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2004 Economic Outlook: Growth is Back

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The National Economy: Finally, jobs will return

Recent Challenges

The national economy grew in 2003 for the second straight year. Indeed, the recent national recession is now dated from March to November, 2001. After stalling in 2001, the broadest measure of national economic activity, real U.S. Gross Domestic Product, is calculated to have increased 2.2% in 2002 and 3.1% in 2003 (Table 1). Yet the expansion in the economy has not been strong enough to generate job growth. While the national unemployment rate declined in 2003, the drop in the jobless rate was entirely due to "discouraged workers" leaving the labor force and not being included in the unemployment numbers.

In addition to the slow recovery from the recession, two other factors have restrained employment growth. One is the continuing rise in labor productivity. Although this is a desired trend for the long run, and a trend that should lead to higher living standards, in the near term improvements in labor productivity have allowed businesses to expand production with the same or fewer number of workers.

Secondly, the recent acceleration in employer-paid benefit costs has increased the cost of labor to businesses even while wage and salary increases have been modest. As a result, total compensation costs (including wages, salaries, and benefits) per employee have increased even while the labor market has remained slack.

Both industrial production and real (inflation-adjusted) personal income recorded better growth rates in 2003 compared to the previous year. Motivated by generation-low interest rates, households increased purchases at retail outlets faster than the increase in their personal income. Consequently, relative household debt loads edged higher in both 2002 and 2003. Some economists think this portends trouble for the future, both from the viewpoint of individual debt-laden households and from the "drag" that household debt will put on future retail purchases.

The inflation rate, measured by the percentage change in the Consumer Price Index, continued to be mild, hovering around 2%. The rate was under 2% in 2002 and modestly above 2% in 2003. However, a large part of the rise in prices in 2003 was driven by higher gasoline prices. Excluding food and fuel prices, the inflation rate in 2003 was only 1.4%.

Interest rates continued their decline to generation-low levels in 2002 and 2003. The decline slowed for short-term rates (the 3 month T-bill rate) but accelerated slightly for long-term rates (the10 yr. T-note rate) in 2003.

The most dramatic turnaround in the economic numbers presented in Table 1 is the change in the stock market, as measured by the S&P 500 Stock Price Index. After falling 27% in 2002, the market came roaring back in 2003 with a 35% gain. If the stock market is a barometer of future economic activity, then the market's jump in 2003 can be interpreted as a return of confidence in the business community and a forecast that a new economic expansion is underway.

What's in Store for 2004?

National economic growth is expected to accelerate in 2004. Two factors are behind the projected faster growth. First, the two economic polices controlled by the federal government - monetary policy and fiscal policy - have been stimulative in recent years. Aggressive monetary policy has reduced interest rates and increased the money supply. Equally aggressive fiscal policy has resulted in federal tax reductions and significant increases in federal spending. Both these policies will continue to fuel the economy in 2004.

Secondly, business inventories have been reduced to such low levels that increases in production will be necessary to meet buyers' demands. Also, with low interest rates and low inflation, businesses will find it relatively inexpensive to expand.

Average real U.S. Gross Domestic Product (GDP) growth of 4.5% in 2004 should be strong enough to increase national employment by 2.5% or 3.5 million jobs. Consequently, the national unemployment rate will fall to near 5%, and both industrial production and real household income will expand at more than twice their rates in 2003. However, historically high household debt levels will restrain consumer retail spending to only marginal improvements in 2004, compared to 2003.

The inflation rate will remain near a modest 2% level in 2004. Yet, with a faster growing economy, both short and long-term interest rates are expected to rise, especially after mid-year. The rise in short-term rates will be larger, meaning the "yield curve" (the difference between short and long-term rates) will flatten. Reflecting a growing economy, the stock market should rise in 2004, but at about one-third the rate in 2003. Most of this increase could take place in the first half of 2004, before the upward trend in interest rates.

What Could Go Wrong?

There are always risks to economic forecasts, so it's useful to ask what could derail continued economic growth in 2004.

At the top of the list would be unexpected major terrorist attacks on U.S. interests, either domestically or abroad, that would shatter business and consumer confidence. Also, with federal economic policy already highly stimulative, there's the added concern that little short-run economic action could be taken by the federal government to counter the shocks of terrorist attacks.

Table 1. Key U.S. Economic Measures

	2002	2003	2004 Forecast
Real U.S. GDP[a]	2.2%	3.1%	4.5%
Employment[a]	-0.4%	0.0%	2.5%
Unemploy. Rate	6.0%	5.7%	5.2%
Industrial Product.[a]	1.4%	2.3%	6.0%
Real Personal Inc.[a]	0.8%	1.0%	3.0%
Hsehld. Debt. Serv.[b]	0.01% pts	0.01% pts	0.02% pts
Real Retail Sales[a]	3.4%	3.1%	3.5%
CPI Inflation Rt.[a]	1.6%	2.3%	2.3%
3 Mon. T-bill Rate[b]	-1.8% pts.	-0.6% pts.	0.6% pts.
10 Yr. T-note Rate[b]	-0.4% pts.	-0.6% pts.	0.4% pts.
S&P 500 Stock Ind.[a]	-27%	35%	12%

[a]Percentage change
[b]Change in percentage points
Sources: U.S. Dept. of Commerce, Federal Reserve System, author's forecasts

The level and direction of oil prices are also concerns. At the beginning of 2004, world oil prices stood above $30/barrel, far higher than analysts had expected in the post-Iraqi War period. Further increases in oil prices would reduce expected economic growth. Futures markets, however, suggest declining oil prices during the year.

As the world has become more commercially interrelated, economic problems can be more easily transferred between countries. The emerging economic powers China and India have enjoyed very high growth rates in recent years. Some economists worry that "speculative bubbles" have developed in these countries, and if so, their "bursting" could have negative consequence for both the world and U.S. economies.

Last, some economists are beginning to caution that recent low inflation rates may not persist. The recession-busting monetary policy of the Federal Reserve has resulted in large increases in the nation's money supply. Past experiences with similar policies show that they ultimately can result in faster increases in prices - that is, a higher inflation rate - perhaps not this year, but next year and beyond.

The North Carolina Economy: Growth with Challenges

The North Carolina economy continued to struggle in 2003. Growth in both real personal income and real retail sales was modest and slower than for the nation. North Carolina did eke out a very small increase in employment, but the state unemployment rate continued to be higher than the national rate in 2003 (Table 2).

By many measures, North Carolina has been more adversely affected by the national recession and its aftermath than most other states. One reason is the concentration of manufacturing facilities in the state. Traditionally, manufacturing is more negatively affected by recessions than other industries due to the ability of buyers to postpone purchasing durable manufactured products when economic prospects are dim. In 2003, North Carolina lost 5% of her manufacturing employment base, after losing 10% of her job base in 2002.

The downsizing of employment in North Carolina's traditional manufacturing industries, including textiles, apparel, tobacco, and furniture, has also been a major element in the state's jobs picture. Most of the job losses have been in textiles and apparel, where over 60% of jobs have been cut since 1990. Although the reduction in trade barriers and the movement of many jobs to foreign countries have certainly contributed to the losses, factory modernization and the replacement of labor with machinery and technology have also been factors related to the downsizing.

A noticeable improvement in the North Carolina economy is predicted for 2004. Real personal income growth will be a robust 5%, employment growth of 2% will add over 75,000 net new jobs to the state's payroll, and the statewide unemployment rate will fall to under 6%. However, downsizing in traditional manufacturing, particularly textiles and apparel, will cause total factory employment to drop even though many manufacturing sectors will add jobs during the year.

Table 2. Key North Carolina Economic Measures

	2002	2003	2004 Forecast
Real Personal Inc.[a]	0.8%	0.3%	5.0%
Real Retail Sales[a]	3.1%	2.3%	3.6%
Total Employment[a]	-2.0%	0.5%	2.0%
Manuf. Employ.[a]	-8.8%	-5.1%	-2.5%
Unemploy. Rate.[a]	6.4%	6.3%	5.8%

[a]Percentage change

Sources: U.S. Dept. of Commerce, NC Dept. of Revenue, Federal Reserve System, author's forecasts

Economic growth will vary by region within North Carolina in 2004. In fact, two regions, Greater Charlotte and the Research Triangle area, will account for half of the state's net job growth. Counties and regions with large investments in traditional manufacturing will face a much less optimistic outlook in the year. Addressing such disparities in economic growth across North Carolina will continue to be a major economic development issue.

The economic world has permanently changed, and North Carolina is re-structuring in light of those changes. Manufacturing is going the way of agriculture - production is rising but machinery and technology are taking the places of workers. Consumers are spending a greater share of their income on services. And the reduction in trade barriers is putting North Carolina companies in competition with foreign companies.

These changes present challenges and opportunities. While some companies may lose production to foreign countries, at the same time, open trade allows North Carolina companies to vie for the business of the growing number of middle class consumers in Asia and other regions. And while the state has lost thousands of manufacturing jobs in the past decade, the service jobs that have been added are not all low paying. In fact, the salaries of 60% of the added service jobs have been as high or higher than the pay of the cut factory jobs.

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