



# ECONOMICS COMMENTATOR

South Dakota State University

No. 530

April 29, 2011



## ECONOMIC OUTLOOK: FIRST QUARTER 2011

by  
Emmanuel Opoku,  
Research Associate,  
Scott Fausti,\*  
Economics Professor

### Introduction

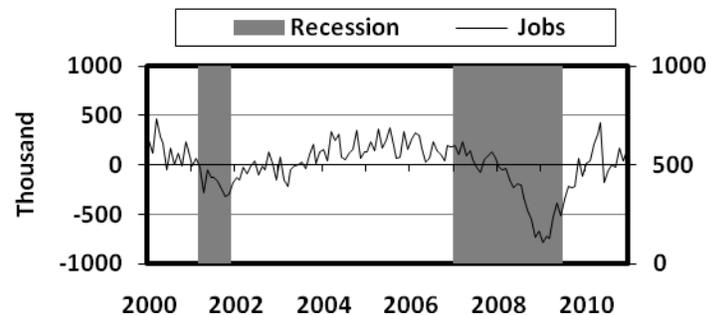
The fiscal and monetary policy actions taken over the past few years by the federal government have aided the economic recovery. The extension of tax relief and unemployment benefits continues to aid the recovery process. The price of petroleum has increased from an average of \$80 per barrel last year to over \$100 per barrel in recent weeks. There is a growing concern that the spike in energy prices will dampen U.S. economic recovery. The other headwind the U.S. economy is facing this year is the reduction in state and local government spending. Economists estimate that states will face a combined \$112 billion deficit. States will be forced to raise taxes or cut spending. Both actions will have a negative impact on the U.S. economic recovery. The current economic impact estimate is 0.75% of Gross Domestic Product (GDP). It is estimated that for every 1% decline in GDP a million jobs are not created. Currently, state and local budget shortfalls could potentially reduce the U.S. economy's ability to create new jobs by 750,000 this year.<sup>1</sup>

### Employment

The Bureau of Labor Statistics reported an increase in nonfarm employment by 192,000 jobs in February 2011.<sup>2</sup> The economy added 1.3 million private jobs between April 2010 and January 2011. The increase in employment occurred in manufacturing, construction, professional and business services,

and health care, as well as transportation and warehousing. Manufacturing and construction sectors gained 33,000 jobs in February 2011. Health care employment continues to increase. In February, the health care sector gained 34,000 jobs which represent the highest sector gain in the monthly report. The total employment level increased by 227,000 jobs from February 2010 to 2011. (See Fig.1)

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



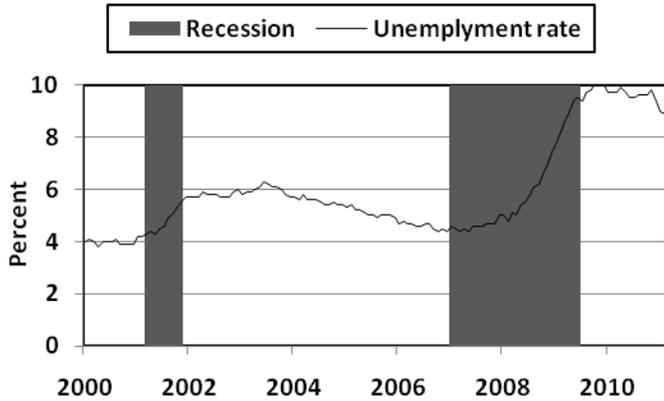
Source: Bureau of Labor Statistics

### Unemployment

The Bureau of Labor Statistics reported a decrease in unemployment to 8.9% from 9.0% in January 2011.<sup>3</sup> The total number of unemployed was 13.7 million as compared to 13.9 million in January 2011. The annual U.S. unemployment rate declined from 9.7% in February 2010 to 8.9% in February 2011, representing 0.8% change. (See Fig.2) A broader measure of unemployment that includes workers who are underemployed and those who are only marginally attached to the labor force (U-6) reached a record high of 17.4% in October 2009, fell to 16.5% in January 2010, and increased again to 17.1% in September 2010 before falling to 16.1% in January 2011.

\*Contact the authors at [Scott.Fausti@sdstate.edu](mailto:Scott.Fausti@sdstate.edu) or [Emmanuel.Opoku@sdstate.edu](mailto:Emmanuel.Opoku@sdstate.edu) or call 605-688-4141. We also wish to gratefully acknowledge the assistance of Kyle Mason, a high school student who assisted with data collection.

**Fig.2: U.S. Unemployment rate**

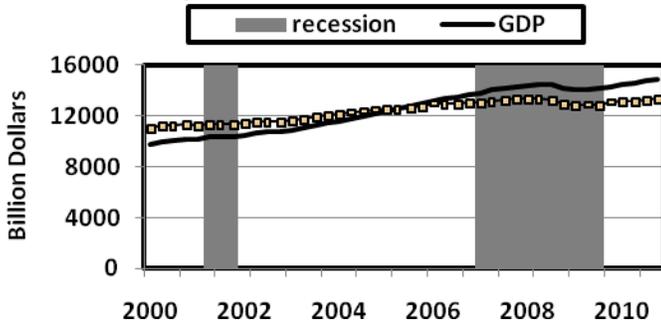


Source: Bureau of Labor Statistics

**Industrial Production**

From February 2010 to February 2011, U.S. industrial production increased 5.6%. Mining and manufacturing output increased 6.8% and 6.9%, respectively. In January 2011 a slight weakening in industrial production occurred, as the overall level of production declined by 0.1% with the largest decline occurring in the manufacturing sector which declined 0.3%.<sup>4</sup> The recession has greatly affected the level of industrial production as U.S. industrial production fell 15% during the 2008-2009 period. As a result, industrial production declined to 1998 levels<sup>5</sup>. The minimal increase in industrial production did not impact Industrial Capacity Utilization (ICU) as it remained unchanged from January 2010 to February 2011.

**Fig.3: U.S. Gross Domestic Product**



Source: Bureau of Economic Analysis

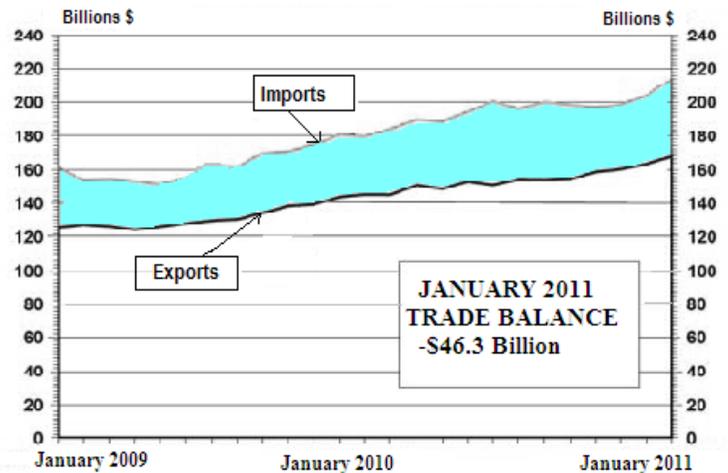
**Economic Growth**

The U.S. Census Bureau reported an annual Real GDP growth rate of 2.8% in the fourth quarter (Q4) of 2010 as compared to the third quarter (Q3) rate of 2.6%<sup>6</sup>. The increase in Real GDP in Q4 was primarily due to increases in personal consumption expenditures, in residential fixed investment, in private residential investment, and exports coupled with a decrease in imports. Consumer spending which accounts for about 70% of GDP, increased at an annual rate of 4.4% in Q4. Real gross domestic product is the inflation adjusted level of output of goods and services produced by labor and capital located in the U.S.

**International Trade**

U.S. trade in goods and services peaked during the latter part of fall 2010. The levels of monthly imports and exports recorded an increase in the fourth quarter. This led to a rise of the U.S. trade deficit from \$40.6 billion in December 2010 to \$46.3 billion in January 2011. The rising trade deficit implies that import levels are rising faster than export levels.<sup>7</sup> The increased crude oil price of \$84.34<sup>8</sup> in January from its December price of \$79.78 per barrel contributed to rising U.S. imports which impacted the trade deficits. This trend, if it continues, could pose additional risk to a sustained recovery for the U.S. economy. (See Fig.4)

**FIG.4: U.S. International Trade in Goods and Services**



Source: U.S. Census of Economic Analysis

### **Bright spot**

Factors including the high level of unemployment and the low level of capacity utilization continue to restrain the inflation rate. The core rate of retail inflation for the last three years has been 1.7% (2008), 1.8% (2009), and 0.8% (2010). The decline in retail inflation is more dramatic when food and energy prices are included: by this measure, inflation for the past three years has been 0.1% (2008), 2.7% (2009) and 1.5% (2010).<sup>9</sup> However, there is concern that the core rate of retail inflation may not continue to improve due to rising commodity prices. An increase in the core inflation rate would reduce consumer purchasing power and dampen the rate of economic recovery.

### **Energy and Oil Prices**

The two most important factors that determine the price of a barrel of oil are the fundamental laws of supply and demand and fear.<sup>10</sup> The U.S. Energy Information Administration (EIA) estimated a rise in crude oil prices in February with the spread of political unrest in North Africa, including violent uprisings in Libya which have led to the shutdown of much of its oil production. EIA expects regular-grade retail gasoline prices to average \$3.71 per gallon during this year's summer peak driving season (June through August). Increasing uncertainties about oil supply have currently pushed the price of oil prices to its highest level since 2008.

The EIA estimated that residential heating oil prices will continue to rise. In the period ending March 7, 2011 the national average residential heating oil price increased to \$3.87 per gallon which is \$0.95 higher than this time last year. According to the American Automobile Association (Triple A), the average American household travels 12,000 miles per year, and if we use the EIA gasoline price estimates summary in 2010 and 2011 then someone with a car which runs 25 miles per gallon is likely to spend \$1,708.80 (\$3.56 per gallon) in 2011 compared to \$1,334.40 (\$2.78 per gallon) in 2010. This implies that an average American will spend \$374.40 more on gasoline in 2011.

### **South Dakota Economy**

The South Dakota economy has continued to improve since the end of the recession. Total nonfarm employment for January 2011 was 402,900

(preliminary estimate). This reflects a decline in SD employment. In November, SD employment was estimated at 404,100, increasing to 408,800 in December 2010 (seasonally adjusted). South Dakota had 409,000 jobs prior to the recent recession which started in December 2007. The Rapid City MSA lost 2,400 jobs between November 2010 and January 2011. The Sioux Falls MSA lost 3,000 jobs between November 2010 to January 2011. The South Dakota over-the-year change in unemployment rate declined from 5.2% in January 2010 to 4.7% in January 2011. The state's unemployment rate has remained stable at 4.7% for three consecutive months. The Rapid City Metropolitan Area (MSA) unemployment rate increased from 4.7% in November to 5.2% in December 2010, and the Sioux Falls MSA unemployment rate increased from 4.3% to 4.9% in the same period.

South Dakota's leading economic indicators point to healthy growth into the third quarter of this year.<sup>11</sup> A monthly survey conducted by Ernie Goss from Creighton University reported an improvement of South Dakota Business Conditions Index (based on supply managers). The Index increased from 61.1 in January to 64.5 in March 2011. As a result of continued improvement of the index, Prof. Goss predicts an expansion in SD employment for the durable and nondurable manufacturing sectors, and for the overall economy into the third quarter of this year.

### **Outlook for the First Quarter 2011**

The economic outlook for the next quarter is positive as the unemployment rate continues to edge downward. The rate of inflation remains contained. U.S. economic indicators discussed above suggest that the overall level of economic activity in the U.S. economy continues to improve. The current uprising in part of North Africa and the Middle East will impact oil prices. However, prudent fiscal and monetary policy initiatives should continue to stimulate the economy and help create more jobs. Potential stumbling blocks to continued economic recovery are: 1) a national decline in state and local spending and increased taxes at the state and local level, 2) raising energy prices, and 3) an unexpected increase in the rate of inflation due to an additional spike in energy prices.

Endnotes:

- <sup>1</sup> <http://www.cbpp.org/cms/?fa=view&id=711>
- <sup>2</sup> <http://bls.gov/>
- <sup>3</sup> [http://bls.gov/news.release/archives/empisit\\_03042011.htm](http://bls.gov/news.release/archives/empisit_03042011.htm)
- <sup>4</sup> <http://federalreserve.gov/releases/g17/Current>
- <sup>5</sup> [http://federalreserve.gov/releases/g17/revisions/current/table1a\\_rev.htm](http://federalreserve.gov/releases/g17/revisions/current/table1a_rev.htm)
- <sup>6</sup> [http://www.bea.gov/newsreleases/national/gdp/2011/gdp4q10\\_2nd.htm](http://www.bea.gov/newsreleases/national/gdp/2011/gdp4q10_2nd.htm)
- <sup>7</sup> [http://www.census.gov/foreign-trade/Press-Release/current\\_press\\_release/ft900.pdf](http://www.census.gov/foreign-trade/Press-Release/current_press_release/ft900.pdf)
- <sup>8</sup> <http://www.census.gov/foreign-trade/trade/statistics/historical/petr.pdf>
- <sup>9</sup> <ftp://ftp.bls.gov/pub/special.requests/cpi/cpi.ai.txt>
- <sup>10</sup> <http://www.economist.com/node/18285768>
- <sup>11</sup> <http://www.creighton.edu/business/economicoutlook/regional/midamericanstates/southdakota/index.php>

\*\*\*\*\*  
**ECONOMICS COMMENTATOR**  
\*\*\*\*\*  
Department of Economics  
South Dakota State University  
Box 504 Scobey Hall  
Brookings, SD 57007-0895  
E-Mail: Penny.Stover@sdstate.edu  
Phone: 605-688-4141  
Fax: 605-688-6386  
90 copies of this newsletter were produced at a cost of less than \$100

