

Western New York ECONOMIC NEWS

Canisius College

Richard J. Wehle School of Business

Volume 11, Number 3

May 2008

Since the last issue of this newsletter, the BEA earnings report for the year 2006 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 generally 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

The recession that we have warned about in recent issues of this newsletter seems to have arrived. Advance estimates of 2008:Q1 real GDP shows the national economy dead in the water, growing at a 0.6% rate for the second consecutive quarter www.bea.gov. Difficulties in the housing and credit markets combined with rapidly escalating energy prices have finally taken their toll on the U.S. economy. It is likely that the economy is either already in recession or will be in the second quarter of this year. It wouldn't be surprising to see the first quarter GDP number revised downward over the next few months. Real GDP growth rates since the first quarter of 2002 are shown in Figure 1. Personal consumption expenditures grew by only 1.0% during 2008:Q1 while consumption of durable goods declined by 6.1%. The latter is noteworthy given the importance of the automotive sector to the WNY economy. Investment in residential housing dropped by almost 27% during the first quarter. This is the third consecutive quarterly drop of more than 20% and the eighth consecutive quarterly double digit decline. The WNY housing market appears to be insulated from these difficulties since we never experienced the rapid price appreciation that took place in much of the rest of the country.

The labor markets have also begun to deteriorate. U.S. payroll employment has decreased over the past four months (see Figure 2). This is important since the NBER, the official arbiter of business cycles in the U.S, pays close attention to aggregate employment in determining when an economic expansion has come to an end.

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Figure 1. Real GDP Growth Rates (2002:Q1 - 2008:Q1)

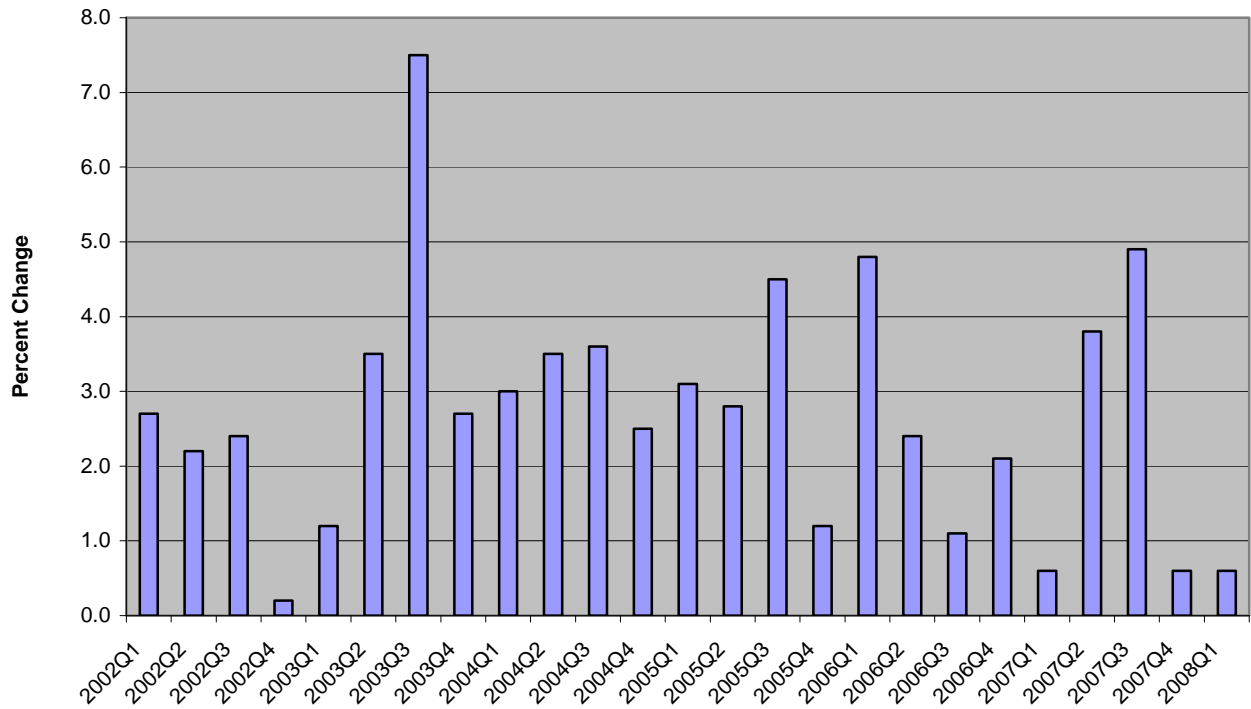
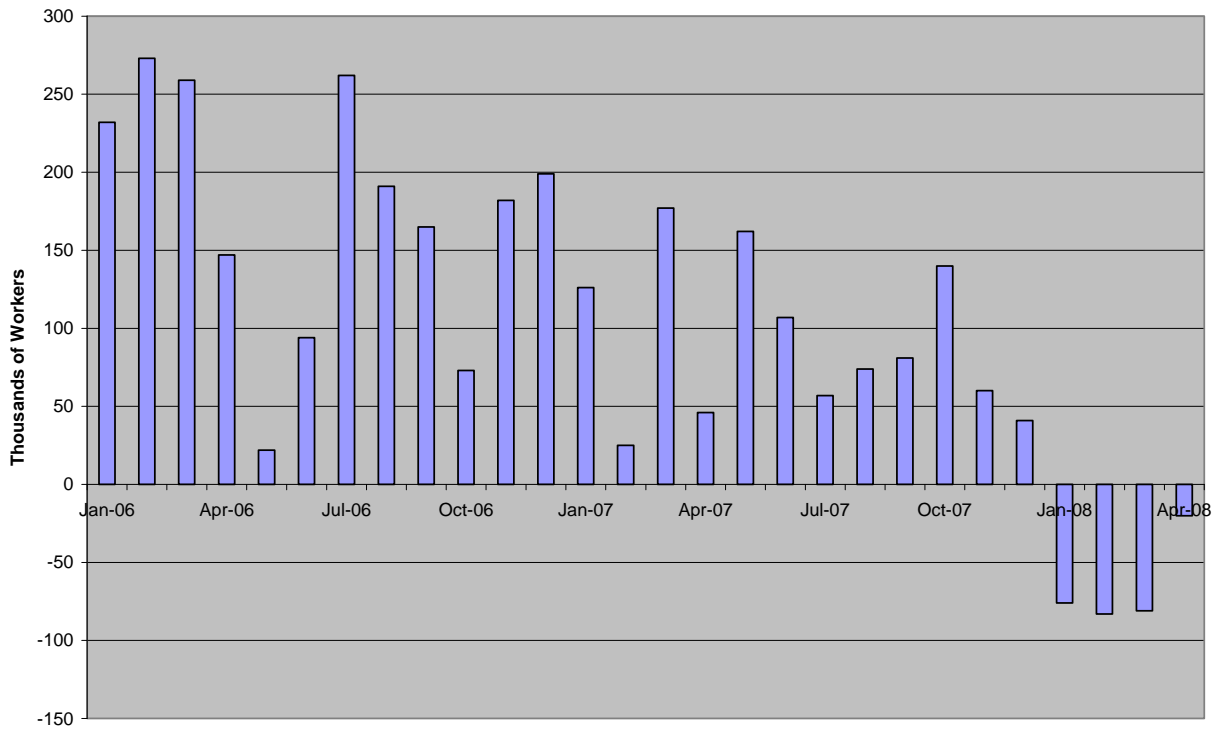
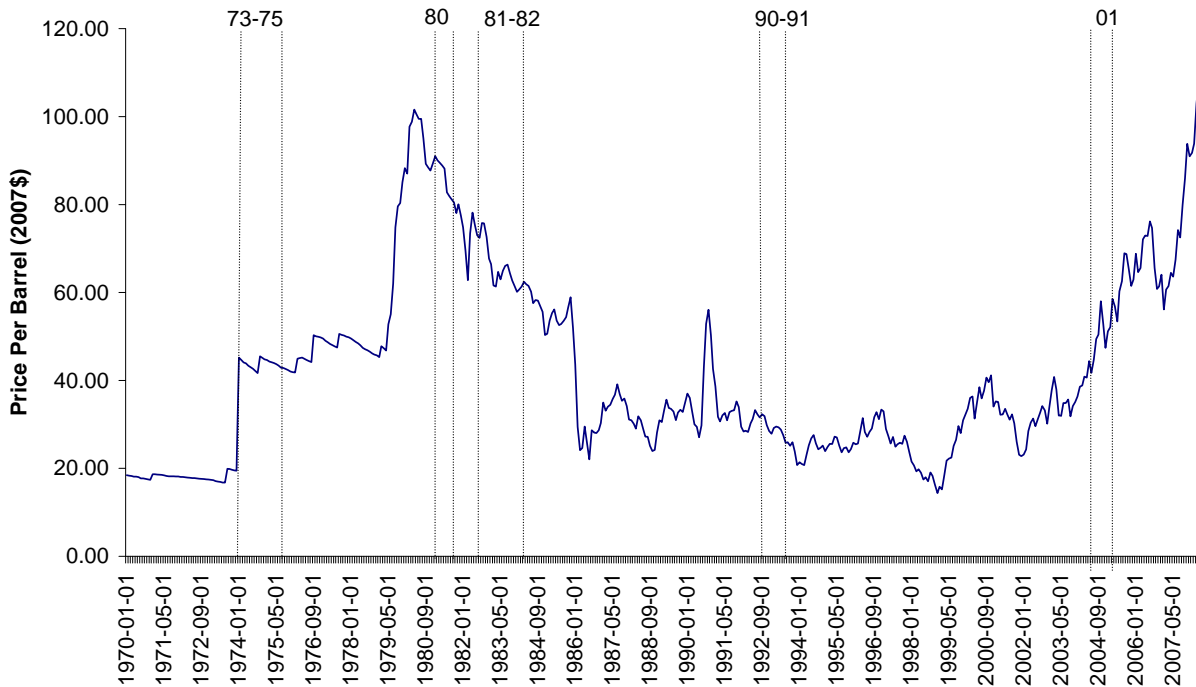


Figure 2. Monthly Change in Non-Agricultural Employment (2006-2008)



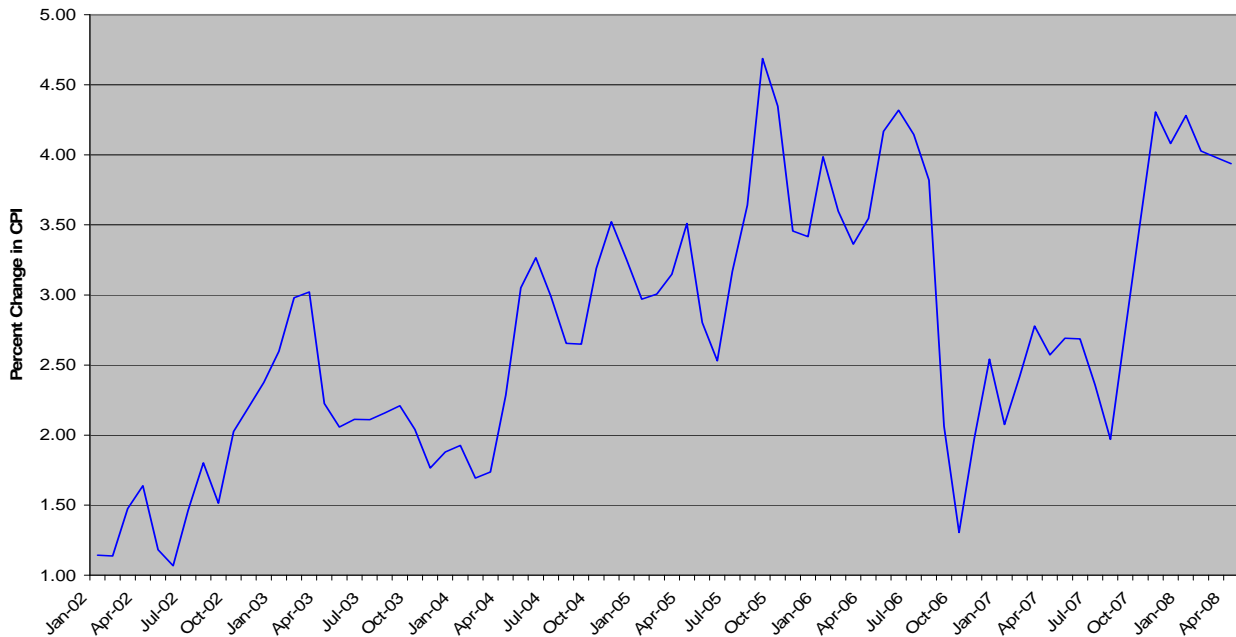
Crude oil prices have reached unprecedented heights, recently approaching \$130 per barrel. On a real basis, crude oil is now at record highs, surpassing the previous high in 1980 that resulted from the oil shocks of the 1970's. This is shown in Figure 3. At present, retail gasoline prices are very close to \$4.00 per gallon. This development will place further pressure on consumers as they decide how to allocate their scarce consumption dollars.

Figure 3. Real Price of a Barrel of West Texas Intermediate Crude Oil (2007\$)



The Federal Reserve has cut their federal funds target rate by 325 basis points since September 2007. The FOMC followed its 75 basis point reduction in the target during their March 2008 meeting with another 25 basis points reduction in April 2008. The fed funds target presently stands at 2%. Inflation based on the Consumer Price Index (see Figure 4) has been advancing at a 4% rate over the past several months www.bls.gov. The Fed has expressed its concern over rising inflation expectations, implying that interest rate reductions have likely come to an end as the Fed attempts to balance control over inflation with economic growth and financial market stability.

Figure 4. CPI Inflation Rates (Twelve Month Percent Change)



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 April 2008. Real personal income growth rates for the Buffalo area, the U.S., and the Rochester area, appear in Table 1. Real personal income grew by 2.01% in Rochester and by 2.18% in Buffalo in 2006. Both areas grew at a slower rate compared to the national economy, which grew at 3.32%. Real personal income grew by 3.36% in the U.S. in 2007. We project that real personal income growth in Buffalo and Rochester will again lag that of the nation, growing by approximately 2.0% 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 1980-2006 (Pearson correlation coefficient = .84). 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 0.85% growth in Buffalo area real personal income. The historic relationship between these growth rates is shown in Figure 5. If the national economy enters recession in 2008 as we expect, personal income growth is likely to be nil.

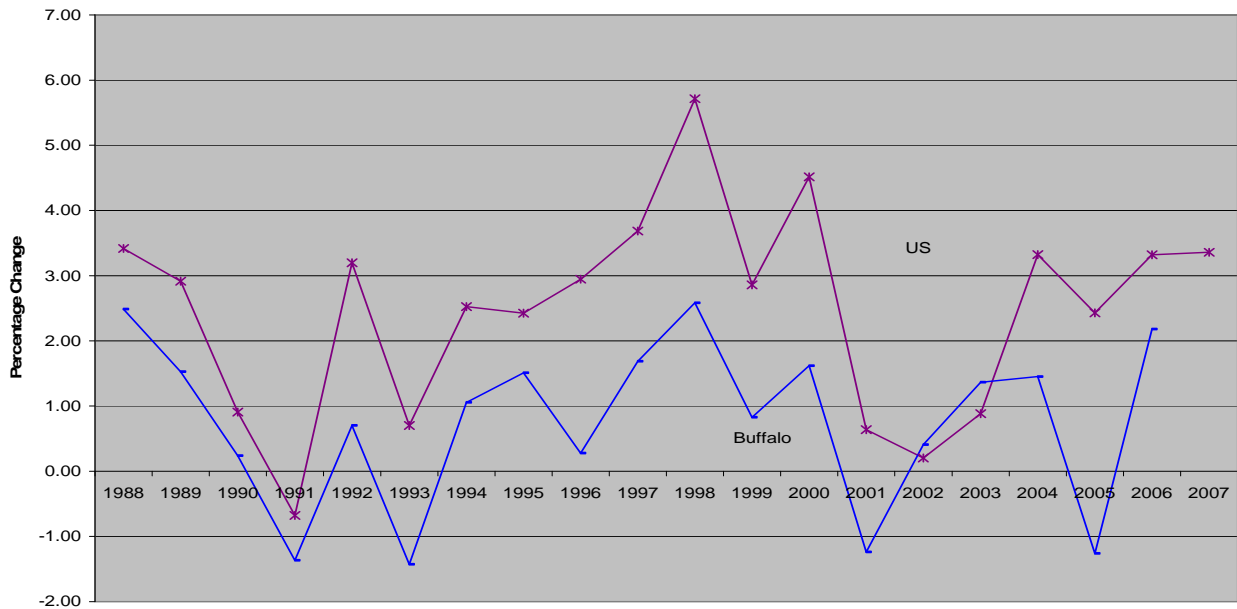
The correlation of the growth rate of real personal income in the Rochester area with that of the U.S. is .71 over the period 1980-2006. Historically, each 1% growth in U.S. real personal income has been met by a .70% growth rate in Rochester area real personal income.

Table 1

Real Personal Income Growth Rates: Buffalo, US, Rochester

YEAR	BUFFALO PERSONAL INCOME (MILLIONS OF 2001\$)	BUFFALO PERCENT CHANGE	US PERCENT CHANGE	ROCHESTER PERCENT CHANGE
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	33,358.5	1.45	3.32	2.81
2005	32,937.6	-1.26	2.43	0.98
2006	33,655.2	2.18	3.32	2.01
2007		2.00	3.36	2.00
2008		-0.25	0.50	-0.35

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



Per capita personal income in Rochester and Buffalo remained below the national average during 2006 but did not deteriorate in relative terms. Since the bulk of personal income is composed of labor earnings (approximately 77%), the economic health of a

region is largely determined by employment and earnings in the region. Employment and earnings per worker data for the WNY area over the period 2001-2006 are presented in Table 2. Employment declined by 1.23% between 2001 and 2006 in WNY. Average earnings per job amounted to \$36,964 in 2006. As has been the case for nearly 20 years, employment in the manufacturing sector continued to decline throughout the first decade of the 21st century. This sector continues to be one of the highest sources of earnings per worker in the region; at \$82,454 per job it was second only to utility employment in 2006. Sustained declines in the auto industry will be felt here as well. Also of note was the decline of over 13% in the information industry. This is important since the average wage per job in this industry is significantly above the regional average.

On the positive side is the 15.5% employment growth in the finance and insurance industry. Average annual wages per job in this sector are \$53,451, substantially above the region's average. As discussed one year ago, Buffalo's wages per worker in the finance and insurance sector were about 80% of the national average a comparison that still holds in 2006. In large money centers like New York and Chicago, the differences are even more dramatic. Average earnings per job in this sector are 3.5 times higher in New York City than they are in WNY. New York City earnings can be skewed by extraordinarily large executive compensation packages. In Chicago, earnings per worker in the finance and insurance sector are 63% higher than they are in Buffalo, and in Baltimore they are 43% higher. The disparity in wage costs between Buffalo and these large metropolitan areas provides the potential for continued growth in local employment in this industry. The benefits from such growth are clear, earnings per worker in this industry are higher than the regional average, and growth in the sector could raise the region's average earnings. The relative weakness of many financial institutions and their potential exposure for loss if the housing market continues to contract could either lead to an increased movement of the financial services employment to low cost centers like Buffalo or the disappearance of some of the firms with the weakest balance sheets. Residents of Western New York should hope for the former rather than the latter.

Of more immediate concern is the nature of the recession in the national economy. Historically, the Buffalo region's dependence on manufacturing, especially the durable goods component of manufacturing, meant that the region would act as an economic barometer for the national economy, leading the nation into recessions. The current economic contraction however has its roots in the housing market and secondarily in the finance and insurance industries. The consequences of the current economic contraction on the durable goods industries may be just beginning. If so, we could see a prolonged economic slide into recession. If the national economy experiences a severe recession like that which occurred in the U.S. in 1980 and 1982, it would likely lead to a continuation of the local economic restructuring that began in the 1980-1982 period. The decline of manufacturing employment in both the nation and Western New York has been long and seems to be irreversible. A sustained national recession could have profound long term consequences for the region.

Table 2
Employment and Earnings in Buffalo MSA 2001 – 2006

NAICS Industry :	Employment						% Change 2001 to 2006	Earnings Per worker 2006
	2001	2002	2003	2004	2005	2006		
Utilities	2,838	2,840	2,665	2,537	2,460	2,351	-17.16%	\$107,972
Construction	26,859	26,421	26,005	27,215	27,217	28,001	4.25%	\$44,340
Manufacturing	80,322	74,187	70,825	68,411	66,529	64,827	-19.29%	\$82,454
Wholesale trade	25,672	24,925	24,159	24,792	25,549	25,603	-0.27%	\$55,245
Retail trade	76,159	75,006	74,365	75,307	76,768	76,348	0.25%	\$22,155
Transportation and warehousing	19,607	18,783	18,434	17,893	18,005	18,326	-6.53%	\$44,701
Information	11,946	11,382	10,785	10,832	10,622	10,324	-13.58%	\$54,048
Finance and insurance	32,756	35,305	36,085	36,472	36,501	37,823	15.47%	\$53,461
Professional and technical services	35,843	35,780	37,173	37,778	37,860	39,000	8.81%	\$50,044
Management of companies and enterprises	7,601	8,715	8,977	8,991	9,210	9,881	30.00%	\$72,299
Administrative and waste services	34,464	34,413	35,677	37,748	38,501	38,986	13.12%	\$27,035
Educational services	14,145	14,829	15,803	16,894	17,689	18,079	27.81%	\$23,090
Health care and social assistance	76,263	76,819	78,651	79,823	79,372	79,319	4.01%	\$39,180
Arts, entertainment, and recreation	10,950	11,369	11,323	11,838	11,667	11,678	6.65%	\$31,155
Accommodation and food services	42,380	43,094	43,461	43,209	43,627	43,926	3.65%	\$15,874
Other services, except public administration	31,251	31,364	31,198	30,698	30,681	31,167	-0.27%	\$23,271
Government and Gov't enterprises	90,860	91,700	94,221	94,977	93,324	92,234	1.51%	\$59,453
Federal, civilian	10,198	10,259	10,585	10,640	10,438	10,070	-1.26%	\$84,541
Military	2,618	2,588	2,526	2,425	2,376	2,084	-20.40%	\$40,597
State and local	78,044	78,853	81,110	81,912	80,510	80,080	2.61%	\$56,789
State government	20,762	21,525	21,650	21,443	21,164	20,863	0.49%	\$60,642
Local government	57,282	57,328	59,460	60,469	59,346	59,217	3.38%	\$55,432
Total employment	639,539	636,221	640,807	647,472	649,898	653,621	2.20%	
Wage and salary employment	563,043	558,497	557,207	559,444	557,433	556,130	-1.23%	\$36,964

NATIONAL, STATE & LOCAL BUSINESS INDICATORS

NATIONAL INDICATORS	% change				
	2007:I	2007:III	2007:IV	2008:I	2007:I - 2008:I
Real GDP (billions of chained 2000\$) (1)(a)	11,412.6	11,658.9	11,675.7	11,693.1	2.5
US Personal Income (billions of \$)	11,469.2	11,735.0	11,856.6	11,986.2	4.5

	% change				
	Apr-07	Feb-08	Mar-08	Apr-08	Apr-07 - Apr-08
Leading Indicators Index (1996=100) (4)(a)	103.9	101.8	101.9	102.0	-1.83
Consumer Price Index (1982-84=100) (2)	206.7	211.7	213.5	214.8	3.94
Exchange Rate Canadian cents/US \$ (3) (b)	90.1	98.4	102.7	100.9	12.02
10 Year Treasury Note Yield (%) (3) (b)	4.63	3.53	3.45	3.77	-0.86
3 Month Treasury Bill Yield (%) (3) (b)	4.91	1.85	1.38	1.43	-3.48
S&P 500 Stock Index (3) (b)	1,482.4	1,330.6	1,322.7	1,385.6	-6.53
Dow-Jones Industrial Average (3) (b)	13,062.9	12,266.4	12,262.9	12,820.1	-1.86

LABOR MARKET TRENDS (2)

Nonag Civilian Employment					
US (1000's)(a)	137,356.0	137,919.0	137,838.0	137,818.0	0.34
NY State (1000's)(a)	8,710.4	8,778.4	8,777.5	8,768.7	0.67
WNY (1000's)	541.0	539.8	542.1	545.2	0.78
Unemployment Rate (%)					
US (a)	4.5	4.8	5.1	5.0	0.5
NY State (a)	4.4	4.4	4.8	4.7	0.3
WNY*	4.7	6.3	6.2	5.4	0.7
Ave. Weekly Hours in Mfg. US (a)	41.1	41.1	41.2	40.9	-0.49
Ave. Weekly Earnings in Mfg. US \$(a)	706.92	721.31	725.53	718.61	1.65
Ave. Weekly Earnings (1982\$(a)	281.54	279.21	279.96	278.64	-1.03

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

Natural Resources, Mining & Construction	17.2	15.7	14.9	15.4	-10.47
Manufacturing	60.8	59.7	59.6	59.1	-2.80
Trade, Transportation & Utilities	101.2	103.5	101.4	101.4	0.20
Durable Goods	37.4	36.8	36.8	36.3	-2.94
Finance Activities	33.6	33.0	33.0	32.8	-2.38
Service Providing	463.2	462.6	465.3	467.6	0.95
Government	95.5	95.1	97.1	97.5	2.09

(1) US Dept. of Commerce

(a) Seasonally Adjusted

(2) US Dept. of Labor

(b) End of month data

(3) Wall Street Journal

(4) The Conference Board