

Western New York ECONOMIC NEWS

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Since the last issue of this newsletter, the BEA earnings report for the year 2003 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 sector. 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 2005:Q1 real GDP shows the national economy growing at an annual rate of 3.5%, after growing at annual rates of 4.5%, 3.3%, 4.0%, and 3.8% during the four quarters of 2004 www.bea.gov. The main contributors to the steady performance of the national economy have been personal consumption expenditures and business investment. Growth rates in real GDP since the first quarter of 2001 are shown below in Figure 1. The magnitude of future growth in the national economy appears guarded given decline in the Conference Board's index of leading economic indicators over the past four months. This index, designed to predict economic growth over the coming year, has declined at an annual rate of 1% over the past six months. Some have interpreted this development as signaling lower rates of growth in real GDP rather than as an indicator of a recession in the near future. This development, along with a flattening U.S. Treasury yield curve, and the possible acceleration of energy prices in the future, make the outlook for future GDP growth guarded. Although we only place a probability of 15% on a scenario that has the national economy enter recession over the next four quarters, this probability has increased significantly since the last issue of this newsletter.

Labor markets have continued to improve as the number of workers on national payrolls has increased by almost 3.5 million over the past two years. Similarly, the national unemployment rate continues to exhibit a downward trend and presently stands at 5.2%, off its peak of 6.4% in June 2003 www.bls.gov. U.S. payroll employment and the unemployment rate since January 2000 are shown in Figure 2. While employment levels have recovered to their pre-recession levels, there has been a substantial transformation in the U.S. economy. In the year 2000 there were 17,263,000 manufacturing workers in the U.S., there are now (2004 annual data) only 14,329,000; a loss of nearly 3 million manufacturing jobs. As this restructuring has occurred, the average earnings per worker in the U.S. for 2003 and 2004 have continued to increase, though not matching the rate of inflation. Data from the U.S. Department of Labor shows that

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Figure 1: Real GDP Growth Rates (2001:Q1 - 2005:Q1)

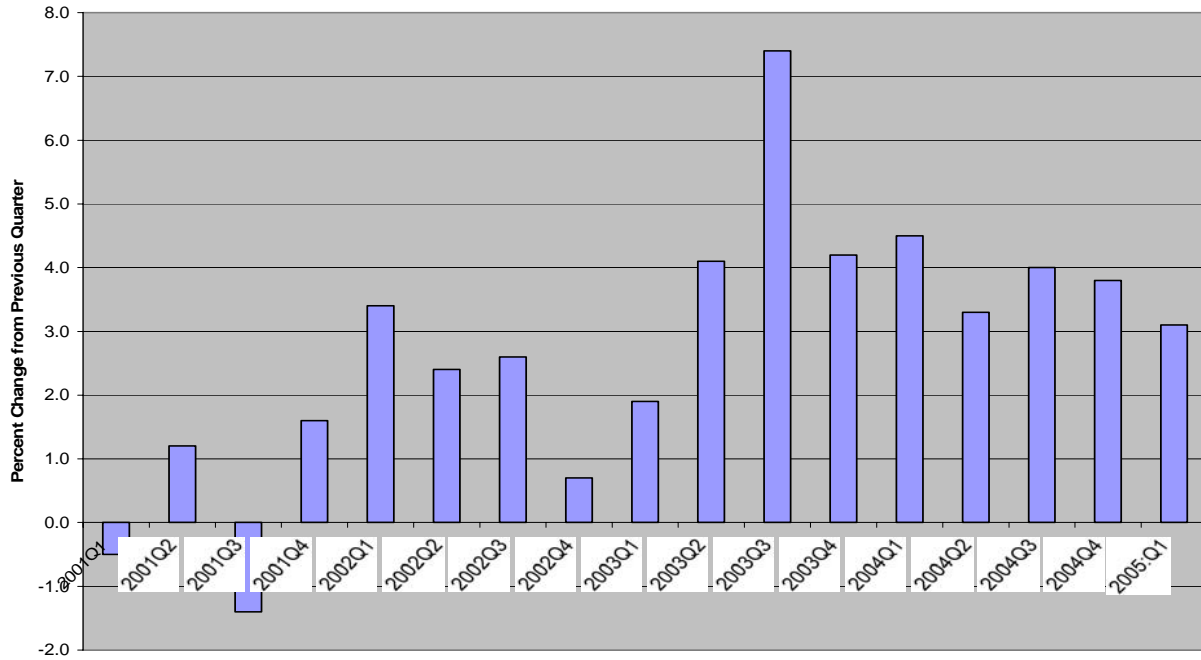
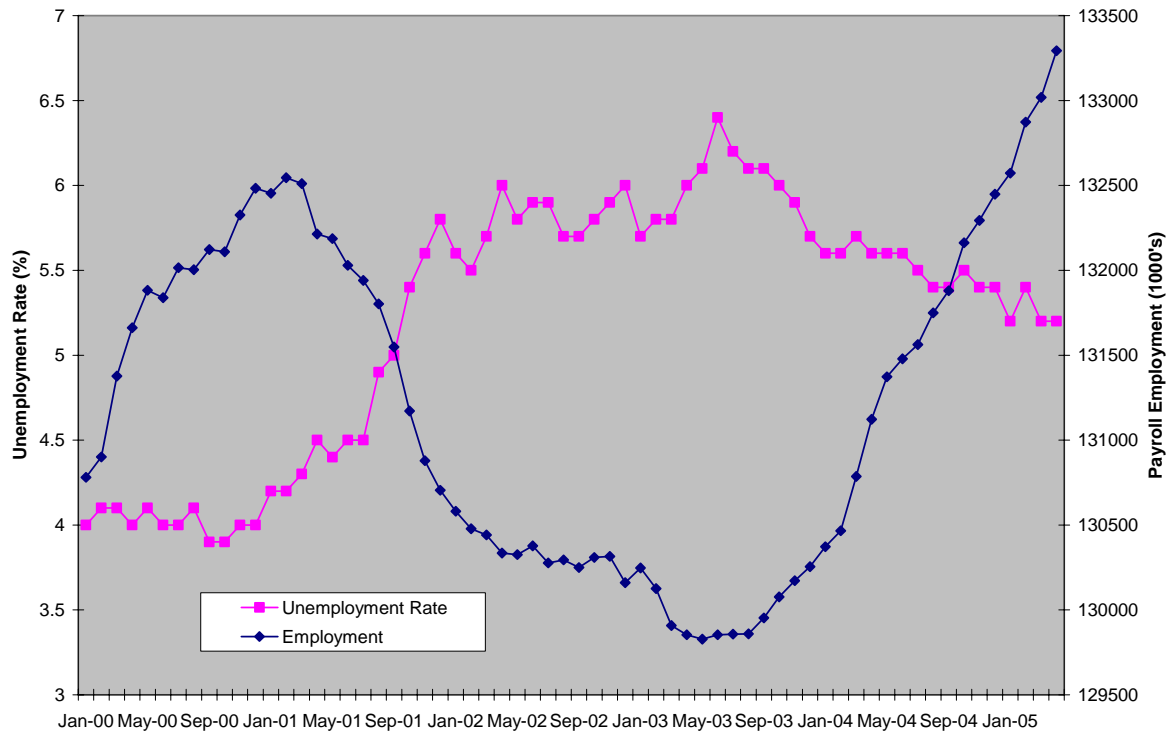


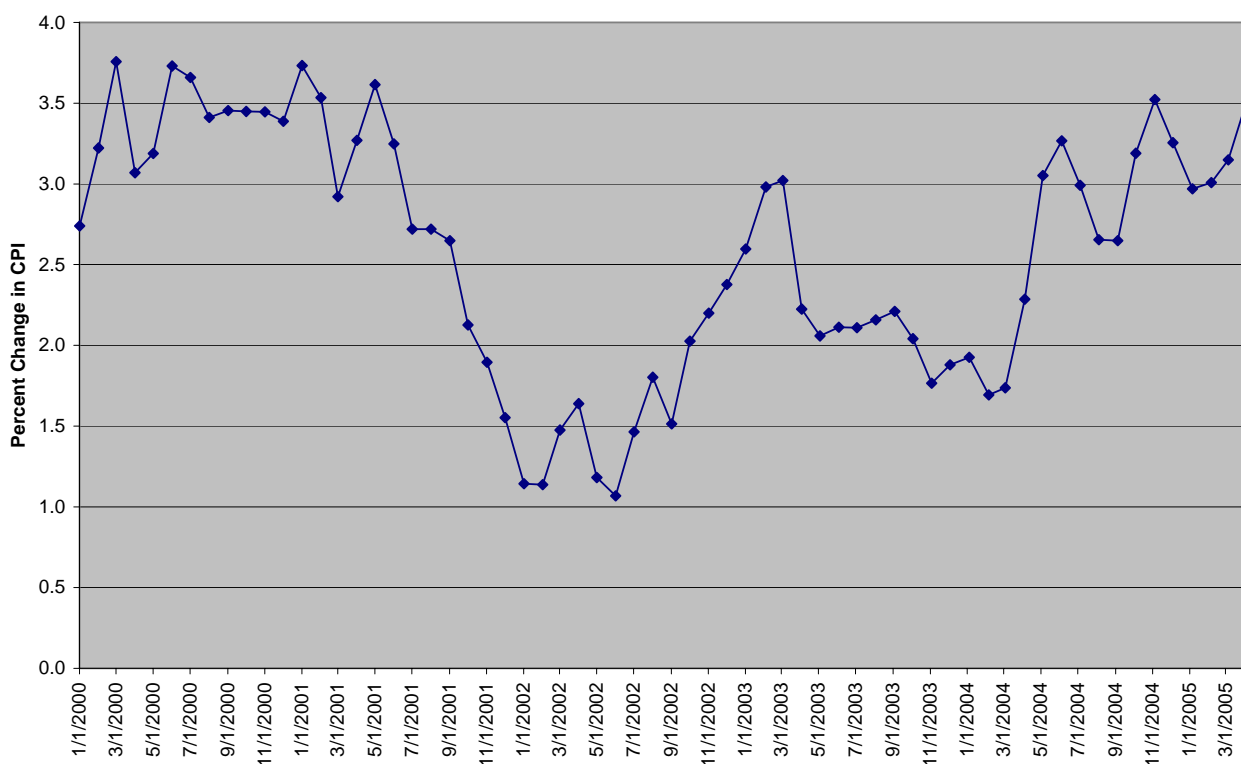
Figure 2: U.S Payroll Employment and the Unemployment Rate: 2000 - 2005



real average weekly earnings in the U.S. for all private sector workers has not grown since 2001, and on a 12-month basis, declined in February, March and April of 2005. A 4% growth in real GDP in the face of constant or declining real wages suggests an increased return to the owners of non-labor factors of production. <http://www.bls.gov/ces/home.htm>

Figure 3 shows the inflation rate based on 12-month changes in the Consumer Price Index (CPI) from January 2000 to the present. Clearly, inflation has exhibited an upward trend over the past year. Energy prices have risen sharply over this period as oil prices have hovered around the \$50 per barrel range. Energy price increments, rising inflation rates and a steadily growing economy have caused the Federal Reserve to continue its policy of gradually raising short-term interest rates.

Figure 3: CPI Inflation Rates (Twelve Month Percent Change)



The Fed has increased its federal funds target rate by 25 basis points at each FOMC meeting since May 2004. The yield curve has continued to flatten with ten-year U.S. Treasury yields at 3.89% and three-month Treasury bill yields at 2.96% on June 1, 2005. Using a reasonable expected inflation rate, short-term real interest rates are negative while the long-term real rate is very close to zero. Chairman Greenspan referred to the behavior of market interest rates as a conundrum in a February speech. The perplexing behavior of interest rates has been explained by some analysts as a result of a worldwide savings glut and the ease of international capital flows. This could indicate unwillingness on the part of international investors to purchase new plant and equipment in the face of an anticipated economic slowdown. Given the rise in the inflation rate, it seems likely that the Fed will continue to slowly increase short-term rates unless the economy shows significant signs of weakness. Our model sheds some light on the possible impacts on the WNY region of changes in the national economy.

The Economic Outlook for the Buffalo Region

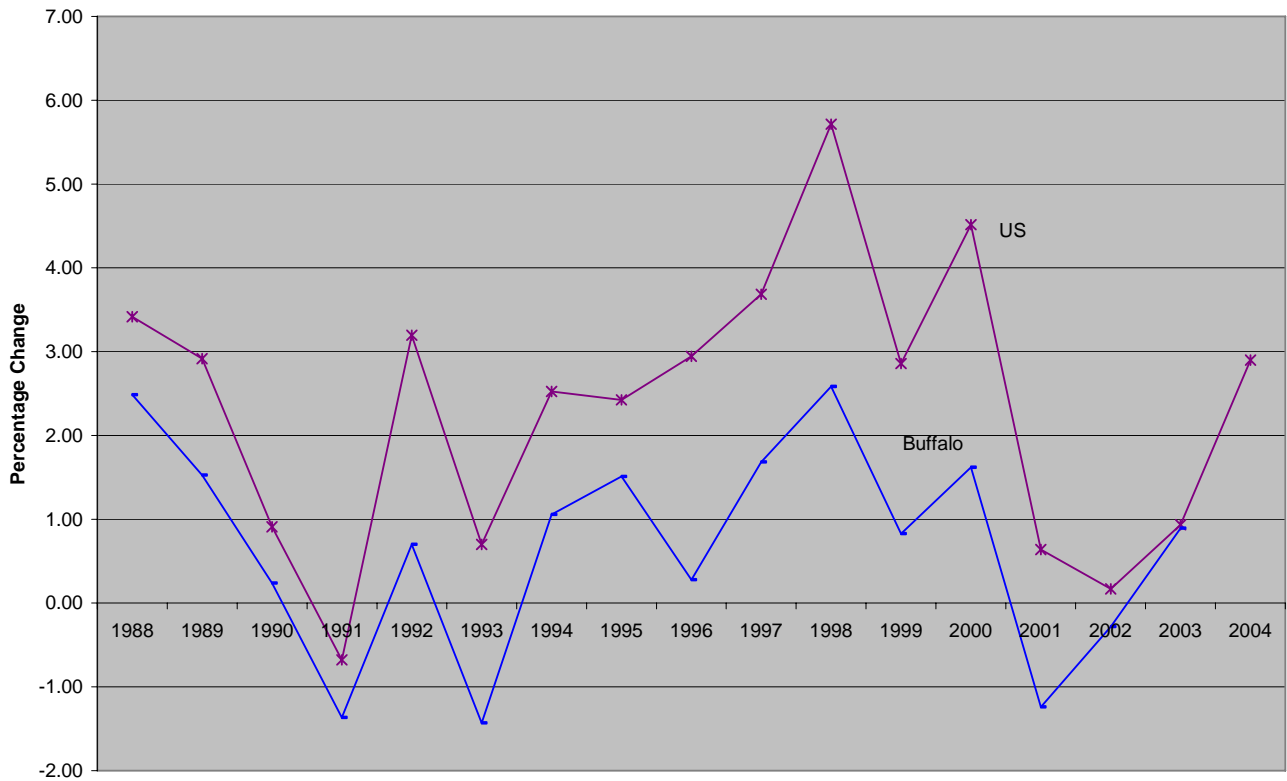
The Bureau of Economic Analysis of the US Department of Commerce <http://www.bea.gov> released revised personal income data for the Buffalo region in May 2005. Real personal income growth rates for the Buffalo area, the U.S., and the Rochester area, appear in Table 1. Buffalo and Rochester real personal income growth rates in 2003 of .89% and .80%, respectively, were very close to the national growth rate of .93%. U.S. real personal income grew by 2.90% in 2004 and we project that it will grow by 4% in 2005. 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 1980-2003 (Pearson correlation coefficient = .89). We use the 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 2004 and 2005 (bold face). Each 1% growth in U.S. real personal income has been met by a .87% 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
1995	30,522.0	1.51	2.43	1.84
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	32,711.5	1.62	4.52	1.46
2001	32,306.3	-1.24	0.64	-0.11
2002	32,215.5	-0.28	0.17	-1.28
2003	32,502.7	0.89	0.93	0.80
2004	32,860.2	1.10	2.90	
2005	33,517.4	2.00	4.00	

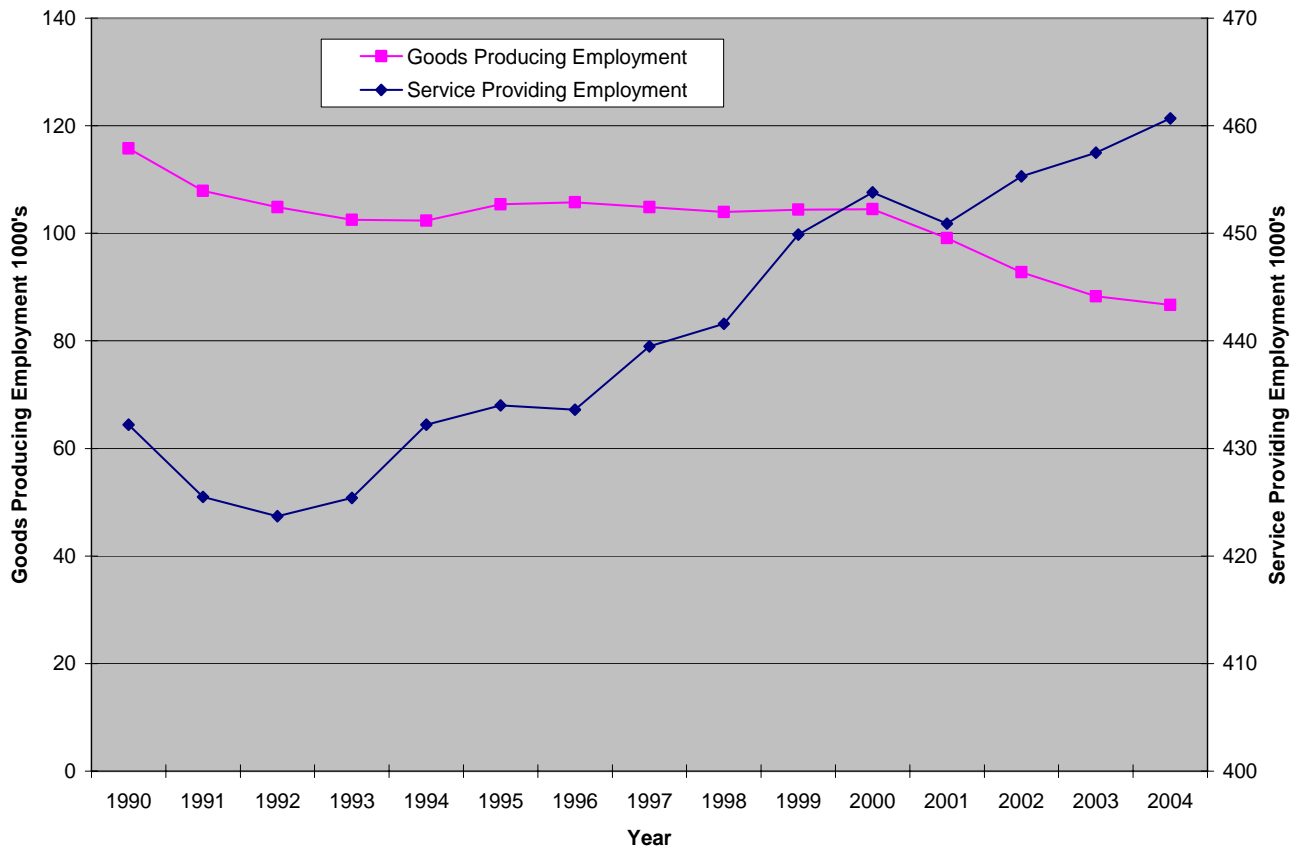
Figure 4: Real Personal Income Growth Rates: US v. Buffalo



In Figure 5, <http://data.bls.gov/PDQ/outside.jsp?survey=sm>, annual data for total goods producing and service providing employment on an NAICS basis for the Buffalo metropolitan area over the period 1990 to 2004 is presented. Even in an era of long-term decline, the dramatic decreases in goods producing and durable goods employment that accompanied the recession of 2001 have been of increasing concern to local analysts. Month over month comparisons for the first four months of 2005 show that there continues to be virtually no increase in goods producing employment. Since November of 2001, over 12,600 local jobs in the goods producing sector have been lost. Approximately two-thirds of this loss was accounted for by the decline in durable goods employment.

This durable goods sector lost more than 8,800 jobs between 1990 and 2001, and an additional 10,000 between April 2001 and April 2005. From data available in the Regional Economic Information System of the Bureau of Economic Analysis, the goods producing sector generated wages amounting to \$46,842 per worker in the Buffalo area in 2003 <http://www.bea.gov/bea/regional/reis/>. The continued loss of these high paying jobs has had and will continue to have a profound effect on the Western New York economy. The consequences are evident in the relative growth of income in the region, the sluggish growth in property values within Erie and Niagara Counties, and the concomitant stress on the property and sales tax bases that fund many of the local government activities provided within the region.

Figure 5. Employment in Buffalo Region: 1990-2004



As shown in Figure 5, the growing segment of the regional economy appears to be the service providing sector. Over the period 1990-2004, the region gained about 28,500 service providing jobs. Month over month comparisons for the first four months of 2005, however, show that there has been virtually no increase in service providing employment. Using BEA employment and earnings data, service providing jobs generated approximately \$30,514 per worker in the Buffalo area in 2003. Thus, the region keeps replacing high paying goods producing jobs with service providing employment opportunities that, on average, offer about two-thirds of the pay. In other words, the region needs to add three new service providing jobs to offset the loss of every two goods producing jobs, just to keep the level of total earnings in the region constant. Even if employment substitution occurred at this rate, per capita income, and therefore, the standard of living, would continue to decline.

The consequences of the transition to a service economy are continuing to be felt by the general population. As the region falls in relative terms compared to the rest of the nation, the declining standard of living is manifested in a number of ways. Using BEA measures of per capita personal income, the region fell from 92.4% of the national average in 1999 to 90.1% in 2002. Interestingly, per capita personal income rose to 92.6% of the national average in 2003. The extent to which this recovery has been influenced by the re-benchmarking of the BEA's data to reflect the journey to work patterns identified by the 2000 census will become more obvious after next year's income information is released.

Of late, much has been made of the strains on local governments within the region to continue to provide the level of service to which residents have become accustomed. Erie County's fiscal crisis may well reflect a lack of effective control over the delivery of services, the increased burden of state and federally mandated expenditures, as well as an unwillingness of the local population to increase its tax burdens at a time when relative personal income and earnings per worker are falling. However, there is little doubt that the sluggish growth rate of the tax bases upon which the county and other local government depend, has not been providing an adequate revenue stream to fund the expenditure needs of the region. As high wage jobs are replaced by jobs that on average pay 50% less, the level of income of the region falls in relative terms. This, in turn, directly affects total income and consumption of local residents and impacts the accrual of sales tax revenues. The slow growth of local income creates slow growth in sales tax revenues.

In a similar manner, slow income growth has led to modest growth rates in property values, assessed values, taxable values and property tax collections. Moody's Investors Service placed Erie County on its watchlist for credit reduction this spring. A major factor in this decision was the small average annual growth rate in local full real property values compared to the rest of the nation over the period 1999-2004 (1.3% locally versus 6.3% for the rest of the country) www.moody.com. In an age when double digit increases in housing values leads to a discussion about a national housing bubble and its associated problems, Erie County actually had a decline in real property full value of 1.5% in 2001. Even if the New York State Comptroller is correct when he claims that Erie County needs "...adult supervision", there are economic forces at work which will make the choices between less government or higher tax rates more difficult in a region that has seen its principal tax base lag behind other regions of the country. If the tax bases don't grow fast enough to generate adequate revenues to provide the desired level of public services, then tax rates must be increased, or the level of services reduced, or cost structures altered, or additional levels of aid must be obtained from the state or federal government.

This analysis avoids asking the question of how much of the tax base is frittered away through tax abatement for so-called economic development projects. When is the last time you heard an economic development advocate identify the number potential jobs, their average earnings per worker and the time commitment to the region associated with a proposal that requires tax abatements and economic development expenditure assistance? Moreover, when have you seen a careful follow-up study that presents the actual economic impact of these development projects?

Conclusions

The region continues its economic decline. The restructuring of the economic base is beginning to show signs downstream of lower standards of living, inadequate tax revenues to deliver current levels of public services and a resistance to higher tax rates by a population that is experiencing lower earnings with no real expectations for improvement in the future.

NATIONAL, STATE & LOCAL BUSINESS INDICATORS

	% change				
NATIONAL INDICATORS	2004:I	2004:III	2004:IV	2005:I	2004:I-2005:I
Real GDP (billions of chained 2000\$) (1)(a)	10,697.5	10,891.0	10,994.3	11,078.2	3.6
US Personal Income (billions of \$)	9,445.0	9,700.4	9,953.8	10,012.5	6.0
	Apr-04	Feb-05	Mar-05	Apr-05	Apr-04 - Apr-05
Leading Indicators Index (1996=100) (1)(a)	116.0	115.4	114.7	114.5	-1.29
Consumer Price Index (1982-84=100) (2)	188.0	191.8	193.3	194.6	3.51
Exchange Rate Canadian/US \$ (3) (b)	72.9	81.1	82.7	79.5	9.01
10 Year Treasury Bond Yield (%) (3) (b)	4.50	4.38	4.49	4.20	-0.30
3 Month Treasury Bill Yield (%) (3) (b)	0.96	2.73	2.78	2.89	1.93
S&P 500 Stock Index (3) (b)	1,107.3	1,203.6	1,180.6	1,156.9	4.47
Dow-Jones Industrial Average (3) (b)	10,225.6	10,766.2	10,503.8	10,192.5	-0.32
LABOR MARKET TRENDS (2)					
Nonag Civilian Employment					
US (1000's) (a)	131,123	132,873	133,019	133,293	1.65
NY State (1000's) (a)	8,430.7	8,489.5	8,497.8	8,504.1	0.87
WNY (1000's)	542.6	539.2	542.0	542.9	0.06
Unemployment Rate (%)					
US (a)	5.6	5.4	5.2	5.2	-0.4
NY State (a)	6.0	5.1	4.6	4.9	-1.1
WNY	6.1	5.9	5.5	5.2	-0.6
Ave. Wkly Hours in Mfg. US	40.8	40.6	40.4	40.5	-0.74
Ave. Wkly. Earnings in Mfg. US (\$)	655.66	666.65	663.37	666.23	1.61
WNY EMPLOYMENT BY SECTOR (1000's) (2)					
Natural Resources, Mining & Construction	19.0	17.4	17.8	19.7	3.68
Manufacturing	66.4	64.8	65.5	65.4	-1.51
Trade, Transportation & Utilities	99.7	99.6	99.7	100.2	0.50
Durable Goods	40.4	39.5	39.9	39.9	-1.24
Finance Activities	34.6	35.1	35.1	35.3	2.02
Service Providing	457.2	457.0	458.7	457.8	0.13
Government	96.2	97.0	97.0	95.2	-1.04

(1) US Dept. of Commerce

(a) Seasonally Adjusted

(2) US Dept. of Labor

(b) End of month data

(3) Wall Street Journal