North Carolina
Cooperative Extension Service
NORTH CAROLINA STATE UNIVERSITY
COLLEGE OF AGRICULTURE & LIFE SCIENCES

NC STATE ECONOMIST

Agricultural and Resource Economics

January/February 1998

1998 ECONOMIC OUTLOOK

General Trends - National and North Carolina

National Economy

M.L. Walden, Professor and Extension Economist

Economic Fundamentals

The continued growth of the national economy in 1997 marks the completion of 7.5 years since the last recession. Through the third quarter of 1997, real (inflation-adjusted) Gross Domestic Product increased at an annual rate of 3% (Table 1). Due to continued economic growth, the unemployment rate fell. Throughout most of 1997, the national unemployment rate hovered near 5%.

Low inflation has been one of the "good news" items in today's economy. Inflation at the retail level, measured by the Consumer Price Index, increased only 2.1% on an annual basis through August of 1997. This was lower than the 3% rate in 1996. Interest rates have also been "well-behaved." In 1997, the benchmark 90-day Treasury bill rate averaged near 5% and the 30-year Treasury bond rate ranged between 6 and 7% for most of the year.

Other economic factors also looked good for the past year. Business inventories relative to sales averaged 1.4, the same as in 1996. This is a low ratio, indicating that businesses are not carrying large product inventories. This important factor indicates that if there is an economic downturn, there will not be a sharp reduction in orders to manufactures. Consequently, any recession would be very mild.

The federal deficit fell dramatically in 1997 to $46 billion, because of federal revenues rising more than twice as fast as federal spending in both 1996 and 1997. The Federal Reserve's monetary policy remained moderate. The "M2" measure of the money supply rose nearly 5% in both 1996 and 1997.

The country's trade balance deteriorated somewhat in 1997. In both years, the country imported more goods and services than it exported. This resulted in negative "net exports" or, in other words, a trade deficit. The trade deficit as a percent of national income (Gross Domestic Product) was 1.7% in 1996 and 1.9% in 1997.

Potential Trouble Spots

The two biggest potential problems for the economy are consumer debt loads and a rekindling of inflation. Consumer installment debt as a percent of income is near an historic high. The good news is that most of the debt is owed by middle- and high-income households, who have the ability to make the payments. However, the bad news is that any "shock" to the economy, like a stock

Continued on Page 2

National Economic Trends

Table 1. Key U.S. Economic Statistics

	1996	1997[a]	1998 Forecasts
Real U.S. GDP,% Chg.	2.8%	3.0%	2.5%
Unemployment Rate	5.4%	5.0%	5.2%
Labor Force, % Chg.	1.2%	1.5%	1.0%
Inflation Rate, CPI	3.0%	2.1%	2.4%
90-day T-bill Rate	5.0%	5.1%[b]	5.3%
30-year T-bond Rate	6.8%	6.8%[b]	7.0%
Real Compensation Per Hour, % Chg.	0.6%	1.4%[c]	1.6%
Output Per Hour, % Chg.	0.9%	2.8%[c]	1.5%
Business Inventory/Sales Ratio	1.4%	1.4%[d]	1.4%
Consumer Installment Debt/Income Ratio	17.8%	17.8%[d]	17.9%
%Change In Fed. Tax Revenues	8.5%	4.1%[e]	4.0%
% Change in Fed. Spending	3.7%	1.6%[e]	2.0%
Federal Budget Deficit	$111 Billion	$46 Billion[e]	$20 Billion
M2 Growth Rate	5.0%	5.1%	5.0%
Net Exports/GDP	-1.7%	-1.9%[e]	-1.9%

[a] Analyzed rate based on January-August, unless otherwise noted.
[b] Analyzed rate based on January-October.
[c] Analyzed rate based on January- March.
[d] Analyzed rate based on January -July.
[e] Analyzed rate based on January-June.
Source: U.S. Department of Commerce, Federal Reserve Bank - forecasts by Mike Walden

market crash or an international crisis, could cause consumers to worry about their ability to make debt payments. This could cause them to retrench and slow their rate of spending. Of course, any major slowing of consumer spending can lead to a general economic downturn.

A rekindling of inflation would arise from faster rising wages and salaries. In 1997, a tight labor market caused real (inflation-adjusted) worker compensation-per-hour to rise significantly faster than in 1996. Real compensation-per-hour rose 1.4% in 1997 after rising only 0.6% in 1996. By itself, this would have led to a faster inflation rate in 1997 than in 1996. Instead, 1997's inflation rate was significantly lower than the 1996 rate.

The reason that faster rising worker compensation in 1997 did not lead to higher inflation is that improvements in worker productivity totally counteracted the rise in wages and salaries. Businesses can afford to pay workers more if those workers are more productive. In 1997 worker productivity, measured by output-per-hour, rose a very strong 2.8%. This allowed businesses to easily increase real worker compensation by 1.4% without increasing product prices.

1998 Forecasts

Forecasts for key economic factors in the national economy are in Table 1. The forecast indicates a growing economy, but with the growth rate slightly slower than in 1997. Slower growth will cause a mild rise in the unemployment rate, and both short- and long-term interest rates will edge up by a very small amount.

The inventory/sales ratio should also remain low. This is a result of better inventory management with computers and "just-

1998 Economic Forecasts

in-time" manufacturing. There will be, however, a slight rise in relative consumer debt loads.

Good news will also continue for the federal budget deficit. Due to strong growth in federal revenues, the 1998 budget deficit is expected to be around $20 billion in 1998.

The biggest changes in 1998 will be in labor costs, worker productivity, and inflation. Worker productivity in 1998 will improve at only about half the rate as in 1997. However, with tight labor markets continuing to push real wages higher, businesses will be motivated to pass on some of these higher costs in the form of higher retail prices. Thus, the forecasted inflation rate for 1998 is slightly higher, at 2.4%, than in 1997.

Nevertheless, the economic fundamentals are still good for 1998. No economic downturn, or recession, is in sight. Yet, the long, continued economic expansion warrants "soft spots" be watched. In today's economy, these soft spots are consumer debt loads, tight labor markets, and the potential for a higher inflation rate.

North Carolina Outlook

The North Carolina economy grew for the sixth straight year in 1997. The broadest measure of the state economy, Gross State Product, grew at an estimated 4.9% rate in 1997, faster than 1996's rate of 3.7% (Table 2). The growth pushed the state's seasonally adjusted unemployment rate to fewer than 4% by mid-year.

Job growth was also healthy in North Carolina in 1997. Employment grew by 2.5% during the year. Jobs increased in all sectors except non-durable goods manufacturing. Jobs increased fastest in financial services, government (including teachers), and durable goods manufacturing.

Table 2. Key North Carolina Economic Statistics

	1996	1997	1998 Forecast
Real N.C. GSP, % Chg.	**3.7%**	**4.9%**	**2.7%**
Unemployment Rate	**4.3%**	**3.7%**[a]	**3.7%**
Total Employment, % Chg.	**1.9%**	**2.5%**[b]	**2.2%**
% Chg., Employment, by Sector:			
Durable Goods Manuf.	**0.2%**	**1.4%**[b]	**1.3%**
Nondurable Goods Manuf.	**-2.8%**	**-3.2%**[b]	**-1.0%**
Transportation and Utilities	**1.7%**	**0.7%**[b]	**1.0%**
Wholesale Trade	**1.1%**	**1.1%**[b]	**2.0%**
Retail Trade	**0.8%**	**0.3%**[b]	**3.0%**
Financial Services	**6.7%**	**2.0%**[b]	**2.3%**
Services	**4.0%**	**0.9%**[b]	**2.5%**
Government	**3.6%**	**1.5%**[b]	**1.5%**

[a] Analyzed seasonally adjusted rate based on January-August.
[b] Analyzed rate based on January-July.
Source: Employment Security Commission of North Carolina, North Carolina Economic Forecast - forecasts by Mike Walden

Continued on Page 4

North Carolina 1998 Outlook

The reduction in employment in non-durable goods manufacturing was primarily due to job cuts in the apparel and textile industries.

Regionally, most areas of the state shared in the economic growth during 1997. The fastest growing region was western North Carolina due, in large part, to tourism and retirement relocations.

The Year Ahead

As always, North Carolina's economic growth will be determined, in part, by national economic growth. Since the nation's economic forecast is for continued growth during 1998, this sets the foundation for state growth during the year.

Indeed, the expectation is for North Carolina's economy to expand during 1998, but at a somewhat slower pace than in 1997. The forecast for Gross State Product is an increase of 2.7% in 1998, down from 1997's 4.9% growth rate.

Total jobs in the state will increase by 2.2%, slightly slower than 1996's increase of 2.5%. Again, job gains will be registered in all sectors except non-durable manufacturing. The greatest percentage increases will be in retail trade, services, and financial services. A slower drop in textile and apparel jobs will slow the reduction in non-durable manufacturing jobs to 1%.

Most regions of North Carolina should share in the 1998 economic growth. The fastest growing regions will be a combination of western and eastern areas, including counties in the mountains and counties in the "downeast" section of the state.

The N.C. State Economist is now on-line at:
http://www2.ncsu.edu/ncsu/cals/ag_rec/virtual_library.html

N.C. State Economist
Published bi-monthly by the Dept. of Ag. and Resource Economics and the Coop. Ext. Serv. Address correspondence to:
The Editor, N.C. State Economist
Box 8109, N.C .State University
Raleigh, NC 27695-8109

Published by
North Carolina Cooperative Extension Service

NORTH CAROLINA
COOPERATIVE EXTENSION SERVICE
NORTH CAROLINA STATE UNIVERSITY
AGRICULTURAL AND RESOURCE ECONOMICS
BOX 8109
RALEIGH, NORTH CAROLINA 27695-8109

NON-PROFIT ORG.
U.S. POSTAGE
PAID
RALEIGH, NC
PERMIT #2353