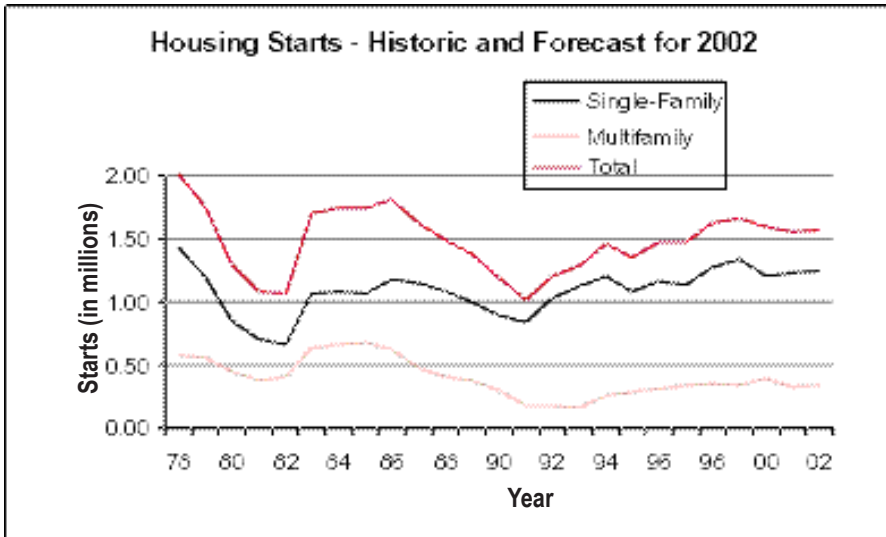


Figure 1



Freddie Mac expects annual growth in home prices to slow to more normal levels, in the 4 to 5 percent range, over the rest of the year. The Federal Reserve Bank's efforts to boost the economy through lower interest rates should help the housing sector remain vibrant and healthy.

Indiana

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The national median existing-home price was \$148,100 in September, up 4.6 percent from September 2000 when the median price was \$141,600. The median is the midpoint, which is a typical market price where half of the homes sold for more and half sold for less.

Regionally, existing homes in the Midwest were selling at an annual rate of 1.08 million units in September, down 9.2 percent from August; the pace was 3.6 percent below September 2000. The median price in the Midwest was \$131,000, up 2.6 percent from September 2000.

Growth in home values increased by an annualized rate of 6.9 percent nationwide in the second quarter of 2001, down from a revised annualized rate of 9.2 percent for the first quarter of 2001, according to the Conventional Mortgage Home Price Index released recently by Freddie Mac. The index showed that annual house-price appreciation also increased 8.5 percent from the second quarter of 2000 through the second quarter of 2001.

Housing has remained a strong sector throughout the first half of 2001, due in part to the low mortgage interest rates that prevailed throughout that period. Nationally, home values have appreciated at more than twice the rate of consumer price inflation, which means housing remains a good investment for families.

Indiana was hit hard by the recession in the early 1980s. From peak employment in mid-1979 to the low point in first quarter 1983, the number of jobs in Indiana fell by 14 percent. The state unemployment rate reached 12.7 percent by Christmas 1982 (see **Figure 1**), well above the national peak of 10.8 percent.

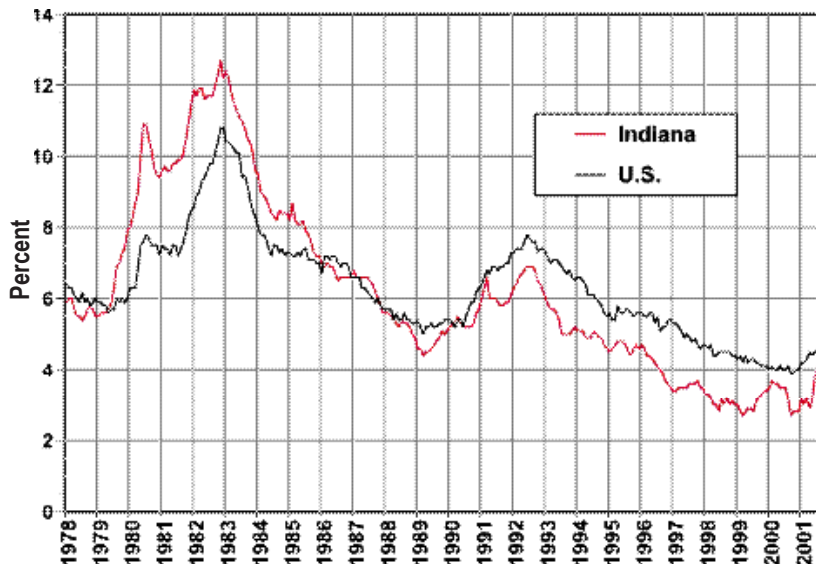
It was three years—1986—before employment in the state climbed back to 1979 levels. The state's unemployment rate stayed above the national average until 1986, too.

As Hoosiers now battle the recession of '01-'02, the situation for Indiana does not look as bad as it did in 1982. Interest rates today are at historical lows instead of at historical highs as they were in the early 1980s, and oil prices are relatively low and stable.

Ironically, one factor that appears to be working in the state's favor is the relatively slow population growth rate of the last decade. The rate of people moving into Indiana slowed markedly in the last few years. The result was a population increase from 1990 to 2000 of only 9.7 percent. Since the average in the nation was 13.2 percent, our relative decline cost Hoosiers a seat in the U.S. Congress.

Figure 1
Unemployment Rates

Indiana's unemployment rate was worse than the U.S. rate in the 1982 recession. Since 1991, Indiana's rate has been better than the U.S. rate.



With the slow growth in Indiana's labor force came labor shortages during the boom years of the 1990s. Demand for more employees in a tight labor market drove the state's unemployment rate to the record low level of 2.7 percent in late 2000. By comparison, the lowest rate that year for the country as a whole was 3.9 percent. As a result, Indiana enters this period of economic weakness with a comparatively healthy employment picture. Our unemployment rate in late 2001 remains near 4 percent—still not bad by historical standards and still below the national rate.

There is another factor that may protect the state from the worst of the recession. Indiana now possesses a more diverse mix of industries compared to 20 years ago. In 1981, 31 percent of all jobs in Indiana were in manufacturing. By 1990 that was down to 25 percent, and this year the percentage is just 22 percent. Even within the manufacturing sector, Indiana's mix has broadened. United States-headquartered auto manufacturers continue to face market share problems. But many jobs in Indiana are now at plants supplying Japanese-owned car companies (whose sales have held up well this year), or at medical device manufacturing firms with growing demand.

And despite widely publicized programs aimed at bringing more "dot.com" business to Indiana in the late 1990s, conservative Hoosier businesspeople

were slow to join the swelling bubble of Internet startup companies. When that bubble burst a year ago, Indiana's economy serendipitously dodged the fallout.

Manufacturing's prominence in Indiana dimmed significantly in late 1997. That was when services industries as a group overtook manufacturing and claimed the largest share of the state's employment. Services industries continued to expand to 26 percent of employment by the end of 2001. This rise in services industries is another form of diversification that will bolster Indiana during the recession.

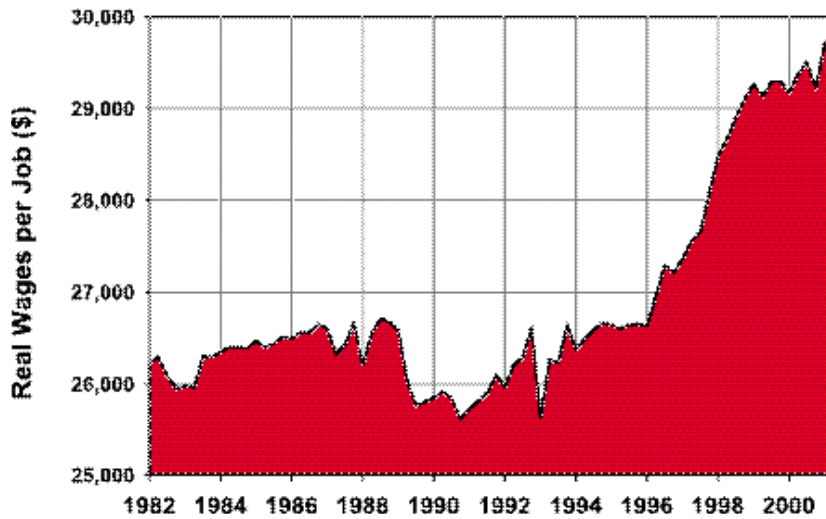
But the term *services* covers everything from lawn care to law firms. What are the big sectors in Indiana's services industry? The two principal subdivisions are health services and business services. Health care jobs now account for 8 percent of all jobs, up from 6.5 percent in 1982. And the business services category, which includes accounting firms and software companies, has nearly doubled its share of Indiana employment, from 3 percent in 1991 to 5.4 percent today.

There is no reason to think we are sacrificing good-paying factory jobs for lower-paying service jobs. Consider the average real annual wage per job in Indiana (see **Figure 2**). After practically no increase at all for almost 15 years after 1982, it began climbing in 1994. By the end of second quarter 2001, the average was up 13 percent since 1994. So the swing to more service industry jobs has not been accompanied by a decline in wages per job.

In 2002, the contraction in Indiana's economy will be limited by the momentum the state carries into this recession. The general U.S. recession will be no more severe than average and output will start expanding again by mid-year—provided no further major shocks to the economy take place. The outlook for Indiana is:

- Indiana's unemployment rate will rise toward the national average, probably exceeding 6 percent by midyear. Even as the third-quarter recovery begins, however, it is likely to begin gradually. So expect the state unemployment rate to remain near 6 percent throughout the second half of 2002.
- In the greater Indianapolis metro area, economic conditions are strongest. Rural Indiana counties and slow-growth metro areas like Kokomo, Terre Haute, Gary and South Bend are likely to experience higher unemployment rates than the state average.

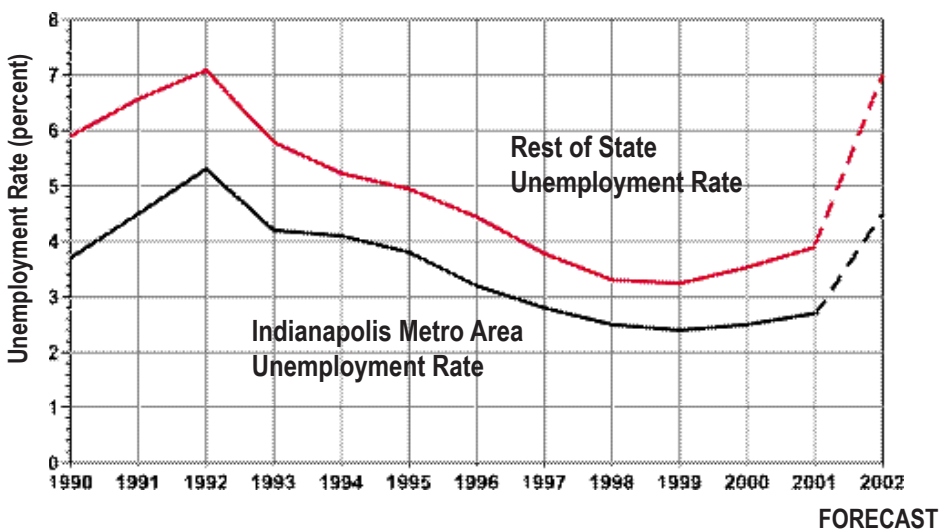
Figure 2
Indiana Real Wages per Job: Quarterly Wages at Annual Rate (1996 dollars)
Real wages changed little in the 1980s but have risen sharply since 1983, even as the share of jobs in services rose.



The unemployment rate in metro Indianapolis should stay below 6 percent. But in many places around the rest of the state, expect unemployment to exceed 7 percent (see **Figure 3**).

- Total jobs, now down about 1 percent from third quarter 2000, will slip at least another two percentage points. That 3 percent to 4 percent decline translates into a shrinkage of about 90,000 jobs since the peak in 2000. By the end of 2002, employment should be on the rise again. There were 3 million jobs in Indiana in 2000, though. For a return to that level, we probably will have to wait until 2003.
- Manufacturing employment will see a larger percent decline, as layoffs continue through the winter. Barring unusual weather, construction employment should do better than manufacturing. And services industries not linked to manufacturing are likely to suffer very few job losses.

Figure 3
Unemployment Rate Percent in Indianapolis and the Rest of Indiana



For additional information on the state of Indiana's economy, please read on.