ERIE
Economic Research Institute of Erie
ERIE is a research center of the Black School of Business at Penn State Behrend

ISSUE 29 | Fall 2018

ELI Erie Leading Index

3RD QUARTER 2018 REPORT

After a Record-Breaking Quarter, ELI Retreats and Fights the Early Winter Blues

Decreases in Erie manufacturing employment and the U.S. interest rate spread contributed to ELI's slight decline

Manufacturing as Well as Overall Job Growth Continue to Pose Challenges as the Regional Economy Evolves

After a record-setting increase of 2.1% last quarter, the Erie Leading Index (ELI) has retreated once again. Although the recent decline in the index was by a very modest amount (less than two-tenths of one percent), ELI is still an important indicator to watch since its movements provide important clues about the state of the local economy in the months ahead.

ELI's decline this quarter reflects the continued sluggish employment growth in the local manufacturing sector. After remaining relatively stable in the first part of the year and rising to this year's peak of 19,000 by July, Erie manufacturing employment has fallen back to 18,800 in October, the same level as in January. According to the latest statistics from the Pennsylvania Department of Labor and Industry, this represents a decline of 1.1% (200 jobs) compared to a year ago. On a seasonally adjusted basis, Erie manufacturing employment fell by 2.2% (420 jobs) between March and June alone.

Other sectors in the local economy that experienced negative job growth over the course of the year, between January and October, include information (–9.1% or –100 jobs), wholesale trade (–2.9% or –100 jobs), and other services (–1.7% or –100 jobs).

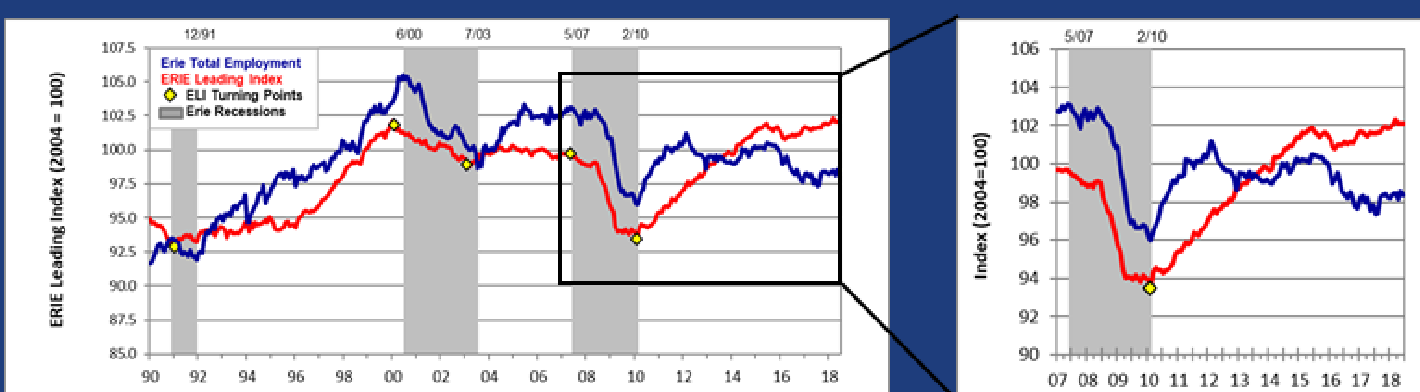
A little bit of good news is that total nonfarm employment still increased by 3.7% (4,600 jobs) between January and October, although this represents a slight seasonally-adjusted year-over-year decrease of 0.2% (200 jobs) for the month of October.

Sectors of the local economy that did experience job growth year-over-year in October were: mining, logging, and construction (+2.3% or 100 jobs); state government (+2.1% or 100 jobs); leisure and hospitality (+2.0% or 300 jobs); education and health services (+1.7% or 500 jobs); and financial activities (+1.6% or 100 jobs).

Overall, these employment trends reflect the gradual but continued evolution of the local economy toward more service-oriented production. Employment in the local goods-producing sectors fell by 0.4% (100 jobs) to 23,300 year-over-year in October, while employment in the local private service-producing sectors held steady at 89,700 during the same period.

The lackluster local job numbers are also reflected in Erie's seasonally-adjusted unemployment rate, which began to inch back upward from 4.3% in August to 4.5% in September to 4.7 % in October, after having fallen from 5.5% a year ago. Erie's unemployment rate remains higher than that in the state and nation, where the unemployment rate has remained at 4.1% and 3.7%, respectively, for both September and October.

Additionally, while the local labor force, which includes the employed plus those who are seeking work, increased by a modest 0.7% (900 individuals) between August and October, it has fallen by 0.9% (1,200 individuals) compared to a year ago.



*Data through June 2018

Components of ELI

Variable	March	April	May	June	Mar.-June	% Change*	Weights
ERIE Leading Index	**102.29**	**102.08**	**102.09**	**102.10**	**-0.20**	**-0.19**	**1.000**
U.S. Interest Rate Spread (%)	1.3	1.2	1.3	1.1	-0.24	-18.05	0.304
U.S. Index of Coincident Indicators (2004=100)	103.3	103.5	103.6	103.9	0.60	0.58	0.268
U.S. Real Money Supply (M2) (bill of chained 2009 $)	12,941.6	12,937.1	12,979.5	13,047.6	106.00	0.82	0.182
PA Avg Weekly Hours in Manufacturing (hours)	41.6	41.7	41.3	41.5	-0.04	-0.10	0.073
Erie Manufacturing Employment (thou of jobs)	19.1	18.9	18.9	18.7	-0.42	-2.20	0.086
U.S. TS Freight Index (2000=100)	134.6	134.4	135.9	136.5	1.90	1.41	0.050
S&P 500 Stock Index (1941-43=10)	2,702.8	2,653.6	2,701.5	2,754.5	51.58	1.91	0.022
U.S. Building Permits (thou of units)	1,377	1,364	1,301	1,273	-104.00	-7.55	0.016

*Symmetric % change, using the average value of the series in the last quarter as the base. *Changes may differ from hand calculations due to rounding.*

Four of ELI's components fell between March and June, pulling the index down by just under two-tenths of one percent.

The component that decreased most was the U.S. Interest Rate Spread, falling by 18.1%. Measured as the difference between the 10-year Treasury bond yield and the short-term federal funds rate, it reflects the long-term goals for bond market investors and the current stance of monetary policy on the part of the U.S. Federal Reserve. The Interest Rate Spread is key to watch as research shows an "inversion of the yield curve" (i.e., when there is a negative interest rate spread because short-term rates are higher than long-term rates) may signal an economic downturn.

The Interest Rate Spread may again narrow as the Fed raises short-term rates amid further national economic growth. U.S. real gross domestic product or GDP, a broad measure of aggregate production and output, increased at an annual rate of 3.5% in the third quarter after rising by 2.2% and 4.2% in the first and second quarters, respectively. By comparison, in 2017, real GDP increased by 2.2%. The continued strength of the national economy would ordinarily generate positive spillover effects on the Erie economy, since it tends to lead it.

But with the continued expansion of the U.S. economy and the concomitant concerns that this might push inflation above the target level of 2%, the Fed has raised its benchmark federal funds rate for the third time this year to a range between 2% and 2.25%. The Fed will likely raise the rate again in December, moving it closer to the 3% level that most Fed officials consider as "neutral;" it would neither stimulate nor stifle economic growth. Furthermore, unless the national economy suddenly stalls, the Fed is likely to push short-term interest rates even higher next year.

It will be important to track the Fed's monetary policy stance, and to gauge the likelihood that it leads to a negative interest rate spread. At a minimum, continued monetary tightening may dampen U.S. economic growth, and this may adversely affect the local economy.

A second factor that pulled ELI down was a decline in Erie Manufacturing Employment, which fell on a seasonally adjusted basis by 2.2% (420 jobs). Pennsylvania Average Weekly Hours in Manufacturing also fell slightly by 0.1 percent. Finally, U.S. Building Permits decreased by 7.6% after increasing by 4.3% in the last quarter.

It is noteworthy that the U.S. Transportation Services Freight Index rose by 1.4% and the S&P 500 Stock Index rose by 1.9%. But these increases, along with modest increases in the U.S. Real Money Supply and the U.S. Index of Coincident Indicators, could not offset the decreases in the other four ELI components.

Upcoming factors that may affect the national and local economies include the congressional debate over approving the new US-Mexico-Canada trade agreement, the uncertainty over U.S. tariffs, and potential changes in fiscal and regulatory policies resulting from midterm elections.

Four ELI components fell this quarter!

Trends and Implications for Different Sectors of the Erie Economy

Goods-Producing Sectors

Mining, Logging, and Construction:

After rising by 27% (1,000 jobs) between March and August, employment in this sector has fallen by 4.3% (200 jobs) since then, as firms prepare for winter. But employment is still up by 2.3% (100 jobs) year-over-year in October and currently stands at 4,500. Regulatory, environmental, and trade policy, including the new US-Mexico-Canada trade agreement, may affect this sector.

Manufacturing:

Employment in this sector rose to a peak for the year of 19,000 by July, but has fallen back to 18,800 in October. This represents a decline of 1.1% (200 jobs) compared to a year ago. Rapid changes in technology, globalization, and government policy will continue to affect this sector, as will the new US-Mexico-Canada trade agreement which has to be ratified by Congress.

Plastics & Rubber Products Mfg:

Employment in this sector has remained quite stable throughout the year and stood at 4,400 in October, unchanged compared to a year ago. Just as in manufacturing overall, technology, globalization, and government policy can affect this sector. The new Shell cracker plant is expected to boost employment in the long run.

Private Service-Providing Sectors

Wholesale Trade:

Employment in this sector remained stable at 3,500 throughout the first nine months of the year, but fell by 2.9% (100 jobs) to 3,400 both in October and compared to a year ago. Seasonal expenditure patterns can affect this sector, as can government fiscal, monetary, and trade policies that influence the global supply chain, such as the new US-Mexico-Canada trade agreement.

Retail Trade:

After falling slightly since May, employment in this sector has recovered in October to the peak level for the year of 14,600. However, this represents a year-over-year decrease of 0.7% (100 jobs). The upcoming holiday season may provide a boost, and government fiscal and monetary policies that affect household disposable incomes can influence this sector.

Transportation, Warehousing, Utilities:

After a few slight dips, employment in this sector has risen back to 3,300 in October, the same level as in January. However, this represents a year-over-year decline of 2.9% (100 jobs). Seasonal factors, government policies, as well as new technologies that affect the global supply chain can influence this sector.

Information:

This broad sector encompasses the following industries: publishing (including software, traditional, and Internet publishing), motion picture and sound recording, broadcasting (including traditional and Internet broadcasting), data processing, and information services. In October, employment in this sector was 1,000, down 9.1% (100 jobs) compared to a year ago. Changes in technology will affect this sector.

Financial Activities:

This sector has been stable, with employment remaining at 6,300 throughout most of the year, but rising by 1.6% (100 jobs) to 6,400 both in October and compared to a year ago. Innovations in data and information processing, as well as government fiscal, monetary, regulatory, and trade policies that affect household and corporate financial decisions, such as the Tax Cuts and Jobs Act, will affect this sector.

Professional and Business Services:

Employment in this sector rose by 6.1% (600 jobs) between January and October to stand at 10,400. However, this represents a year-over-year decrease of 1.9% (200 jobs). As in most other sectors, employment in this sector can be affected by changes in government regulatory fiscal, monetary, and trade policies such as the Tax Cuts and Jobs Act.

Education and Health Services:

Between January and October, employment in this sector rose by 3.5% (1,000 jobs). Moreover, the current employment level of 29,700 represents a year-over-year increase of 1.7% (500 jobs). This continues to be the largest sector (by employment) in the local economy. Education and health care policy, educational and medical technology, and shifting demographics in the local region, are all likely to affect this sector.

Leisure and Hospitality:

Employment in this sector increased by a robust 24% (3,300 jobs) between January and July, reaching a peak level for the year of 17,000. While employment has fallen back, as expected with the changing of the seasons, the October level of 15,100 still represents a year-over-year increase of 2.0% (300 jobs). In addition to seasonal patterns, employment is likely to expand with the development of the Bayfront and other efforts to promote the Erie region.

Other Services:

Employment in this sector rose from 5,900 in January to a peak level for the year of 6,200 in June. But it has fallen back to 5,800 in October, a decline of 4.9% (300 jobs) compared to a year ago. Changes in the industrial structure of the local economy as well as government policies that affect household disposable incomes and business and household consumption patterns are likely to influence this sector.

Government Sector

As of October 2018, Erie employment in the government sector stood at 16,500, the highest level reached for the year, but down 0.6% (100 jobs) compared to a year ago. Federal government employment remained unchanged at 1,600 throughout the first ten months of the year, the same level compared to a year ago. Changes in state and local government employment normally occur over the course of the school year. State government employment fell by 15.2% (700 jobs), between May and August before rising back to 4,900 in October, representing an increase of 2.1% (100 jobs) compared to a year ago. Local government employment has also fluctuated during the year, falling during the summer months, but the October employment level of 10,000 is the same as that in January. However, this represents a decrease in local government employment by 2.0% (200 jobs) compared to a year ago. Federal as well as state education, fiscal, and regulatory policies may also affect local government employment at all three levels.

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