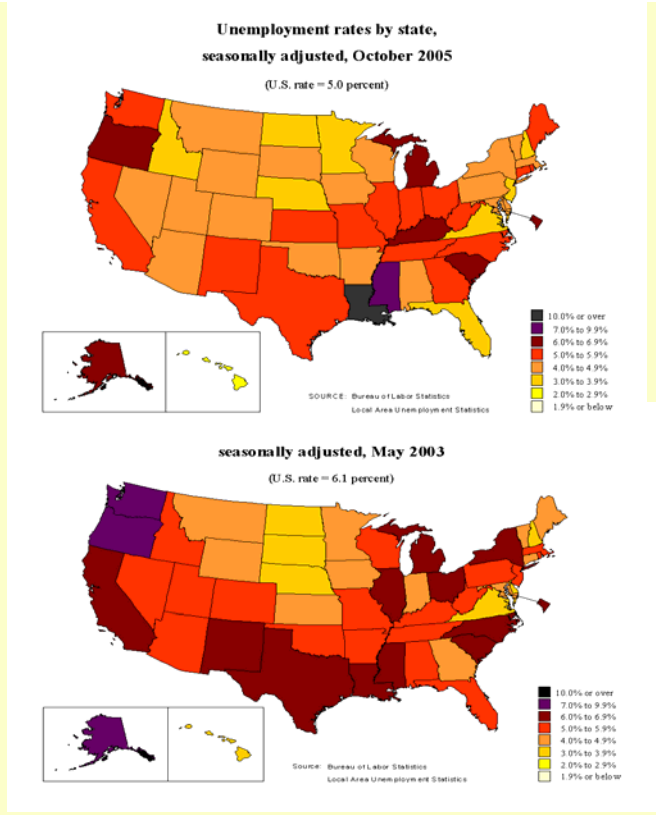
The 2006 forecast assumes that the Fed will continue to ratchet up rates on into March or April and will then hold off on tightening money supply growth. CPI measured inflation will rise a bit. The added inflation will make its way into the longer term interest rates, while the expanding economy will reduce the unemployment rate.

The Dow-Jones? Here is my Achilles Heel. Once again, I am calling on the Stock Market Angels to respond to the recovered economy.

Katrina and the Economy

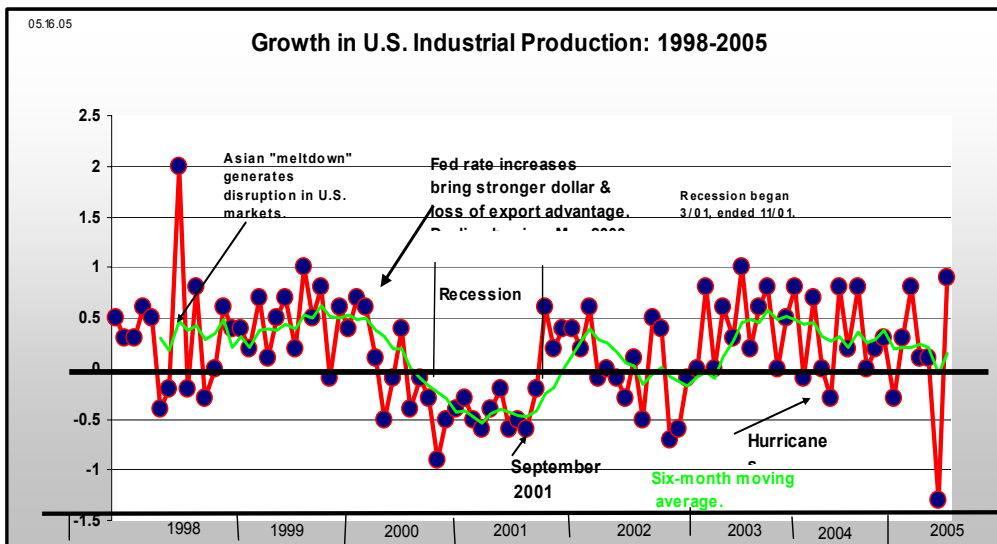
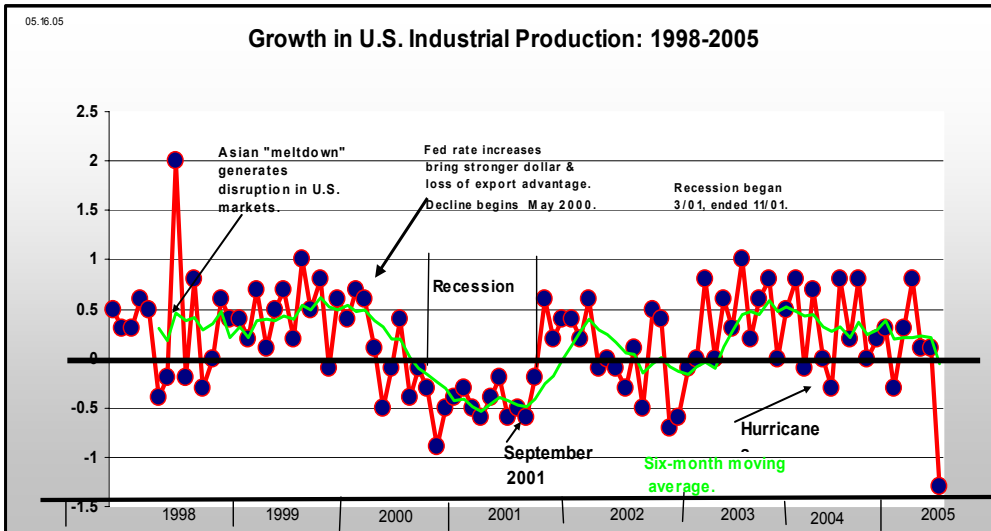
When Katrina hit on August 29th, the U.S. economy was well on its way to recovering from a manufacturing recession. But with energy production interrupted and a large geographic section of the country adversely affected, it was clear that industrial production would suffer. The question was by how much and how long.

The regional impact of Katrina and the general recovery from the manufacturing recession are seen in the next charts, which report unemployment rates across the states. The chart at the top for November 2005 shows how the Gulf States are impacted. (It also shows how South Carolina is still lagging, a topic explored later in the report.)



The Great Bread Machine responds

The amazing ability of the U.S. economy to adjust is seen vividly in post-Katrina data for industrial production. The next two charts show a two-month sequence of U.S. industrial production data. The first chart shows the results through September 2005. The September observation, which runs almost off the chart, records the worst decline since 1974. By the way, that was a year of an Arab embargo. The chart that follows shows data through October 2005 and records the incredible ability of the U.S. economy to adjust and respond.

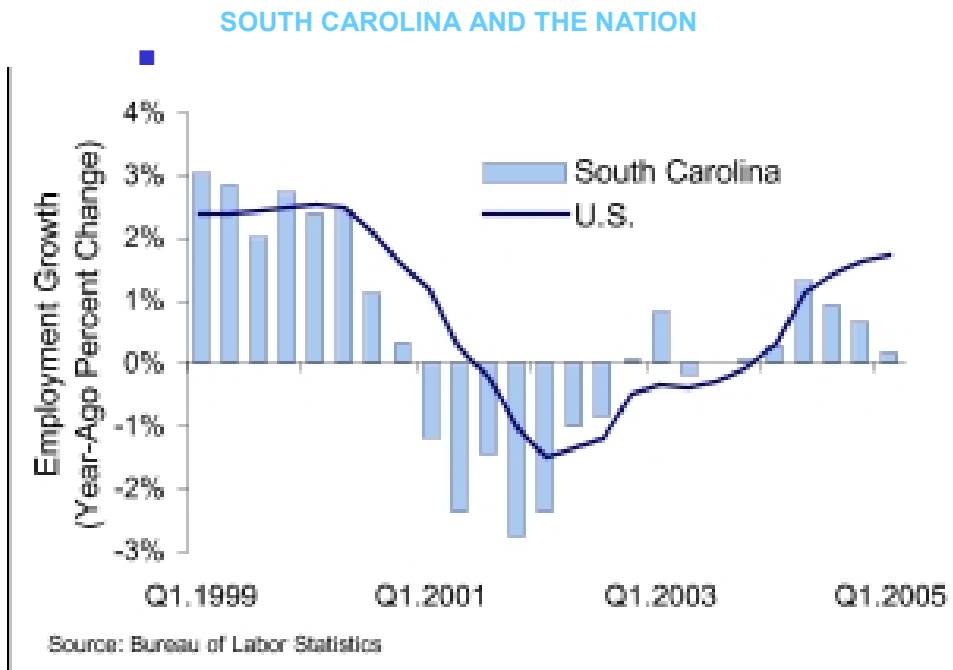


There is every indication that the U.S. economy generally is operating on a solid growth track.

South Carolina's Slow Economy

With the exception of South Carolina and the Gulf Coast region, the rest of the nation has recovered substantially from the late manufacturing recession. As much as we might wish otherwise, the data that continue to arrive paint an unhappy picture for the Palmetto state.

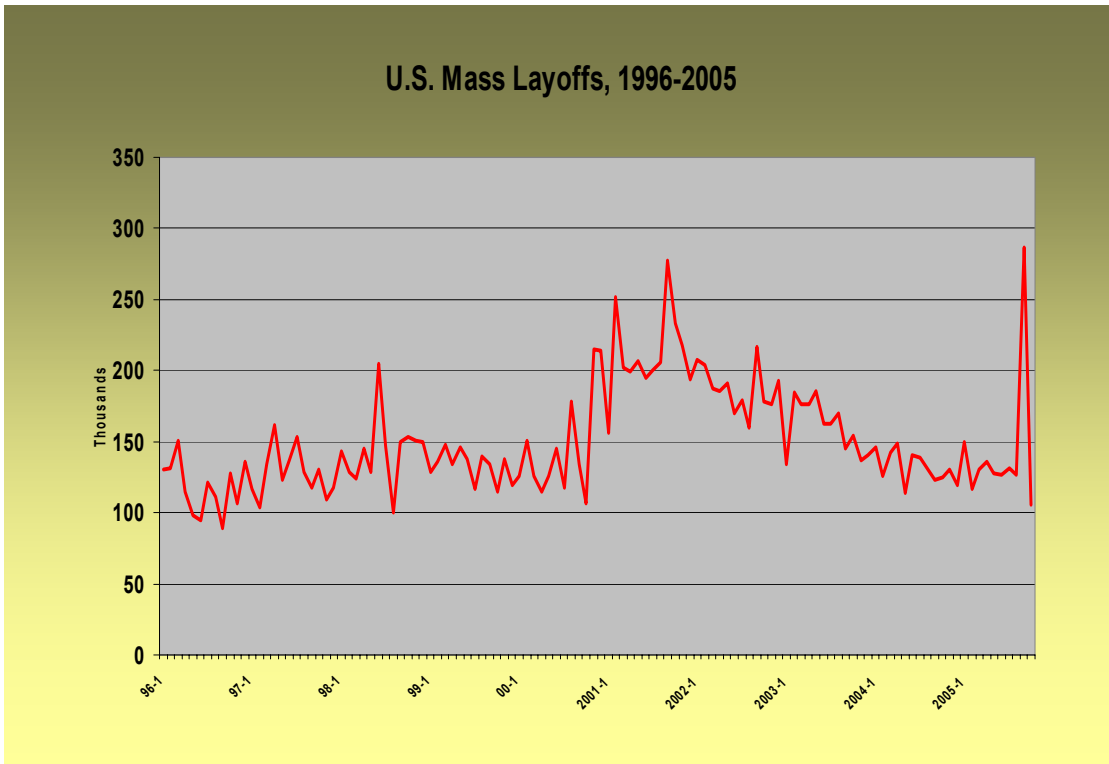
For example, Economy.com's November ranking of employment growth for 2004-2009 shows South Carolina standing at 35th among the states, while North Carolina is 15th, Georgia is 27th, Virginia is 20th, and Tennessee is 21st. The next chart shows how S.C. employment growth is weakening in the face of stronger national growth. A similar picture is seen when S.C. employment growth is compared with the rest of the Southern states. Indeed, even when Florida is removed, the state is still lagging.



Part of the slow performance may be explained by past employment shocks that came with major layoffs. Another part may relate to the scarcity of labor prepared for the new knowledge economy.

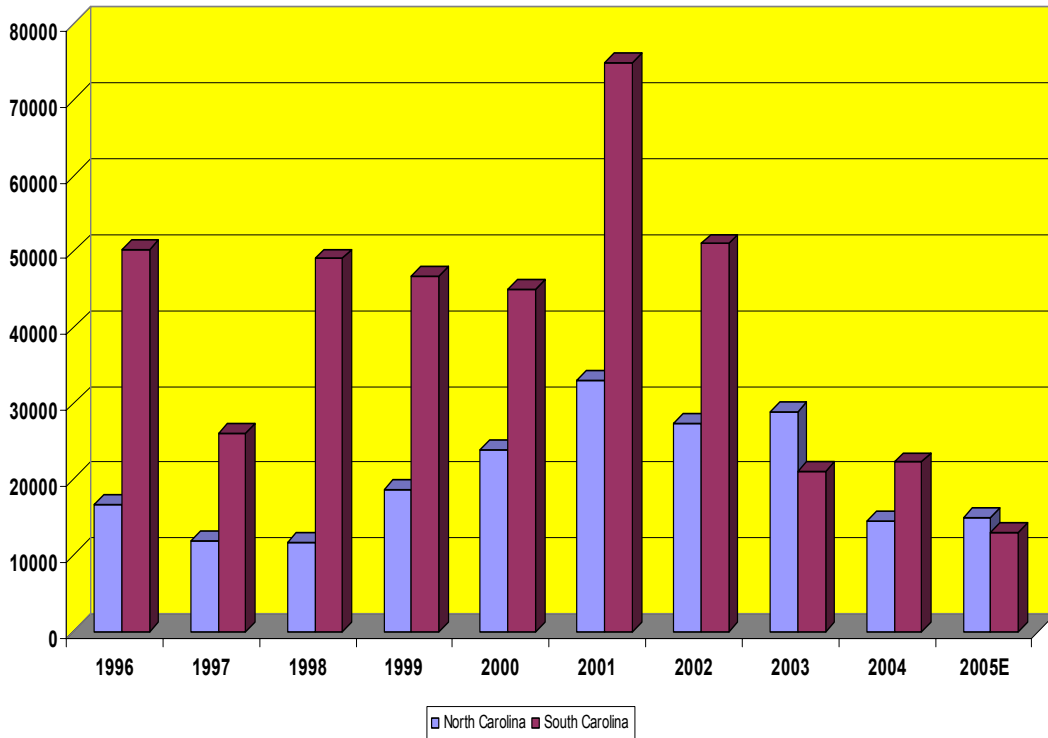
Mass Layoff Patterns

The Bureau of Labor Statistics maintains data on mass layoffs. These are layoffs that involve more than 50 people in a single event. The next chart shows data for the nation for 1996-2005. The peak of the chart corresponds with the depth of the manufacturing recession. The recent spike is caused by Katrina. There were many mass layoffs that followed the devastation in the Gulf.



Data for South Carolina and North Carolina are shown the next chart. The data are clear. South Carolina's hits came earlier and were harder than North Carolina's.

N.C. & S.C. Mass Layoffs, 1996-2005



Looking for Knowledge Workers

On October 21st, a conversation on the South Carolina economy was held at the Palmetto Center in Greenville. Sponsored by the S.C. Competitiveness Council and organized by Clemson's College of Business & Behavioral Science, the day-long program brought together economists and other researchers from Clemson and the University of South Carolina. A presentation by Clemson's David Barkley and Mark Henry focused on the knowledge or innovation economy and the extent to which South Carolina metropolitan regions are geared to participate in it. There are several important indicators of readiness. These include patents per capita, educational attainment, and the level of research at major universities.

Using a sample of more than 100 metro areas in the South, Barkley and Henry produced rankings that speak to the South Carolina situation. The next three charts, which were produced by Barkley and Henry, give results worth considering.

Patents Per 1000 People by Southern Metropolitan Area, 1995-1999

Leading Southern Metropolitan Areas

1. Austin San Marcos	4.28
2. Baton Rouge	3.71
3. Raleigh Durham Chapel Hill	2.66
4. Gainesville, FL	1.96
5. West Palm Beach Boca Raton	1.75
6. Houston	1.52
7. Dallas Fort Worth Arlington	1.49
8. Melbourne-Titusville-Palm Bay	1.45
14. Greenville-Spartanburg Anderson	1.16
29. Florence	.79
31. Charlotte-Gastonia-Rock Hill	.75
50. Charleston	.56
51. Columbia	.54
64. Augusta Aiken	.39
82. Myrtle Beach	.31
104. Sumter	.17

Total R&D Expenditures at Universities and Colleges, 1998-2000

<u>Area</u>	<u>Total R&D 1998-2000</u>	<u>R&D Expenditures Per Capita</u>
<i>Leading Southern Metropolitan Areas</i>		
1. Bryan-College Station, TX	1,193,191,000	\$7.81
2. Athens, GA	713,914,000	4.63
3. Gainesville, FL	893,001,000	4.09
4. Baton Rouge, LA	703,565,000	3.62
5. Hattiesburg, MS	388,843,000	3.46
6. Charlottesville, VA	410,689,000	2.56
7. Auburn-Opelika, AL	260,924,000	2.26
8. Raleigh-Durham-Chapel Hill, NC	2,550,055,000	2.12
16. Columbia	305,927,000	\$.57
20. Charleston	179,002,000	.33
21. Greenville-Spartanburg-Anderson	306,074,000	.32
22. Augusta-Aiken	133,100,000	.28
54. Charlotte-Gastonia-Rock Hill	36,745,000	.02
68. Myrtle Beach	1,638,000	.01
NR Florence	0	0
NR Sumter	0	0

Source: National Science Foundation

Share of Adult Population with College Degrees, 2000.

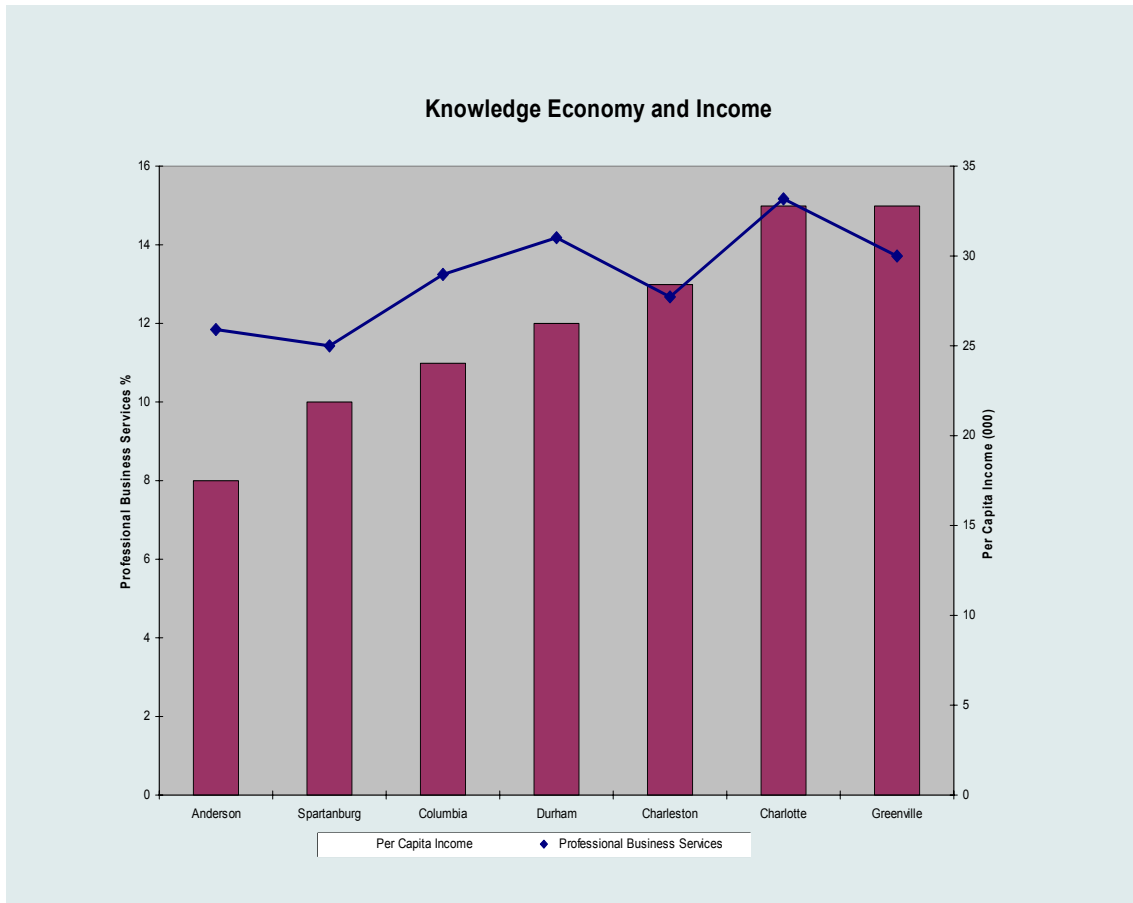
Leading Southern Metropolitan Areas

1. Charlottesville	40.1%
2. Raleigh-Durham-Chapel Hill	38.9
3. Gainesville, FL	38.7
4. Bryan-College Station	37.0
5. Austin	36.7
6. Tallahassee	36.7
7. Athens, GA	34.1
8. Atlanta	32.0
10. Columbia	29.2%
19. Charlotte-Gastonia-Rock Hill	26.5
23. Charleston	25.0
58. Augusta-Aiken	20.9
60. Greenville-Spartanburg-Anderson	20.7
74. Florence	18.7
75. Myrtle Beach	18.7
99. Sumter	15.8

Source: U.S. Census, 2000

Translating knowledge workers into income

The share of the workforce employed in professional business services is another proxy for the presence of a knowledge/innovation economy. This is the sector that includes accountants, attorneys, consulting firms, engineering management firms, and research organizations. The next chart shows a mapping of data for selected metro areas into per capita income.



The message found in the data is rather clear..., and simple. If we are to have a knowledge economy, we must have knowledgeable people.

South Carolina faces a human capital challenge.

Human capital and more.

Writing in the November 13 *New York Times*, David Brooks cut deeply into the human capital challenge faced by America and offered some interesting food for thought. According to Brooks, there is more to the challenge than finding ways for young people to receive a strong four-year college education, as important as that may be. To be effective in the global economy, a person needs more than just technical knowledge. What else is there? Brooks describes cultural capital that is transmitted to children at home and in communities. Then, there is social capital that relates to knowledge of how to behave in social settings. There is also moral capital that causes an individual to want “to do the right thing.”

The call is for leaders, creative people who have the skills required to collaborate, communicate, and form teams that innovate. Of course, we cannot expect every young person to acquire all these skills. The hope is that there will be more.

Just a small amount of yeast makes the bread rise.