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Georgia's economic outlook for 2004

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Georgia's economic performance will best that of the nation in 2004. The gross state product—the inflation-adjusted sum of goods and services produced within Georgia—will increase by 4 percent, which is higher than the 3.5 percent increase in GDP expected for the U.S. The forecast also compares well to the 2.7 percent advance in Georgia's real GSP estimated for 2003, which led the 2.4 percent advance in the nation's GDP. Georgia's inflation-adjusted personal income will follow a similar path, increasing by 3.7 percent in 2004, which will exceed the 1.8 percent gain estimated for 2003. Job growth rather than wage and salary increases will be the most important factor contributing to income growth. The surplus supply of labor will give employers the upper hand in 2004, limiting the boost to income from wages and salary increases. The cost of fringe benefits will rise, however. Personal income derived from interest, dividends, and capital gains gradually will recover from its extremely depressed level. But the number of vacancies that plague many real estate markets means that personal income derived from rent will not increase much.

The upside and downside risks for the state appear to be evenly balanced, and are external to Georgia. The major downside risks are that businesses do not pick up the pace of spending and hiring or that consumer spending is considerably weaker than estimated. The major upside potential is that that spending on information technology and hiring is much more vigorous than forecast.

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Employment

The jobless phase of Georgia's economic recovery ended in April 2003, and the combination of faster and more predictable gross state product growth and some pent-up demand for workers will help employment to grow a bit more quickly in 2004. On an annual average basis, the state's nonagricultural employment will increase by 1.5 percent, which compares well to the 0.6 percent increase estimated for 2003. Total employment will increase by 60,300 to reach 3,987,200 jobs in 2004. The overall gain, however, masks two very divergent outlooks: all of the state's services-producing subsectors will add jobs and all of the state's goods-producing subsectors will lose them. Nonetheless, total employment finally will rise above the pre-recession peaks, indicating that recovery will give way to economic expansion. Georgia's 2004 employment gain of 1.5 percent is larger than the 1 percent increase predicted for the nation, therefore Georgia's labor market will recover faster than the nation's.

Georgia's unemployment rate will continue to rise, however, and thus will maintain an uncomfortable degree of slack in the state's formerly taut labor market. On an annual

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average basis, Georgia's unemployment rate will rise to 5.3 percent in 2004 (up from 5 percent in 2003), and several of the monthly reports will indicate unemployment that is 5.5 percent or higher. (We do not anticipate that the rate will fall below 5 percent until sometime in 2005.)

Two factors will be responsible for rising unemployment. As new jobs are created, Georgians who had stopped looking for work will start job hunting again, thereby reactivating their unemployment status as they search. This typical cyclical response to an improving labor market will be reinforced by an influx of jobseekers from other states where labor market conditions are not as good. Employers will benefit from this rapid labor force growth because it will prevent wages from climbing faster in Georgia than in the nation as a whole, keeping labor costs well below the national average.

In 2004, year-over-year employment gains will be restricted to services-producing industries, which will add a total of 67,500 jobs; and employment losses will be restricted to goods-producing industries, which will cut 7,300 jobs. Although the losses are small when compared to the 102,000 goods-producing jobs that Georgia lost in 2001-2003, it could take a decade or longer to recoup them.

Services-Producing Industries

Professional and business services will create 18,800 jobs (more than any other type of business) and will tie with education and health services for the largest percentage gains in employment. The projected 3.5 percent increase includes heightened demand for temporary or contingent workers, legal services, and accounting, tax preparation, and bookkeeping. The expansion of corporate profits and rising markets for most goods are the primary forces spurring the demand.

Private firms that provide education and health care will add 13,500 jobs, prompted by above-average population growth, favorable demographic trends, and the cuts in publicly-funded services resulting from diminished government revenues. Long-term trends are favorable, too, since current and future jobs will require increasing investments in education. The growing market power of health care providers will help this industry's bottom line, but the institution side of medicine will remain vulnerable to efforts to contain the costs of Medicare and Medicaid.

After three extremely difficult years, characterized by relentless layoffs and bankruptcies, information services are poised to hire. The industry has addressed most of its overcapacity issues, and demand is surging for a broad range of service offerings. Demand for DSP and broadband connections will grow extremely rapidly. Mobile telecom services will be a major source of revenue growth, and the potential of the wireless Internet is just beginning to be felt.

The trade (wholesale and retail), transportation, and utilities grouping will add 14,200 jobs in 2004. The projected gain in statewide employment, consumers' rising confidence, above-average population growth, income growth, and the lagged effects of an improving stock market all will keep the retail and wholesale markets relatively healthy. One negative for retailers, however, is that since consumers never really stopped spending, there will be no extra boost from pent-up demand to fuel retail sales in 2004. Georgia's ports will thrive, truckers and railroads will benefit from cyclical increases in demand, and low-cost airlines will remain profitable, but economic woes will continue to hurt the major airlines. Utilities too will see their sales expand along with the gradually accelerating economy.

The hospitality cluster will create 4,800 jobs, but this industry's performance will continue to lag behind the overall economy. Since spending by vacationers will increase much faster than spending by business travelers, the immediate prospects are better for firms that cater to leisure travelers. The industry also must adjust to a smaller proportion of business travelers who are willing to pay a premium for convenience and amenities. Moreover, the prolonged drop in international visitors to the U.S. will be a problem for full-service hotels in gateway cities, such as Atlanta.

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Financial services companies will add 2,400 jobs in 2004. Although expectations for employment gains are tempered for banks and brokers, insurers will benefit from a seller's market for insurance products. The major barriers to more aggressive hiring by bankers will be higher interest rates, slower growth of non-revolving loans to consumers, less home mortgage refinancing, weak performance of most types of commercial real estate, and persistent overcapacity.

Overall employment in government will expand by only 0.4 percent, or 2,500 jobs, and intense budgetary pressures will force a decline in state government employment. Receipts received by state government will grow slowly, and revenue growth will lag economic growth by at least two quarters. Local governments' coffers will be healthy, however, thanks to money generated by property taxes. Fortunately, the federal government will continue to increase spending in 2004, and its efforts will more than offset budget cuts at the state and local level.

Goods-Producing Industries

Georgia's manufacturers are mired in a deep depression, having lost 99,400 jobs since 1998, and are forecast to shed an additional annual average 1,300 jobs in 2004. The 0.3 percent drop in 2004 manufacturing employment obscures an important development, however. After a protracted period of cutbacks that eliminated nearly one out of every five factory jobs, manufacturers will start hiring again late in the year. The gains will be meager, but they are a distinct change from years dominated by plant closings and layoffs. Somewhat less excess capacity in many manufacturing subsectors, decreased competition from imports due to the weaker dollar, the continued migration of auto manufacturers and parts suppliers to the state and region, and rising markets for many manufactured products are four primary factors behind the turn in employment. Even as demand for factory goods accelerates, gains in manufacturing productivity will tend to limit employment growth, however.

As occupancy rates decline and unsold properties accumulate, there will less new construction in 2004. With many projects on hold, construction employment will drop by 5,500 jobs, or 2.7 percent, which will return construction employment to where it was in the spring of 1999. Thus, despite the impetus provided by the lowest mortgage rates in over 40 years, 2.7 percent fewer homes were built in 2003. The 2004 forecast calls for permits authorizing 5.4 percent fewer new homes. The slide in multi-unit residential construction is much steeper: 50 percent fewer units were authorized in 2003 and a further decline of 13.6 percent is

TABLE 1

GEORGIA'S GROSS STATE PRODUCT, 1990-2004, IN CURRENT AND CONSTANT (1996) DOLLARS WITH YEAR-TO-YEAR PERCENTAGE CHANGES (billions of dollars)

			Percentage Change from Previous Year	
Year	Current $	Constant (1996) $	Current $	Constant (1996) $
1990	141.4	164.8	4.8	1.2
1991	148.7	167.2	5.2	1.4
1992	160.8	175.6	8.1	5.1
1993	172.2	183.2	7.1	4.3
1994	187.6	195.3	9.0	6.6
1995	203.5	206.4	8.5	5.7
1996	219.5	219.5	7.9	6.3
1997	235.7	231.8	7.4	5.6
1998	254.9	246.0	8.1	6.1
1999	276.5	261.5	8.5	6.3
2000	295.5	274.9	6.9	5.1
2001	299.9	273.9	1.5	-0.4
2002	309.8	278.5	3.3	1.7
2003	325.6	286.1	5.1	2.7
2004	343.5	297.5	5.5	4.0

Source: Data for 1990-2001 were obtained from the U.S. Department of Commerce. Data for 2002-2004 were obtained from the Selig Center for Economic Growth, Terry College of Business, The University of Georgia (September 11, 2003).

expected in 2004. In contrast, spending on home improvements will weaken only slightly. Public spending for schools and other infrastructure probably will decrease as a result of several years of feeble revenue collections, and spending associated with bond-financed projects may be hurt by lower bond price.

Prospects for MSAs

Atlanta On an annual average basis, the twenty-county Atlanta MSA will add 46,100 jobs, a year-over-year increase of 2.1 percent that is well ahead of the 1.5 percent gain predicted for the state as a whole. Altogether, the MSA will account for 76 percent the jobs that will be created in the entire state. The statewide economic expansion therefore will be more broadly based geographically than it was in 2003, when Atlanta accounted for more than 90 percent of the growth. Atlanta's high concentration of services-producing industries and its paucity of manufacturing and government jobs (the lowest in the state) partially explains the above-average growth. One factor hindering growth is the continuing downturn of Atlanta's large construction industry.

Albany After four years of job losses, Albany's labor market improved in 2003, and the forecast suggests the area will see some additional improvements in 2004. But Albany is the state's smallest MSA, so the actions for the better or for the worse by one major company probably will determine the area's actual performance. Still, Albany will capitalize on its many assets, including a low cost of doing business, an excellent telecommunications infrastructure, the Material Command for the Marine Corps, and the area's low crime rate. The area's increasing role as a regional center for health care also weighs in its favor.

Athens This MSA is economically stable because it has the largest share of government jobs in the state. The presence of the University of Georgia in particular helped to spare Athens the worst of the recession. Even as total employment dropped elsewhere, the number jobs in Athens held relatively steady from 1998-2003. Nonetheless, since a large proportion of spending and employment at the university is tied to state appropriations and/or to the value of endowments, an upturn in university-related spending will severely lag the overall recovery. Thus, employment growth rates will be modest relative to the rest of the state and the nation. Fortunately, other sectors of the local economy will absorb some of the slack created by a heavy dependence on government spending and push the area's employment up by 0.7 percent in 2004.

Augusta The MSA is struggling to overcome the negative repercussions of the 2001 recession and the sub-par recovery. The area lost small numbers of jobs since 2001, but the 2004 outlook calls for a much-anticipated turnaround in labor market conditions. Augusta will see a 0.4 percent increase in employment, which represents about 500 new

TABLE 2

GEORGIA'S ECONOMIC FORECAST, 2003-2004

Georgia	1999	2000	2001	2002	2003	2004
Real Gross State Product, Bil. of 96$	261.5	274.9	273.9	278.5	286.1	297.5
Percent change	6.3	5.1	-0.4	1.7	2.7	4.0
Nonfarm Employment (thousands)	3854.6	3949.3	3943.2	3905.2	3926.9	3987.2
Percent change	3.0	2.5	-0.2	-1.0	0.6	1.5
Real Personal Income, Bil. of 96$	203.9	215.5	218.8	221.2	225.1	233.6
Percent change	5.0	5.7	1.6	1.1	1.8	3.7
Housing Permits, Total	89581	91820	93059	97523	84500	79000
Percent change	4.9	2.5	1.3	4.8	-13.4	-6.5
Unemployment Rate (percent)	4.0	3.7	4.0	5.2	5.0	5.3

Source: The Selig Center for Economic Growth, Terry College of Business, The University of Georgia, September 11, 2003.

TABLE 3

GEORGIA'S EMPLOYMENT FORECAST, 2003-2004

Georgia	1999	2000	2001	2002	2003	2004
Nonfarm Employment[1]	3854.6	3949.3	3943.2	3905.2	3926.9	3987.2
Goods Producing	757.2	748.7	715.6	683.3	662.5	655.2
Natural Resources and Mining	14.0	13.7	12.9	12.2	11.4	10.9
Construction	200.6	204.4	204.3	199.2	203.4	197.9
Manufacturing	542.6	530.5	498.3	471.8	447.7	446.4
Services Providing	3097.3	3200.6	3227.6	3221.9	3264.5	3332.0
Trade, Transportation, Utilities	835.3	858.0	851.7	834.6	834.6	848.8
Information	134.6	143.5	143.8	133.3	126.2	130.3
Financial Activities	204.5	209.4	211.4	212.5	213.8	216.1
Professional and Business Services	522.3	537.3	527.4	520.7	537.4	556.2
Education and Health Services	338.8	347.3	359.3	373.5	385.1	398.6
Leisure and Hospitality	325.8	332.5	334.7	337.7	341.4	346.2
Other Services	146.5	175.3	188.6	183.4	193.3	200.6
Government	589.6	597.2	610.3	625.8	632.7	635.2
Percent Change						
Nonfarm Employment	3.0	2.5	-0.2	-1.0	0.6	1.5
Goods Producing	1.9	-1.1	-4.4	-4.5	-3.0	-1.1
Natural Resources and Mining	-2.8	-2.1	-5.8	-5.4	-6.9	-3.8
Construction	9.5	1.9	0.0	-2.5	2.1	-2.7
Manufacturing	-0.5	-2.2	-6.1	-5.3	-5.1	-0.3
Services Providing	3.3	3.3	0.8	-0.2	1.3	2.1
Trade, Transportation, Utilities	3.6	2.7	-0.7	-2.0	0.0	1.7
Information	7.2	6.6	0.2	-7.3	-5.3	3.2
Financial Activities	2.7	2.4	1.0	0.5	0.6	1.1
Professional and Business Services	6.0	2.9	-1.8	-1.3	3.2	3.5
Education and Health Services	2.0	2.5	3.5	4.0	3.1	3.5
Leisure and Hospitality	2.6	2.1	0.7	0.9	1.1	1.4
Other Services	5.7	19.7	7.6	-2.8	5.4	3.8
Government	0.6	1.3	2.2	2.5	1.1	0.4

[1]Indicates thousands of workers.

Source: The Selig Center for Economic Growth, Terry College of Business, The University of Georgia, September 11, 2003.

jobs. The turn will be gradual, however, so it will be 2005 before the area replaces all of jobs it lost.

Augusta is a center for telecommunications services, including telemarketing and reservations. The overall outlook for providers of information services is excellent, but the advent of the federal “no call” list will reduce opportunities for telemarketers. As the national economy regains its footing, the area’s hospitality industry should benefit from many recent downtown developments. Retirees, too, are drawn here by its low costs, good climate, and medical facilities, or by ties to Fort Gordon. Another plus: the Georgia Medical Authority will use the expertise available at the Medical College of Georgia to establish Augusta as a center for the rapidly growing biotechnology sector.

Columbus After three straight years of employment losses, the MSA hopes for a stable 2004 although an immediate catalyst for growth is not apparent. The area’s employment will not change, postponing recovery for at least another year. Ultimately, the demonstrated commitment of business, government, and residents to business and economic development will reinvigorate the area’s economy. Columbus’s skilled labor force is attractive to technology-oriented companies; and in time, the MSA could benefit from successful efforts to move some state government operations out of Atlanta. Fort Benning is by far the area’s largest employer and its importance as a mainstay will be even more vital as the economy stabilizes.

Macon This MSA’s economic recovery began in 2002 and it stayed the course in 2003. The area will post a year-over-year increase in employment of 1.7 percent in 2004, which is the third largest percentage gain predicted for any of the state’s metropolitan areas. Macon has a diversified economic base, with trade, manufacturing, lodging, and food services providing the most jobs. The aerospace, health, and insurance industries also provide a large number of well-paid jobs.

Macon’s extensive surface transportation system and its proximity to Atlanta are pluses, as is its strategic location at the intersection of I-75 and I-16. Additionally, the driving time to Atlanta’s international airport from downtown Macon is no greater than from the northern suburbs of the Atlanta MSA. Also, as Atlanta becomes more congested, sites in Macon will become very attractive to both private businesses and state government operations.

Savannah This coastal MSA emerged from the recession largely unscathed, and is busy capitalizing on its many strengths. Employment will rise by 2.5 percent, which is the largest percentage gain predicted for any of the state’s metropolitan areas. Its dual personality—that of a major tourist destination and an extraordinarily successful port—gives it a vibrancy that few other cities can match. The city also is premier destination for national conventions and trade shows, thus convention business is one of the fastest growing sectors of Savannah’s economy. ❖

The National Outlook 2004

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A strengthening U.S. economy will lead the global economic recovery in 2004. Consumers and the federal government will be the mainstays, but more robust spending by businesses will help GDP growth to accelerate from the 2.4 percent rates experienced in 2002-2003 to 3.5 percent in 2004. The sources of GDP growth will shift, too. Compared to last year, the contribution made by consumers will increase, but it will account for a smaller share of GDP growth. Government will contribute less and account for a smaller share of growth, while businesses will contribute more and will account for a substantially larger share of growth. Foreign trade will subtract from growth, but the subtraction will be far smaller than it was in 2003.

As businesses across a broader swath of industries begin to hire, conditions in the nation's labor market gradually will improve, and the much-needed jobs will reinvigorate consumer spending. There are several more reasons for optimism. Monetary and fiscal policies will be expansionary, the stock market rallied, and the high-tech bust is over. Inventories are lean, and the geopolitical risks appear to be lower than they were in 2002 and 2003. Energy prices are expected to recede from recent peaks. As always, there are several reasons to be cautious about the outlook. Less spending for construction, cutbacks in purchases by state and local governments, low—albeit rising—capacity utilization, and relatively weak export markets are among the forces that will restrain growth. Also, labor force entry and job losses in logging, mining, construction, manufacturing, and government will keep the unemployment rate from falling any lower.

The combination of faster economic growth and the broadening of the forces supporting the expansion to include spending by businesses will make the U.S. economy much less vulnerable to a sudden economic shock, such as another major disruption in the flow of crude oil from abroad, or further terrorists actions and/or armed conflicts. Since the economy will be operating well above its current stall, there is only a 20 percent chance of a double-dip recession in 2004, which is much lower than the 35 percent downside risk that existed at the beginning of 2003. The main risks include a paucity of job growth, the weak global economy, and higher energy prices. The U.S. dollar's value could plunge rather than decline gradually, prompting foreign investors to dump dollar-based assets such as U.S. stocks. Also, SARS and terrorism are wildcards for the U.S. and global economies.

Due to slack capacity in labor and product markets, consumer price inflation will decline from 2.2 percent in 2003 to 1.5 percent in 2004, with the drop most evident for goods. Since this is the lowest inflation for this economic cycle—and the lowest annual inflation since 1964—the Federal Reserve is apt to maintain its very accommodative monetary policy, at least into the third quarter of 2004. The Fed will keep short-term interest rates very low, but the federal budget deficit and the current account deficit will exert upward pressure on long-term interest rates. Although inflation will retreat to its lowest level in forty years, the combination of significant money supply growth and accelerating economic growth should be more than adequate to stave off outright deflation.

Consumer Spending

Despite sagging confidence, consumers kept the economy going in 2002-2003, accounting for disproportionately large shares of GDP growth, and basically determined the economy's path. Gains in inflation-adjusted after-tax income, low interest rates, rising home values, greater need for medical care, and low prices for manufactured goods stimulated spending. but new jobs were nonexistent.

Assuming that business leaders step up the pace of hiring, consumers' inflation-adjusted spending will increase by about 4 percent in 2004, which exceeds the annual gains of 3 percent in each of the last two year. The positive forces that will sustain the nation's consumer markets include improving conditions in the labor market, current dollar personal income growth, relatively steady interest rates, the lagged effects of recent robust sales of new and existing homes, and federal income tax cuts. Due to the rising value of stocks, real estate, and most other household financial assets, the wealth effect will be a positive force in 2004. Nonetheless, it will take several years for household net worth to revisit the peaks attained in 2000. Consumers' confidence measures gradually will improve, but a stubbornly high unemployment rate will keep people from becoming too optimistic about the current state of the economy. Negative forces include the lack of pent-up demand for new cars, higher mortgage rates, and the dearth of jobs in manufacturing.

In 2004, increases in inflation-adjusted disposable personal income will account for most of the projected rise in consumers' spending. The number of jobs is forecast to expand by 1.5 percent, supporting this income growth. The annual increase in workers' compensation will be larger than in recent years, but it will be the fringe benefits rather than wage and salary increases that account for the overall gains.

A substantial drop in the effective personal tax rate in 2001 and 2002 provided extra boosts to consumers' after-tax incomes, which helped people to simultaneously spend more and increase their savings. Thanks to the federal tax cuts agreed upon in 2003, this familiar pattern will intensify in 2004.

Consumer credit outstanding will expand much more slowly. Massive debt, limited appreciation of residential real estate, and lingering uncertainty about the job market are among the factors that account for the slower growth in consumer borrowing. The lagged benefits of mortgage refinancing will cause debt service to decline as a percentage of disposable income, which suggests that major debt will not restrain consumer spending.

Home values rose sharply over the last six years, but prices of new and existing homes probably will climb only slightly higher in the coming year. Nonetheless, many homeowners have seen their housing investments increase in value, helping them to at least partially offset huge losses in the stock market. Gains in the housing market are probably more important determinants of overall consumer spending than gains in the stock market, which benefit only about one half of households. Conversely, stock prices probably are more important for high-income households.

Borrowing against the increasing worth of the family home boosted consumer outlays in 2001-2003, and attractive mortgage rates made tapping into this source of wealth more palatable. In 2004, however, the refinancing boom will become a "re-fi" bust. People will be much less likely to use cash-out refinancing and home equity loans to buy consumer goods. This reflects two developments: first, the pool of eligible homeowners who have not refinanced their mortgages yet is shrinking; and second, mortgage rates already are higher than they were in mid-2003 and are expected to rise slightly higher in 2004. Thus, the one-time push to consumer spending from cash-out mortgage refinancing will be absent, but the ongoing benefits from lower debt service burdens will help to keep consumers' wallets wide open.

In the coming year, consumers' spending for goods and services will increase at about the same rate. Among goods, spending for durables will grow faster than spending for nondurables. Outlays for computers, used cars, and software will increase briskly. Spending on drugs and medicines also will increase substantially. Moderate gains are expected in spending for clothing, shoes, and auto parts. Outlays for

UNITED STATES ECONOMIC FORECAST, 2003-2004

United States	1999	2000	2001	2002	2003	2004
Gross Domestic Product, Bil. of 96$	8859.0	9191.4	9214.5	9439.9	9666.5	10004.8
Percent change	4.1	3.8	0.3	2.4	2.4	3.5
Nonfarm Employment (Mil.)	129.0	131.8	131.8	130.4	130.1	131.4
Percent change	2.4	2.2	0.0	-1.1	-0.2	1.0
Civilian Unemployment Rate (%)	4.2	4.0	4.7	5.8	6.2	6.4
CPI-U, Ann. % Chg.	2.2	3.4	2.8	1.6	2.4	1.5

Source: The Selig Center for Economic Growth, Terry College of Business, University of Georgia, September 11, 2003.

tobacco products will decline. Among service sectors, spending for telecommunications and recreation will expand the fastest, followed by spending for personal business services, medical care, and electricity.

Labor Markets

The much delayed and much anticipated upturn in net hiring is the major development that will distinguish the 2004 economy from the 2003 economy. Total nonfarm employment will increase by 1 percent in 2004, but labor force growth will keep the unemployment rate above 6 percent. Although net hiring will expand, several factors will ensure that the pickup in job growth is gradual. First, productivity continues to rise strongly while domestic and global demand for goods and services grow moderately. Second, the outsourcing of U.S. jobs to developing countries is spreading from blue-collar occupations in manufacturing to white-collar occupations in high tech and service industries, which historically have been relatively immune to such practices. Third, high and rapidly rising benefits costs are making it much more expensive for U.S. companies to hire workers. Finally, venture capital—which fuels employment growth—still will not be abundant, but it will be more available in 2004 than it was in the last two years.

In the coming year, employment will rise fastest in the nation's services-producing industries. Forces behind this growth include more households, favorable demographic and social changes, and consumers' dependence on household help and other personal services. Among services producers, health care jobs will increase the most. Increases in retail sales will provide a tiny boost to retail employment. More jobs will be available with the federal government, but intense budgetary pressures will eliminate jobs in state and local government. Manufacturing employment will continue its prolonged decline. Overall, the manufacturing sector will be the weakest link in the nation's labor market. The real estate and construction sectors also will lose jobs as buyers' interest in both commercial and residential properties wanes.

Corporate Profits

The U.S. economy experienced a deep profits recession in 2001 and 2002, but sharp cost reductions and strengthening of demand for most goods and services helped profits climb by about 7 percent in 2003. This growth will accelerate in 2004. Excess capacity in many industries remains high, but it is gradually diminishing. Although many pension plans are still under funded, the rallying stock market helps to fill the hole. As market conditions improve, companies are expected to increase both spending and hiring. The business sector therefore will be a major contributor to economic growth in 2004. Unfortunately, net hiring will not increase fast enough to cut the nation's unemployment rate.

Business Spending

In 2003, business became the third leg of the expansion (the first was the consumer and the second was the federal government), and thus improved the balance of growth. This upturn in investment spending will strengthen in 2004. The pickup reflects strong cash flow, the lagged effects of the recovery in corporate profits, slightly higher rates of capacity utilization, more confidence in the current and future economic situation, and better corporate discipline. Higher rates of capacity utilization reflect higher demand, depreciation of the capital stock over time, and recent low levels of capital spending. Current spending for new capital goods is so low that it should be relatively easy to justify somewhat higher spending. Changes in federal tax laws that allow more rapid depreciation and more liberal small business expensing also will provide some stimulus to capital outlays. Overall spending on non-defense capital equipment and software therefore will rise in 2004, and the gains will be broadly based. Spending for computers, transportation equipment, cars, and software will increase the fastest. Spending for industrial equipment will grow only modestly, and spending for aircraft probably will stabilize.

Businesses have kept a tight rein on inventories, maintaining low inventory to sales ratios. As sales rise in 2004, businesses' spending on inventories will increase, which will reinforce GDP growth.

Spending on structures and communications equipment definitely will decline again in 2004, but the rate of decline will moderate sharply. Since 2000, demand has not grown fast enough to absorb all of the new space that was already under development, so in most markets, tenants will have the upper hand in gaining concessions from property owners. It probably will be at least 2005 before rents begin to increase significantly, and until that happens, speculative projects in most areas will be scaled back now that both interest rates and risks are rising.

Federal Government Expenditures

Although the outlook for the federal budget is very uncertain, it is clear that the federal fiscal policy push will be substantial in 2004. Real federal purchases will grow by 7 percent or more, and transfer payments also will grow very quickly.

The sub-par expansion, accelerated outlays, and the reverberations of the terrorist attacks are making expenditures rise much faster than receipts. The FY 2004 budget deficit will expand to more than $500 billion, or just over 4 percent of GDP. (Although this will be a record in absolute dollar terms, as a percentage of GDP, it will be much lower than the 5.5 percent deficit recorded in 1983.) It is increasingly likely that there will not be a surplus for many years to come, and big deficits could crowd out investment in private capital, which is vital to increasing economic productivity. Thus, over the long term, large budget deficits may have adverse side effects on the nation's prosperity.

State and Local Government Expenditures

Fiscal actions by state and local governments are not expected to aid in the recovery. Receipts will grow slowly in calendar year 2004, and revenue growth will lag local economic growth by at least two quarters, so many governments will be forced to cut their budgets or dip into rapidly dwindling reserves to make their budgets balance. Thus, even as economic conditions improve, almost all jurisdictions will see hiring slowdowns and freezes on discretionary spending. Some governments will be forced to lay off workers. Businesses dependent on this income will be hurt, too. Government workers also will not see their economic situations improve in 2004. Total employment will decline, raises will be nonexistent, and employees will be forced to absorb more of the costs of their fringe benefits.

The lagged effects of the recent peaking of both the housing market and new car sales will make property tax collections rise in most jurisdictions. Personal income tax collections will rise modestly, curtailed by limited capital gains, scant use of stock options, and the slow-paced recovery of the labor market. Sales tax collections will roughly match trends in consumer spending, and therefore should increase moderately. Corporate income tax collections will spike in most jurisdictions, and increases in funds derived from federal grants-in-aid will help to offset weak receipts from other revenue sources. The overall impact of these trends will be much more positive for municipal and county governments than for state government, however.

Housing Markets

Although the Federal Reserve will keep interest rates very low, the construction forecast calls for housing starts to decline. Nationally, sales of both new and existing homes are expected to drop. Also, after several years of strong gains in home prices, the average sales price of existing homes may not keep pace with inflation in 2004. The downturn in housing is attributed to two factors. First, mortgage rates hit cyclical lows in mid-2003, and rates are expected to rise slowly in 2004. Second, because activity levels were extraordinarily high in 2001-2003, there is virtually no pent-up demand for homes. The other fundamental determinants of demand for homes—growth in employment, population, personal income, relocation activity, and consumers' confidence—are positive, and will help to shore up demand for homes in 2004.

Several factors will help to support demand for home renovations, however. Since this business cycle has seen booming sales of existing homes, owners are likely to invest in repairs and improvements. They can readily afford to do this, thanks to appreciating values that have increased equities, and refinancing that has lowered monthly payments. Also, those who bought new homes over the last three years soon may be ready to tackle some home improvement projects.

International Trade

Real exports decreased slightly while real imports rose substantially last year, sharply cutting the rate of GDP growth. In 2004, the U.S.-led recovery will boost imports more than exports, but it will boost both. A weaker U.S. dollar will help exports and deter imports, but trade will cut growth as long as foreign GDP grows much more slowly than U.S. GDP. Also, the decline in the dollar's value is most pronounced with respect to the currencies of industrialized rather than developing countries.

In 2004, both imports and exports are expected to rise, but exports will rise somewhat faster. Nonetheless, because the volume of imports is so much greater than the volume of exports, the net effect on trade will be negative for U.S. GDP growth in 2004. The drag on growth from international trade will be much smaller in 2004 that it was in 2003, however. The already massive current account deficit will rise to just over 5 percent of GDP, which is an all-time record in both dollar terms and as a percentage of GDP. The sheer size of the deficit will continue to weaken the value of the U.S. dollar, but the loss will be gradual, thanks to the dollar's role as a de facto reserve currency and to faster growth in the U.S. than in the rest of the developed world.

Inflation

Many of the forces that have held consumer price inflation to the lowest levels in more than thirty years still exist. If oil prices behave as expected, the index will increase by only 1.5 percent in 2004. Widespread labor surpluses, excess capacity in many economic sectors, and heightened competition for jobs from foreign workers will keep the lid on U.S. wages and benefits. Worried American workers will not make louder demands for higher compensation. The lackluster global economy will limit the rise in commodity prices in 2004. The bottom line: businesses will find it only slightly easier to raise the prices of the goods and services they produce, which implies that inflationary pressures—virtually absent in recent months—will build very slowly.

The trade-weighted value of the dollar is forecast to decline in 2004, and it will continue to deteriorate for the next several years, which eventually will provide a tailwind to prices. Thus, inflation will accelerate in 2005. The anticipated slowdown in productivity growth eventually will lead to higher inflation, too, but current slack capacity will prevent this from happening soon.

The forecast assumes that the Federal Reserve's monetary policy will remain on hold through most of 2004. The massive monetary stimulus (550 basis points of easing in thirteen moves) achieved considerable traction in the household sector of the economy, but so far, excess capacity has limited its impact on business spending. Businesses did lower their costs of capital, which puts them in a good position to spend as conditions improve.

Interest rates will not be raised until the pace of growth accelerates and excess capacity is reduced. The federal funds rate target will be 1.00—essentially a negative inflation-adjusted rate—will not be increased until late in 2004. (The Federal Reserve's heightened concern about the possibility of deflation implies that it would like to see higher inflation and that its policies will be designed to do just that.) Because of the lags inherent in monetary policy and expected declines in energy prices, inflation will drop in 2004 before it accelerates in 2005 and 2006.

Crude Oil Markets

Oil prices averaged $28 per barrel during 2003, which was much higher than the $23 price that prevailed in 2001 and 2002. Assuming that there are no major additional crimps in the supplies, oil prices should average about $25 in 2004, which is close to OPEC's target.

Market conditions favor lower or at least stable oil prices in 2004, with only slightly stronger demand for petroleum products more than offset by increases in supply. Any unusual disruptions in supply or quota reductions by OPEC would make prices climb, however. Both demand growth and capacity growth will be slow, suggesting relative price stability; but discipline within the OPEC cartel is difficult to predict and current prices probably are unsustainably high.

Given a modest degree of inventory accumulation, strengthening consumption will leave little surplus capacity to offset the loss of a major refinery or two. Energy markets will continue to be sensitive to unexpected shifts in supplies, political instability in oil-producing nations, or armed conflicts in the Middle East. ❖

Auto Alley South

Beata D. Kochut

As the competition heats up, and foreign automakers cut into the U.S. market and workforce, the South emerges as an ever-stronger center of the auto industry in America.

With the Midwest firmly established as the hub for the American automakers, foreign car manufacturers began to locate in the South, taking advantage of cheaper labor and access to U.S. markets. Today, the automakers are still looking down South, but also toward Mexico and Canada. Low unionization, a younger work force, lower costs of benefits and wages, good technical schools, universities, and a vast transportation network are among the chief objectives for auto companies looking for new plant locations.

Now, the Southern Automotive Corridor—the string of assembly plants, supplier plants, processing and distribution facilities that parallel Interstates 75 and 65—is home to many well-known makers. Although foreign auto manufacturers started to locate plants in Kentucky (Toyota) and Tennessee (Nissan and Saturn) in the 1970s and 1980s, the 1990s marked the automotive boom in the South with the 1992 BMW location in South Carolina, and the 1993 Mercedes-Benz assembly plant's arrival in Alabama. In recent years, auto manufacturers have penetrated farther into the South, and competition to lure these plants is intense. Much to the region's disappointment, however, Toyota made its long-awaited decision and chose San Antonio, Texas as the site of its new assembly plant.

Although Georgia ranks third among twelve southern states in vehicle assembly production and employment, it missed most of the 1990's boom in assembly plant locations in the South. The state's auto industry is centered around plants which located here much earlier: Ford came to Hapeville in 1909; in 1927 Blue Bird Corporation opened a plant in Fort Valley; and General Motors' Doraville plant has operated since 1947. In the near future, Panoz (in partnership with DaimlerChrysler subsidiary Micro Compact Car) will begin building the Smart Car in Hinesville and thus become—together with the new Suzuki ATV plant in Rome—the latest addition to the state's auto industry.

Among many factors considered in automotive plant locations, state- and locally- offered incentives generate the most attention, but the cost of doing business and the availability of large tracts of suitable land are equally important. Compared to other states in the South, Georgia's established and diverse economic base makes it more expensive to do business here, and policy makers are less willing to spend millions of dollars to attract car manufacturers.

Nonetheless, the massive number of well-paid jobs is difficult to ignore, and success stories, such as Alabama's, make Georgia, Tennessee, and other states dig deeper into their coffers to compete. In the negotiations with DaimlerChrysler, for example, Georgia offered a $322 million incentive package, though the proposal is now dead. To attract other car manufacturers, state development officials are also searching for three suitable sites (200 to 1,000 acres) for possible purchase within the next five years.

Since any major auto plant location announcement translates into multiple thousands of jobs and millions in taxable income, states are determined to outbid each other in incentives. The South's determined pursuit of the auto industry can be explained by the dramatic contraction of its manufacturing sector. In 1990, Georgia's manufacturing sector was responsible for 18.4 percent of the GSP, but by 2001 this had dropped to 14.5 percent. In Alabama, manufacturing provided 23.5 percent of GSP in 1990, but only 17.8 percent in 2001. In South Carolina, it shrank from 25.3 percent to 20 percent, and in Tennessee, it dropped from 24.3 percent to 18.7 percent. At the same time, the relative importance of motor vehicle production in Tennessee climbed from 0.99 percent in 1990 to 2.97 percent in 2001, in South Carolina from 0.2 to 1.9 percent, and in Alabama from 0.7 to 1.3 percent. While these three states have all experienced drops in the relative importance of manufacturing that far exceed the national average, they also have seen the fastest growth in the automotive sector in the South, second only to Kentucky.

In Alabama, the decision to invest in the auto industry was a part of a campaign to change the state's image, and the cost of incentives was considered as an investment in their future. In 1993, Alabama spent $253 million on incentives to Mercedes-Benz to build a plant in Vance, which translates into $168,000 spent on each of the 1,500 jobs. The recently announced plans to expand both the Mercedes and Honda plants, and the construction of a new Hyundai plant will add about 6,000 jobs to Alabama's economy. Car manufacturing jobs pay almost double the average manufacturing hourly wage in that state. With each new plant or expansion attracting 10 to 12 suppliers and several smaller "suppliers to the suppliers," the economic impact seems to be well worth the initial investment.

In Georgia, several major assembly plants—such as Ford, Blue Bird, and GM, a vast network of suppliers, and the automotive shipment and processing concentrated around Brunswick and Savannah provide jobs for over 46,000 workers. The state is also ideally positioned to benefit from the assembly plants locating along its borders. Situated within 13 highway hours from 83 percent of all U.S. auto assembly plants, and boasting one of the best transportation networks in the country, Georgia is home to a vast network of transportation-related manufacturing activity that includes 268 original parts suppliers for Honda, Toyota, and many others. Corporations such as Pirelli, Goodyear, Porsche, Saab, Daewo, and Hella have also established their presence in Georgia.

The Port of Brunswick, where the number of transshipped cars increased by nearly 84 percent between 1997 and 2002, serves clients such as Audi, Hyundai, Jaguar, Land Rover, Mitsubishi, Saab, and Volkswagen. Brunswick also operates outbound facilities for Mercedes, Ford, GM, Daimler-Chrysler, and Saturn. In 2002, the port added Porsche and Volvo to the list of its prestigious clients, and, for the first time, shipped a record 250,000 cars. ❖