

Western New York ECONOMIC NEWS

Canisius College

Richard J. Wehle School of Business

Volume 10, Number 2

May 2007

Since the last issue of this newsletter, the BEA earnings report for the year 2005 has been released. This report has historically served as the basis for our projection of the region's income change and the relationship between the regional and national economy. Western New York continues its painful transition away from the high earnings, goods producing sector to the lower earning elements of the service providing economy. The effects of this transition are seen throughout the region in changing relative values for income, consumption, property values, real property and sales tax collections. The full text and internet links for this newsletter are available at <http://www.canisius.edu/wnyeconomicnews>.

The National Economic Outlook

Advance estimates of 2007:Q1 real GDP shows the national economy growing at an anemic rate 1.3% www.bea.gov. During the last four quarters, the real GDP growth rate has averaged 2.1%, a sign that the economic recovery we have experienced over the past five years may be coming to an end. Over the period 2006:Q1 – 2006:Q4, annual real GDP growth rates were 5.6%, 2.6%, 2.0%, and 2.5%, respectively. Real GDP growth rates since the first quarter of 2002 are shown in Figure 1. Although personal consumption expenditures grew by 3.8% during 2007:Q1, gross private domestic investment declined by 6.5%. This decline coincided with a 17% drop in residential investment, the fourth consecutive quarter of double digit declines in construction of residential housing.

Along with energy market price spikes, the deflation of the housing bubble and the concomitant decline in residential construction pose major threats to the economic expansion. The average retail price of gasoline in the U.S. reached a record high of more than \$3.10 per gallon recently www.eia.doe.gov. Average retail gasoline prices since 1990 are shown in Figure 2. After nearly two decades of relative stability, gas prices began their ascent in early 1999 and have now more than tripled. Since mid-2005, prices have exhibited significant fluctuations between \$2.00 and \$3.00 per gallon. The price rise has been attributed to both a lack of refining capacity in the U.S. and an increase in worldwide demand. Energy market analysts are forecasting a rise in gas prices to the \$4.00 per gallon level this summer. If this occurs, we expect to see a reduction in personal consumption expenditures on non-energy related items and significant increase in the probability of a recession.

The Wehle School of Business at Canisius College publishes the *Western New York Economic News* as a public service to the Western New York community with research and analysis performed by faculty members:

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Figure 1: Real GDP Growth Rates (2002:Q1 - 2007:Q1)

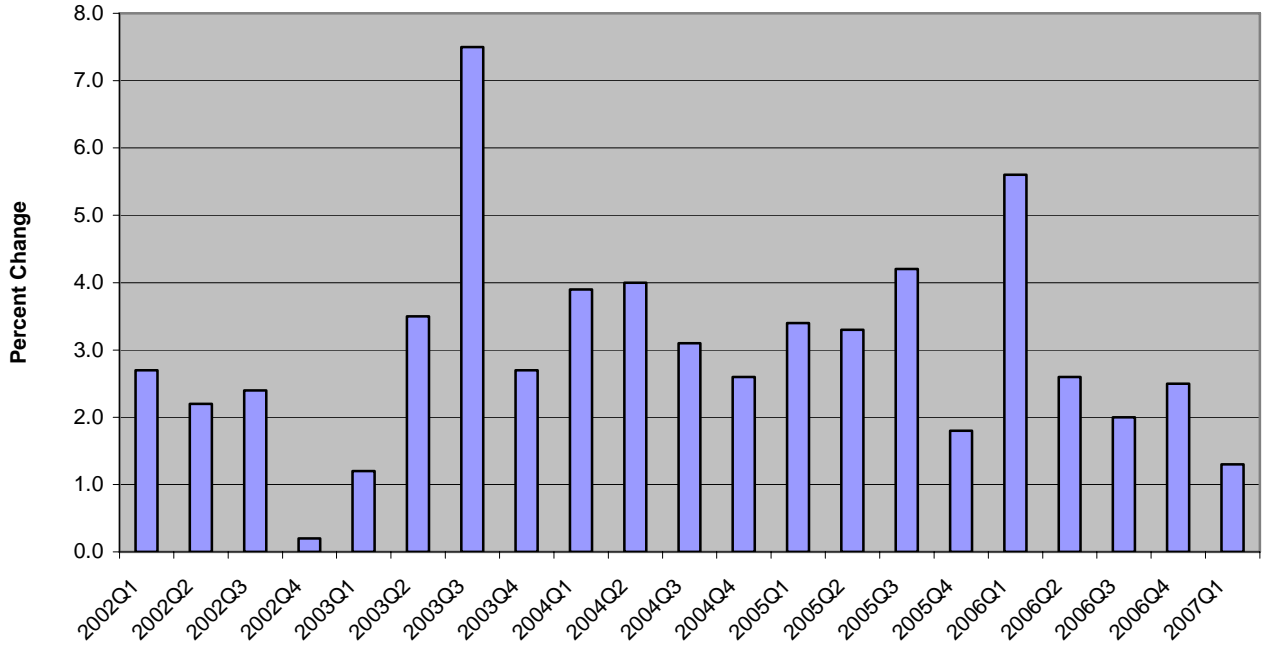
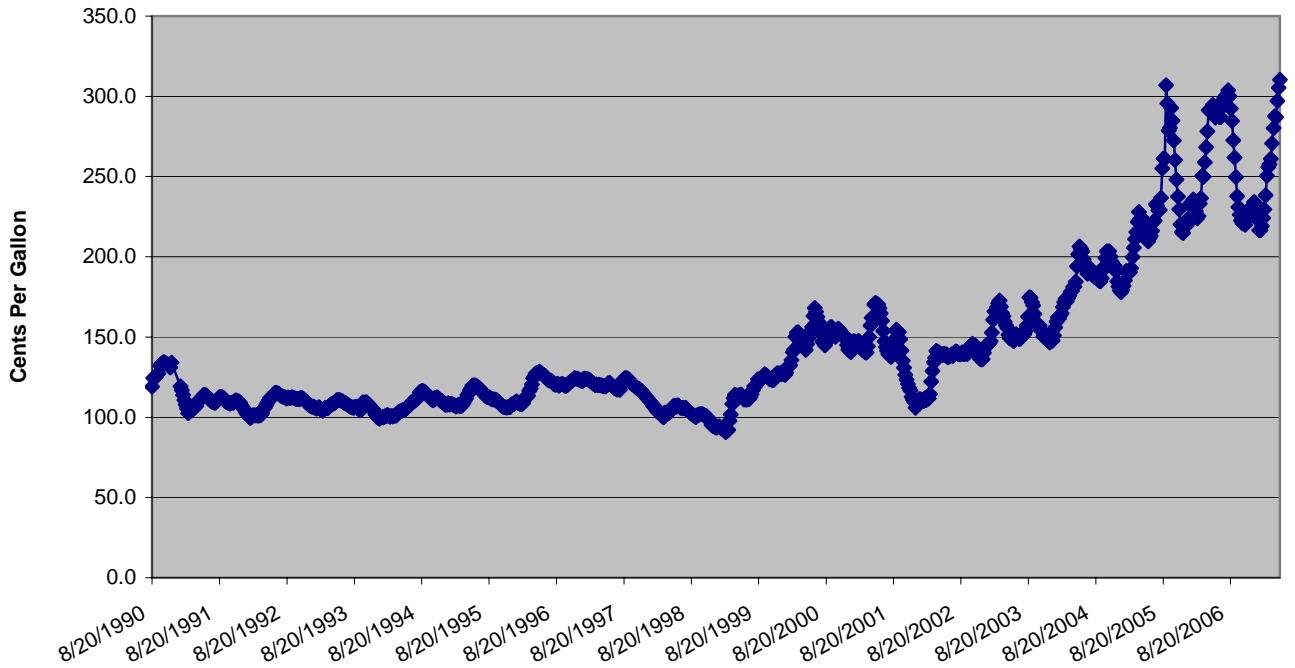
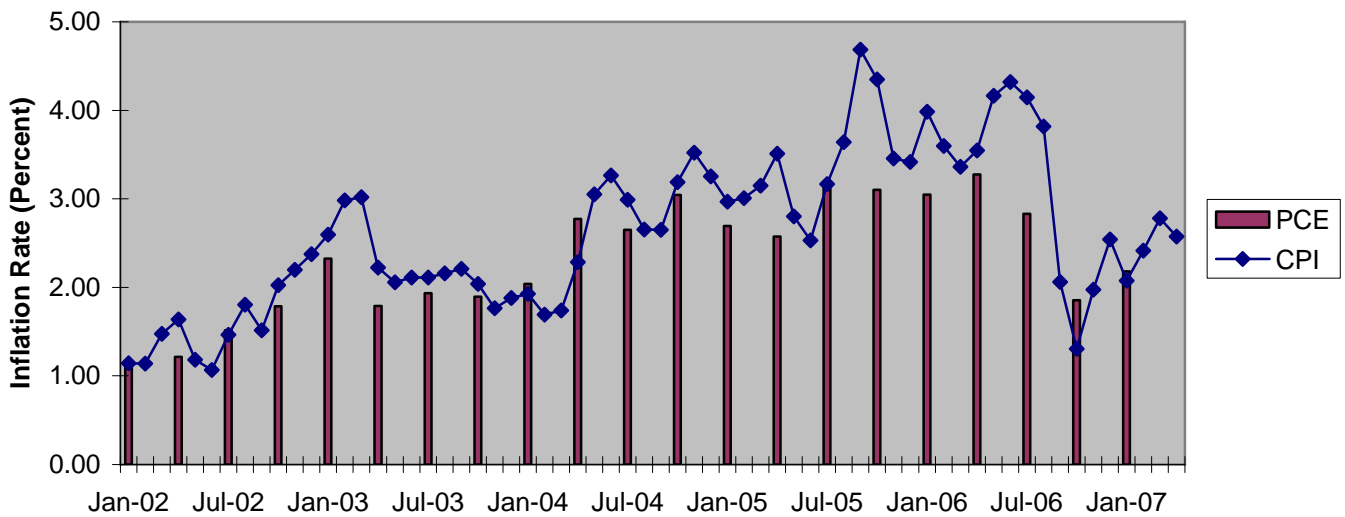


Figure 2: Average U.S. Retail Price of Regular Unleaded Gasoline



The Federal Reserve has left the federal funds target rate untouched at 5.25% since June 2006. The slowdown in GDP growth and economy-wide inflation has resulted in a “hands-off” approach by the Fed. Figure 3 shows the inflation rate based on 12-month changes in the Consumer Price Index (CPI) www.bls.gov from January 2002 to the present and rates of change in the implicit price deflator for personal consumption expenditures. Inflation based on both of these indicators has moderated significantly since June 2006.

Figure 3. Inflation Rates based on the Implicit Price Deflator for Personal Consumption Expenditures & CPI

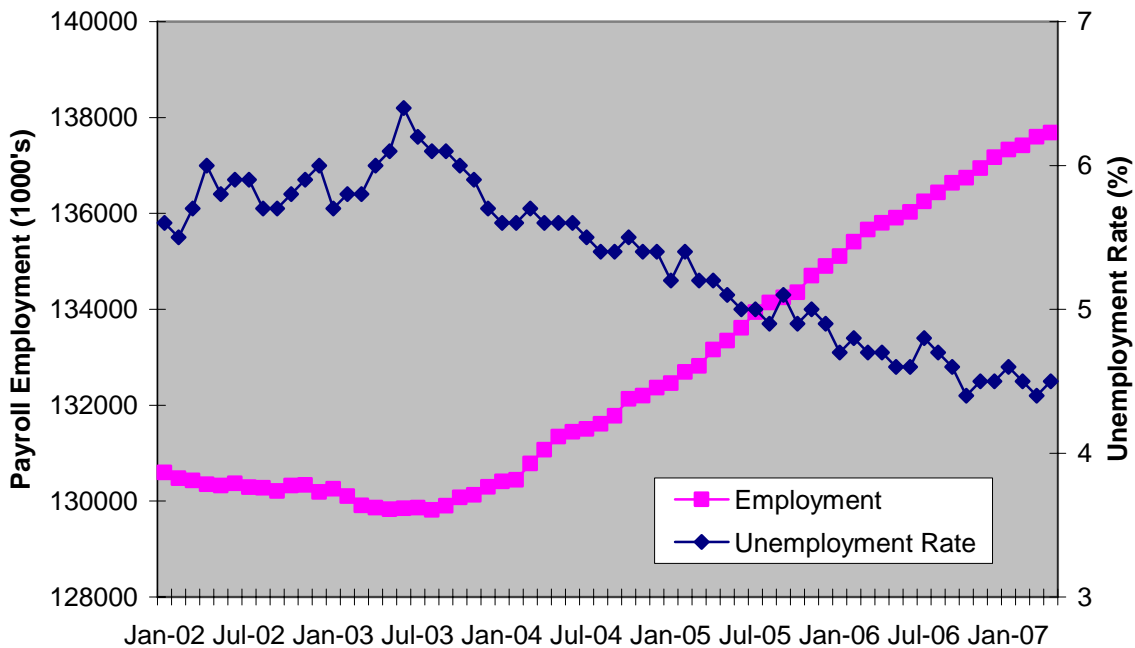


**Table 1
BLS Earnings Information U.S Workers**

	Quarterly Average		Monthly data		
	2006 4 th Quarter	2007 1 st Quarter	2007		
			Feb.	Mar.	Apr.
Average hourly earnings, total private	\$17.00	\$17.16	\$17.16	\$17.21	\$17.25
Average weekly earnings, total private	\$575.73	\$579.90	\$578.29	\$583.42	\$583.05

Labor markets have continued their steady improvement as the economy has created almost 7 million new jobs since August 2003. The national unemployment rate continues to exhibit a downward trend and presently stands at 4.5%, indicative of an economy close to or at full employment. U.S. payroll employment and the unemployment rate since January 2002 are shown in Figure 4.

Figure 4. US Payroll Employment and the Unemployment Rate: 2002-2007



From BLS data, the earnings information presented above in Table 1, shows average hourly and weekly earnings levels. Over the past year, these series have grown by 3.7 and 3.4 percent, respectively, indicating that the growth in real labor earnings noted in our last newsletter has continued. However, this growth has substantially lagged behind the growth in real GDP throughout the current recovery. Early in the recovery, increasing employment could leave labor's share of income unchanged even as real GDP growth outstripped the increases in real labor earnings. The persistent gap between real GDP growth and the real growth rate of average labor earnings however, suggests a restructuring of the share of total income generated in the U.S. that is going to labor as opposed to owners of the other factors of production.

An article entitled "Do Workers Benefit From Globalization?" authored by Owen Humpage and Michael Shenk, recently appeared in *Economic Trends*, a publication of the Federal Reserve Bank of Cleveland. This article addresses the impact of

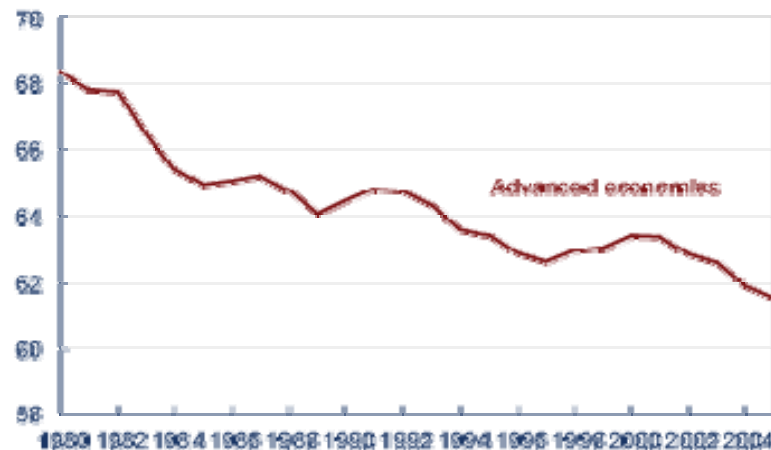
globalization on labor's share of income as shown below.

http://www.clevelandfed.org/research/trends/2007/0507/01intmar_050107.cfm

While this chart is for all advanced economies in the world, it is indicative of what has been happening in the United States, where labor's share of total income has fallen from about 62% in 1998 to slightly more than 60% in 2005. The trend in factor shares of total income has always been clouded by the share of proprietary income that is a return to labor as opposed to the ownership of land or capital, but the meaning of the decline in the share of income that goes to unskilled workers, 26% in 1980 to 18% in 2003, is clearer. The earnings of unskilled workers in the United States are converging with the earning of workers with similar skills around the world. This is the predicted impact of free trade, and it is now part of the national pattern. Humpage and Shenk go on to say, "Real compensation per unskilled worker in the United States, however, fell until fairly recently and has since made only meager gains."

Income Share of Labor

Percent of GDP



Source: International Monetary Fund, *World Economic Outlook*, April 2007.

It is possible that the national economy is undergoing a restructuring similar to that which started in the Buffalo economy during the mid-1970's and whose full impact has yet to be seen.

The Economic Outlook for the Buffalo Region

The Bureau of Economic Analysis of the US Department of Commerce <http://www.bea.gov> released revised personal income data for the Buffalo region in May 2007. Real personal income growth rates for the Buffalo area, the U.S., and the Rochester area, appear in Table 2. Real personal income grew by 0.4% in Rochester

but fell by 0.3% in Buffalo in 2005. Both areas exhibited growth well below the national rate of 1.75%. Real personal income grew by 3.15% in the U.S. in 2006 and we project that it will grow by approximately 1.5% in 2007. The growth rate of real personal income in the Buffalo area has been strongly correlated with the growth of real personal income in the US over the period 1980-2005 (Pearson correlation coefficient = .86). We use historic growth rates of real personal income in the US and Buffalo to generate the forecast of the change in real personal income for Buffalo in 2006 and 2007 (bold faced type in Table 2). Each 1% growth in U.S. real personal income has been met by a .84% growth in Buffalo area real personal income. The historic relationship between these growth rates is shown in Figure 5.

The correlation of the growth rate of real personal income in the Rochester area with that of the U.S. is .71 over the period 1980-2005. Our forecast of the change in real personal income for Rochester in 2006 and 2007 is given in Table 2. Historically, each 1% growth in U.S. real personal income has been met by a .71% growth rate in Rochester area real personal income.

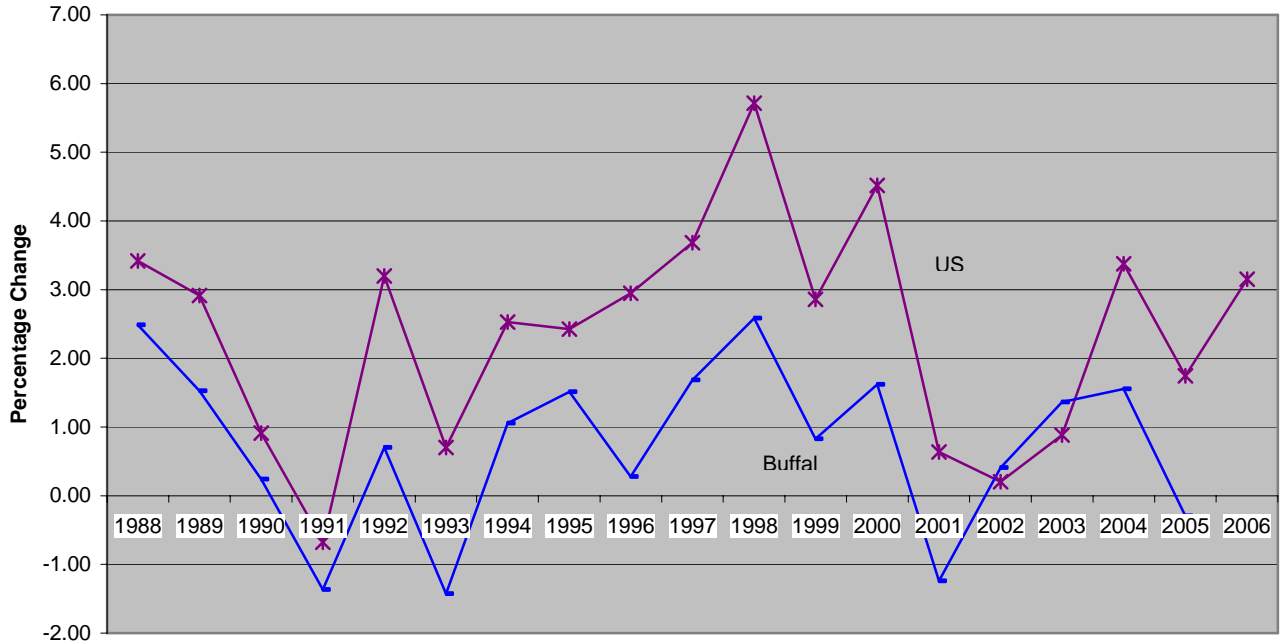
Table 2

Real Personal Income Growth Rates: Buffalo, US, Rochester

YEAR	BUFFALO PERSONAL INCOME (MILLIONS OF 2001\$)	BUFFALO PERCENT CHANGE	US PERCENT CHANGE	ROCHESTER PERCENT CHANGE
1997	31,122.6	1.68	3.68	2.21
1998	31,926.4	2.58	5.71	3.11
1999	32,190.6	0.83	2.86	0.21
2000	32,711.5	1.62	4.52	1.46
2001	32,306.3	-1.24	0.64	-0.11
2002	32,438.4	0.41	0.20	-0.52
2003	32,880.9	1.36	0.88	-0.59
2004	33,392.4	1.56	3.38	2.48
2005	33,293.3	-0.30	1.75	0.40
2006		1.36	3.15	1.34
2007		-0.03	1.50	0.15

The actual level of personal income in the Buffalo metropolitan area is 1.3% higher than was projected from our model last year. How significant is this error? It is not very large when one considers that in 2006, BEA stated that 2004 personal income in the Buffalo region was \$33,538.7 million and in 2007 they revised this figure downward to \$33,293.3 million. This amounts to a reduction of approximately three-quarters of one percent .

Figure 5. Real Personal Income Growth Rates: US v. Buffalo



Conclusions

The economic recovery we have experienced over the past six years may be coming to an end. This recovery has been marked by a return to full-employment. Unemployment rates are low and real GDP growth until recently have been robust. The national recovery, however, has been marred by lagging growth rates in real hourly and weekly earnings, suggesting a recovery that has helped the owners of capital more than those they employ. The benefits of the recovery on the labor front have been most extensively felt by skilled workers, while unskilled labor has actually experienced reductions in real earnings until recently.

In the Buffalo metropolitan area there has been a continuous movement of employment away from the high paying goods producing sector to the lower paying service providing sector. This, in conjunction with the out-migration of population, has led to a reduction in total real income of .3 of a per cent in the latest BEA release of personal income in 2005. It is worth noting that the Buffalo metropolitan area has led the nation into each recession dating back to 1974-75. We will continue to monitor the state of the region's economy with an eye on the future of the area, as well as the nation.

NATIONAL, STATE & LOCAL BUSINESS INDICATORS

NATIONAL INDICATORS	% change				
	2006:I	2006:III	2006:IV	2007:I	2006:I - 2007:I
Real GDP (billions of chained 2000\$) (1)(a)	11,316.4	11,443.5	11,513.0	11,549.1	2.1
US Personal Income (billions of \$)	10,721.4	10,939.4	11,065.5	11,311.2	5.5

	% change				
	Apr-06	Feb-07	Mar-07	Apr-07	Apr-06 - Apr-07
Leading Indicators Index (1996=100) (4)(a)	138.6	137.2	138.0	137.3	-0.94
Consumer Price Index (1982-84=100) (2)	201.5	203.5	205.4	206.7	2.57
Exchange Rate Canadian/US \$ (3) (b)	89.4	85.3	86.7	90.1	0.73
10 Year Treasury Note Yield (%) (3) (b)	5.07	4.52	4.90	4.63	-0.44
3 Month Treasury Bill Yield (%) (3) (b)	4.77	5.11	5.04	4.91	0.14
S&P 500 Stock Index (3) (b)	1,310.6	1,406.8	1,420.9	1,482.4	13.11
Dow-Jones Industrial Average (3) (b)	11,367.1	12,268.6	12,354.4	13,062.9	14.92

LABOR MARKET TRENDS (2)					
Nonag Civilian Employment					
US (1000's)(a)	135,803	137,419	137,596	137,684	1.39
NY State (1000's)(a)	8,598.7	8,671.4	8,673.1	8,668.3	0.97
WNY (1000's)	544.6	540.9	543.9	546.6	0.68
Unemployment Rate (%)					
US (a)	4.7	4.5	4.4	4.5	-0.2
NY State (a)	4.7	4.4	4.0	4.1	-0.6
WNY*	5.4	5.4	4.9	4.5	-0.9
Ave. Weekly Hours in Mfg. US (a)	41.2	40.9	41.2	41.1	-0.24
Ave. Weekly Earnings in Mfg. US \$(a)	690.1	689.7	701.6	705.2	2.19
Ave. Weekly Earnings (1982\$(a)	277.7	281.6	281.9	280.5	0.99

WNY EMPLOYMENT BY SECTOR (1000's) (2)					
Natural Resources, Mining & Construction	19.2	16.1	16.8	18.1	-5.73
Manufacturing	63.0	60.9	61.2	60.9	-3.33
Trade, Transportation & Utilities	100.9	100.4	100.3	100.8	-0.10
Durable Goods	38.6	37.0	37.2	37.2	-3.63
Finance Activities	34.9	36.0	36.0	36.2	3.72
Service Providing	462.4	463.9	465.9	467.6	1.12
Government	94.7	96.9	97.3	96.5	1.90

(1) US Dept. of Commerce	(4) The Conference Board
(2) US Dept. of Labor	(a) Seasonally Adjusted
(3) Wall Street Journal	(b) End of month data