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Economic Currents: The State of the State Economy

Alan Clayton-Matthews

University of Massachusetts Boston

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ILLUSTRATION: NAOMI SHEA

Economic currents

ALAN CLAYTON-MATTHEWS

THE STATE'S
EXPANSION HAS NOW
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"MIRACLE YEARS"
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THE MASSACHUSETTS ECONOMY

REMAINS IN HIGH GEAR

As economists continue to explain why growth will slow and inflation will reemerge, the Massachusetts jobs engine accelerates, generating jobs and income at an increasing rate even as inflation continues to subside. The state's expansion has now surpassed the "Miracle Years" in length, and there is no evidence to suggest that it will end soon. In spite of this, a slowing is inevitable; the region is running out of skilled workers and cannot support this rate of growth indefinitely. The pool of available workers now appears concentrated among less-skilled workers with low levels of educational attainment. These workers could support continued expansion, albeit at a slower pace of income growth, if employers can absorb them into the workforce.

RECENT EMPLOYMENT GROWTH IN THE YEAR ENDING IN APRIL 1998

The number of jobs¹ in Massachusetts grew by 3.2 percent in the 12-month period ending in April, outpacing every other New England state and the nation. During this time, employment in both New England and the United States grew by 2.5 percent. The job growth was broad-based, with every major sector growing by at least 1.3 percent.

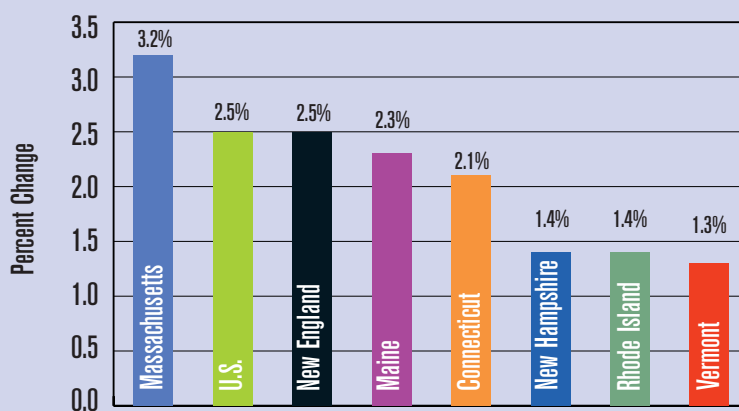
Manufacturing gains continue to be noteworthy. During this time, manufacturing employment expanded at a 1.9-percent pace. Growth was especially robust in industries supplying durable investment goods. Employment in industrial machinery and equipment grew by 2.2 percent, computer and office equipment by 4.3 percent, electronic and electrical equipment by 2.3 percent, transportation equipment by 4.2 percent, and instruments by 3.2 percent. Nondurable manufacturing jobs expanded at the slower pace of 0.7 percent, although some sectors also exhibited substantial growth (food, 2.4 percent; and textile mill products, 2.1 percent). The Asian crisis has had little effect so far on the manufacturing sector, but adverse effects on exports are expected to take root in the coming months, so this sector bears close monitoring.

Construction employment grew at 9.5 percent, aided

by a mild winter and low interest rates. Transportation, communications, and utilities growth was led by a 6.5-percent increase in communications employment; employment in utilities fell by 2.9 percent. Consumers and businesses are spending, particularly on durables, boosting wholesale and retail trade. Wholesale trade employment in durable goods rose by 5.7 percent, while retail employment growth in building materials and furniture was strong, at 3.9 percent and 9.7 percent respectively. People are also eating out more, as implied by 4.9-percent employment growth in eating and drinking

Employment Growth Rates Compared

April 1997 – April 1998
Massachusetts grew faster than the nation
and all other New England states.



Sources: U.S. Bureau of Labor Statistics;
Massachusetts Division of Employment and Training

establishments. In finance, the non-banking sector (non-depository institutions), which includes mutual funds and a broad array of financial management firms, continues to lead employment growth at an 8-percent pace. The banking sector (depository institutions) is expanding once again, as employment grew by 3.7 percent. However, employment in the insurance industry continues to decline, dropping by 3.3 percent. Employment growth of 3.8 percent in the large service sector was led by business services, 8 percent, and engineering and management services, 6 percent. Health-sector employment continued to expand relatively slowly, at 1 percent, with small losses in the hospital sector of 0.1 percent.



INCOMES AND

CONSUMER CONFIDENCE

Earnings and incomes continue to rise rapidly. Wage and salary disbursements of Massachusetts workers in the last quarter of 1997 were 7.4 percent above a year earlier, while personal income of residents was 6.3 percent higher. In real terms, after deflating by the Boston CPI-U, the growth rates were 5.2 percent and 4.1 percent respectively. Consumer confidence of Massachusetts residents, as polled by Mass Insight, grew by 9.2 percent in the year ending in January to 130, its highest level since the survey began in 1991. Interestingly, the current conditions portion of the index rose a dramatic 22.4 percent from the prior year, while the future expectations portion remained unchanged. Apparently, consumers and economists agree on their bottom-line assessments of the economy: conditions are good, so good that it is difficult to see how they can get better.

HOUSING

The housing market is performing moderately well. Economy watchers remember that one of the defining characteristics of the 1980s boom-and-bust was the speculative bubble in real estate, with rapidly rising prices and over-building followed by collapse. Therefore, they like to see slow, steady growth in housing stock and moderate price increases. Recent activity on a statewide basis confirms to this scenario. Housing permits averaged 1493 per month in the year ending in April. Although this is

Massachusetts Employment Growth in Selected Sectors April 1997 – April 1998

Manufacturing:	1.9%
Industrial Machinery and Equipment	2.2%
Computer and Office Equipment	4.3%
Electronic and Electrical Equipment	2.3%
Transportation Equipment	4.2%
Instruments	3.2%
Food and Kindred Products	2.4%
Textile Mill Products	2.1%
Printing and Publishing	1.8%
Transportation, Communication and Utilities:	4.2%
Communications	6.5%
Electric, Gas and Sanitary Services	-2.9%
Wholesale Trade:	4.4%
Durable Goods	5.7%
Retail Trade:	3.1%
Building Materials and Garden Supplies	3.9%
Furniture & Equipment Stores	9.7%
Eating and Drinking Places	4.9%
Finance, Insurance and Real Estate:	2.2%
Depository Institutions	3.7%
Non-depository Institutions	8.0%
Insurance	-3.3%
Services:	3.8%
Business Services	8.0%
Health Services	1.0%
Hospitals	-0.1%
Engineering and Management Services	6.0%

Source: Massachusetts Division of Employment and Training

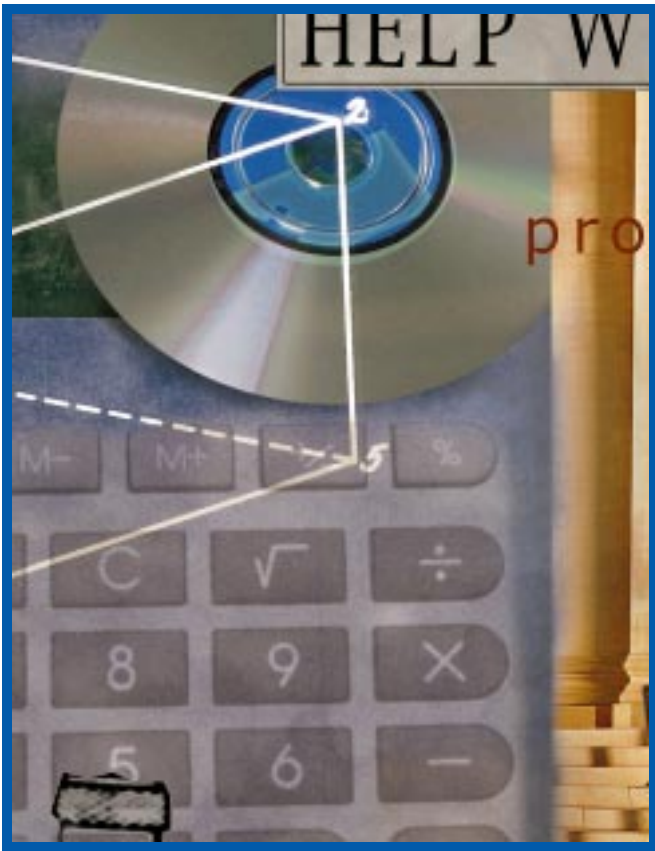
down 1.3 percent from the prior 12-month period, it is still in the comfortable 1200–1600 range of the past several years, less than half the rate of the speculative boom at the end of the 1980s. Sales of existing homes in the third quarter of 1997 were 11.3 percent higher than in the same quarter the prior year. Housing prices rose 6 percent in the year ending in the fourth quarter of 1997, according to Fannie Mae and Freddie Mac.

Recent evidence indicates that the market may be heating up in the metropolitan Boston area, as inquiries to brokers — an indicator of demand — are unseasonably high, time on the market is declining, and agreement prices as a proportion of initial listing prices are averaging over 95 percent, even for luxury homes. Prices in several communities are rising at annual rates exceeding 10 percent.² So far, this activity seems to reflect real underlying demand and supply forces, and not speculative psychology.

OTHER INDICATORS

State tax revenues keep growing in step with the economy. In the 12-month period ending in March, revenues were 6.7 percent above the prior 12-month period. Income tax revenues continue to meet or exceed official estimates. The Massachusetts Current Economic Index, based largely on real, inflation-adjusted tax revenues, is up 3.4 percent in April from the preceding year.





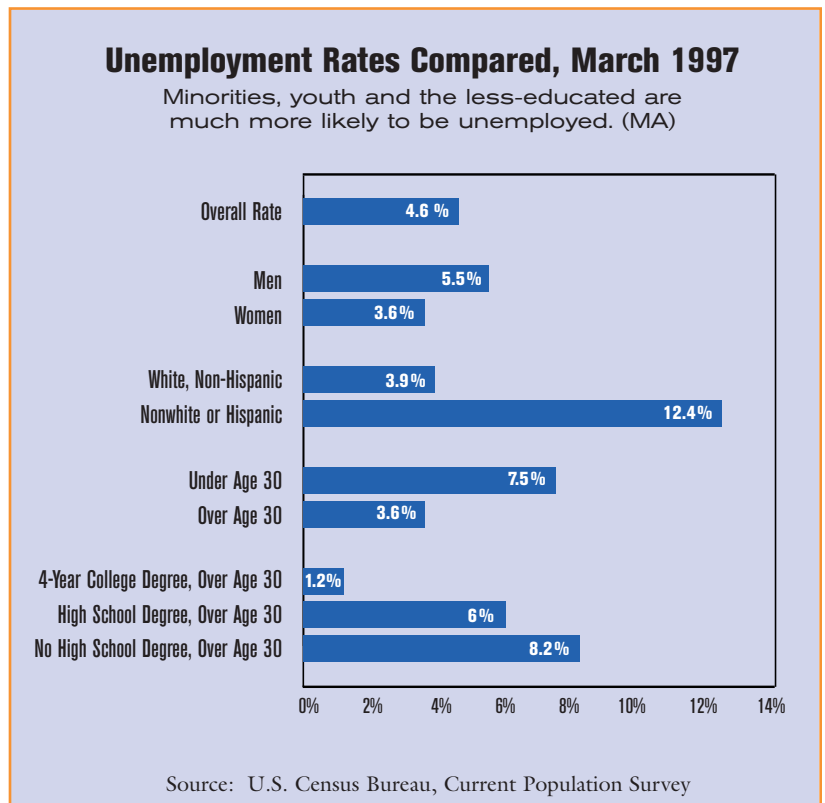
INFLATION IS CURRENTLY LOW, BUT FEARS OF RISING WAGES ARE GROWING STRONGER

Inflation continues to defy traditional cyclical patterns. In the face of increasing growth both locally and nationally — real GDP is estimated to have grown at an annual rate of 4.2 percent in the first quarter of 1998 — price inflation has remained remarkably restrained. The Boston Consumer Price Index (CPI-U) rose only 1.9 percent in the 12-month period ending in March. This is low, yet nationally consumer prices rose at an even slower pace of 1.4 percent over the same period. Producer prices for final goods actually fell by 1.2 percent in the year ending in April (0.1 percent, excluding food and energy).

The Asian crisis is contributing to price restraint in several ways. First, devaluation of the Asian Tiger nations’ currencies makes imports of final and intermediate products from that region cheaper in terms of U.S. dollars. Second, the depressed Asian economy has reduced worldwide demand for several important raw inputs to production, including oil, with consequent deflationary effects on producer prices. Third, as

international investors reallocate funds from risky Asian markets to “high quality” U.S. markets, downward pressure is exerted on domestic interest rates. This enables firms to pass savings in their interest costs on to their customers. Yet another explanation for low inflation in the face of robust growth is the “new economy” thesis of productivity-enhancing investment in technology. Whether or not this is a lasting secular phenomenon or a fortuitous cyclical event, Massachusetts has benefited, as witnessed by the growth in high-tech manufacturing and telecommunications.

Nevertheless, well-founded inflationary fears still persist. With job growth outpacing population and labor force growth, both nationally and locally, economists are worried about wage-rate growth as a cause of future inflation. Some evidence suggests that, at least among manufacturing workers, this may have already begun. For the state, during the 12-month period ending in April, hourly wages in manufacturing are 2.5 percent higher than for the previous 12-month period. This is still a moderate increase, but anecdotal evidence from the Boston Federal Reserve Bank’s *Beige Book* survey suggests that compensation of skilled workers in all sectors is under mounting upward pressure, as labor shortages become more and more acute.

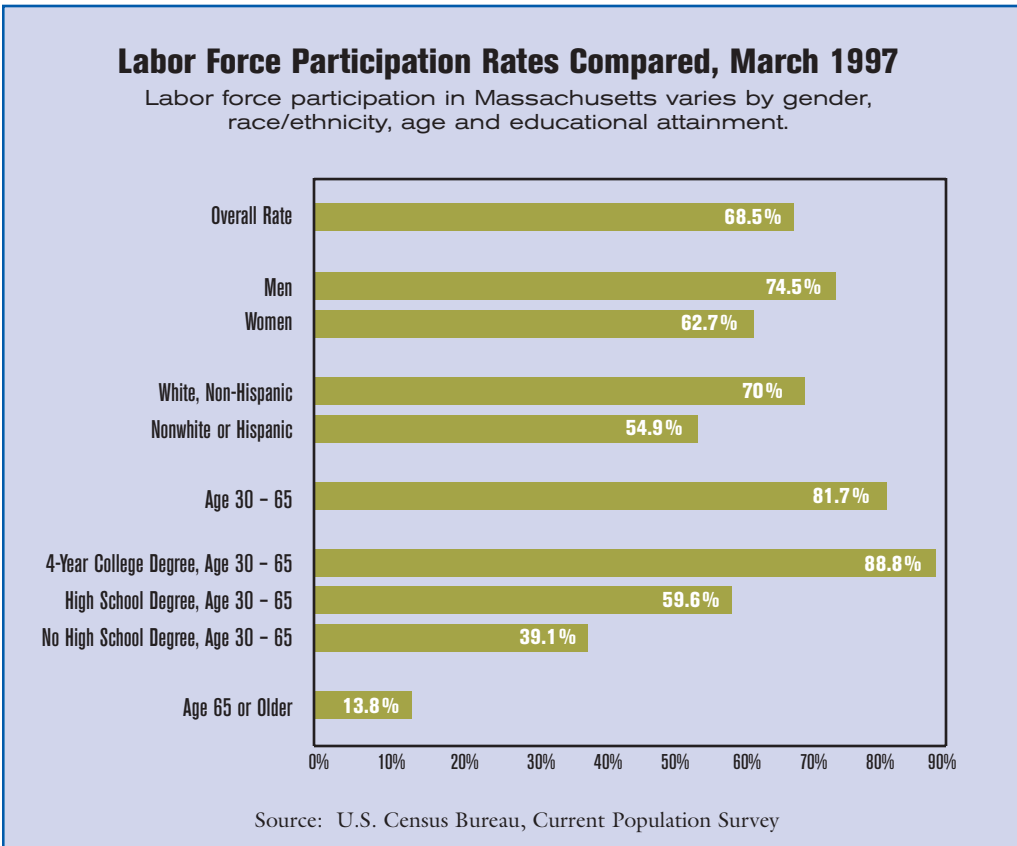


GROWTH CONSTRAINTS

At a 2.9-percent unemployment rate and a 68.4-percent labor force participation rate, Massachusetts has little room for additional growth, at least among skilled

Participation rates are also low (13.8 percent) for those over 65 years old.

These figures suggest that there are only two (non-mutually exclusive) ways for employment to continue expanding at recent rates. One way is for the expansion to extend to minorities and to persons of low educational attainment and skills. This would require employers to locate to areas they have avoided thus far: inner city neighborhoods within the Boston area, and selected regions outside the Boston metro area, such as New Bedford and Fall River. Firms throughout the commonwealth would have to hire lower-skilled workers and provide training. The second way to enable the expansion to continue is for employers to increase wage rates enough to induce even higher labor force participation among the



workers. The March 1997 Current Population Survey for Massachusetts illustrates just how tight the skilled labor market is, and where there is remaining slack. In March 1997, when the overall unemployment rate was 4.6 percent, the unemployment rate for residents over 30 years old with a four-year college degree was a mere 1.2 percent. The labor force participation rate for this group was 84.3 percent (88.8 percent if we exclude those over 65 years of age).

The pool of unemployed workers is concentrated among the less-educated (6 percent for those over 30 with a high school degree, and 8.2 percent for those over 30 with less than a high school degree), younger workers (7.5 percent for those under 30), and minorities (12.4 percent for those who are nonwhite or Hispanic). Participation rates are also low for these groups: 59.6 percent for those with only a high school degree, 39.1 percent for those with less than a high school degree, and 54.9 percent for those who are nonwhite or Hispanic.

skilled, more hours of work from those already employed, and increased participation among the elderly. Either way, there will be consequences for productivity, labor costs, and ultimately, prices and profits. ▴

1. The jobs (or employment) measure used here is the conventional measure of the number of payroll employees in nonagricultural establishments located in Massachusetts, released jointly by the Massachusetts Division of Employment and Training and the U.S. Bureau of Labor Statistics. The measure excludes the self-employed, and double counts workers who have more than one job.

2. According to the Case-Shiller-Weiss repeat sales index, housing prices in the following communities rose more than 10 percent in the year ending in the fourth quarter of 1997: Belmont, Cambridge, Everett, Malden, Medford, Mattapan, Needham, Newton, Watertown, Wellesley, West Roxbury, Westwood, and Winchester.

ALAN CLAYTON-MATTHEWS is assistant professor and director of quantitative methods in the public policy program at the University of Massachusetts Boston. He is also vice president and forecast coordinator for the New England Economic Project.