

Western New York ECONOMIC NEWS
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The national recession may have ended, but economic weakness continues as indicated by recent statements and actions from the Fed. It is difficult for many to see the signs of recovery since the unemployment rate continues to increase and payrolls have been pared, even though real GDP is rising. The local economy seems to have escaped its traditional pattern in national recessions, with the trend in unemployment and earnings reflecting the national average. If the current pattern continues, the Buffalo region could emerge from this recession in better condition relative to the national economy than at any time since the national recession of 1973-75. The potential exists, however for a dramatic reduction in durable goods activity, which could plunge the nation into a double dip recession and set-up the Buffalo region for economic dislocations reminiscent of the Great Lakes recessions of 1979-83.

The full text and supporting documents of the newsletter appear on the Internet under the address <http://www.canisius.edu/wnyeconomicnews>.

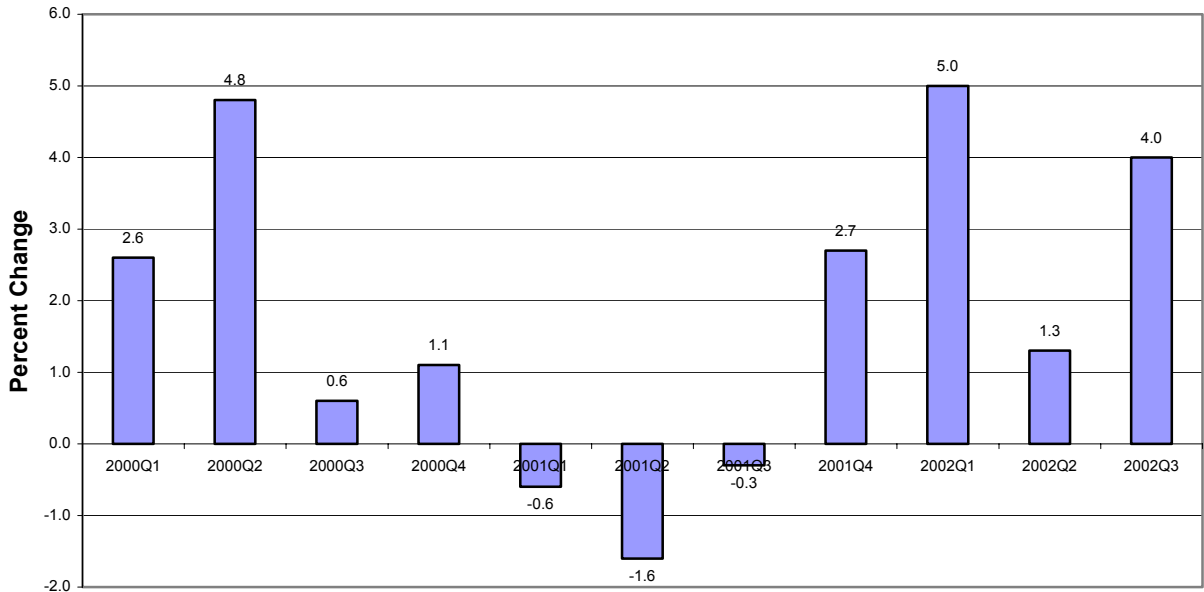
The National Economic Outlook

Over the first three quarters of 2002, real GDP has grown by 5.0%, 1.3%, and 4.0%, respectively. The slowdown in growth during the second quarter of 2002 had analysts worried about the prospect of a double dip recession. The upward revision in real GDP growth from the 3.1% advance estimates makes the likelihood of a double dip more remote. However, real GDP growth has been below what one would expect in the quarters following a recession. The percentage change in real GDP over the previous quarter from the first quarter of 2000 to the third quarter of 2002 are shown in Figure 1.

Consumer spending remains the driving force behind US economic performance, exhibiting a 4.1% increase during the third quarter of 2002. Economists are closely watching for signs of erosion in consumer confidence that would cause consumers to cut back on spending and send the economy on its way to another recession. Consumer behavior was particularly important during the crucial fourth quarter shopping season. While retail sales during October and November 2002 were up by 2.1% from the same months in 2001, a healthy holiday shopping season was less than certain. However, the US military buildup in the Persian Gulf region and the rising national unemployment rate are factors that could easily sour consumer confidence and result in a decrease in consumer spending.

Investment expenditures increased by 3.1% in real terms during the third quarter of 2000 but remain below levels that are necessary for a robust economic recovery.

Figure 1: Percent Change in Real GDP from Previous Quarter



Equity markets have recovered nicely in October and November 2002, coming off their September lows, but fell off again in December. This leaves the issues of consumer confidence still in doubt. The US Treasury yield curve has steepened considerably in recent months. Three-month US Treasury bill yields are at 1.20%, while the ten-year note is yielding 4.01%. These yields are low by historical standards. The Federal Open Market Committee surprised markets with their 50 basis point federal funds rate target cut during its November meeting. This was widely interpreted by analysts as a last ditch response to a weakening economy by the Fed. Will this weak trend continue? Consumer confidence has fallen nationally, and unemployment rates persist at recession levels. Only time will tell.

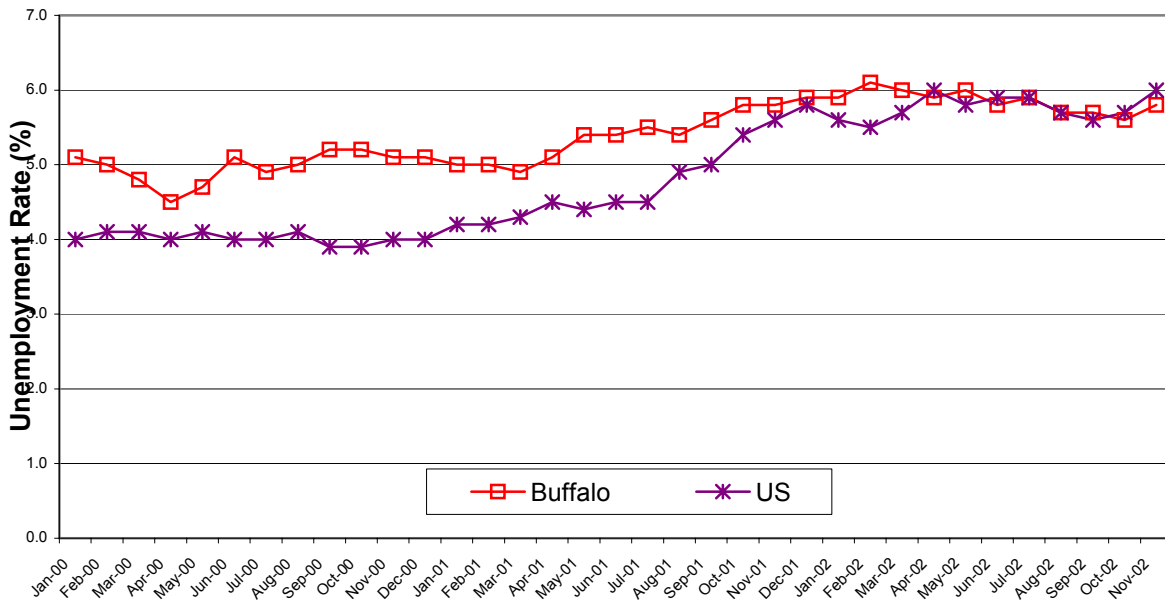
The Western New York Economy

The relationship between unemployment rates nationally and in the Buffalo region since January 2000 is shown in Figure 2. Both series are seasonally adjusted. It appears as though the Buffalo and US unemployment rates converged in April 2002 after a prolonged period where the Buffalo rate was consistently above the national rate. The Buffalo rate peaked in February 2002. The national rate reached 6% in April 2002, declined, and then returned to a 6% level in November 2002.

Viewing the behavior of the national unemployment rate series, the problem many analysts have had calling an end to the 2000 recession or worrying about a double dip

becomes apparent. The Buffalo area appears to have bottomed before the nation, as the unemployment rate peaked during February 2002. This is inconsistent with our analysis in previous issues of this newsletter where we have found that the Buffalo region has remained in recession well after the nation as a whole begins its recovery. A possible explanation for this anomaly is the increased dependence of the Buffalo region on the automobile sector and the fact that consumer expenditures have remained stable or have increased during the 2001 recession.

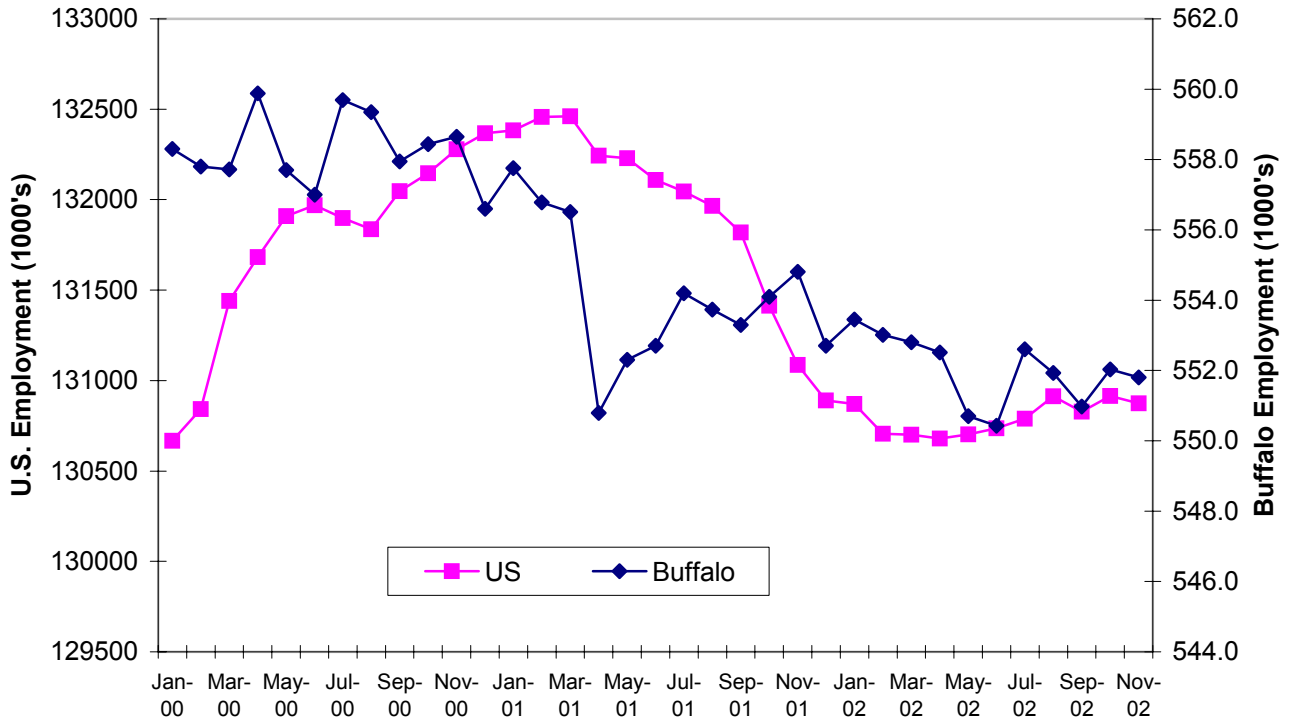
Figure 2: Unemployment Rates in Buffalo and US



The linkage between the local and national economy of .9% change in local earnings for each 1% change in the US economy, presented in Volume 5 Number 1 of WNYEconomicNews, works most strongly through the durable goods sector. Over the long term, the WNY region has consistently lost durable goods employment and the income generated by this sector. The traditional cyclical sensitivity in the durable goods sector has been missing during the latest economic downturn. During the national recessions of 1980-82 and 1990-91, the durable goods sector in the United States fell by 2% and 1% respectively. No such decline has been seen over the course of the current recession. If there is no traditional durable goods led recession coming then we should expect the Buffalo economy to break from its past. It is possible that the region has not led the nation into the recession, it will not fall further into recession, and it will not take longer to recover from this recession. That is why it is very important for those of us interested in the economy of Western New York to keep a close watch on current national trends.

Durable goods production and consumption by their nature are susceptible to changes in the outlook of households and business firms. Since durable goods have an extended lifetime, households have traditionally delayed the purchase of autos and household appliances when they become concerned about the future. The consumer

Figure 3: Payroll Employment US and Buffalo



confidence index, a gauge of uncertainty in the nation's households, has shown weakness in recent months. Households have watched unemployment rates continue to climb even after the announced end of the recession. They have heard the Fed announce that weakness in the economy has justified another cut in short-term interest rates. Households have also reached debt levels that may give them cause for concern, along with a reduction in the rate of consumption of big-ticket durable goods items. Finally, the level of political tension related to potential war in Iraq, developments in the Korean peninsula, and the threat of domestic terrorism, all contribute to a level of uncertainty that could well put a damper on durable goods consumption during 2003. Increased energy prices, particularly gasoline, which has approached the \$1.70 per gallon mark locally as a result of the Venezuelan oil strike, adds to this uncertainty.

An additional concern for the coming year is the effect of the unstable American equities markets on the future of the US and by inference, the Western New York economy. Over the past year, the major stock indices fell between 16 and 32 percent. 2002 was the third year in a row that households saw their wealth held in the form of equities diminish. The cumulative effect of these declines on the consumption levels of US households is yet to be determined.

One thing is certain though, it can not be positive. A national contraction of the more traditional durable goods variety will have a more traditional effect on the Buffalo economy.

Seasonally adjusted payroll employment in the US and Buffalo over the period January 2000 – November 2002 is shown in Figure 3. US employment reaches a peak in March 2001 and bottoms out in February 2002. From February 2002 through November 2002, the downward trend of US employment has been reversed but growth has been anemic. The identification of peaks and troughs in the Buffalo region is much more difficult to identify given the long-term secular decline in the region, which has occurred recently.

While the direct impact of the recession has been relatively modest in Western New York, there have been some significant indirect effects that will have some long-term negative consequences. New York State income and sales tax revenues are closely related to changes in the level of personal income, as are tax revenues in most states. The current recession has had the expected effect on these two revenue streams, while expenditures for cyclically sensitive social service and income maintenance programs has increased. The ensuing budget deficits have caused state governments across the country to re-assess their traditional intergovernmental transfer programs aimed at local governments. A number of municipal governments in Western New York, most notably the City of Buffalo, are heavily dependent on state aid to finance their local expenditures. The current fiscal condition of the State government will have a negative impact on local government finances in the region.

The Buffalo region has been selected as one of the 101 observed metropolitan areas in the US Department of Housing and Urban Development's *State of the Cities Data System*, <http://socds.huduser.org>. These cities and their surrounding areas have had the fiscal activity of all overlying governments, such as county, school district and special district governments, aggregated into city and suburban areas. If one measures the level of total aid, state plus federal, as a percent of general revenue, the City of Buffalo is the 17th highest in the sample at 48%. That means nearly 1 out of every two dollars of city revenues were provided by the state or the federal government. As the budget problems of New York State increase, the flow of funds to local governments will be jeopardized. The potential impact of this aid reduction was suggested last fall, when the state re-directed expenditures to New York City in the wake of the 9/11 attacks. One could expect similar pressure on local governments this year when the state faces the decisions that will accompany a projected \$10 billion deficit. Buffalo's suburban governments receive aid that is, on average, only 30% of their general revenues, and as such, are somewhat less at risk. A serious reduction in real aid flows will result in tax increases or expenditure cutbacks at the local level in Western New York.

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:III	2002:I	2002:II	2002:III	2001:III - 2002:III
Real GDP (billions of chained 1996\$) (1)(a)	9,186.4	9,363.2	9,392.4	9,485.6	3.3
US Personal Income (billions of \$)	8,706.2	8,803.4	8,913.7	8,993.3	3.3
% chg.					
	Nov-01	Sep-02	Oct-02	Nov-02	Nov-01- Nov-02
Leading Indicators Index (1996=100) (1)(a)*	110.0	111.4	111.4	112.3	2.09
Consumer Price Index (1982-84=100) (2)	177.4	181.0	181.3	181.3	2.20
Exchange Rate Canadian/US \$ (3) (b)	63.6	63.0	64.2	63.9	0.52
10 Year Treasury Bond Yield (%) (3) (b)	4.73	3.59	3.89	4.21	-0.52
3 Month Treasury Bill Yield (%) (3) (b)	1.75	1.54	1.43	1.22	-0.53
S&P 500 Stock Index (3) (b)	1,139.5	815.3	885.8	936.3	-17.83
Dow-Jones Industrial Average (3) (b)	9,851.6	7,591.9	8,397.0	8,896.1	-9.70
LABOR MARKET TRENDS (2)					
Nonag Civilian Employment					
US (1000's) (a)	131,087	130,829	130,915	130,875	-0.16
NY State (1000's) (a)	8,574.5	8,539.2	8,538.1	8534.1	-0.47
WNY (1000's)	563.6	553.9	560.0	560.6	-0.53
Unemployment Rate (%)					
US (a)	5.6	5.6	5.7	6.0	0.40
NY State (a)	5.6	5.6	5.8	6.0	0.40
WNY	5.2	5.4	5.0	5.4	0.20
Ave. Wkly. Hours in Mfg. WNY	42.1	42.8	42.8	42.7	1.43
Ave. Wkly. Earnings in Mfg. WNY (\$)	780.96	821.33	820.48	835.64	7.00
Ave. Wkly Hours in Mfg. US	40.3	40.9	40.7	40.7	0.99
Ave. Wkly. Earnings in Mfg. US (\$)	613.35	636.02	630.68	634.68	3.48
WNY SECTOR EMPLOYMENT (1000's) (2)					
Construction and Mining	21.3	22.6	21.9	20.9	-1.88
Manufacturing	82.3	79.3	79.4	78.8	-4.25
Transportation and Public Utilities	27.8	26.7	26.8	26.6	-4.32
Wholesale and Retail Trade	133.1	127.7	128.5	131.3	-1.35
Finance, Insurance and Real Estate	31.0	31.2	31.3	31.4	1.29
Services	174.7	175.8	176.5	175.9	0.69
Government	94.8	90.6	95.6	95.7	0.95

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

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