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The accelerated decline in the price of oil and other energy sources could boost the growth rate of the national economy and result in major beneficial effects for the Western New York area. The growth rate of real average weekly earnings for all private sector employees in the U.S. began to increase recently, lifting us out of the lull generated by the 2001 recession. Locally, the decline in the high paying goods producing sector that has been all too common in the upstate economy over the past two decades, continues to be associated with a relative decline in real earnings per worker compared to the nation as a whole. Of interest, however, is the increase in real earnings per worker between 2002 and 2004 in all three of the upstate metropolitan areas. The full text of this and all previous newsletters appear at <http://www.canisius.edu/wnyeconomicnews>.

The National Economic Outlook

Final estimates of 2006:Q3 real GDP shows the national economy growing at an annual rate of 2.0%, after growing at annual rates of 4.2%, 1.8%, 5.6% and 2.6% over the period 2005:Q3 – 2006:Q3 www.bea.gov. National economic growth has slowed considerably since the first quarter of 2006. Gross private domestic investment increased by 1% during 2006:Q2 and declined by .8% during 2006:Q3. Residential fixed investment has declined over the past four quarters but the pace of decline has accelerated as the housing bubble deflates. During the second and third quarters of 2006, residential construction activity declined by 11.1% and 18.7%, respectively. Growth rates for real GDP since the first quarter of 2002 are shown in Figure 1.

The December 2005-December 2006 inflation rate based on the Consumer Price Index was 2.5%. This is considerably lower than the June 2005-June 2006 inflation rate of 4.3%. Declining oil prices have been largely responsible for the deceleration in the rate of inflation. Oil prices have been hovering around \$50 per barrel since the Saudi oil minister's recent announcement that there was no need for OPEC to hold an emergency meeting to address falling oil prices. Crude oil is presently more than 35% below its August 2006 high of \$77 per barrel. Declining oil prices are favorable to a continued expansion in national economic activity.

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Figure 1: Real GDP Growth Rates (2002:Q1 - 2006:Q3)

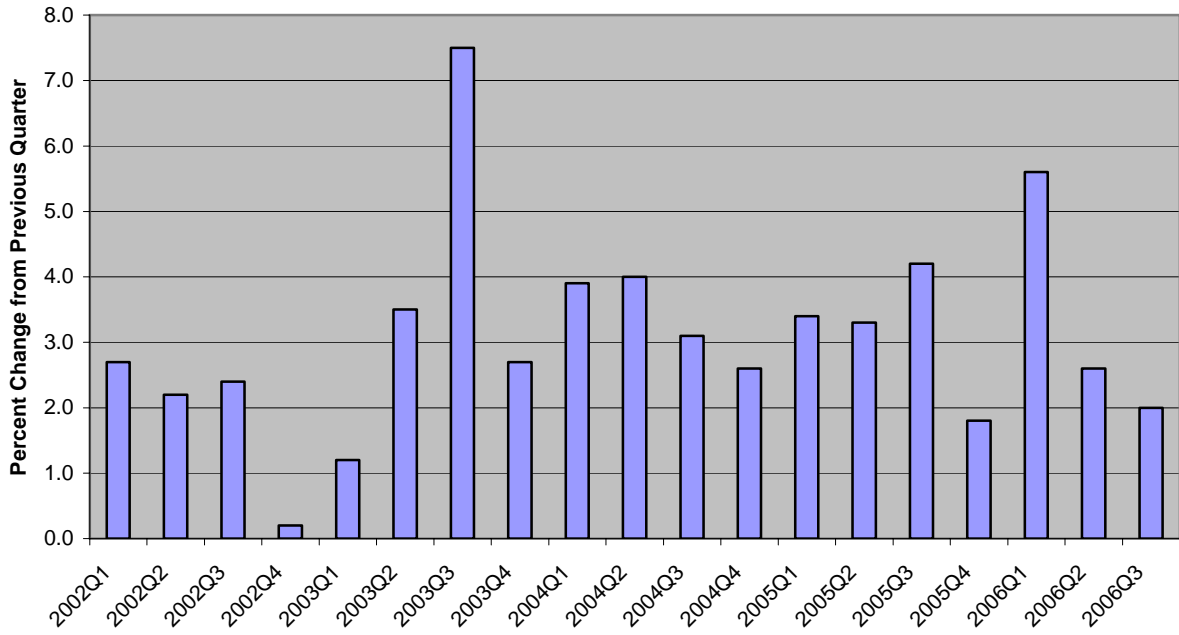
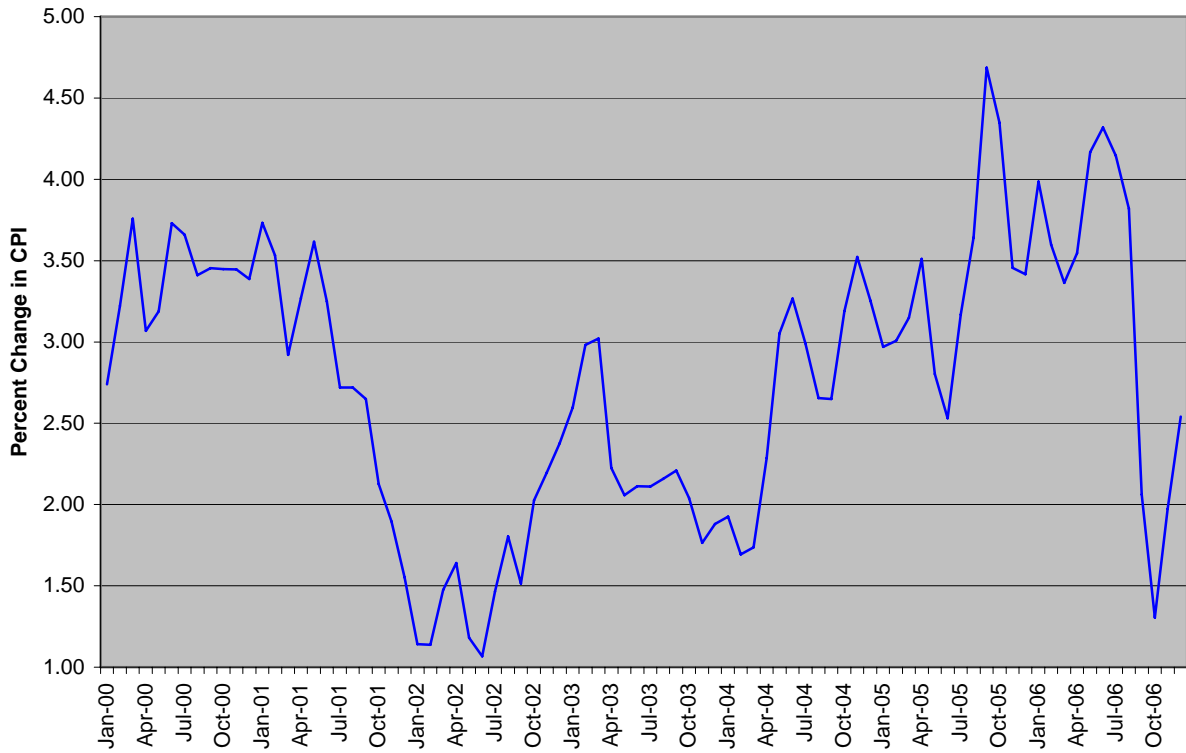


Figure 2: CPI Inflation Rates (Twelve Month Percent Change)

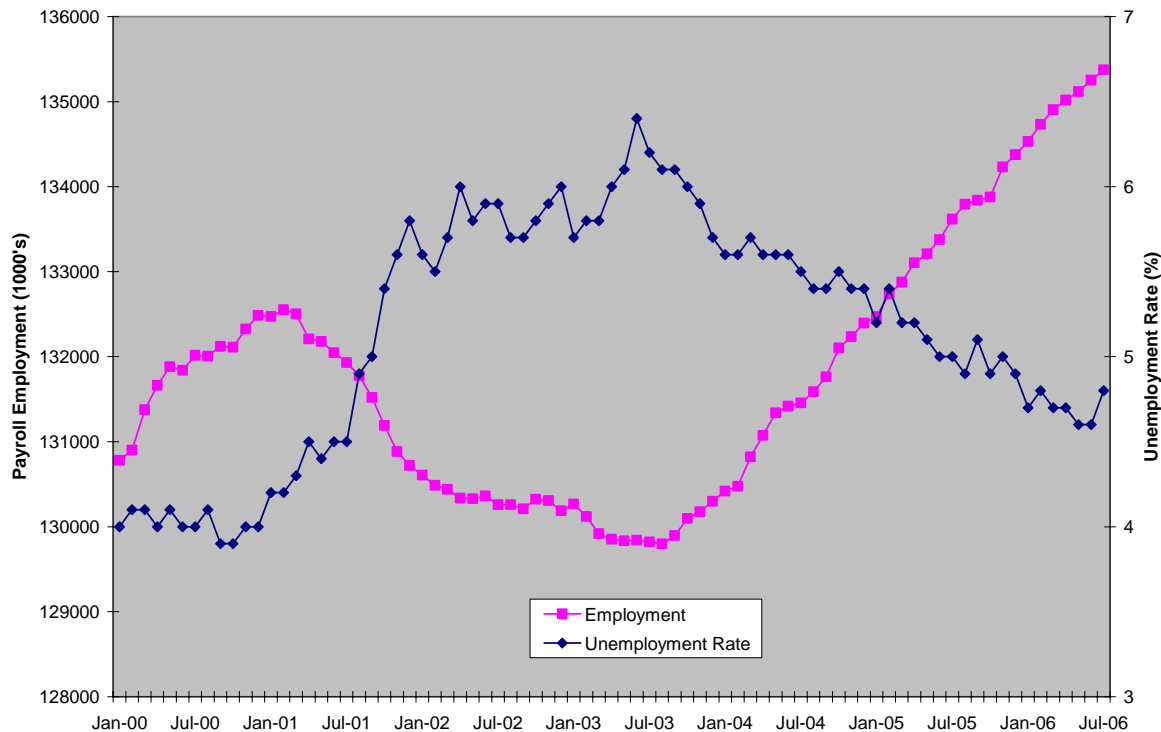


Moderate rates of GDP growth and a declining inflation rate have caused the Federal Reserve to follow a “hands-off” monetary policy. The FOMC left its federal funds rate target at 5.25% in its August, September, October, and December 2006 meetings. If GDP growth continues to weaken and inflation remains benign, it is likely that the Fed will lower the fed funds target.

A disturbing sign about the future course of economic activity is the presence of an inverted U.S. Treasury yield curve. The yield curve briefly inverted in February 2006 but has been continuously inverted since July 2006 from the 13 week maturity to the 10 year maturity. Yield curve inversions have preceded each recession that the U.S. has experienced since the 1960’s.

Labor markets continue to show marked improvement as the economy continues to add significant numbers of new jobs and the unemployment rate continues to fall. The unemployment rate presently stands at 4.5%, a level that is unlikely to decrease much further. Continued tightening in the labor markets is a cause of concern for the Fed in that this will lead to increased costs of production and will tend to raise the rate of economy-wide inflation.

Figure 3. US Payroll Employment and the Unemployment Rate: 2000-2006

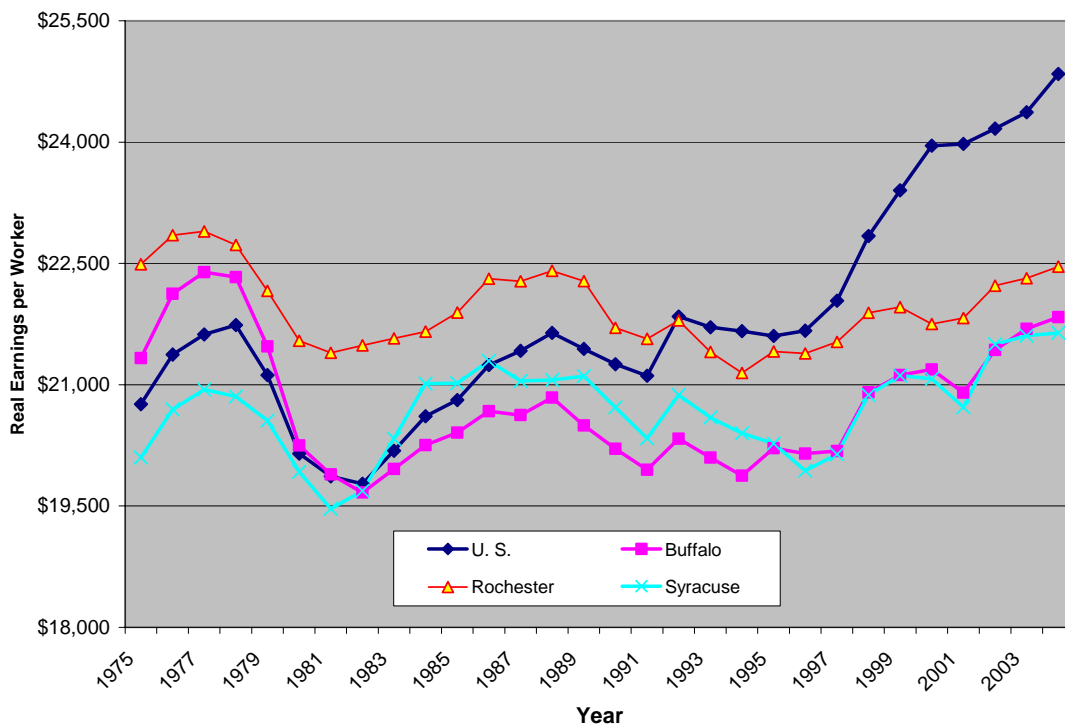


The State of the Upstate Economies

For the metropolitan areas of upstate New York, the decline of goods producing employment since the mid-1990s continues unabated. Every region has lost a substantial number of goods producing jobs. In the Buffalo metropolitan area, the uncertainty surrounding the automobile industry poses a threat to an economy whose growth potential was limited at best.

The recent infusion of capital at the Ford stamping plant could lead to higher productivity and thus lower unit costs. This could reduce the uncertainties about the future of the local Ford plant. Without this investment of new capital, one wonders if there would have been a future for the facility. Workers at the General Motors Tonawanda Engine plant are relatively more productive than workers at similar plants in North America, making unit costs lower here. This is the reason why GM continues to invest in the Tonawanda plant, recently announcing a \$300 million investment to produce a new V-8 engine at the plant. The uncertainty for these workers is related to the stability of GM.

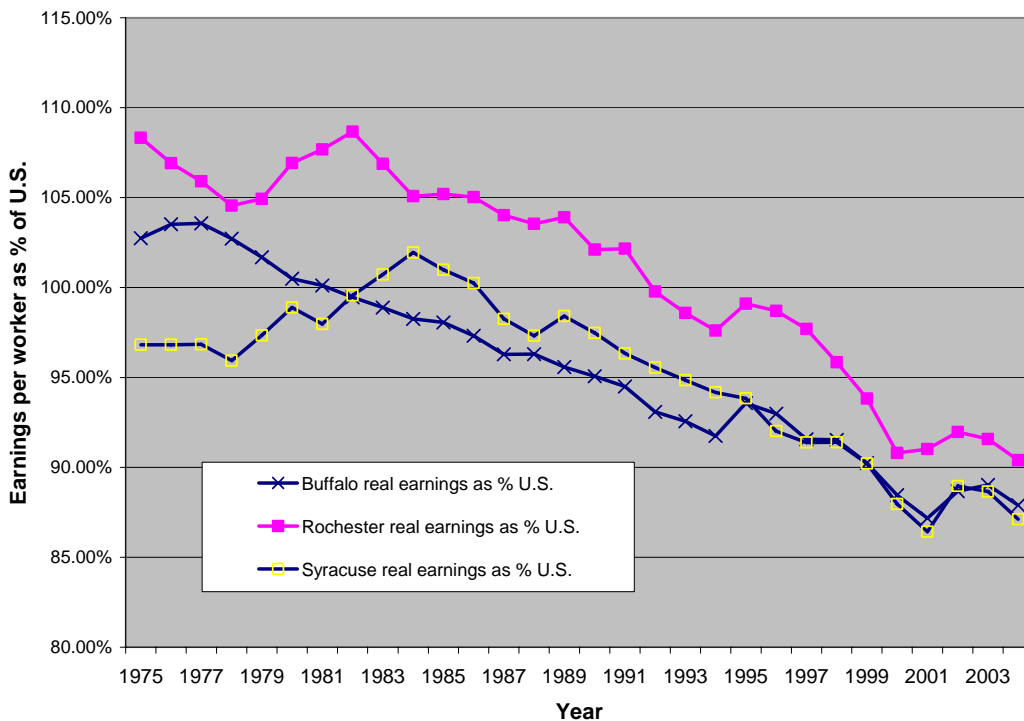
Figure 4. Real Earnings per Worker: 1975-2004



The future of the Buffalo area American Axle plants is less clear, though it would seem not to be very good in the absence of new investment. American Axle recently announced that it was going to shut down its Woodlawn Avenue plant. The future of the Delphi plant in Lockport will be clearer when the bankruptcy restructuring is complete.

The continuous decline in the goods producing sectors of the upstate metropolitan areas is an important contributing factor to the decline in earnings per worker relative to the rest of the nation. Figure 4 presents real earnings per worker between 1975 and 2004 for the United States and for the metropolitan areas of Buffalo, Rochester and Syracuse. The earnings per worker series are constructed from the earnings and employment data generated by the Bureau of Economic Analysis, Regional Economic Information System. We have placed earnings on a real basis using the CPI for all urban consumers. In the Buffalo metropolitan area, real earnings per worker were no higher in 2001 than they were in 1988. In fact, workers in Buffalo and Rochester had lower real earnings in 2004 than they had in 1978! What is most disturbing about this trend is that the rate of divergence from the national average has been accelerating over the past decade. If the remaining American Axle plants leave the region, this decline will only worsen.

Figure 5. Real Earnings per Worker as % of U.S.: 1975-2004



In Figure 5, each upstate region's real earnings are expressed as a percent of U.S. real earnings. After the twin recessions of 1980-82, real earnings per worker in the Buffalo and Syracuse metropolitan areas fell below the national average. More importantly, this gap has widened over time. Since 1998, the rate of divergence has increased as Buffalo and Syracuse have fallen further behind the nation in terms of real earnings per worker. Earnings per worker in the Rochester metropolitan area fell below the national average in 1992 and began to converge with earnings in the Buffalo and Syracuse metropolitan areas.

The other side of the low earnings per worker equation is the increased attractiveness of relatively low wage areas to profit maximizing firms. In 2005, Financial Services employees in the Buffalo metropolitan area had average earnings of \$51,100. The national average for workers in this sector is about \$62,900. This places Buffalo at about 80% of the national average. Average earnings in large money centers like New York (\$133,200), Chicago (\$72,900) and even Baltimore (\$65,805), are substantially higher than they are in Buffalo. It seems likely that Finance and Insurance sector employers will be gravitating to the Buffalo area to take advantage of these potential reductions in costs. The recent expansion by Geico and Citigroup are examples of this, and may indicate the direction of future growth in the region.

Conclusion

In the last five years the Buffalo region has lost nearly 20,000 goods producing jobs that generated some of the highest earnings per worker in the area. Total non-agricultural employment also continues to decline, falling by .9% from December 2005 to December 2006. The ongoing decline in real earnings per worker has continued to put the region farther and farther behind the rest of the nation. This decline manifests itself in lagging property values and the concomitant sluggishness of the tax base. The existence of external fiscal control authorities at both the county and city level is a reflection of the constraints placed on government budgets by a stagnant tax base. The declines in relative real earnings may also be a contributing factor as is the out-migration of young people from the region. Lower real wages in the upstate metropolitan areas compared to the rest of the nation, translates into fewer local career opportunities.

On the bright side, economists generally see lower wage costs as an inducement to owners of capital to locate in the region. The potential for growth in the financial services sector is real and is probably related to the lower wage bills that accompany expansion in Buffalo, rather than in higher cost areas like New York, Chicago or even Baltimore.

NATIONAL, STATE & LOCAL BUSINESS INDICATORS

NATIONAL INDICATORS	% change				
	2005:III - 2006:III				
	2005:III	2006:I	2006:II	2006:III	2006:III
Real GDP (billions of chained 2000\$) (1)(a)	11,115.1	11,316.4	11,388.1	11,443.5	3.0
US Personal Income (billions of \$)	10,262.7	10,721.4	10,807.3	10,964.5	6.8

	% change				
	Dec-05 - Dec-06				
	Dec-05	Oct-06	Nov-06	Dec-06	Dec-06
Leading Indicators Index (1996=100) (1)(a)	138.2	137.6	137.6	138.0	-0.14
Consumer Price Index (1982-84=100) (2)	196.8	201.8	201.5	201.8	2.54
Exchange Rate Canadian/US \$ (3) (b)	86.00	89.04	87.53	85.76	-0.28
10 Year Treasury Note Yield (%) (3) (b)	4.39	4.61	4.47	4.71	0.32
3 Month Treasury Bill Yield (%) (3) (b)	4.07	5.07	5.02	5.01	0.94
S&P 500 Stock Index (3) (b)	1,248.3	1,377.9	1,400.6	1,418.3	13.62
Dow-Jones Industrial Average (3) (b)	10,717.5	12,080.7	12,221.9	12,463.2	16.29

LABOR MARKET TRENDS (2)

Nonag Civilian Employment					
US (1000's)(a)	134,376	135,893	136,047	136,214	1.37
NY State (1000's)(a)	8,566.3	8,624.5	8,629.3	8,627.5	0.71
WNY (1000's)	555.9	552.5	553.0	550.9	-0.90
Unemployment Rate (%)					
US (a)	4.9	4.4	4.5	4.5	-0.4
NY State (a)	5.0	4.0	4.2	4.0	-1.0
WNY	5.1	4.3	4.5	4.5	-0.6
Ave. Weekly Hours in Mfg. US (a)	40.8	41.1	41.0	41.0	0.49
Ave. Weekly. Earnings in Mfg. US \$(a)	681.36	694.59	693.72	695.77	2.11
Ave. Weekly Earnings (1982\$(a)	277.01	282.11	283.08	282.75	2.19

WNY EMPLOYMENT BY SECTOR (1000's) (2)

Natural Resources, Mining & Construction	19.2	20.8	19.8	18.2	-5.21
Manufacturing	63.1	61.4	61.5	61.0	-3.33
Trade, Transportation & Utilities	107.4	103.7	106.3	107.2	-0.19
Durable Goods	38.8	37.7	37.9	37.6	-3.09
Finance Activities	35.6	34.9	34.8	34.8	-2.25
Service Providing	473.6	470.3	471.7	471.7	-0.40
Government	96.7	96.0	96.7	96.5	-0.21

(1) US Dept. of Commerce

(a) Seasonally Adjusted

(2) US Dept. of Labor

(b) End of month data

(3) Wall Street Journal