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The last edition of this newsletter expressed our concerns about the national economic contraction, the financial markets collapse and the severity of the current recession. Now that the NBER <http://www.nber.org/cycles/dec2008.html> has officially recognized that the nation is experiencing an economic contraction, the main questions are how deep will it be, how long will it last, and how will it affect the local economy? The mess in the housing and financial markets has spilled over into the rest of the economy with consumers reducing their expenditures and firms postponing investment. Low cost credit and a failure to recognize the risks inherent in holding exotic derivative securities have put the nation on the brink of economic disaster. The notion that the federal government can indemnify firms from a decade of imprudent behavior has begun to take hold. With little transparency in the financial markets bailout packages, even non-financial firms have begun to line up at the federal government money trough.

Even though commodities like food, raw materials, oil, and other energy prices have fallen, the future of the Detroit based American auto industry is not bright. The upstate New York components of these firms face an equally uncertain future. It is hard to believe that total compensation paid to current and retired employees of these firms in the region will not decline. Additionally, the strength and future security of the region's financial services firms may be just one startling revelation away from weakness.

Those who claim that the local economy will not decline as much as the nation obviously have not noticed that the local economy has not yet fully recovered from the 2001 recession as total non-farm employment has yet to return to its level in 2000. There is little doubt that the fiscal stability of state and local governments has been eroded, and it is likely that the region will have to face up to the task of cutting employment and services it can no longer finance. Many state and local politicians are hoping for assistance from a federal government fiscal stimulus program.

The effects of the economic contraction will have to play out before we know if the Buffalo metropolitan area has once again led the nation into recession, fallen deeper, stayed longer, and recovered less fully than the nation. The full text for this newsletter and links to data sources are available at <http://www.canisius.edu/wnyeconomicnews>.

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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The National Economic Outlook

Real GDP contracted by .2% during the fourth quarter of 2007, grew by .9% and 2.8% during the first and second quarters of 2008 and fell by .5% during 2008:III (see Figure 1). The National Bureau of Economic Research, the official arbiter of business cycles in the U.S., has determined that the recession began in December 2007. Consumers have begun to reduce their expenditures as personal consumption expenditures declined by 3.8% during 2008:III with durable goods consumption declining by 14.8%. Investment in residential housing continued to decline by double digit levels as the housing market continued its search for a bottom.

As we pointed out in the last issue of this newsletter, labor markets have continued to deteriorate. Payroll employment (see Figure 2) has declined for twelve consecutive months and the economy has shed almost 2.6 million jobs since December 2007. The unemployment rate has continued to trend upward and presently stands at 7.2%, its highest level since January 1993. The key questions of interest concern how long the recession will last and how severe will be its magnitude. From a historical perspective, the average post World War II recession lasted approximately 10 months with an average decline in real GDP amounting to 2%. It seems likely that this recession will be more severe than average.

**Figure 1. Real GDP Growth Rates
(2005:Q1 - 2008:Q3)**

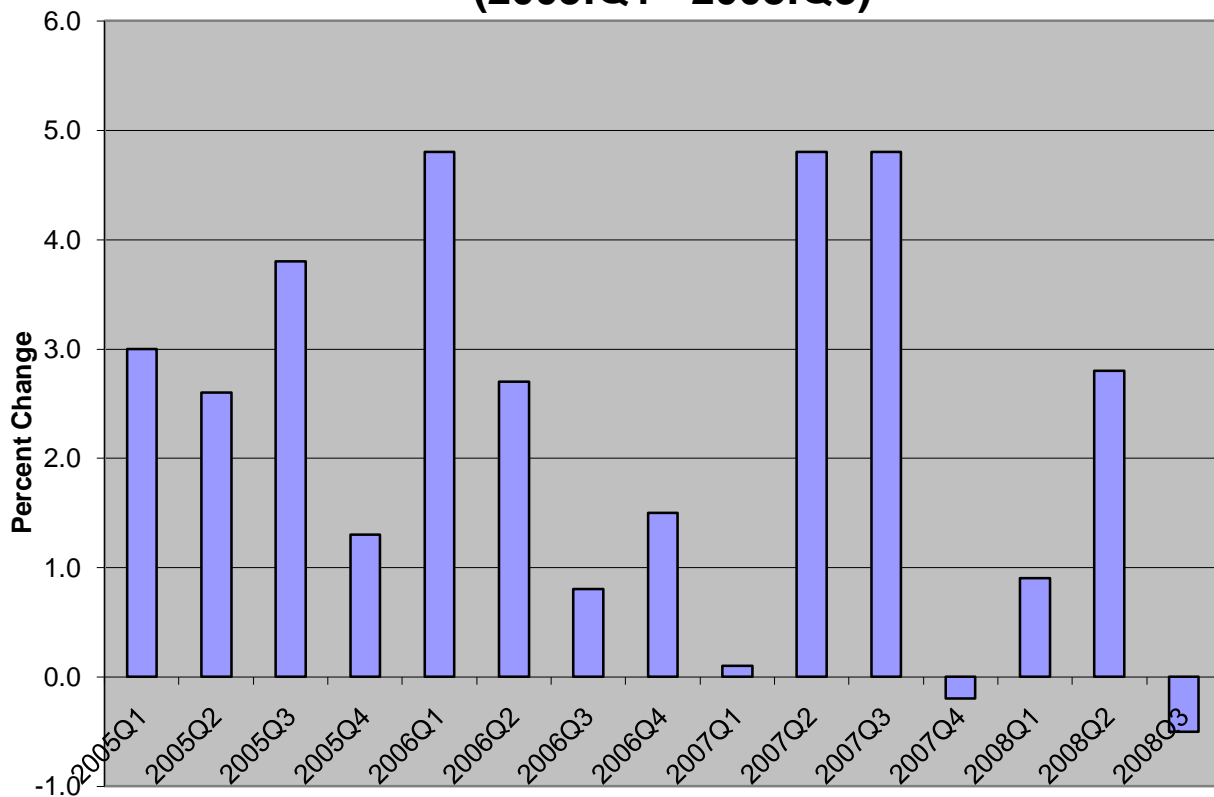
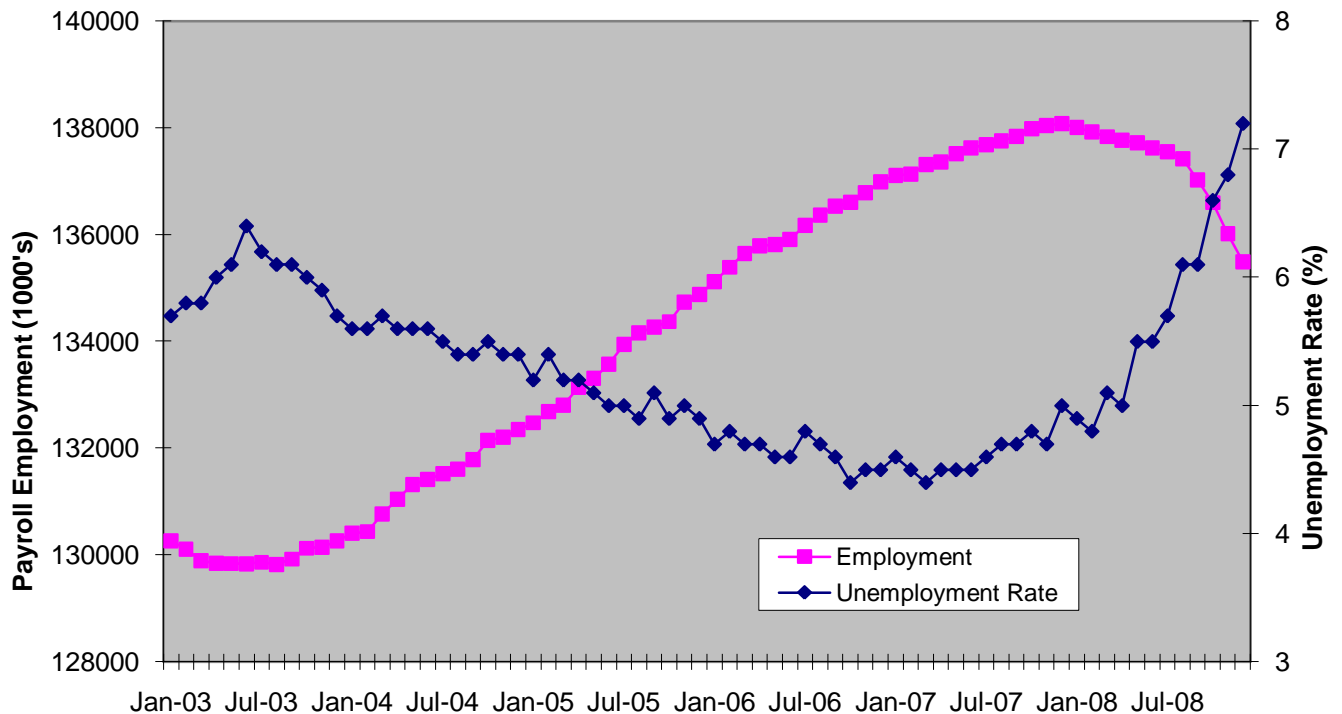


Figure 2. US Payroll Employment & the Unemployment Rate



The Federal Reserve has dramatically increased liquidity and expanded its balance sheet in an unprecedented fashion. They have continued to pump liquidity into the markets in an attempt to unfreeze credit. The present federal funds target is at a historical low, between 0 and .25%. Since the Fed has run out of room to reduce interest rates further, it was necessary for them to use non-traditional methods of expanding liquidity. These included direct purchases of agency debt and mortgage backed securities and granting bank holding company status to many non-bank financial institutions.

Fiscal Stimulus

The Keynesian notion of using federal government expenditures and tax rates to manage the level of aggregate expenditures in the nation is not new. During the Great Depression of the 1930's, the federal government took several tentative steps in the direction of managing aggregate expenditures through expanded government expenditure programs. During World War II, the federal government dampened excess aggregate demand with dramatic increases in income based taxes. The combination of substantial tax cuts and large increases in federal government expenditures have received much of the credit for moderating both the length and severity of the 2001 recession.

Much of the \$700 billion Troubled Asset Relief Program (TARP) passed by Congress has been used to stabilize the banking and financial system. There is a debate underway on how to spend the remainder of the TARP appropriation and on the necessity of additional fiscal stimulus. Thus, what is currently under review in Washington is neither unprecedented nor untested. What is new however, is the effects of globalization on our economy and the impact it could have on any new fiscal stimulus package.

The effects of globalization were recognized in the late 1990s when labor market tightness did not lead to an accompanying upswing in retail prices that usually accompanied low levels of unemployment and high levels of plant utilization. It seemed as if the ability to outsource production to lower cost foreign producers had decoupled full employment and inflation. This notion was reinforced in the period between 1998 and 2001, when unemployment rates were below 5% and inflation was between 2 and 3% per annum. During the present period of economic contraction, the same has been true in the opposite direction. Over the past 18 months, Americans have lost wealth in the equity markets, have faced an increased threat of unemployment and income reduction, and have experienced turmoil in the once predictable housing markets. As consumers, Americans have reacted in a very rational way by reducing their expenditures on durable and nondurable goods and services. This decrease in consumption reflects the lowest levels of consumer confidence in our history and has led to dramatic declines in retail sales and imports

<http://www.conference-board.org/economics/ConsumerConfidence.cfm> . On a Census basis, US imports of goods were down between September and October 2008 by \$2 billion. In a very real sense, Americans have been exporting our recession to the foreign producers of the goods that we have been importing.

The increased domestic spending that is the goal of any fiscal stimulus plan will also increase the demand for imported goods. Thus, government borrowing to support fiscal stimulus will reduce unemployment and increase income in China, India and the other nations that supply us with imported goods. This does not mean that fiscal stimulus will not work, but it does mean that we will get much less 'bang for the buck' than was the case earlier in our history.

The Economic Outlook for the Buffalo Region

Much was made during 2008 about the lack of contraction in the Western New York economy as it was becoming clear to many that the national economy was in serious decline. While it is true that the housing market declines that were prevalent throughout the country were not in evidence in the Buffalo metropolitan area, it is also true that the growth rate of total property values was less than 1/3 of the average in the rest of the nation over the previous decade. The trend in total assessed valuation is consistent with the trend in population, employment, and earnings relative to the rest of the nation.

Total non-farm employment (see Figure 3a) through the first 11 months of 2008 stood at 548,000. Employment has not grown appreciably since 1990 when it stood at 547,500,

and has declined rather substantially since 2000. In a very real sense the Buffalo economy has not yet recovered from the recession of 2001 in terms of total employment.

Figure 3a. Total Non-farm Employment 1990-2008

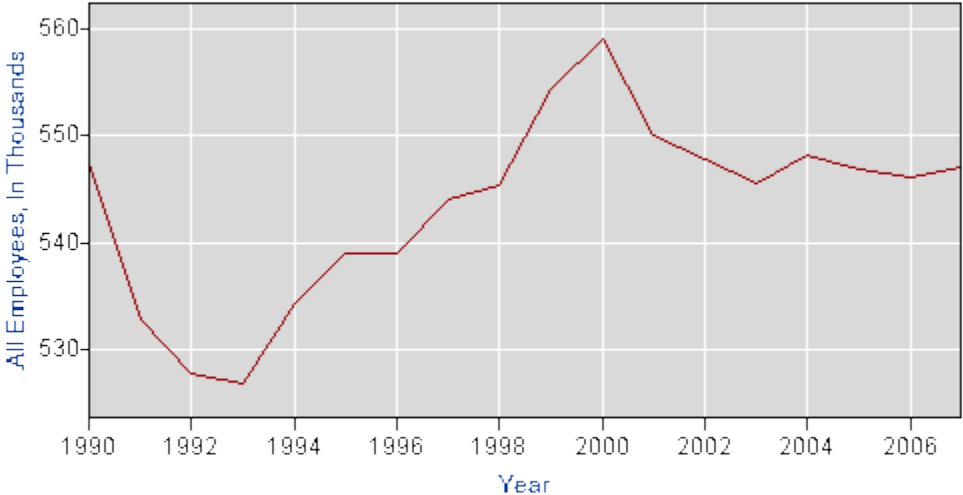


Figure 3b. Total Goods Producing Employment 1990-2008

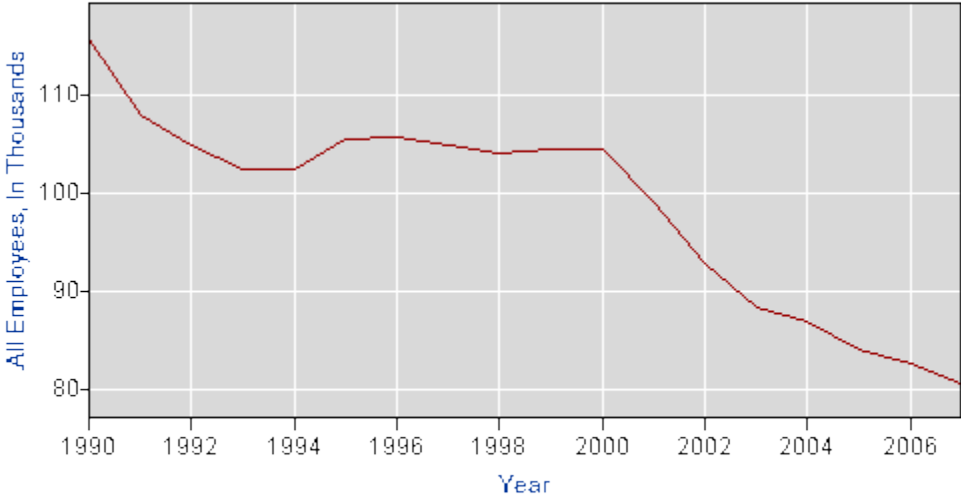


Figure 3b shows a more pronounced pattern of decline. Goods producing employment fell through the early 1990's and then leveled off until 2000. Following the recession of 2001, employment in this high wage sector has continuously declined. None but the most optimistic could believe that the current recession, which gives every indication of being more severe and of longer duration than its immediate predecessor, will reverse this trend.

The tenuous position of the American based automobile industry places Western New York in its most perilous position since the demise of the local primary metals industry more than 30 years ago. The future employment of many of the 35,000 durable goods workers in Western New York will be determined on the floor of Congress rather than on the production floor. If the perception that total compensation packages for auto workers in the Great Lakes region is substantially higher than for the workers of transplanted auto producers in the South is correct, it is hard to imagine that the status quo will be preserved.

The combination of reduced employment levels, the threat to the earnings potential for the remaining durable goods workers and the continued decline in population will probably lead to fiscal stress on the governments within Erie and Niagara Counties that is going to require a significant restructuring of the manner in which government services are delivered and financed.

Full valuation property value growth has lagged behind the rate of inflation by nearly 40% for close to a decade. To simply retain the real purchasing power of public sector workers' salaries would have required ever increasing property tax rates; or an increased dependence on non-property tax revenues like sales taxes, excise taxes, fees and charges. An increased transfer of state and federal aid, which was about 25% of Erie County's and 58% of the City of Buffalo's total expenditures in the last Census year, is another alternative. With New York State budget deficit estimates ranging from \$9 to \$14 billion for the next fiscal year, substantially more aid on a long term basis from the State does not seem likely. A similar argument can be made about the federal government which is facing deficits in excess of a trillion dollars. This leads us to the conclusion that local governments in Western New York will need to slow or reduce their growth in expenditures. One can foresee lower levels of services, lower wages and compensation packages for local government employees and quite possibly fewer governmental units operating in the region. It is also possible that we could at long last hear an informed discussion about the true economic development impacts of many publicly subsidized projects that to some observers have been *a tale told by an idiot, full of sound and fury but signifying nothing*.

To this end, we suggest that emphasis needs to be placed on public sector investments that will make the region more competitive in the world economy. Initiatives that will lead to lower production costs such as more productive laborers, lower energy costs, lower governmental costs and lower transportation costs are the key to lowering the cost of producing goods and services in the region. With a public infrastructure capable of supporting a population that is 30% larger than the current level, the cost savings associated with economies of scale could be the key to the future of the regional economy.

NATIONAL, STATE & LOCAL BUSINESS INDICATORS

NATIONAL INDICATORS	% change				
	2007:III - 2008:III				
	2007:III	2008:I	2008:II	2008:III	2008:III
Real GDP (billions of chained 2000\$) (1)(a)	11,625.7	11,646.0	11,727.4	11,712.3	0.7
US Personal Income (billions of \$)	11,730.4	11,960.5	12,152.2	12,156.8	3.6

	% change				
	Nov-07 - Nov-08				
	Nov-07	Sep-08	Oct-08	Nov-08	Nov-08
Leading Indicators Index (1996=100) (4)(a)	102.8	100.3	99.4	99.0	-3.70
Consumer Price Index (1982-84=100) (2)	210.2	218.8	216.6	212.4	1.07
Exchange Rate Canadian cents/US \$ (3) (b)	100.0	106.4	120.6	123.6	23.58
10 Year Treasury Note Yield (%) (3) (b)	3.97	3.83	4.01	2.96	-1.01
3 Month Treasury Bill Yield (%) (3) (b)	3.15	0.92	0.46	0.15	-3.00
S&P 500 Stock Index (3) (b)	1,481.14	1,164.74	968.75	896.24	-39.49
Dow-Jones Industrial Average (3) (b)	13,371.72	10,850.66	9,325.01	8,829.04	-33.97

LABOR MARKET TRENDS (2)

Nonag Civilian Employment					
US (1000's)(a)	138,037	137,020	136,597	136,013	-1.47
NY State (1000's)(a)	8,769.2	8,772.70	8,760.20	8,736.90	-0.37
WNY (1000's)	556.5	551.90	555.00	554.00	-0.45
Unemployment Rate (%)					
US (a)	4.7	6.1	6.6	6.8	2.1
NY State (a)	4.6	5.8	5.7	6.1	1.5
WNY*	4.5	6.1	5.6	6.2	1.7
Ave. Weekly Hours in Mfg. US (a)	41.3	40.5	40.4	40.3	-2.42
Ave. Weekly Earnings in Mfg. US \$(a)	718.62	720.50	721.54	722.98	0.61
Ave. Weekly Earnings (1982\$(a)	279.67	275.23	278.67	285.97	2.25

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

Natural Resources, Mining & Construction	20.5	20.2	19.8	18.3	-10.73
Manufacturing	60.6	58.7	58.5	58.6	-3.30
Trade, Transportation & Utilities	107.1	102.3	102.8	103.9	-2.99
Durable Goods	37.2	35.8	35.7	35.8	-3.76
Finance Activities	32.9	34.2	34.1	34.1	3.65
Service Providing	475.4	473.0	476.7	477.1	0.36
Government	96.9	94.9	98.4	99.1	2.27

(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