

Western New York ECONOMIC NEWS
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The national economic contraction that started in March 2001 is now officially over, though the outlook for the economy is perceived to be weak by many analysts. The potential for international conflict in Iraq and the impact it could have on energy prices is a cause for concern. While the contraction has ended, there is little evidence that any substantial recovery is underway. While Western New York has historically lagged behind the rest of the nation in the recovery process, this recession has been uncharacteristically mild in our region. The extent to which the region will participate in any future recovery is unclear. Complicating matters, there is a serious potential for a double dip recession at the national level, if the decline in leading economic indicators and consumer confidence levels have any meaning. This second dip may well look like a more traditional recession, led by declining durable goods purchases, and as such will have a more traditional impact on the Western New York economy. This must be viewed in the context of an unstable geopolitical climate that could at any time change our expectations about the future. The full text and supporting documents of the newsletter appear on the Internet under the address <http://www.canisius.edu/wnyeconomicnews>.

The National Economic Outlook

Revised estimates of real GDP growth showed the economy contracting during the first three quarters of 2001 by .6%, 1.6%, and .3%, respectively. Economic growth turned positive in the fourth quarter of 2001 and has remained so through the second quarter of 2002. Over this period, real GDP growth was 2.7%, 5.0% and 1.1%, respectively. The slowdown in growth during the second quarter of 2002, the erosion in consumer confidence, a three consecutive month decline in the leading economic indicators, and the decline in equity markets, has analysts worried about the possibility of a double dip recession. A decline in national economic conditions will surely lead to a decline in the Western New York economy.

Consumers were responsible for preventing a more severe recession from occurring, as growth in real personal consumption expenditures remained positive throughout the 2001 recession while business investment has continued to deteriorate. Consumer expenditures on new housing have also continued to increase in real terms. Low mortgage interest rates seem to have been responsible for continuing the boom in new home construction.

The Conference Board's consumer confidence index has shown monthly declines in the four consecutive months from June 2002 – September 2002. Should consumers curtail spending as the decline in consumer confidence suggests, the probability of a double dip recession significantly increases. The index of leading economic indicators, designed to predict economic conditions two to three quarters into the future, has declined in June, July and August. A three consecutive month decline in this index is a traditional harbinger of recession.

Equity markets have continued to drop and trillions of dollars of wealth have evaporated. The S&P 500 index has lost almost 27% of its value since the beginning of the year and is down more than 80% off its high. The accompanying erosion in the wealth position of households, in part, is responsible for the decline in consumer confidence.

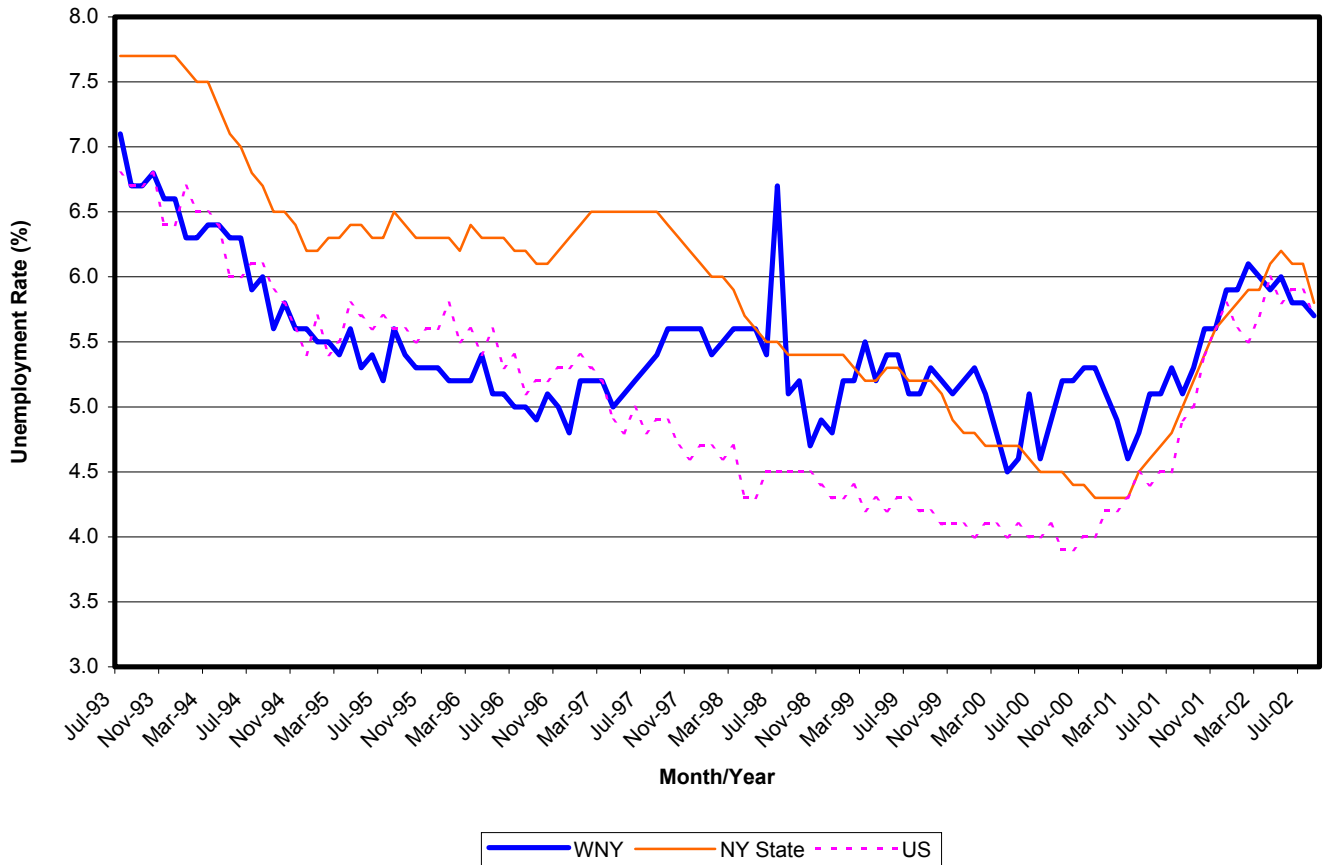
Three-month US Treasury bill yields are at 1.65%, while the ten-year note is yielding 3.75%. One must go back to the early 1960's to observe such low short and long-term interest rates. The Federal Open Market Committee has resisted further cuts in the federal funds target during its late September meeting. This is likely due to the already very low market interest rates and the FED's desire to avoid a liquidity trap. This liquidity trap phenomenon occurs when interest rates are at such a low level that the influence of an increase in the money supply on interest rates and interest sensitive real expenditures is negligible. Consequently, monetary policy has no influence on economic activity in a liquidity trap.

The Economic Outlook for the Buffalo Region

The recent national recession has been different from most of its predecessors in several interesting ways. The first is the strength of consumption activity throughout the decline. There has been a surprising resiliency in the automotive sector, which over the last 25 years has grown in relative importance to the Western New York economy. The second interesting characteristic of this decline is the relatively high level of consumer confidence through most of the contraction. This confidence may be a little shaky in the face of recent corporate scandals and the dramatic declines in real wealth that have accompanied the decline in the equity markets. As national income and employment levels have started to recover and the unemployment rate drop, consumer confidence has started to decline. If this decline in confidence triggers a decline in durable goods consumption, the automobile sector could be hit harder than it was in the first dip.

The importance of the automobile sector to the Western New York economy has been the focus of several earlier newsletters. Substantial declines in this sector can reverse expansions in other sectors of the local economy. The third interesting characteristic of this recession is its relationship to the terror attacks of 9/11. These attacks intensified

Figure 1. Unemployment Rates in the US, NY & WNY: 1993-2002



the decline in the air and travel industries. This was combined with a steep drop in the telecommunications and computer related industries. Since the Buffalo area missed much of the growth that occurred in these sectors in the decade of the 90's, it contracted less with their decline. Historically, the Western New York economy has led the nation into recessions, declined more deeply, recovered less rapidly, and less fully than the rest of the US economy. Could the nature of the current recession lead to a different result for the region after this recession?

Figure 1 compares the unemployment rate in the Buffalo MSA to the rates in the nation and New York State. Except for the period 1999-2001, the unemployment rate in Western New York has been less than or equal to the rate in New York State. Employment started to decline in Western New York during 2000, and the unemployment rate in the Buffalo Metropolitan Area has been above the rate in the rest of the nation since 1997. The traditional pattern of leading the rest of the nation into a recession seems to have held for the current recession. It does not appear to be the

case though that the region declined deeper than the rest of the country or that the recession will last longer than in the nation as a whole.

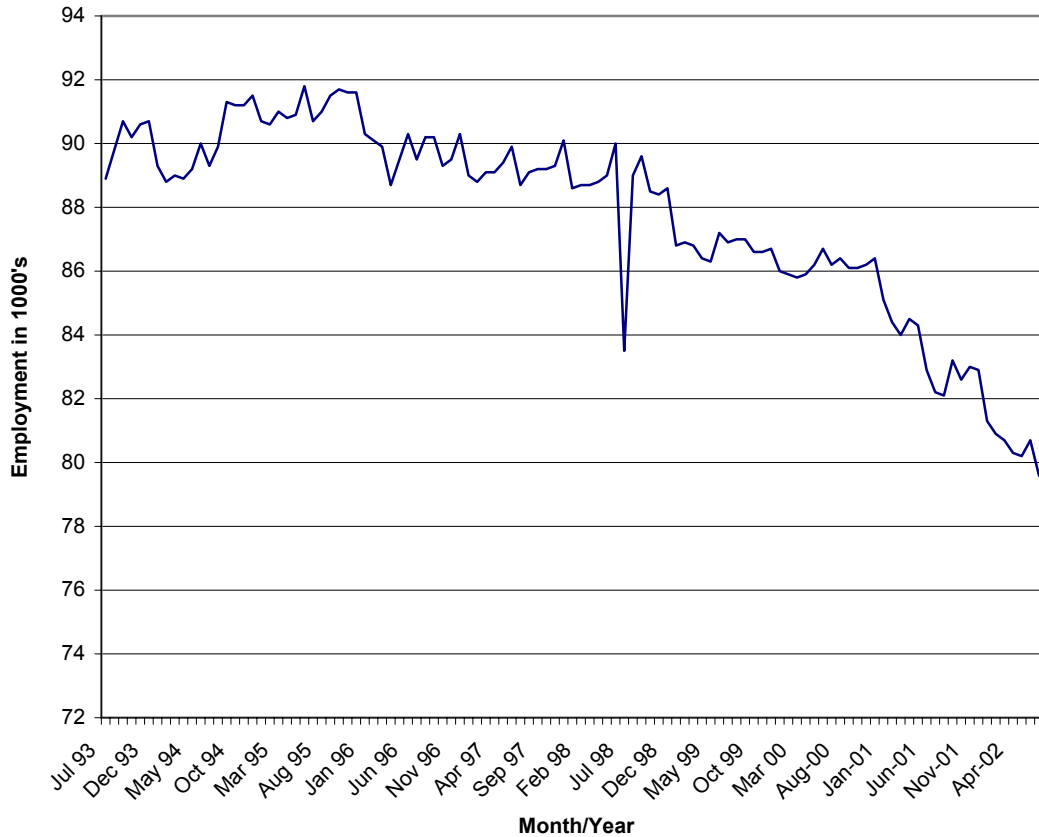
Table 1. Regional Changes in Unemployment Over Business Cycles

Metropolitan Area	Unemployment rate change peak to trough 1979 - 83	Unemployment rate change peak to trough 1990 - 93	Unemployment rate change peak to present 2000 - 2002
Albany-Schenectady-Troy, NY	2.10	1.20	.30
Binghamton, NY	2.20	2.60	2.5
Buffalo-Niagara Falls, NY	4.50	1.50	.60
Rochester, NY	3.50	1.20	1.6
Syracuse, NY	2.30	-1.70	1.1
United States	3.80	1.30	1.6
Buffalo difference from US	0.70	0.20	-1.0
Rochester difference from US	-0.30	-0.10	0
Syracuse difference from US	-1.50	-3.00	-.50
Binghamton difference from US	-1.60	1.30	.90
Albany difference from US	-1.70	-0.10	-1.3

From Table 1 it appears that while the unemployment rate in the Buffalo metropolitan area was higher than the rate for the nation, it increased a full percentage point less over the period of the Buffalo recession than the increase in the US unemployment rate. This was also true in Syracuse and Albany over the same period as well. This is very different from the patterns in the previous two periods of economic contraction, 1979 – 83 and 1990 – 1993. This break in the pattern may be due to the changing nature of the Western New York economy, or it might reflect the special circumstances of the latest national recession.

Timing the local recession is made more difficult by the long-term changes that have been restructuring the local economy since 1975. Figure 2 presents the changes in manufacturing employment that have occurred since July 1993. From its recent peak of 91,700 workers in 1995, manufacturing employment has fallen to 79,300 in August 2002. This decline must be seen in the context of the longer-term change in the region. In 1980, there were approximately 136,000 manufacturing employees in the Buffalo metropolitan area. This indicates an ongoing secular decline that will probably not be replaced with national economic recovery. Since 2000, there has been cyclical decline that will most likely be reversed with an upturn in the business cycle. Total employment in the Buffalo metropolitan area started to decline in 1998. It seems possible that the decline related to the recession did not begin until sometime in 2000. It is the 2000 date that we have chosen for the peak in Table 1, and all declines in employment and

Figure 2. WNY Manufacturing Employment: 1993 - 2002



earnings or increases in unemployment for the local economy will be anchored to that date.

Average weekly earnings in the manufacturing sector have remained strong, approximately 30% higher than the national average, as the employment levels in the sector continue to shrink. Would a second dip in the national economy lead to a substantial cyclical decline in the region, or worse, be the proximate cause for the permanent closure of one of the plants generating these relatively high wages?. In the past, plant closures have occurred during periods of economic contraction, when old facilities are no longer needed. Plants that have not had substantial levels of new capital investment are vulnerable to closure at that time.

Older plants, with substantial levels of underutilized capacity, can be maintained during periods of economic growth to provide output at relatively low incremental costs. These plants can be phased out during periods of contraction, or replaced with newer more cost effective plants during the early stages of economic recovery. The Western New York automotive transport sector has come through the last recession in relatively good shape. A second dip led by a declining durable goods sector, or the replacement of high cost older plants during a recovery, would place a significant strain on a local

economy that is more dependent on the incomes generated by the auto sector today, than it was 30 years ago.

On the bright side, the recent acquisition by M&T Bank Corporation of Allfirst Financial Inc. of Baltimore, may help solidify the bank's position in the ever more competitive financial services industry. The benefits of headquarters activity to the region include high salary employment opportunities, wealth building potential, and attractive career paths for the children of Western New York. Cities such as Cleveland, Pittsburgh and Rochester have long been the beneficiaries of corporate headquarters. Benefits have ranged from investment in the community's economic base, to support for cultural and educational institutions. This was what was many hoped would happen with the Adelpia presence in Buffalo.

Conclusions

Historically the Buffalo region has entered recessions before the nation, fallen more deeply than the nation, taken more time to recover, and recovered less fully than the nation from national economic contractions. This scenario will probably not repeat itself in the present instance unless there is a double dip recession, such as that which occurred from 1980 to 1982. The likelihood of this occurring depends as much on unpredictable external forces like war, oil prices and political upheaval, as it does on traditional economic variables like, consumption, new investment and government economic policy. As such, the future of the national economic recovery remains uncertain, and as always, the economic vitality of the region is closely linked to changes in the national economy. The region's aging capital stock is also an issue. Look for large-scale re-investment as the recession ends as a signal of a long-term commitment to the region. In its absence, the region should be concerned about future plant closures, even if there is no second dip.

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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NATIONAL, STATE & LOCAL BUSINESS INDICATORS

NATIONAL INDICATORS	% chg.				
	2001:II	2001:IV	2002:I	2002:II	2001:II - 2002:II
Real GDP (billions of chained 1996\$) (1)(a)	9,193.1	9,248.8	9,363.2	9,389.6	2.1
US Personal Income (billions of \$)	8,676.2	8,700.9	8,810.4	8,921.5	2.8

	% chg.				
	Aug-01	Jun-02	Jul-02	Aug-02	Aug-01- Aug-02
Leading Indicators Index (1996=100) (1)(a)*	108.6	112.1	112.0	111.8	2.95
Consumer Price Index (1982-84=100) (2)	177.5	179.9	180.1	180.7	1.80
Exchange Rate Canadian/US \$ (3) (b)	64.5	65.9	63.2	64.2	-0.52
10 Year Treasury Bond Yield (%) (3) (b)	4.8	4.8	4.5	4.1	-0.70
3 Month Treasury Bill Yield (%) (3) (b)	3.4	1.7	1.7	1.7	-1.67
S&P 500 Stock Index (3) (b)	1,133.6	989.8	911.6	916.1	-19.19
Dow-Jones Industrial Average (3) (b)	9,949.8	9,243.3	8,736.6	8,663.5	-12.93

LABOR MARKET TRENDS (2)					
Nonag Civilian Employment					
US (1000's) (a)	131,966	130,736	130,803	130,842	-0.85
NY State (1000's) (a)	8,628.8	8,541.6	8,559.7	8,549.6	-0.92
WNY (1000's)	552.6	556.3	550.4	550.8	-0.33
Unemployment Rate (%)					
US (a)	4.9	5.9	5.9	5.7	0.80
NY State (a)	5.0	6.1	6.1	5.8	0.80
WNY	5.0	5.7	6.1	5.5	0.50
Ave. Wkly. Hours in Mfg. WNY	42.3	42.7	42.1	42.5	0.47
Ave. Wkly. Earnings in Mfg. WNY (\$)	785.5	813.9	795.3	810.9	3.23
Ave. Wkly Hours in Mfg. US	40.7	41.1	40.7	40.8	0.25
Ave. Wkly. Earnings in Mfg. US (\$)	607.5	631.1	615.0	626.6	3.14

WNY SECTOR EMPLOYMENT (1000's) (2)					
Construction and Mining	23.1	22.1	22.7	23.0	-0.43
Manufacturing	82.1	80.7	79.6	79.3	-3.41
Transportation and Public Utilities	26.9	27.3	26.6	26.5	-1.49
Wholesale and Retail Trade	128.2	128.2	127.4	128.0	-0.16
Finance, Insurance and Real Estate	30.9	31.7	31.5	31.5	1.94
Services	174.4	174.6	174.6	174.8	0.23
Government	87.0	91.7	88.0	87.7	0.80

(1) US Dept. of Commerce
(2) US Dept. of Labor
(3) Wall Street Journal

(a) Seasonally adjusted
(b) End of month data