Eye on the Economy

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2001: An Unusual Recession In Terms of Productivity

by Chris Urban

Just like most recessions in our history, the 2001 recession saw a significant decline in employment. What's unusual in this recession is the surprising resilience of productivity growth. In 2001, productivity increased in all three quarters of the recession, with an annualized growth rate of 2.3 percent during that time period (chart 1). Compared to the -0.6 percent average productivity growth during all recessions in the past 50 years, this is a significant difference.

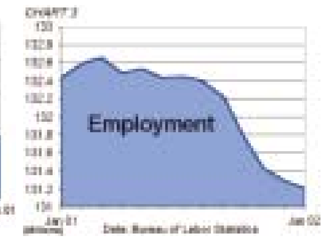
The 2001 recession has been mild GDP declined in the third quarter by -1.3 percent, followed by a surprise growth of 0.2 percent in the fourth quarter. This means that the 2001 recession hasn't even met the accepted definition of a recession: two straight quarters of GDP decline. This, however, is not the definition used by the National Bureau of Economic Research, which officially dates economic cycles. Their definition is based on employment, and they marked March as the beginning of the 2001 recession.

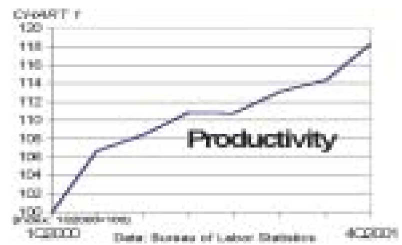
But what caused this unusual rise in productivity, and what does it imply for employment trends in 2002?

Unlike during past recessions, top management of corporations now take a more aggressive stance toward cutting costs, thereby increasing profit. This is because their compensation is increasingly linked to the company's stock price, providing them with greater incentive. Whereas in the past top management was slow to react to slowdowns in sales, in 2001 they responded almost immediately by announcing layoffs – the easiest and quickest method for cutting costs (chart 2 and chart 3).

Although employment declined significantly during the 2001 recession, this did not have a major impact on total output, as the GDP figures indicate. That is unusual for a recession, and it can be explained by the major investment in information and computer technology (ICT) during the 1990s. ICT increases productivity because it allows greater output per person per hour, and provides a cushion for companies during a recession. Companies could afford to lay off workers in 2001 because those who remained could keep production up. So, with fewer workers producing the same dollar value of goods and services, productivity increased despite the recession.

Productivity growth in the first quarter of 2002 is likely to follow the past five years' average quarterly growth of 2.5 percent, which is higher than the expected GDP growth of 1-2 percent for the first quarter. This means that employment is likely to further decline during the first few months of 2002. Although the pace of employment decline has been slowing since October, we may still have to wait a few more months before companies start hiring more workers than they lay off.





Europe's Lead in Wireless Technology Waning

American Companies' Bets Against Wireless Standards Pay Off

by Christopher Ford

For years, Europe had its hand on the pulse of wireless technology. The industry was booming; companies were buying up bandwidth as fast as it became available.

Government-run bandwidth auctions brought in tens of billions of euros, leaving companies with enormous debt and little money left for development. As a result, European companies have been lagged far behind initial predictions for rollouts of more powerful cellular phones. To add insult to injury, venture capitalists have been extremely stingy due to the industry's failures and the downturn of the economy.

Europe's wireless woes are not new, however. They can be traced to the telecommunications boom years – the late 90s. It was then that Europe's major telecom players decided to adopt the Wireless Application Protocol (WAP) standard for their cellular phones.

WAP is essentially a micro-browser that, in theory, allows for the display of news, weather, sports scores, etc. on the screen of a cellular phone. However, early users of WAP found the technology far from perfect. The connection was slow, even for text-only pages, and disconnects were a sure thing. A study done in Fremont, California, found that a practiced WAP phone user took an average of two minutes just to look up their hometown weather forecast. These problems contributed to the rapid disillusionment by the technology sector with WAP and, as a result, European telecommunications companies. WAP also lead to a frenzy of dot-com startups, the great majority of which went nowhere fast. Programmers and executives alike flocked to WAP startups, thinking their only mistake was getting into the market so late.

In the end, their problem was that they started working with WAP in the first place. By mid-2000, the rising star of the telecommunications sector was falling fast. The protocol was blacklisted in the eyes of developers and venture capitalists. Major telecom companies across Europe were faced with millions, and sometimes billions, of now-useless R&D.

U.S. companies, previously criticized for not adopting the new standard, now have the last laugh. In a release by Ericsson Venture Partners, the company stated that nearly 65 percent of the wireless startups the company looked at were based in North America. The telecom sector's newfound prodigy is actual WAP-free connections to the Internet. Here, US-based Sun Microsystems' Java standard is the clear front runner. To make Silicon Valley's triumph complete, virtually the lone wireless-Internet startup that is now a major international player, Openwave Systems, is based in California.

In June 2001, Sun held its annual conference for Java developers, JavaOne. At the conference, a Sun executive gave a speech describing the power and utility of Java-based wireless. Sun's booth heralding their Java-based phones was one of the most popular at the show.

As we enter 2002, it has become clear that Europe has forfeited their telecom dominance to the U.S. While European companies are scrambling to play catch up, the American head start in this race should give Europe a run for its money.

Financial Times European Telecommunications Index

Nasdaq Telecommunications Index

Vital Signs of the American Economy

America's New Recession Old Remedies May Not Apply

by Sean Wright

In the late 1990's, the American economy experienced unprecedented growth breaking some of the old rules. The Phillip's curve was disproved. America was at full employment and yet experienced mild to low inflation. That was a phenomenon of the "new" economy and one must keep that in mind when looking at the recession like trend of the previous four quarters.

In My Opinion

Under the technical definition, a recession is defined as two quarters of negative growth. The United States experienced only one quarter of negative growth. So does one call it a recession? The indicators were there to say that America was experiencing a slowing and slump in the economy. In total, 1.6 million people lost their jobs, the National Association of Purchasing Mangers (NAPM) for manufacturing slipped below 50, and inventories went up. Yet GDP remained on the positive side save one quarter.

Just as America saw a "new" prosperity period in the economy, America is seeing a "new" recessionary period within the economy. The strict definitions no longer apply. One must look to the future and ask what exactly is going on and can a person predict it? For instance, a recession could now be defined as just a slowing in the economy. Over the last 10 years, we have seen sharp peaks of prosperity, followed by a dip into recession and then a quick development back into prosperity. In looking to the future, one must look at various signs of slowing, not negative growth to define a recession.

The situation now appears to be leveling off and perhaps growth into prosperity. Initial Jobless claims have leveled off, coming in 8,000 less then what had been predicted. Consumer confidence is up to 94.6, and CPI has remained relatively level. New Housing Starts went up .4 million between November and January, and durable good orders went up before going back down in the early first quarter of this year.

Americans are ready to spend, and in fact they have slowly started. The confidence is there and people are ready to buy. However, businesses are not ready for a large demand from the consumer side. Inventories have steadily been decreasing, .6 percent in the latest report, and jobless claims have just started leveling out. The NAPM for the manufacturing sector is currently at 49.8, which shows even the manufacturing sector is ready to start production.

But businesses are not ready to buy back labor until they see an increase in demand for their product and sell their inventories from the slump in the economy. This is a concern for inflationary pressures. If businesses sell their inventories but do not produce any goods to restock inventories, there will be more money chasing fewer goods, creating a demand-pull inflation.

In the next 6 months, inflation will be a problem with the rising economy. But looking further, how wills a person be able to predict how far the economy can prosper, or how little it can fall. America and the world are looking at a new definition for the business cycle, and one must predict future occurrences in a like fashion, carefully.

Rates at a Glance

Top # Rates to Know

-Fed Funds: 1.875
-Discount: 1.25
-Prime: 4.75
-Currency Exchange
US $ In Currency
Yen: 134.27
Pound: 70.76
Euro: 1.15
Ruble: 30.9620

Insights

EOE's economic newsbytes
March 4

ISM formerly the NAPM advances to a 19 month high of 54.7 up from 49.9

Inventories lowered to 39.5 setting the stage for a resurgence in the manufacturing sector

Price paid gauge fell to 41.5 from 43.9 reinforcing the idea that inflation is in check

Personal consumption rose 4/10 of one percent and personal income also rose 4/10 of one percent well above prediction

World Economy: Up, Down, and Perhaps Just Sideways

by Jon Bender

The economies of the Euro-zone and Japan are in a slump. European economies grew a meager amount in 2001. France's economy grew a meager .1 percent in the fourth quarter, and just two percent for all of 2001. The German economy grew merely .6 percent for all of 2001. However, due to massive budget revisions in many of the EU countries, GDP's are predicted to stabilize in 2002. All 12 countries in the Euro-zone have projected growths of 1.5 percent. This may be considered border-line recession, but considering how poor the Euro-zone has performed over the past year, this news is a welcomed change.

Japan's economic condition is significantly worse than Europe, with the Nikkei slumping to an 18 year low in late 2001 and early 2002, with a possible banking crisis. Japan's economy is expected to shrink one percent for 2002, the third recession in a decade. Furthermore, the Bank of Japan is expected to sell one trillion yen in government securities to bolster the sinking currency, as opposed to the expected 800 billion. Furthermore, business bankruptcies in Japan have reached an astounding 17 year high. Coupled with this is deflation: prices in Japan have consistently fallen for the past two and a half years. Japanese investors are pulling their money out of the stock markets, and putting it into investments of gold.

Furthermore, US trade deficits have fallen sharply in 2001. The United States' trade deficit with Japan was nearly 82 billion dollars in 2000, but it fell to 63 billion dollars in 2001. Similarly, the trade deficit with China was 84 billion in 2000, but it dropped to 78 billion in 2001. Germany's trade deficit fell from 29 billion in 2000 to 27 billion in 2001. This is due both to dropping foreign and domestic economies. However, despite this, imports are the same as they were in 1999, after spiking in 2000, dropping sharply in September 2001, and recovering in October and November 2001, bringing the figure back up to 105 billion dollars a month. Exports have remained relatively stable over the past two years, dropping only 6 billion dollars, from 84 to 78 billion dollars. Falling foreign economies may have an adverse effect on the US economy. Dropping values of the yen and the euro allows for goods to be shipped into the US at a lower cost. Therefore, domestic producers may be hurt as a result of cheap foreign goods. This is unlikely, however, considering the aforementioned drop in trade deficits.

In conclusion, the world economy is in a mixed state. With Europe claiming recovery, Japan claiming recession, and the US on what seems to be a rebound, the world's economy is still a thorny place.

Guynn: Flip Flops at the Top

by Dan Kagan

With the last month's decision by the Federal Reserve Bank not to change the Federal Funds Rate, the rumor arose earlier this month that there was a good possibility that with the economy on the rise, the Federal Reserve Bank would raise this rate 25 basis points to compensate the .6 percent rise in the Consumer Price Index. It was Jack Guynn, a non-voting president of the Federal Reserve Bank of Atlanta, who "jumped the gun" and decided to make relatively strong comments reporting to the other Fed Bank Presidents that they should raise the interests rate.

As reported by Bloomberg news, Guynn said two weeks ago, February 24, "The economy turns much more quickly in many respects today and I would suggest that policy, too, needs to be prepared to be more nimble than has been the case in the past." At the time with inflation going up .6 percent he thought that it was time to act. What really needs to be noted is that this increased was do to a huge increase in the price of foods, a variable usually left out when calculating inflationary pressure. It was this comment with caused much controversy over the last few weeks between the many members of the Open Market Committee (OMC), "I don't have any doubts, having participated in the discussions and listening to where people are coming from, that if that's the reading we make of where we are, we would be willing to move the other way as well."

With his comments so distinct and clear, no one could have predicted what he said this past week, preemptive of Allen Greenspan's significant speech to Congress and the OMC. This past Monday, February 25, it was Guynn who again was the preemptor to much discussion across the nation for he went back on his previous arguments saying: "This is a different kind of recession; just as we're living through a different kind of contraction, I think we're going to get a different kind of recovery too. So we probably ought to reset our expectations accordingly." Such a change in attitude really adjust the market for this "gun hoe cowboy" that was seen before was now refuting his previous arguments. This caused the Euro dollar rates to fall eight basis points down from 1.95, a three month high set which was a result that could be directly correlated to Guynn's previous remarks two weeks ago.

Why did Jack Guynn a very decisive man change his opinion of the economy, along with many other Fed Bank Presidents like Gary Stern, president of the Fed Bank of Minneapolis, a previous support of raising interests rates? This question can easily be explained with Guynn's comments: "Consumer spending never really declined. The story's the same with housing. So without a kick from consumer spending, the level of business investment will determine how fast the economy grows in the coming quarters. That investment could be sluggish, for a great deal of excess capacity in the nation's factories and a long wait for profits in some industries may delay the increase in corporate earnings that's necessary for strong recovery."

Thus, with consumer spending and confidence reports which affect 2/3 of our counties GDP in the Consumer Consumption section, the economic recovery will have to really on the small business investment sector. Thus, with consumer spending usually lead a quick recovery of almost a seven percent increase in GDP, economist predict that by the end of the year our economy will at most rise three percent a factor under one half, which was seen during the post World War II economic recovery. In conclusion, Guynn stated that the Open Market Committee must stay focused and not become weighed down with inflationary and consumer debt reports.

Jobless Rate Drop Due to Record Decline in Civilian Labor Force in January

by Chris Urban

The Labor Department announced Friday, February 1, that the unemployment rate declined to 5.6 percent from December's 5.8 percent. This marks the first time the rate has dropped since May 2001.

The decline, however, conveys a misleading message about the employment situation, as total employment declined by an unexpectedly high 587,000 from December to January. This has been the fourth straight month of employment decline, and January's decline was the largest since August. Nonfarm payroll employment (representing 131 million of 134 million total employed) decreased by only 89,000. This means that the rest of the half million decline had to come from the 3 million other employees.

The two seemingly contradicting numbers can be explained by looking at the definition of unemployment: "those who are not employed but had actively searched for work in the 4 weeks preceding the survey". Employment and unemployment together make up the civilian labor force, which makes up approximately 66 percent of the entire population.

January's total civilian labor force declined by 924,000, a number so unusually high that it has been the greatest month-to-month drop in the 54-year history of the survey. These almost 1 million people leaving the labor force are not part of either the employment or unemployment figures, and contributed significantly to both the decline in the jobless rate and the decline in employment.

Therefore, January's unemployment decline is almost meaningless. Employment is a key factor of production and is an easily defined and measured data. Unemployment on the other hand is merely a subset of those "not employed", and thus provides a skewed, misleading picture of the employment situation.

Despite the decline in employment, economists still expect a growing economy for the first quarter of 2002. The recently announced, unexpected GDP growth of 0.2 percent for the fourth quarter of 2001 suggests that the recession was mild, and that a recovery may well be under way. The Fed's decision to leave interest rates at 1.75 percent also suggests a more optimistic outlook for 2002.

Dow Jones	*Nasdaq*	*S&P 500*	*NYSE Comp.*
10,433.40	1,866.30	1,146.14	594.61
-153.42	+6.98	-7.70	-4.28

Supply Meets Demand

by Chris Urban

Perhaps the most consistent economic indicator in terms of month-to-month change during the past year has been inventories, which declined in every month during the year 2001. The total decline from January to December 2001 was 5.94 percent (graph). Such aggressive inventory-cutting by corporations resulted in significantly decreased industrial production. Indeed, during the entire year 2001, industrial production declined by 5.05 percent, and it further declined in January 2002 (graph). This data, along with a considerable downturn in manufacturing shipments and new orders, suggests that the manufacturing sector was hit hard by the recession.

Meanwhile, the demand side of the economy has showed remarkable resilience. As Federal Reserve Chairman Alan Greenspan said in his semiannual monetary report to Congress on February 27, "spending by the household sector held up well and proved to be a major stabilizing force". He also stated that "consumer spending appears to have advanced at a solid pace in recent months". As Greenspan points out, the demand side of the economy has stayed healthy throughout the recession, and it should keep up as the recovery gets underway.

As the inventory liquidation slows in 2002, industrial production will soon have to pick up to meet this resilient demand. One of the first signs of an improving industry was released today, March 1st. The Institute for Supply Management's (formerly known as the National Association of Purchasing Management) Manufacturing Index rose to 54.5 in February from 49.9 in January, indicating an expanding manufacturing sector. This new data suggests that they supply side has finally reached a turning point. And during the next few months, as supply meets demand, we will begin to see a slow but steady upturn in the economy.

Fed Should Hold Interest Rates

by Rui Lu

The Fed should hold off on making any changes to interest rates. Although signs seem to be improving, there are still conflicting reports and a little unease about the nation's current economic health. Federal Reserve Chairman Alan Greenspan expressed confidence on Wednesday that the U.S. economy was emerging from recession. He also went on to warn that the recovery would likely be moderate, raising hopes the country was in for a period of stable borrowing costs.

There have been optimistic signs: according to the *ABCNEWS/MONEY* magazine, Consumer Comfort Index, consumer confidence remains unchanged. 33 precent of Americans feel positive about the economy, 41 percent say that it is a good time to purchase items and 58 percent say their own finances are in good shape. Though this dropped somewhat from the fall, the figures remain where they had been all year. However, one needs to take into consideration other factors. It is important to note that confidence was higher among Americans that are better off financially. At the same time, The Conference Board, a private research group, said that its index of consumer confidence fell to 94.1 in February from 97.8 in January, lower than the expected value of 97.0 by economists surveyed by Briefing.com.

Further uncertainty comes from the area of home sales. According to the National Association of Realtors, the sale of existing home sales jumped to a record 16.2 percent to an annual rate of 6.04 million units in January, higher than the 5.2 million unit pace in December. The unreasonably warm weather also helped fuel the home sales in January, as did the low mortgage rates. At the same time, the Commerce Department also stated that sales of new U.S. single-family homes plunged 14.8 percent in January, the biggest decline in eight years.

Steady as She Goes

Greenspan indicates no change in current Fed policy

by Dan Kagan

With stocks skyrocketing last Friday to the highest levels since August, consumer spending continually keeping up with pace, and unemployment rates relatively at a stand still, one may wonder why Alan Greenspan spoke so negatively against raising interests rates at the end of March's Open Market Committee meeting. It is evident that because spending has "advanced at a strong pace" as consumer spending has grew 3.1 percent last year, while GDP only sustained a mere .2 percent growth, that the economy really will not see an increase until businesses significantly start investing. With the recession leaving many businesses with large inventories, it has become evident that until the businesses make a significant push in the direction of capital formation, this recession will be a very slow one to conquer.

With this past week showing mixed results in reports, it is evident that getting out of this recession will be a "shaky ride." On Tuesday, February's Consumer Confidence report was released showing a huge drop from the former eight month high of 97.8 to an 8 year low of 94.1. Normally with such a significant drop, one can expect a huge reaction with the stock market but instead it led to a slight increase, which might show the lack of importance to the consumer spending and investment sector of the economy, which makes up 2/3 our country's GDP. With such a lack in the confidence by the consumer, this report may make a significant impact on a business's confidence to invest.

Greenspan further stated, "Economic growth that was seen in 1999 and 2000 seems doubtless because lost business investment in preparing for Y2K and the Internet boom, will significantly hurt our economy." Chief senior economy of First Tennessee Bank, Chris Low, stated in reaction to Greenspan's speech to Congress on February 27, "The inability of companies to raise prices, which slows the economy and gives a boost to bonds by keeping inflation slow."

With this Low forecasted a mere 1 percent growth in GDP for the first quarter. With inflation only going up .1 percent a major factor of the consumers having to much money from the previous 11 rate cuts, it is definitely evident that no change needs to be made in terms of the Federal Funds Rate.

Some positive news is that recent reports show that the Durable Goods Orders, an instrument for measuring a company's willingness to make new products, went up 2.6 percent in January and are expected to have gone up 1.5 percent last month. Greenspan spoke that with the recent accounting problems and the Enron collapse, "Companies will invest more if they see the economy improving, for they are very fragile because the trust and reputation can vanish overnight; factories and (inventories) cannot." From all of this the economy can be summed up by some of Greenspan's most influential words, "The U.S economy is close to a turning point and should begin growing at a slower pace than after precious recessions." With the best Economic Forecasters predicting a maximum of 2.5- 3.0 percent increase in GDP and that it is evident that our economy is slowly picking up, there is no reason to constrict the recent progress made or help inflationary trends so the Federal Reserve Bank should leave the Federal Funds Rate alone.