THE ECONOMIC SITUATION

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- **The economy is moving with a full head of steam….for now.**
- **But will 2006 meet the Yandle forecast?**
- **The zooming manufacturing economy.**
- **And with it, so goes the labor market.**
- **South Carolina's adjusting economy takes another blow.**
- **The latest in the search for the knowledge economy.**
- **Time for a renaissance.**

GDP hits a home run

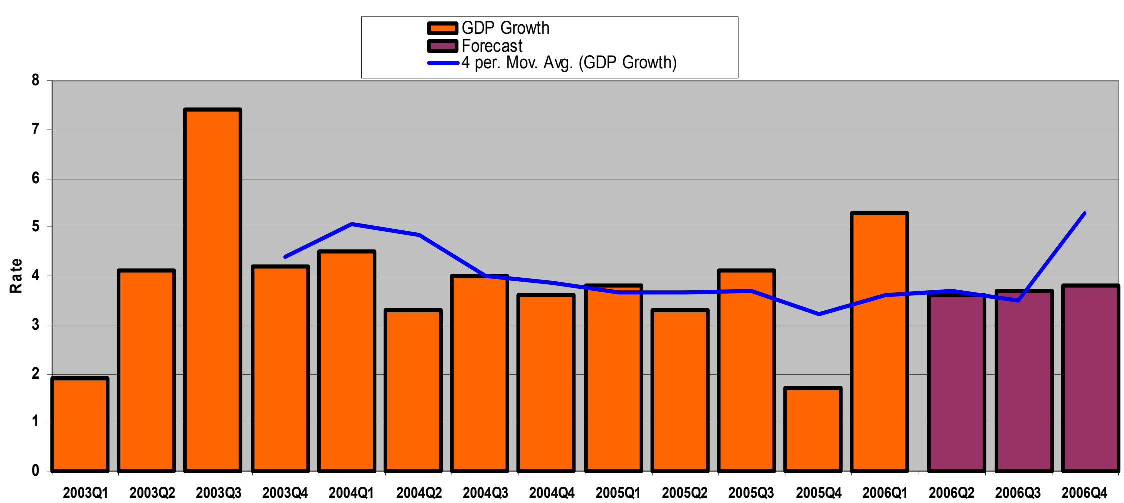
Wow! 5.3% real GDP growth for this year's first quarter.

The latest reading on 1Q2006 GDP growth raised hardly a salute from the press, even though the quarterly growth rate was the largest since 3Q2003. Instead, the reaction was more a whimper, maybe a scowl or two. Why the unhappy looks? With such good news, and so many people becoming employed, it's enough to make the Fed hit the brakes one more time. (So look out when the Fed meets in late June.) Too much of a good thing?

The simmering 5.3% growth for 1Q2006 followed 1.7% for 4Q2005. Put them together and divide by two, you get 3.5% average for the last two quarters, which is still about the norm. As seen in the accompanying figure, this most recent quarter's robust growth looks like a homerun for GDP.

Once again, consumer spending led the rally, with heavy increases in the purchase of durable goods. And don't make the mistake of thinking it was automobiles. The big increase is in household goods. Bought one of those large screen TVs yet?

GDP Growth and Projections



The more interesting GDP news relates to exports. These increased 14.7%, compared to 5.1% in 4Q2005. The weakening of the dollar may be having an effect. The Economist magazine reports that in recent months the dollar has weakened 6% against the Euro and 7% against the Yen. But on a broader trade-weighted basis, the dollar has declined 18% since 2002. Contributing to the recent weaker dollar, interest rates internationally have been rising relative to those in the U.S. Investment in dollar assets are a bit less attractive.

But of course, there's trouble right here in River City. Gasoline prices. Higher interest rates. Commodity prices headed toward heaven. A huge federal deficit.

What about my end-of-year forecast?

What about a mid-term forecast report card?

The mid-year mark is probably as good a time as any to put the cards on the table and compare May 30 data with my forecast for December 2006. The next chart tells the tale.

	December 2006	*June 1, 2006*
GDP	3.8%	3.5%
Inflation (core)	2.7%	3.0%
30-yr. Mortgage	6.80%	6.58%
Unemployl Rate	4.4%	4.7%
Prime	7.70%	8.00%
Dow	11,500	11,200
Employ.	200M	210M
Oil	$ 67.00	$ 71.00
Gold	$ 510	$ 650.00

So far, GDP growth looks promising. But consider inflation. The growth rate for prices in the CPI is already higher than I forecast for the year, and rising. Indeed, the May 17 report that core inflation had risen 0.3% for April seems to have brought near panic to equity markets. How the new Fed chairman, Ben Bernanke, plays his hand is the critical question here. And that remains to be seen.

As the report card shows, there is room left in my forecast for growth in the 30-year fixed mortgage rate. Of course, what happens to inflation expectations has a direct bearing on the rate paid for 30-year fixed rate mortgages. Higher inflation brings higher rates.

The bottom of the chart presents a mixed bag. The Prime is already at 8.00% and will likely be at 8.25% after the Fed meets in late June. The chances of 7.70% by yearend are slim to none. The Dow, of course, has already hit 11,500 and pulled back, so the chances of another run are good. Monthly employment growth (household data) is running a tad above forecast, and should hold that pace. But then… But then, there is oil and gold. 'Looks like a bit of trouble there. Both prices jumped when our leaders hinted at war with Iran.

For now, at least, the forecast looks like a B paper…, well, maybe a C+.

What about the run up and stay up of gasoline prices?

But what about those gasoline prices? Will those sky-high prices take a major plug out of the economy?

The best we can do with that question is consider some data, and the data come from a study by the Joint Economic Committee. First off, even with the real price of crude oil rising above the past record highs, today's economy is far more stingy when it comes to using energy. For example, since the late 1970s the amount of GDP generated per BTU has doubled. Less to worry about than before.

But what about consumers? The average price of gasoline adjusted for inflation is higher now than in the late 1970s following the Arab oil embargoes. Consumers are also stingier with energy now than they were then. Gasoline spending today is 3.22% of all personal consumption. In 1980 it was 5%. The recent price increases have raised the share of income spent for gasoline eight-tenths of one percent, or 80 dollars out of a thousand has been shifted away from other purchases to gasoline. I know these are averages, and most of the people I know don't always fit the data.

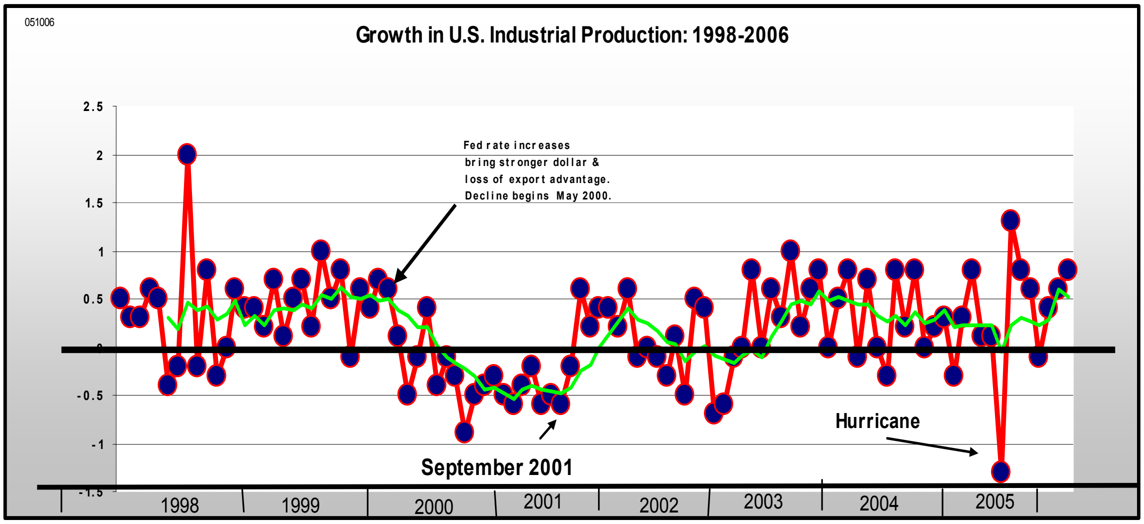
There is one last measure to consider. In 1981, a person earning average wages reported by the Social Security Administration worked 12 minutes to buy a gallon of gas. Today, a person earning average wages works 7 minutes.

But there is a lot more to the problem than gasoline. Home heating is another matter, and the outlook for next winter is not all that bright. There are also expected effects on investment and changes in trade patterns.

All things considered, the JEC study suggests that less than a half of a percent will be subtracted from GDP growth as we adjust to higher priced energy.

Industrial production data look good too.

The recent GDP growth was driven largely by consumer spending and export growth, but there was another piece of good news in the data. Manufacturing is accelerating. This is seen rather vividly in Industrial Production data, which also include activities from mining and public utilities. Please focus on the green six-month running average and look closely at the data for the last three months. Output growth looks good.



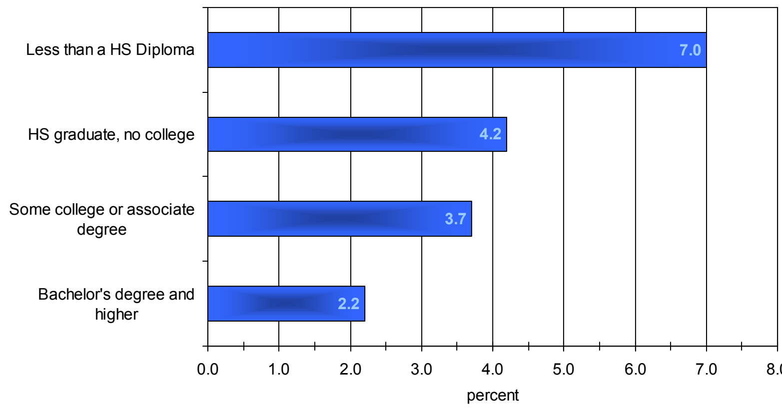
The recovery from Katrina's September body blow, which is marked in the chart by "hurricane" is truly amazing. Oh yes. The weak performance seen for January 2006, four months back, was generated by unusually warm weather. The public utilities took it on the chin that month.

Employment growth, another confirmation.

In the last few months, several labor market measures have turned to the sunny side. While April's unemployment rate held steady at 4.7%, the number of people working part-time, because they could do no better, fell to the lowest level since August 2001. In addition, voluntary separations—take this job and shove it!—has risen steadily from 50% of all separations in December 2003 to close to 60% in recent months.

Once again, the story about unemployment and education is compelling. How else could it be? To work in a knowledge economy requires knowledge. Here's the chart for March 2006.

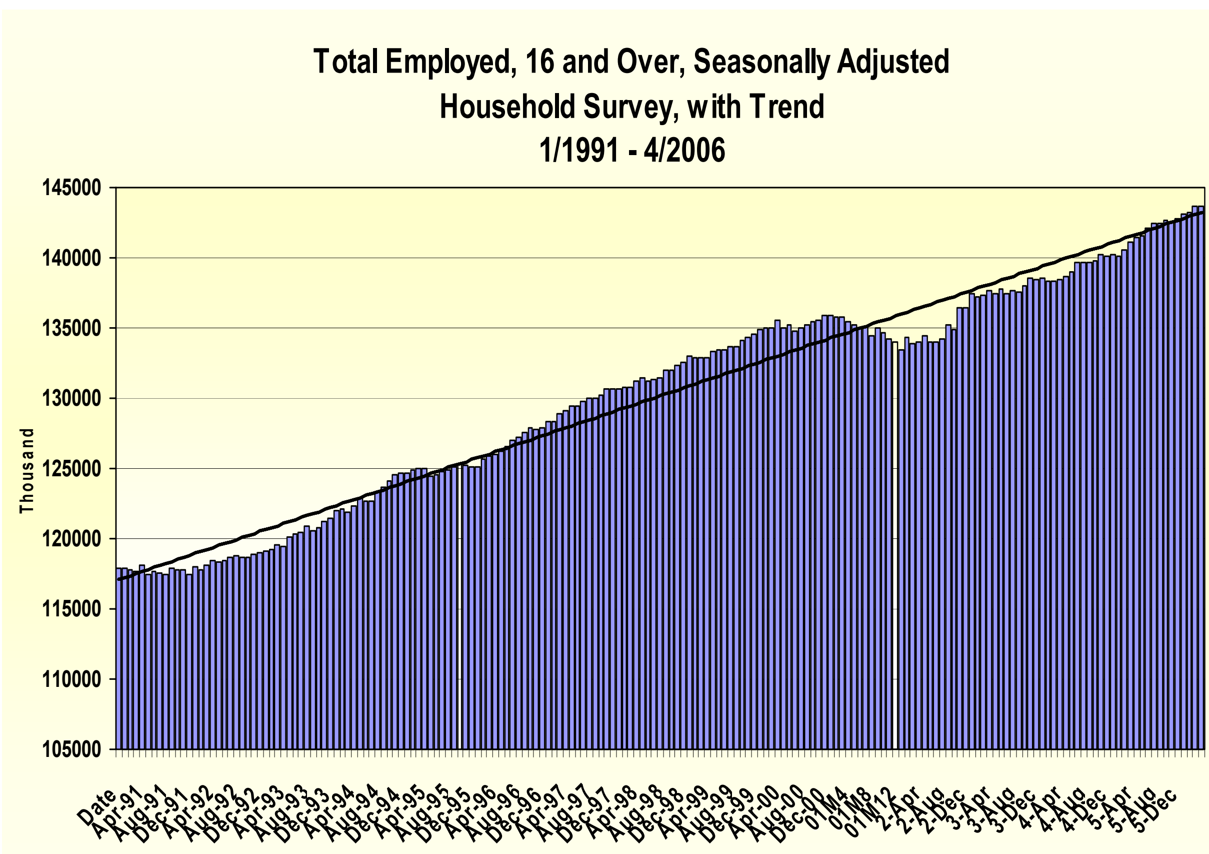
US Unemployment Rate by Educational Attainment March 2006



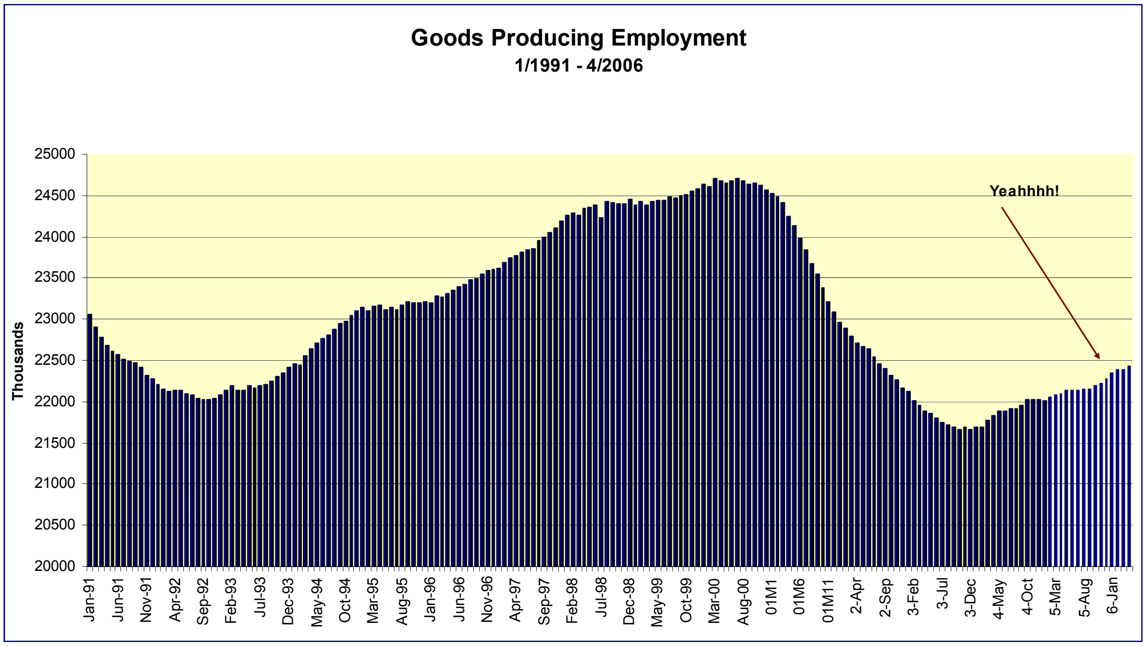
Employment status of the civilian population 25 years and older by educational attainment
Source: Bureau of Labor Statistics

Employment: the larger picture.

Household employment data shown in the next chart give yet another confirmation of higher than expected economic growth for 2006. Again, consider the difference between the trend line and the bars in the accompanying chart. We are now above the trend line. Once again, the Great American Job Machine is chugging away.

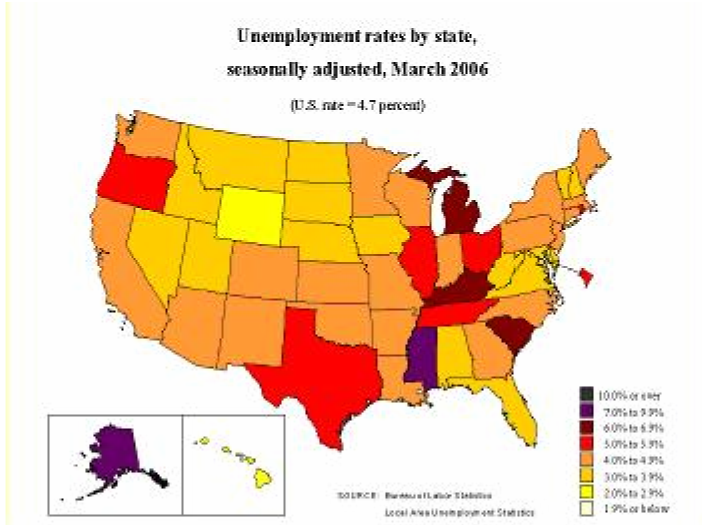


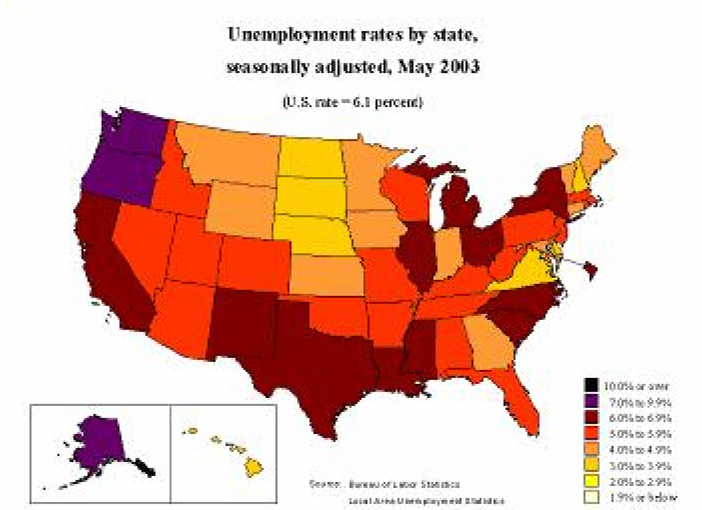
And there is even improvement in the goods producing sector. Most of the growth there is in high skill, management related, manufacturing jobs. The number of production line workers is still falling.



The geographic imprint.

A comparison of the accompanying state outline maps for March 2006 with May 2003 helps to identify the widespread character of the economic recovery. In the chart, higher unemployment rates are associated with darker colors. In March 2006, there were five states with unemployment rates greater than 6%. Mississippi was one. Katrina is the story. Michigan another. The old auto center is struggling. Kentucky is weak. Tobacco is no longer a driver. Alaska always seems to have a higher unemployment rate than the states in the lower 48. It is interesting to note that Louisiana is not a high unemployment state. Texas is where many of Louisiana's Katrina unemployed are located.
And then, there is South Carolina, a state caught in a heavy employment transition from commodity textiles to chemicals, machinery, and services.





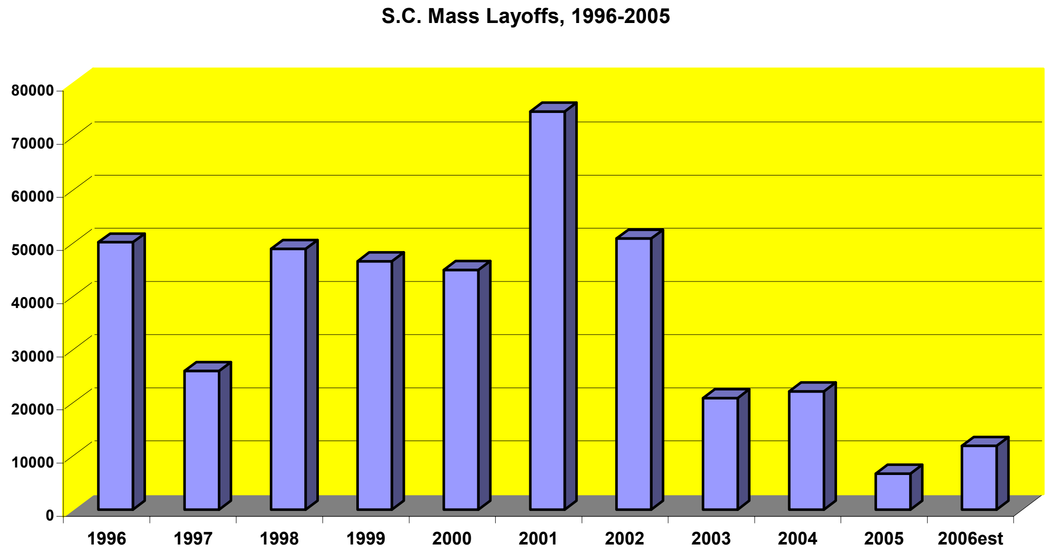
South Carolina's transition economy takes a blow.

With major plant closing occurring in the older industrialized Upstate, South Carolina's transition economy has sustained some pretty tough blows in 2006. But the May 23 news of the Graniteville Mill closing delivered a serious blow to the lower part of the state.

Founded in 1848, Graniteville Mills, named for the granite buildings erected by the New England proprietors, was one of South Carolina's oldest continuing operating textile mills. Owned by Avondale Mills, headquartered in Monroe, Georgia, Graniteville stayed ahead of competition by modernizing plants. The firm was confident about the future, even in the face of severe global competition. But, as Stephen Felker, president of Avondale, put it, international competition was one thing, a train wreck, fatalities, and chlorine spills are something else. The January 6, 2006, Graniteville train disaster killed nine people, caused the evacuation of some 5,000 people and spread chlorine gas near the mills. Even now, machinery in the plants is corroding.

The Graniteville closing affects 1,900 S.C. manufacturing jobs. To put this in perspective, total S.C. manufacturing employment is around 260,000. Total employment in the state is about 1.9 million. Total unemployment is about 140,000, or 6.6% of the labor force. The full impact of the Graniteville closing, if in a short period, could push the number of unemployed to close to 142,000, and the unemployment rate to 7.0%. With huge personal costs involved, the Graniteville event illustrates the tougher side of South Carolina's major employment challenge.

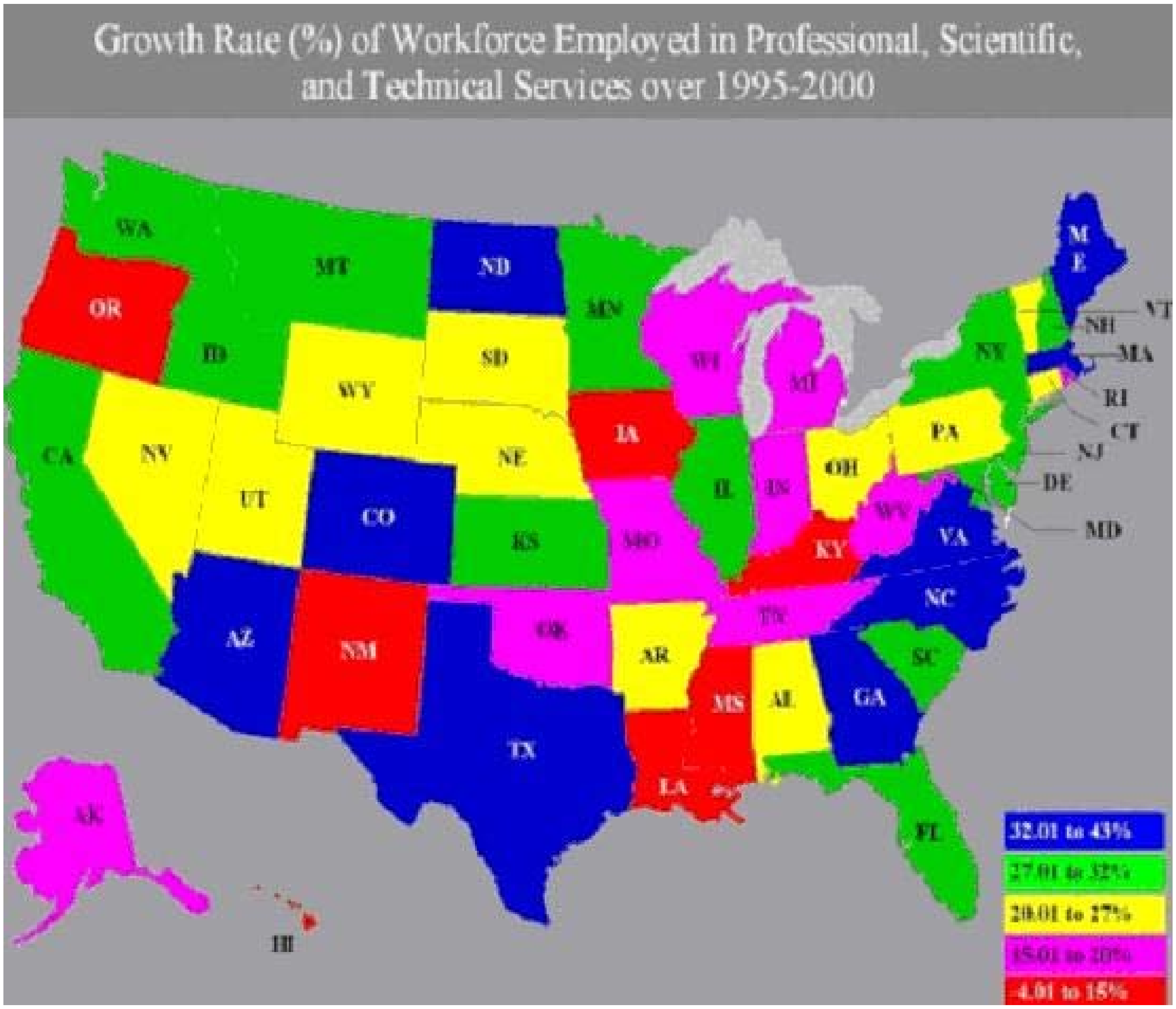
The next chart shows the record through 2005 for S.C. mass layoffs, these are events where more than 75 workers lose their jobs in a single event. Based on data for the first four months of the year, we will obviously see a reversal for 2006.



Continuing the search for the knowledge economy.

In the March Economic Situation Report, I discussed an ongoing project that seeks to identify the location of the emerging knowledge economy. Using maps aplenty, I described migration patterns, patents per capita, and other metrics often used to locate knowledge workers. This time, I provide one map, which shows 1995-2000 state growth rates for workers employed in professional, scientific, and technical services.   Dark blue is the highest growth. Green is next. And red is negative.

Notice that South Carolina is in the second tier of states and located in the high growth Atlantic coast region.



Clemson's Renaissance Center: a personal note.

The South Carolina economy is literally undergoing a renaissance, a rebirth, a process accelerated and accommodated by the expanding global economy. Harnessing and focusing human imagination, creativity, entrepreneurship, and innovation and then bringing products and services to market with profitable enterprises are the major challenges we face.

The challenges can be stated differently. To create more wealth, we must expand participation in the knowledge economy.

Clemson's College of Business & Behavioral Science has announced a new Greenville initiative that will facilitate the process.

With a planned opening in Fall 2007, and possibilities for some activities to start sooner, the Clemson Renaissance Center will be a hub of entrepreneurial activities. The Center will organize engagement of Clemson students and faculty with business, industry, government and nonprofit organizations. High impact, start-up entrepreneurs will be identified and supported. Lectures, symposia, and conferences will be coordinated by Center staff. And entrepreneurship will be celebrated continuously.

The Renaissance Center will be a focal point for Clemson's Small Business Development Center, the Center for International Trade, and the Spiro Center for Entrepreneurial

Leadership. The Center will also provide a venue for activities co-sponsored by the Rutland Ethics Center and the Clemson Institute for the Study of Capitalism.

In July, I will end my work as Interim Dean of the Clemson's College of Business & Behavioral Science and focus my energies on the development of the Renaissance Center. Working with Clemson students, faculty and staff as Interim Dean has been a high honor and a rewarding two years. I now look forward to the work that makes our College part of the knowledge renaissance.

If you wish more information, please send me an email. yandle@clemson.edu.