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Economic Outlook for the Second Quarter

by

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Introduction

The outlook for the economy remains weak as the recovery slowed down sharply in the months of May and June. Crude oil prices recorded a low of \$93.01 per barrel on June 24, 2011 having reached a record high of \$113.93 in April 25, 2011. The fall was triggered by the pronouncement from International Energy Agency (IEA) to release 60 million barrels of oil from global markets to offset disruptions of the production from Libya and other oil producing countries¹.

Employment

The Bureau of Labor Statistics reported an increase in employment by 117,000 jobs in July 2011². This indicates a marginal improvement of June's figure of 54,000 job gains. Health care, retail trade, manufacturing and mining recorded job gains. Employment levels in other major private-sector industries were little changed, and employment in the manufacturing industry had risen by an average of 24,000 per month since May 2010. The industrial sector has added 246,000 jobs since a recent low in March 2010. Local government recorded 28,000 job losses over the month and has lost 446,000 jobs since an employment peak in September 2008. (See Fig.1). The decline in jobs in May offers startling evidence that the U.S. economy is slowing, hampered by high gas prices and natural disasters in Japan that have

affected manufacturers. The marginal job gains in July exhibits a glimmer of hope but the private sector will have to be given the needed impetus for expansion through an increase in consumer demand for goods and services to sustain job creation.

Fig.1:U.S. Change in Nonfarm Employment Level



Unemployment

The U.S. Bureau of Labor Statistics reported a 0.1% fall in the unemployment rate from 9.2% in June to 9.1% in July 2011. Nevada registered a 12.9% unemployment rate, the highest among the states, where as North Dakota reported the lowest unemployment rate of 3.3%. The total number of unemployed peaked at 13.9 million as compared to 13.7 million in April 2011. There are 2.8 million persons who were marginally attached to the labor force; about 1.1 million of these marginally attached were discouraged workers. The official unemployment rate includes only job seekers who are actively looking for work. Underemployed workers (those who indicate they would like full-employment) and discouraged workers (individuals who would like to work but are not actively engaged in a job search) are not included in the official unemployment statistics. A measure of

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unemployment (U-6) that includes workers who are underemployed and those who are marginally attached to the labor force declined from 16.5% in July 2010 to 16.1% in July 2011.



Industrial Production

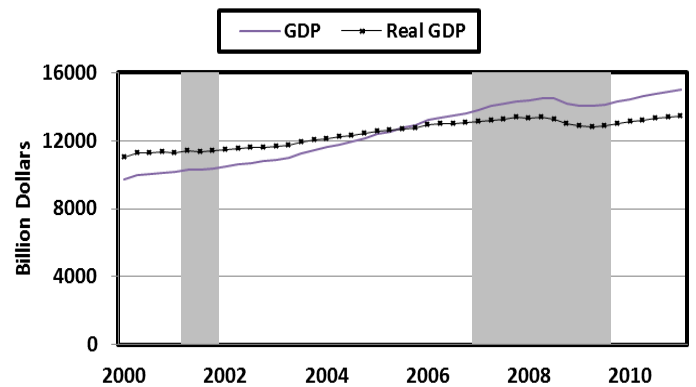
Industrial production edged up 0.1% in May 2011. There was an increase of 0.4% in manufacturing production. The output of motor vehicles and parts has been held down in the past two months because of supply chain disruptions following the earthquake in Japan³. Excluding motor vehicles and parts, manufacturing output advanced 0.6% in May and edged down 0.1% in April; the decrease in April in part reflected production lost because of tornadoes in the South at the end of the month. Outside of manufacturing, the output of mines increased 0.5% in May, while the output of utilities fell 2.8%. At 93.0% of its 2007 average, total industrial production in May was 3.4% above its year-earlier level. Capacity utilization for total industry was flat at 76.7%, a rate 3.7 percentage points below its average from 1972 to 2010.

Economic growth

Real gross domestic product (GDP) is the output of goods and services produced by labor and capital located in the United States. There is a sharp slowdown of economic growth as real GDP increased at an annual rate of 1.8% in the first quarter (Q1) of 2011⁴. The real GDP increased at 3.1% and 2.6% in the third quarter (Q3) and fourth quarter (Q4), respectively. (See Fig.3). However, Government Consumption and Gross Investment declined at 1.7% in the Q4 and 5.1% in Q1. The decline in federal government spending and state and local government

spending partially offset increases in personal consumption expenditure, private investments and exports.

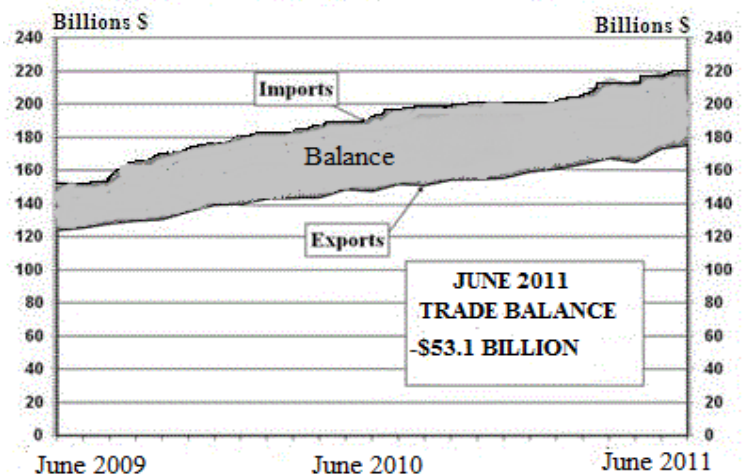
Fig.3:U.S.Gross Domestic Product



International Trade

The U.S. trade in goods and services reported in June for exports was \$170.9 billion and imports totaled \$223.9 billion in June. As a result, the U.S. had a goods and services deficit of \$53.1 billion. June imports were \$1.9 billion less than May imports of \$225.8 billion, whereas exports in June were \$4.1 billion less than May exports of \$175.0. The goods and services deficit increased \$6.2 billion from June 2010 to June 2011. Exports increased 18.8% (\$27.8 billion) and imports were up 15.9% (\$30.0 billion). The increase in exports from June 2010 to June 2011 was due to an increase industrial supplies and materials, capital goods; foods, feeds, and beverages; consumer goods; automotive vehicles, parts, and engines. The rising trade deficit implies import levels are rising faster than the export levels.

Fig.4:U.S. International Trade in Goods and Services



Energy and Oil Prices

Crude oil prices recorded a low of \$93.01 on June 24, 2011 having reached a record high of \$113.93. The fall was triggered by the pronouncement from International Energy Agency (IEA) to release 60 million barrels of oil to offset the disruptions of the production from Libya and other oil producing countries. Fifty percent of the total, which constitutes 30 million barrels, will be released from U.S. strategic petroleum reserves whereas the remaining half will be released by other members of the agency. The U.S. was the world's largest petroleum consumer in 2010 using 19.1 million barrels per day. The U.S. Energy Information Administration (EIA) estimates U.S. net import of crude oil and refined petroleum products for 2010 at 9.4 million barrels per day. According to AAA's Daily Fuel Gauge Report, U.S. average gasoline price fell to \$3.61 per gallon on June 23, having reached its 2011 record high of \$3.98 per gallon on May 5, 2011⁵.

South Dakota Economy

The economy of South Dakota continues to slowly recover from the Great Recession. With a labor force of 447, 512, South Dakota has 426,553 employed and 20,959 (preliminary estimate) unemployed. Total nonfarm employment for July 2011 was 408,100 (preliminary estimate). Between July 2010 and July 2011, South Dakota gained a meager 4500 nonfarm jobs. The state's unemployment rate of 4.7% trails the 4.1% and 3.3% rate of Nebraska and North Dakota, respectively. South Dakota's over-the-year change in unemployment rate remained stable at 4.7% from July 2010 to July 2011.

The Rapid City Metropolitan Statistical Areas (MSA) and Sioux Falls MSA reported a 4.6% unemployment rate for the month of June. The over-the-month change in unemployment for the two MSAs in South Dakota reported promising results. The Rapid City MSA unemployment rate fell from 5.7% to 5.0% (March and April 2011) and that of Sioux Falls decreased from 5.4% to 4.7% in the same period. The Rapid City MSA gained 900 nonfarm jobs between March and April 2011. The Sioux Falls MSA gained 2,300 nonfarm jobs in the same period. Job gains for the two MSA were contributed mainly by additions from the leisure and hospitality industry, as well as mining, logging and construction.

However, the Rapid City MSA region reported over-the-month job gains in March and April, but over-the-year change in employment declined by 900 (1.5 %) in that same period. The Sioux Falls MSA region reported its over-the-year change in employment increased by 1,100 (0.8%).

South Dakota's leading economic indicators point to a robust growth in the three months ahead. The Business Conditions Index is a mathematical average of indices for new orders, production or sales, employment, inventories and delivery lead time. The Business Conditions Index from a monthly survey of supply managers declined to 55.2 in July, from June's healthy rate of 63.1⁶. According to Ernie Goss of Creighton University, healthy employment growth in the state has pushed South Dakota's unemployment rate down by 0.1%. Recent survey results point to positive but slow job growth and a flat unemployment rate for the next three months. This implies that if manufacturers continue to expand production as reported this month, the state will experience an upward trend in employment levels in the months ahead.

US Debt Ceiling

According to the U.S. Treasury Department, the debt limit is the total amount of money the U.S. government is authorized to borrow to meet its existing legal obligations, including Social Security and Medicare benefits, military salaries, interest on the national debt, tax refunds, and other payments. The debt limit does not authorize new spending commitments. It simply allows the government to finance existing legal obligations that Congresses and presidents of both parties have made in the past⁷.

Although Congress managed to pass the bill on raising the debt ceiling after political discord on August 2, 2011, passage did not prevent S & P from downgrading the U.S. credit rating from top-tier AAA to one level lower (AA-plus) on August 5, 2011.

The impact of US credit down grade on the economy

The AAA rating awarded to the U.S. in 1917 was counted as zero-risk rating. Lowering of the credit rating by S&P and ranking the U.S. at AA is at par with the rankings awarded to South Korea and New

Zealand. A dip in the rankings implies that the repayment risk of lending to America has increased and could impact Americans in the following ways: 1) increase in interest rates, 2) increase in lending rates, 3) increase in cost of products, 4) decrease in profit, 5) negative impacts on stock markets, 6) jobs lost and unemployment increase, and 7) a decrease in GDP.⁸

Economic outlook for the Second Quarter

The economic outlook for the second quarter is positive since the reduction in crude oil will continue to impact total employment levels as companies will be willing to hire in order to boost production. U.S. economic indicators discussed above suggest that the economic activity will continue to slowly improve.

The IEA's released 60 million barrels of oil from its various reserves in order to boost supply and lower gas prices. Companies expanded production triggered marginal job gains in July. I anticipate a decline in the rate of inflation due to an expected continue decline in energy prices. The S&P downgrade of U.S. credit ratings will impact the lives of average Americans as interest rate are expected to increase, and more importantly, cost of production is expected to edge up, restricting companies from hiring and this will trigger a slowdown in the rate of job growth.

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¹ http://www.iea.org/press/pressdetail.asp?PRESS_REL_ID=418

² <http://www.bls.gov/>

³ <http://www.federalreserve.gov/releases/g17/current/>

⁴ <http://www.bea.gov/national/nipaweb/TableView.asp?SelectedTable=310&Freq=Qtr&FirstYear=2009&LastYear=2011>

⁵ <http://www.eia.gov/steo/>

⁶ <http://www.creighton.edu/business/economicoutlook/regional/midamericanstates/southdakota/historicaldata/2011/index.php>

⁷ <http://www.treasury.gov/initiatives/Pages/debtlimit.aspx>

⁸ <http://www.charteredclub.com/how-will-sp%E2%80%99s-downgrade-hurt-the-us-and-impact-americans-in-7-ways/>

