

Western New York ECONOMIC NEWS

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Since the last issue of this newsletter, the BEA earnings report for the year 2004 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

Preliminary estimates of 2006:Q1 real GDP shows the national economy growing at a robust annual rate of 4.8%, after growing at annual rates of 3.8%, 3.3%, 4.1%, and 1.7% over the period 2005:Q1 – 2005:Q4 www.bea.gov. The national economy has exhibited amazing resilience with its rebound from the hurricane/energy market induced slowdown during the fourth quarter of 2005. The acceleration in growth has been fueled primarily by personal consumption expenditures on durable goods, federal government expenditures and investment in equipment and software. Growth rates in real GDP since the first quarter of 2000 are shown in Figure 1.

Labor markets have continued to improve as the economy has created more than 5 million new nonagricultural civilian jobs since August 2003. The national unemployment rate continues to exhibit a downward trend and presently stands at 4.6%, paring a half of a percent off its value from a year ago www.bls.gov. U.S. payroll employment and the unemployment rate since January 2000 are shown in Figure 2. Many economists would interpret these labor market developments as indicative of an economy operating at, or very close to full employment.

Acceleration in economic growth and in the rate of inflation will likely be met with further increments in the federal fund rate target by the Federal Reserve. Figure 3 shows the inflation rate based on 12-month changes in the Consumer Price Index (CPI) from January 2000 to the present and rates of change in the implicit price deflator for personal consumption expenditures. The latter was reportedly a favorite inflation indicator of former Fed chair Alan Greenspan. Inflation based on both of these indicators has clearly exhibited an upward trend since 2002. Combining these developments with volatile oil prices that have recently reached \$75 per barrel poses significant risks to an acceleration of inflation expectations which will force a tightening monetary policy by the Fed. The Fed has increased its federal funds target rate by 25 basis points 16 consecutive times since May 2004. The latest increase in May 2006 brought the target to 5%. Uncertainty about whether the FOMC will increase rates at their June meeting

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Figure 1. Real GDP Growth Rates: 2000Q1 - 2006Q1

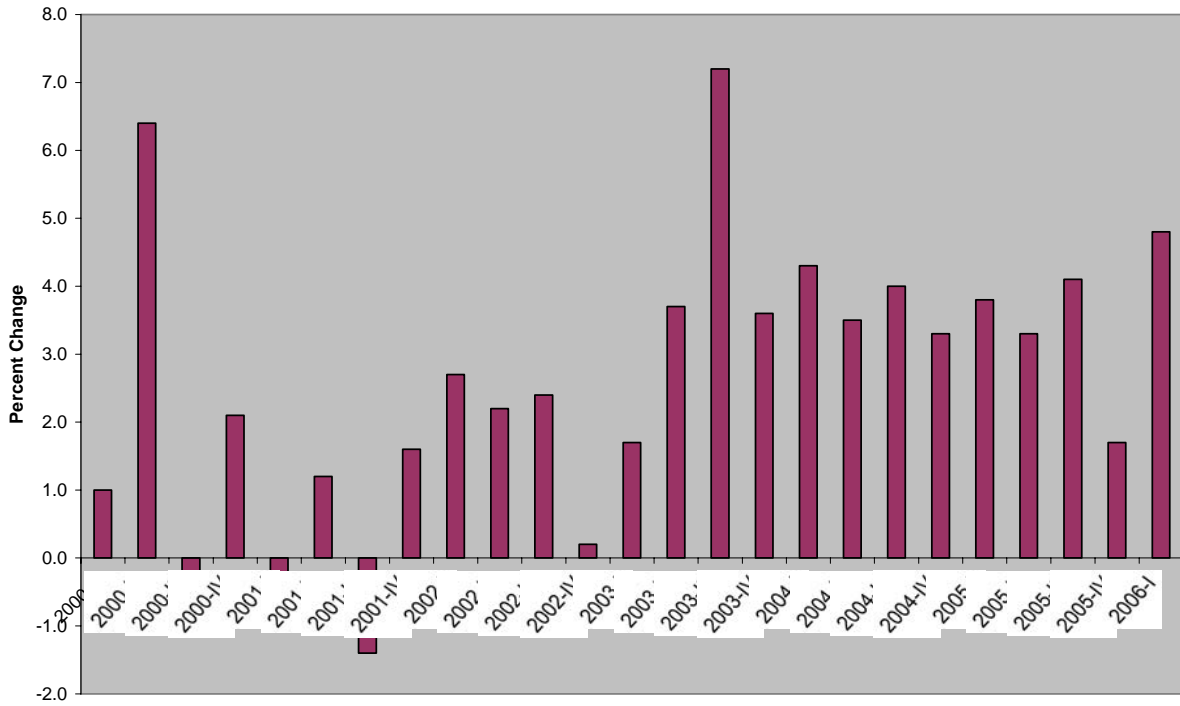
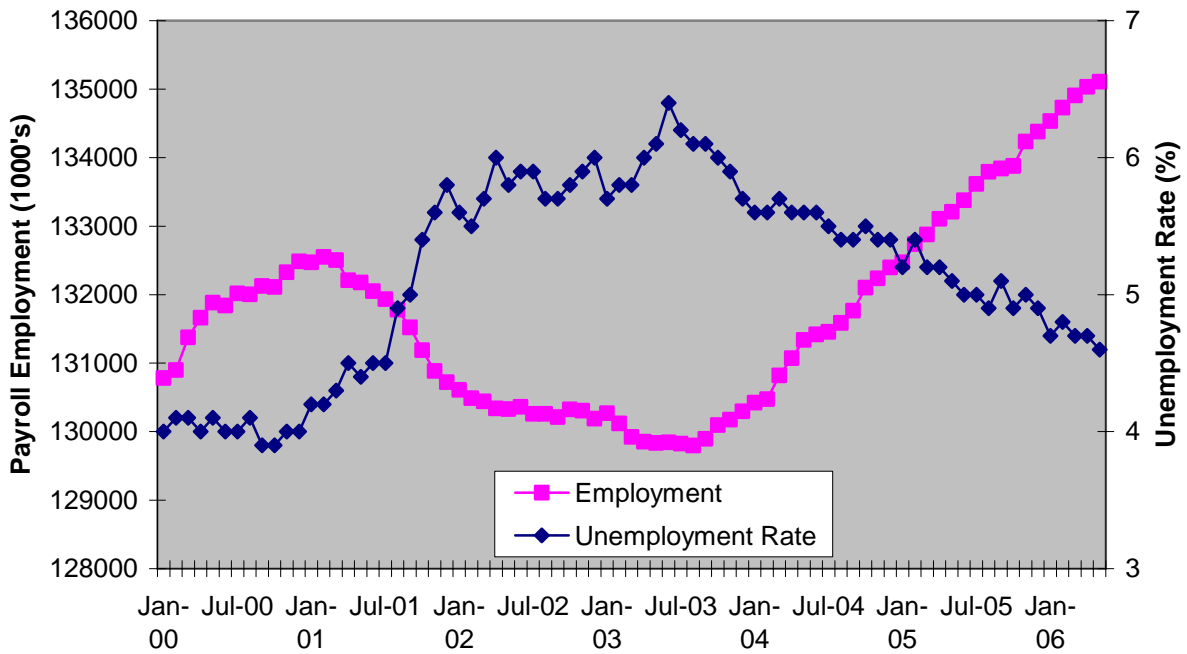


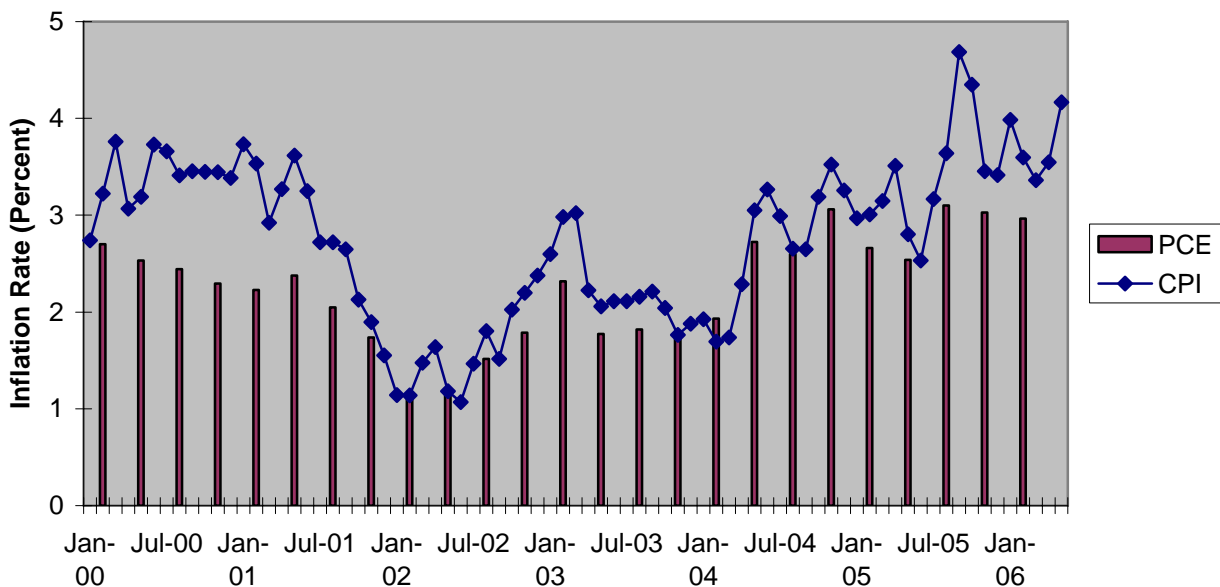
Figure 2. US Payroll Employment and the Unemployment Rate: 2000-2006



has caused considerable angst in the financial markets.

The Treasury yield curve inverted briefly in February and March from the three month to the 10 year maturity. Since a yield curve inversion has preceded each recession experienced in the U.S. since the 1960's, there remains a significant threat of future weakness in the economy in the coming year. In addition, the Conference Board's index of leading economic indicators has declined in each of the past two months. In our view, the major risk to national economic performance involves further oil price spikes, monetary policy tightening by the Fed to combat inflation, and a souring of consumer confidence that results in recession.

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



The Economic Outlook for the Buffalo Region

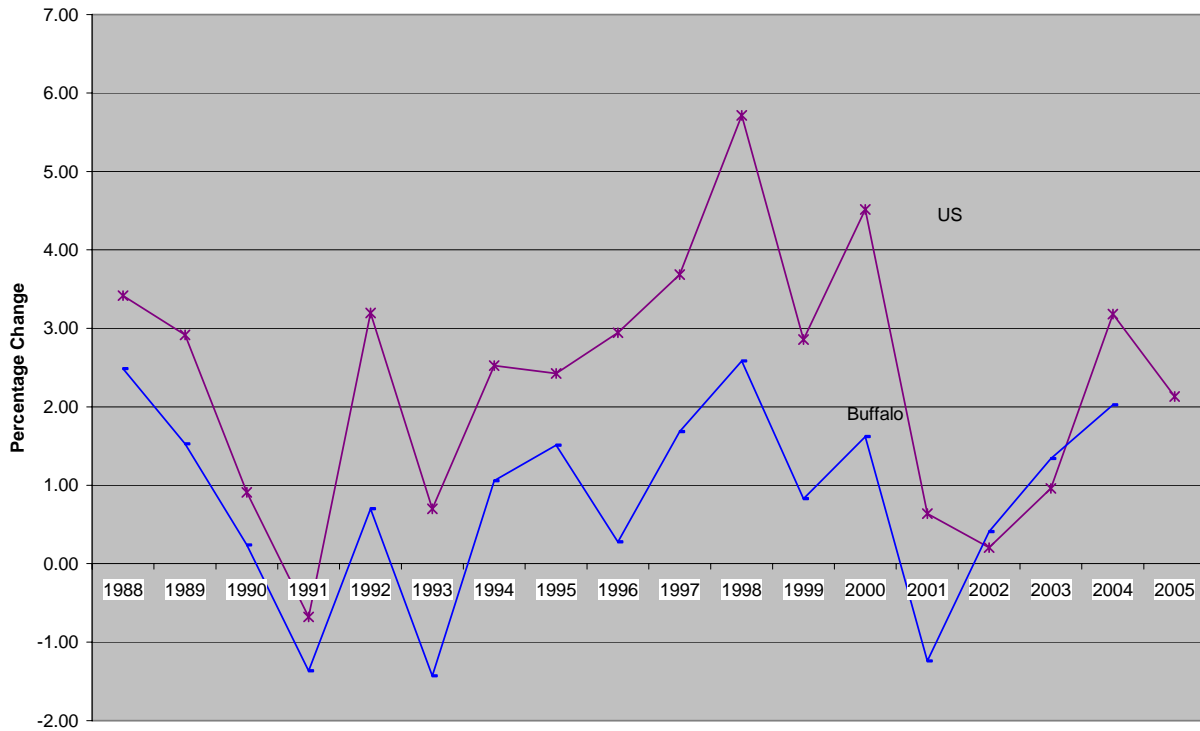
The Bureau of Economic Analysis of the US Department of Commerce <http://www.bea.gov> released revised personal income data for the Buffalo region in April 2006. Real personal income growth rates for the Buffalo area, the U.S., and the Rochester area, appear in Table 1. Real personal income grew by approximately 2% in both Buffalo and Rochester in 2004. This compares with a national growth rate of 3.18%. U.S. real personal income grew by 2.13% in 2005 and we project that it will grow by approximately 2% in 2006. 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 1980-2004 (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 2005 and 2006 (bold face). Each 1% growth in U.S. real personal income has been met by a .85% growth in Buffalo area real personal income. The historic relationship between these growth rates is shown in Figure 4.

TABLE 1

Real Personal Income Growth Rates: Buffalo, US, Rochester

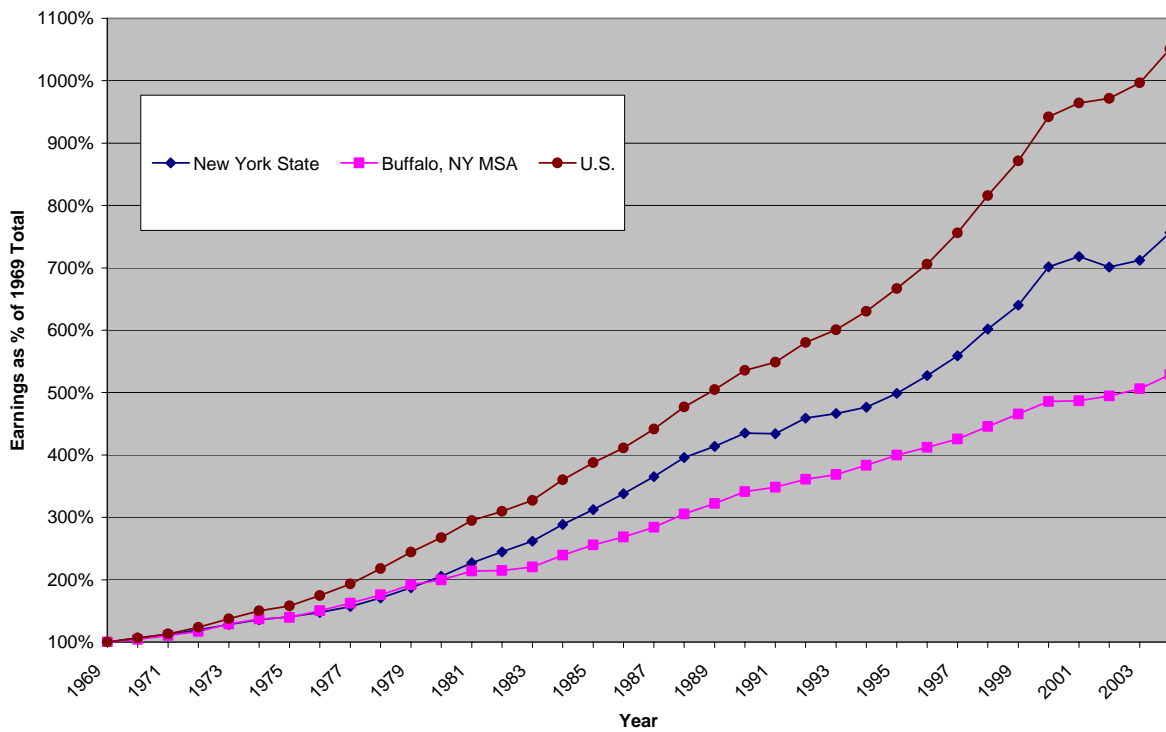
YEAR	BUFFALO PERSONAL INCOME (MILLIONS OF 2001\$)	BUFFALO PERCENT CHANGE	US PERCENT CHANGE	ROCHESTER PERCENT CHANGE
1996	30,607.0	0.28	2.94	0.99
1997	31,122.6	1.68	3.68	2.21
1998	31,926.4	2.58	5.71	3.11
1999	32,190.6	0.83	2.86	0.21
2000	32,711.6	1.62	4.52	1.46
2001	32,306.3	-1.24	0.64	-0.11
2002	32,438.4	0.41	0.20	-0.52
2003	32,872.9	1.34	0.96	-0.74
2004	33,538.7	2.03	3.18	2.05
2005	32,860.2	0.84	2.13	
2006	33,418.8	0.66	1.92	

Figure 4: Real Personal Income Growth Rates: US v. Buffalo



The Buffalo MSA started to diverge from its historic path during the decade of the 1980s. From 1969 to 1981, there was a close link between earnings in New York State and earnings in Buffalo. Figure 4 compares the growth in earnings in the region, the state and the nation using total earnings in 1969 as a base. Since 1969, earnings in the Buffalo metropolitan area have grown at less than half the rate of the rest of the nation. The single most important determinant of this disparity is the decline in the region's population, which began in earnest between 1970 and 1980. The population of the Buffalo metropolitan area has declined by more than 15% since 1970, while the U.S. population has increased approximately 45%.

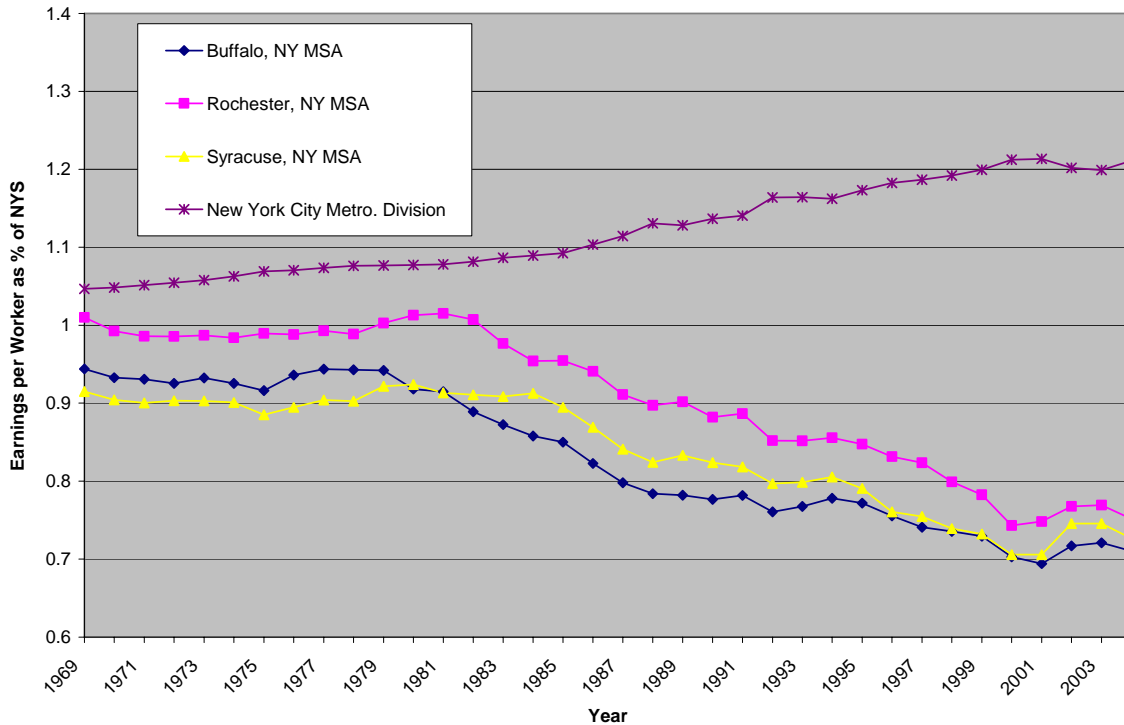
Figure 4. Growth of Earnings: 1969-2004



What has caused this decline in population in the Buffalo metropolitan area? A number of economists have concluded that the lack of economic opportunity has been the basis for this change. Much has been made recently about the so-called brain drain from Upstate New York and particularly Buffalo. In the Buffalo metropolitan area, the proportion of the population between 25-34 years of age is less than the national average, 6.1% locally in 2000 versus 7.1% nationally. This is true even though in 1990 the proportion of the population between 15 and 24 years of age in Buffalo was higher than the national average, 14.3% locally versus 13.5% nationally. Thus, as it aged, the cohort seems to have diminished in the Buffalo metropolitan area relative to the nation. The causes of this decline are most assuredly the net out-migration from the region.

What are the root causes that have attracted fewer in-migrants than there have been out-migrants? The perception that there are limited economic opportunities for young people entering the labor market could reduce the attractiveness of our region compared to the rest of the state and the nation.

Figure 5. Earnings per Worker in New York State

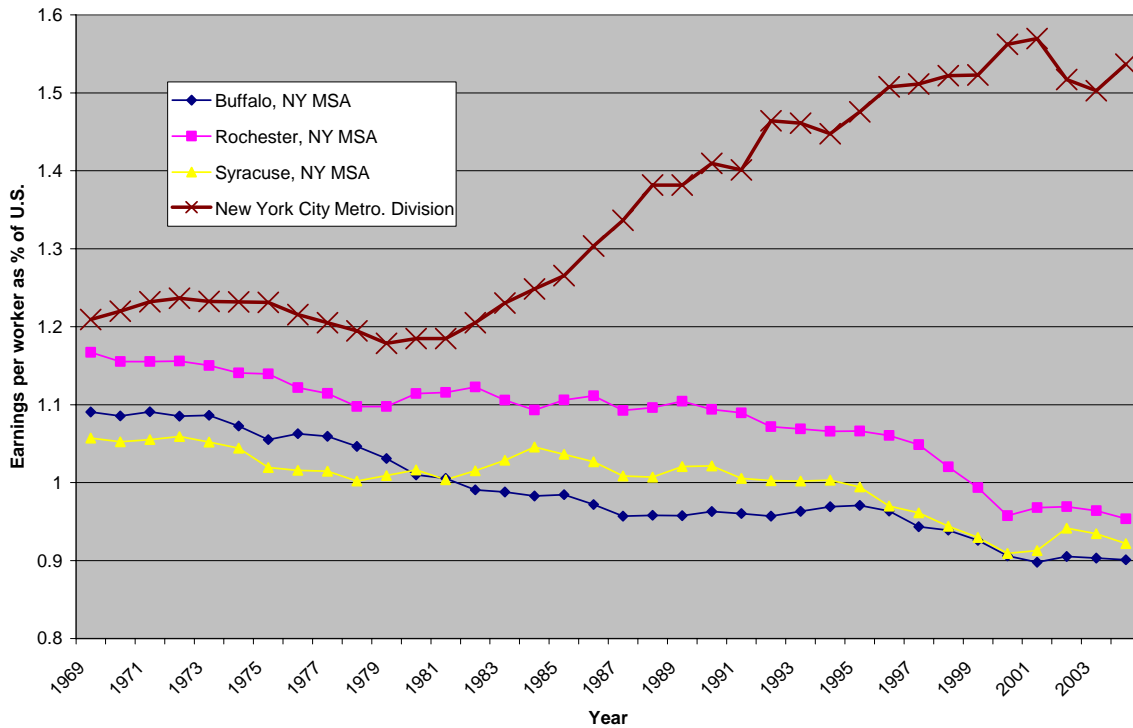


The ratio of earnings per worker in the upstate metropolitan areas of Buffalo, Rochester and Syracuse, to the earnings per worker in New York State is shown in Figure 5. The same is also shown for the New York City metropolitan division. For the upstate areas, this ratio has exhibited a precipitous downward trend since the early 1980's. This is in sharp contrast to the consistent growth in the ratio for the New York City area.

In Figure 6, a similar comparison is made between earnings per worker in the upstate areas and in New York City, with earnings per worker in the nation as a whole. While not as precipitous as the decline within New York State, earnings per worker in the upstate areas has exhibited a downward trend compared to the nation as a whole. Earnings per worker dipped below that of the nation in the early 1980's in Buffalo, in the mid 1990's in Syracuse, and in 1999 in Rochester. The downward trend in this ratio has been apparent since the 1980's for all three areas. Earnings per worker in New York City have exhibited a strong upward trend over this period and increasing at a rate more than 50% above the nation as a whole in 2004.

Based on Census Bureau information, the most common destinations for migrants from the Buffalo metropolitan area are New York City and Rochester, the latter no doubt due to its proximity. The Moody's Economy.com site states that Buffalo's economy shows "...few signs of life and the metro area's reliance on the declining auto industry puts BUF[falo] at risk of further backsliding." Moody's continues that the median income of out-migrants from the Buffalo metropolitan area is nearly \$2000 higher than the median income of in-migrants.

Figure 6. Earnings per Worker vs. U.S. 1969-2004



Conclusion

The Buffalo region has recovered from the latest business cycle decline, but remains in a long term decline in population and economic activity. Population is declining, which dampens the growth of total income. In the face of relatively substantial increases in property values over the last seven years nationally, property values in Western New York have increased only modestly. While this leads to the well worn refrain that we have affordable housing in the region, it also leads to slow growing taxable property values, lagging tax collections, fiscal stress and budgetary crises of one form or another.

In addition to our long standing concerns about secular decline, the current precarious position of the automobile industry and the Buffalo regions dependence on this industry for high earning employment should make even the most optimistic analyst nervous. If the Fed continues raising interest rates resulting in a national recession, it is likely that it will be felt first in Western New York with negative effects that last longer than they will for the nation as a whole.

NATIONAL, STATE & LOCAL BUSINESS INDICATORS

NATIONAL INDICATORS	% change 2005:I - 2006:I				
	2005:I	2005:III	2005:IV	2006:I	2006:I
Real GDP (billions of chained 2000\$) (1)(a)	10,999.3	11,202.3	11,248.3	11,394.7	3.6
US Personal Income (billions of \$)	10,073.4	10,250.4	10,441.1	10,593.7	5.2

	% change May-05 - May-06				
	May-05	Mar-06	Apr-06	May-06	May-06
Leading Indicators Index (1996=100) (1)(a)	135.6	138.9	138.7	137.9	1.70
Consumer Price Index (1982-84=100) (2)	194.4	199.8	201.5	202.5	4.17
Exchange Rate Canadian/US \$ (3) (b)	79.7	85.3	89.4	90.8	13.95
10 Year Treasury Note Yield (%) (3) (b)	4.00	4.86	5.07	5.13	1.13
3 Month Treasury Bill Yield (%) (3) (b)	2.97	4.62	4.77	4.83	1.86
S&P 500 Stock Index (3) (b)	1,191.5	1,294.8	1,310.6	1,270.1	6.60
Dow-Jones Industrial Average (3) (b)	10,467.5	11,109.3	11,367.1	11,168.3	6.70

LABOR MARKET TRENDS (2)					
Nonag Civilian Employment					
US (1000's)(a)	133,210	134,905	135,031	135,106	1.42
NY State (1000's)(a)	8,519.2	8,573.9	8,584.6	8,585.1	0.77
WNY (1000's)	555.0	541.8	544.6	549.7	-0.95
Unemployment Rate (%)					
US (a)	5.1	4.7	4.7	4.6	-0.5
NY State (a)	5.1	4.7	4.9	4.6	-0.5
WNY	5.2	5.6	5.4	4.9	-0.3
Ave. Weekly Hours in Mfg. US (a)	40.4	41.1	41.2	41.1	1.73
Ave. Weekly. Earnings in Mfg. US (\$)	668.22	685.11	677.91	690.51	3.34
Ave. Weekly Earnings (1982\$)(a)	276.18	276.67	277.38	275.51	0.43

WNY EMPLOYMENT BY SECTOR (1000's) (2)					
Natural Resources, Mining & Construction	20.1	16.3	18.1	19.8	-1.49
Manufacturing	64.6	62.5	62.2	62.5	-3.25
Trade, Transportation & Utilities	103.5	101.6	102.2	103.2	-0.29
Durable Goods	39.5	38.2	38.0	38.2	-3.29
Finance Activities	34.1	35.2	35.4	35.4	3.81
Service Providing	465.3	463.0	464.3	467.4	0.45
Government	95.9	96.3	95.3	95.6	-0.31

(1) US Dept. of Commerce

(a) Seasonally Adjusted

(2) US Dept. of Labor

(b) End of month data

(3) Wall Street Journal