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2002
Economic Outlook Update

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The horrible events of September 11 have had a chilling effect on an already sluggish economy. Whether you watched it on television or stood on Broadway looking down Fulton Street or Maiden Lane toward the smoking rubble that was once the World Trade Center, you knew immediately that no facet of the economy would be unaffected.

I had become increasingly pessimistic about the possibility of avoiding a recession in 2001 as we moved through August and into early September. The unemployment rate surged in August to 4.9% from 4.5% the previous month. Companies continued to miss earnings projections and to announce massive layoffs. The world economy sickened. September 11 was the final nail in the coffin of the longest economic expansion in US history.

I believe the recession began before the attacks on the Pentagon and the World Trade Center. The fact that the economy posted a miniscule 0.3% gain in output in the second quarter is irrelevant. Although the popular definition of a recession is back-to-back quarters of declining gross domestic product (real GDP), it's far more complicated than that. Sometime well after the fact, the National Bureau of Economic Research will meet in Cambridge, Massachusetts to look at a plethora of economic indicators and emerge with a determination of when the expansion ended and the recession began. The date doesn't necessarily coincide with the end of a quarter, although, if I'm not mistaken, it is always the 15th of the month. I expect them to date the beginning of this recession some time in the second quarter.

Why do I think the economy was already in recession on September 11? As we've discussed before, consumer spending alone was maintaining the expansion. Business investment had long since ceased to be a positive factor. Consumer confidence plunged in September, posting one of the sharpest declines on record, according to the University of Michigan. In the first reading following the terrorist attacks, the Conference Board reported the largest one-month decline since the Gulf War in 1990. Its measure of consumer confidence is now at its lowest level since 1996. Retail sales and travel collapsed over the course of the summer. The airline industry was already set to lose $2-3 billion in 2001 and huge layoffs there were inevitable. All of this preceded September 11.

Manhattan accounts for 2.5% of our GDP. If, as *Economy.com* estimates, the terrorist attack reduced that by $30 billion, that subtracts about one percentage point from the annual rate of growth. That alone pushes an economy growing at only a 0.3% annual rate into recession.

The Revised Outlook for 2002

When I prepared the 2002 forecast in late July and early August, I gave a 55% probability to a mild recession lasting 9-12 months, a 5% probability to a more severe downturn and a 40% probability to escaping recession altogether. By the time I released the forecast on September 5, I had raised the probability of a severe recession to 10% and reduced the probability of continued expansion to 35%. Today, following the events of September 11, the probability of a serious recession lasting through the spring of 2003 has increased to 25%. Although I still attach a 10% probability to avoiding a recession, this is merely a statistical anomaly. In fact, the chances of avoiding recession are about the same as pigs flying. It's not going to happen.

What does that mean as we move though the rest of 2001 and into 2002? Consumers will continue to reduce spending, primarily on discretionary purchases such as automobiles, appliances and vacations. They will cut back on holiday spending and are more likely to save their tax rebate checks or use them to pay down a credit card bill. They will defer plans to buy a new home or a vacation home, will be less likely to relocate in hopes of finding a better job. In other words, they will hunker down and wait to see what the September terrorist events mean.

Businesses will do the same. They will reduce corporate travel, have more meetings by teleconference or videoconference, delay their few remaining plans to replace or upgrade technology or invest in new equipment. Layoffs will continue and may accelerate.

The Law of Unintended Consequences will come into play. The very actions that are responsible decisions for the individual family or company facing a time of uncertainty will play havoc with the economy. Each canceled order or spending plan ensures more layoffs, more negative headlines, further declines in consumer and business confidence and even further reductions in spending. The downward cycle will continue until inventories are finally worked off, cars and appliances wear out, some sector of the world's economy recovers enough to boost export demand or some other event gets the economy back on track.

I see no way for the US to avoid a recession. The longest economic expansion in our history is over. The only question is whether it will be a typical post-war downturn, lasting about 12 months with growth underway next summer. Or, will it be a more serious collapse that will have the economy staggering until well into 2003?

The Colorado Outlook

As the nation goes, so will go the Colorado economy. The only two healthy sectors of the basic economy today are mining, primarily oil and gas, and agriculture, in large part because of huge government subsidies. These two sectors account for less than three percent of the Colorado workforce.

Construction, which was strong through the first half of the year, suffered job losses in July and August. Employment also declined on an August 2001/August 2000 basis in manufacturing (for the fifth consecutive month), transportation/ public utilities (down for six months) and finance/insurance/real estate (down for five months). With the unemployment rate at 3.6% and rising in August, recession has engulfed the local economy as well. Recovery will not begin locally until it is underway at the national level.

COLORADO ECONOMIC INDICATORS

	2000	*2001e*	*2002f*	*99/00*	*00/01e*	*01/02f*
Population (000s)	4,325	4,406	4,486	2.6%	1.9%	1.8%
Net Migration	62,000	50,000	45,000	n/a	n/a	n/a
Wage and Salary Employment (000s)	2,214.8	2270	2309	3.9%	2.5%	1.7%
Unemployment Rate	2.7%			n/a	n/a	n/a
Personal Income (bil)	$141.7	151.8	159.7	10.8%	7.1%	5.2%
Per Capita Income	$32,949	$34,453	$35,600	4.4%	4.6%	3.3%
Retail Sales (bil)	$90.5	$92.1	$96.0	11.5%	1.8%	4.2%
Housing Permits (units)	54,596	53,340	46,459	10.7%	(2.3)%	(12.9)%
Nonresidential Building Contracts (millions)	$3,244.2	$3,179	$2,836	(14.1)%	(2.0)%	(10.8)%
Denver-Boulder CPI-U (1982-84=100)	173.3	182.0	189.5	4.0%	5.0%	4.1%

n/a = not applicable   e = estimate   f = forecast