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Indiana Business Review



Outlook 2003

Problems in Economy May Not Be As Large As They Appear

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For the Record:

According to the Bureau of Labor Statistics, there are one hundred economists in the state of Indiana. A quick perusal of the Economists@Indiana University web page reveals forty-four economists on the Bloomington campus of Indiana University alone, with at least six more at the various other IU campuses. Therefore, an astounding 50 percent of the state's economists are part of the Indiana University network. What better testament that both the Annual Outlook Tour (since 1972) and the annual outlook edition of the IBR originate from this university?

Revealed within these pages are closely observed details on the entire spectrum of economies affecting Hoosiers. The authors have spent considerable time researching and analyzing past economic events in order to forecast what we may face in the next year.

A talented cadre of economic experts share their expertise with the citizens of Indiana in broad (the tour traveled to ten Hoosier cites in just two weeks) and accessible ways (the written forecasts appear in print and on the web), making significant and noteworthy contributions to this state and its economic development.

—COR

Outlook for 2003

After the longest economic expansion in U.S. history, the economy slipped into recession in March 2001. Fortunately, it turned out to be fairly short and fairly mild. We estimate that the recession ended in the first quarter of 2002. That makes it less than a year in length. The peak to trough decline in real Gross Domestic Product (GDP) was only 0.6 percent. Both in depth and duration, this was a minor recession.

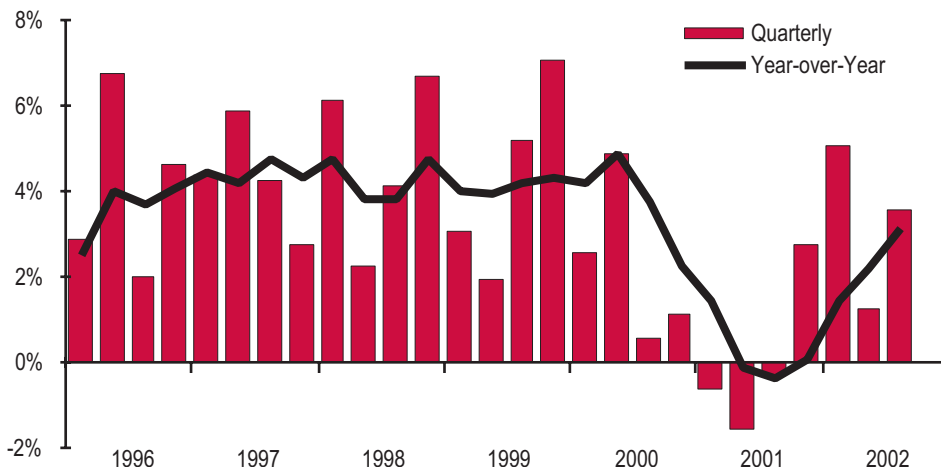
The recovery now under way has also been modest. Real economic growth has averaged 3.0 percent over the last four calendar quarters, a solid performance but not spectacular. The questions we face as we look to 2003 are many. Will the economy continue to grow? Will the recovery accelerate? Will inflation remain in check? What are the domestic and international risks we face?

The articles that follow address these questions and others. Bill Witte gives us an overview of the national economy and the major domestic issues we face. Andreas Hauskrecht provides background on the international economy, a key factor in the prospects for the U.S. economy. Robert Neal and Bill Sartoris examine the financial markets and give some clues on where interest rates and equity prices might be heading. Jeffrey Fisher analyzes the housing market, which has been a bright spot in the economy through the last few troubled years. Finally, Morton Marcus compares how Indiana and the U.S. have reacted to the recession. ◀

R. Jeffery Green

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Figure 1
Real Output—Annual Rate of Change



The U.S. Economy

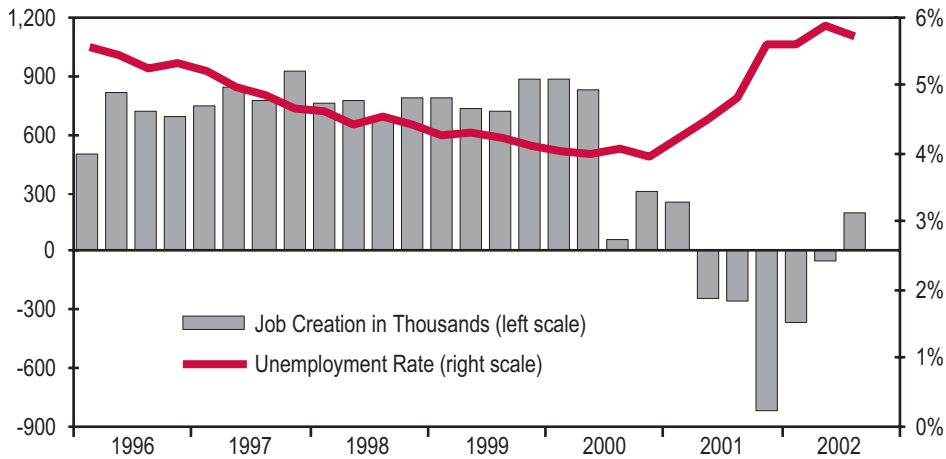
Willard E. Witte

Associate Professor of Economics, Indiana
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The performance of the U.S. economy during the past year is something of a paradox. A year ago, in our preview of the prospects for 2002, we forecast that the recession would probably end during the second quarter, with growth for the year of only 1 percent. We thought that inflation would be a little above 2 percent and that unemployment would average 6.3 percent. Each of these estimates has proved to be too pessimistic. In fact, the recession was clearly over by last spring. Output growth during the first three quarters of 2002 has averaged above 3 percent, while inflation (as measured by the consumer price index) has been below 1.5 percent over the past year. The unemployment rate is currently 6.0 percent, and the average for 2002 as a whole will be about 5.8 percent. Productivity growth has been strong. Overall, it was not a bad performance, and certainly better than expected.

The paradox is that it doesn't feel very good. Most people would probably say that the economy has worsened over the past year. Some of the reasons for this disconnect are easy to perceive. One is that the standard of comparison is set by the exuberance of the 1996–99 period, one of the best in U.S. economic history. As is shown in **Figure 1**, year-over-year output growth (real GDP) was consistently above 4 percent over that period, with quarterly spikes that often surpassed a 6 percent rate. By comparison, the 3 percent growth over the past year seems unsatisfactory. The same type of situation prevails in the labor market, as shown in **Figure 2**. Over the four-and-a-half years prior to mid-2000, the U.S. economy added over 3 million jobs per year. By contrast, during the five quarters prior to the middle of this year over 1.7 million jobs were lost. This is the dark side of rapid productivity growth. With rising productivity, fewer workers are needed to produce the same output. In the 1990 recession, it was three full years after the onset of the downturn before employment again reached its level at the cyclical peak. The current recovery may be on a similar trajectory.

Figure 2
Changes to Labor Market



A second reason why the economic situation seems darker than the raw numbers is a tendency to think in terms of goods markets. Goods account for less than half of the value of total demand and less than a fifth of total employment, but they represent our image of what the economy is really about. During the recession, total output declined for three quarters and by a total of only 0.6 percent. The drop in goods production lasted five quarters and totaled almost 2.7 percent. Total output reached its previous peak in the fourth quarter of last year, only one quarter after the recession trough. Goods production was still below water until this year's third quarter. As shown in **Figure 3**, both investment in equipment and exports are indicative of this pattern. After rapid growth in the 1990s, both sectors plunged during 2001. Through the third quarter of this year both are still 10 percent below their peak levels. In the labor market, employment in goods production started to decline in the second quarter of 2000 (a year earlier than overall employment) and accounts for all of the overall job loss and then some.

Other factors have been reinforcing a bias toward pessimism as well. The steady barrage of news about corporate criminality and malfeasance and the dismal performance of the stock market do nothing to encourage confidence. Deranged snipers and continuous warnings about possible terrorist threats also weigh on the mind.

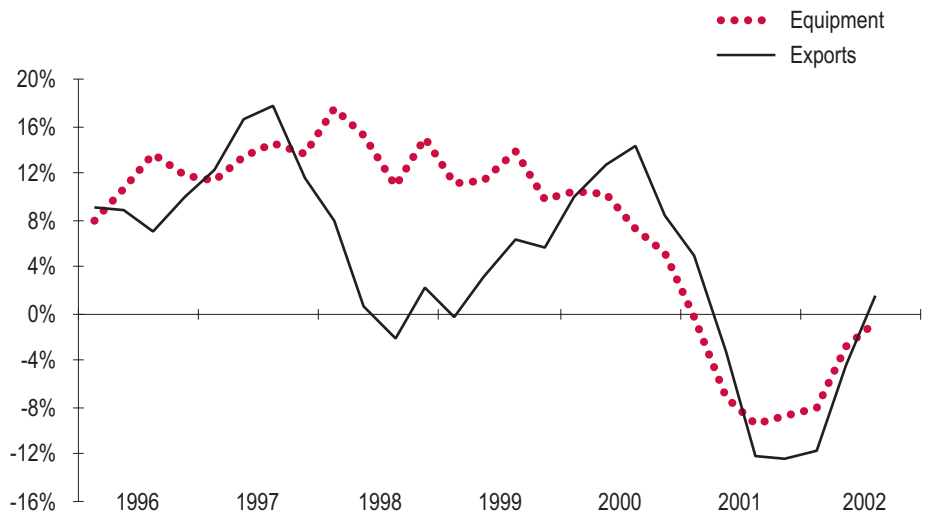
We don't expect great cheers of joy, but we think the economy will continue to move upward in 2003.

Clearly, it is not hard to be negative. However, we choose to see the glass as half full rather than half empty. We don't expect great cheers of joy or a booming economy in 2003, but we think the economy will continue to move upward as it has this year. After a relatively slow fourth quarter to end 2002, we expect output to grow at about 3.2 percent during the next year. As was the case this year, consumer spending plus a strong increase in federal government expenditures will lead growth. The positive side of rising productivity is that it raises income levels. After mid-year, business investment will become a positive force as well. Other sectors will contribute less. Construction will do well to maintain its current levels. For housing, it should be said, this would mean holding at a very high level. In the government sector, much of the federal stimulus will be offset by retrenchment from budget-constrained state and local units. Finally, weak economies in much of the rest of the world mean that exports will struggle to keep pace with rising imports, keeping the trade deficit in record territory.

Inflation has been notable the past two years only by its absence, a situation we expect to continue. Consumer prices will rise a little more rapidly than the past year, but still only by a little more than 2 percent.

Good, but not great, output growth combined with a continuing rise in productivity implies that the labor market situation may

Figure 3
Demand for Goods—Annual Rate of Change



The International Economy

hold its own, but not much more. The economy will add about 1.5 million jobs, but this will only be enough to produce a small reduction in the unemployment rate. Virtually all of the added employment will be in the services sector.

In the financial markets, we expect the Federal Reserve to hold short-term interest rates stable until well into next year. Rates are currently at a 40-year low, and we do not expect any further Fed easing beyond their cut in early November. We think rates a year from now will be a little above current levels.

Risks

All things considered, this is a relatively sanguine outlook. It is, however, by no means a sure thing. It could be thrown off track by a variety of developments. Some risks are non-economic. Further terrorist events in the U.S. would be a setback. The course of events in Iraq is a great imponderable, and its economic consequences are nearly impossible to predict. A quick resolution would probably be a positive; a quagmire would eventually be a negative.

Economic risks are very much present as well. Over the past two years, we have been reminded with emphasis that equity markets can go down as well as up. By some measures, equity values are still very high, especially if corporations continue to find profit increases elusive. So far, declines in their market holdings have not affected households' willingness to spend. If the market were to fall further, damaging effects on spending would become increasingly more likely.

A related concern is the housing market. Some observers think the rise in housing prices over the past few years is producing a bubble akin to that in technology stocks prior to 2000. While about half of American households own stocks, in many cases the ownership is indirect, via pension funds or 401k plans. But two-thirds of households own homes, and in most cases it is their largest asset. If there is a bubble, and if it bursts, the wound could be deep.

A third underlying concern is the very large U.S. trade deficit, which has been rising steadily for over a decade. This is the normal pattern during a strong expansion like that of the 1990s, as increasing income leads to rising purchase of imports. Usually,

however, recession yields a reversal. During the expansion in the 1980s, for example, the deficit rose to almost 3 percent of GDP. But when the economy weakened after 1990, the deficit came down almost to the point of balance in 1992. By contrast, during the recent recession, the deficit has continued to grow. In the third quarter of this year it amounted to 5.2 percent of GDP. The mirror image of the trade deficit is an equal level of borrowing from abroad. At some point this imbalance must be corrected. The questions are when and how? One element will probably be a decline in the value of the dollar. If this unfolds abruptly, all bets are off. In the short run, depreciation could be stimulative, making U.S. goods more competitive on world markets. But it would also be inflationary, probably pushing the Federal Reserve toward higher rates.

Each of the problems just discussed represents risks that things will change. A final risk is that things will simply continue as they are with consumption alone pushing the economy slowly uphill. Even without troubles abroad or in the market, this would be a risky imbalance.

But we think that investment will take a little pressure off consumption and that with a little luck the U.S. economy will rack up another adequate, but not great, performance in 2003. ◀

Andreas Hauskrecht

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World economic growth for 2002 is estimated at 2.2 percent, measured in terms of real Gross Domestic Product (GDP), compared to growth rates of 4.7 percent in 2000 and 2.2 percent in 2001. The International Monetary Fund in Washington forecasts world economic growth for 2003 at a disappointing 2.8 percent and points to evidence for a probably even lower growth rate.

The world still lacks a power engine, a growth locomotive to help pull other regions out of economic struggles. The recovery in the U.S. and Europe is delayed and more modest than originally hoped. Japan is still stuck with a combination of deflation and a very low growth rate of GDP with the imminent risk of falling back into recession. Moreover, Latin America is on the brink of an economic collapse. Gleams of hope are the prospects for Southeast Asia and, to a smaller extent, for Middle and Eastern Europe and Russia (see **Table 1**).

Table 1
Growth Comparisons for Selected Countries

Country	GDP		Inflation (Consumer Price Index)		Current Account (Percent of GDP)		Unemployment	
	2002	2003	2002	2003	2002	2003	2002	2003
United States	2.2	3.25	1.5	2.3	-4.6	-4.7	5.9	6.3
Canada	3.4	3.4	1.8	2.1	1.7	1.9	7.6	6.7
Japan	-0.5	1.0	-1.0	-0.6	3.0	2.9	5.5	5.6
France	1.2	2.3	1.8	1.4	1.9	1.4	9.0	8.9
Germany	0.5	2.0	1.4	1.1	1.9	2.1	8.3	8.3
Italy	0.7	2.3	2.4	1.8	0.2	0.2	9.3	8.9
Euro Area	0.9	2.3	2.1	1.6	1.1	1.0	8.4	8.2
United Kingdom	1.7	2.4	1.9	2.1	-2.1	-2.3	5.2	5.3
Mexico	1.5	4.0	4.8	3.7	-4.5	-4.1	-	-
Brazil	1.5	3.0	6.5	4.3	-3.8	-3.6	-	-
China	7.5	7.2	-0.4	1.5	1.5	1.0	-	-
India	5.0	5.7	4.5	5.1	0.1	0	-	-
South Korea	6.3	5.9	2.7	3.3	2.1	1.5	0.9	3.0
Taiwan	3.3	4.4	0.4	1.6	5.8	5.9	5.0	4.9

Europe

Despite already modest forecasts for the growth rate of real GDP, the core European countries performed even worse than predicted. Germany's growth rate of real GDP in 2001 was a diminutive 0.5 percent. France, Italy, and the United Kingdom all showed growth rates of GDP below 2.0 percent. The picture for 2003 looks only slightly brighter with an expected economic growth rate of 2.3 percent for the European Union.

The explanation for this gloomy outlook is multifaceted. With low domestic demand, Europe's economic prospects depend largely on dynamic export growth. The dramatic stock market price decline further weakened domestic consumption and investment. Universal banks and life insurers keep huge unrealized losses from large equity holdings in their balance sheets that depress lending. In contrast to the U.S., and not well understood by economists, productivity growth in Europe is declining and tarnishes growth perspectives. Considering the rapid aging of European society, far-reaching reforms of the social insurance schemes and the labor markets are urgently needed. While current interest rate levels are appropriate for Euro-member countries with inflation rates above 3.0 percent (such as Ireland and Spain), they are clearly too high for Germany, Italy, and France. Furthermore, the strict rules of the stabilization pact do not allow the needed fiscal stimulus.

North America

The best guess for the U.S. economy is a continued but modest economic recovery and a growth of real GDP slightly above 3.0 percent. Productivity growth rates are encouraging signals for a continuing self-sustained growth path.

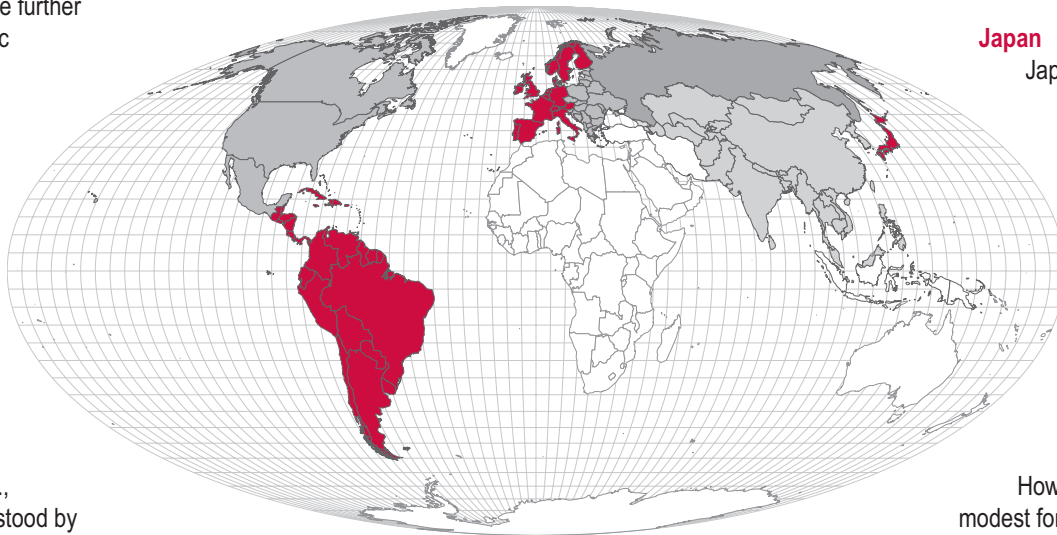
NAFTA members are closely integrated through trade. Canada and Mexico are strongly dependent on U.S. demand for their exports. Real GDP growth for Mexico and Canada in 2003 is expected to be considerably above the world average with around 4.0 percent and 3.4 percent, respectively.

Russia and Eastern Europe

Russia and most Middle and Eastern European countries are doing well and look rather optimistically toward 2003 with expected growth rates of about 4.0 percent. Still, these economies are too small to have a profound effect on world economic growth.

Asia

The picture for emerging economies in 2003 looks very diverse. Asia recovered surprisingly fast and well from the recession; real GDP growth for 2003 is estimated at 6.1 percent. Highlights are China and India with forecasted growth rates of 7.2 percent and 5.7 percent, respectively.



Japan

Japan seems unable to come out of its economic calamity. Real GDP growth is estimated to be at -0.5 percent in 2002 while a meek increase of 1.0 percent is predicted for 2003.

However, even this modest forecast might be overly optimistic. Export growth is jeopardized by a stronger yen against the U.S. dollar and the euro. With a government debt of roughly 150 percent of GDP, not much scope for a financial stimuli package is left. Essentially, Japan has not redressed the real causes of the economic disaster; that is cleaning up the balances of banks and enterprises, thereby tackling the non-performing debt problem and allowing insolvent economic entities to go bust. The dramatic decline of stock prices aggravated the situation because banks held large portfolios of equities. Political power struggles block any attempt for a fundamental change.

Latin America


The outlook for most countries in Latin America is murky. The Argentine full-blown debt default sent shock waves to Uruguay, Paraguay, and Bolivia. Whether the former will be able to avoid a financial collapse in 2003, despite a generous International Monetary Fund loan in 2002, is an open question. While Venezuela suffers considerable political and economic uncertainty, Brazil—by far the biggest economy of the continent—is at risk of defaulting on its debt.

Financial Forecast

The Risks

A possible war against Iraq presents a large risk in this forecast. Another risk is the projected U.S. Current Account deficit of almost \$500 billion, which is around 4.7 percent of GDP. A reversal of capital flows could cause a rapid and dramatic devaluation of the U.S. dollar against other key currencies, such as the euro and the yen. This would badly distort world trade and harm world economic growth. However, the dynamic productivity growth rate in the U.S. is a hint that it might be continuously attractive to invest here.

The risk of a Brazilian default is acute. With an overall debt of almost \$300 billion—a little more than 60 percent of GDP—it is hard to understand how stern the situation really is. It is the debt structure more than the actual level of debt that causes concern. After the last monetary reform in 1994, the Brazilian government tried to minimize the financing cost of government debt by indexing sovereign bonds either against the U.S. dollar or the short-term domestic interest rate. Consequently, any devaluation of the domestic currency (the real) or an increase of the domestic interest rate to avoid a further slipping of the currency increases the debt burden. Brazil seems to be caught in a vicious cycle. Only if the new government is able to reverse the devaluation trend of the real and to lower real interest rates will Brazil have a realistic chance to avoid a fall-back into monetary chaos and economic contraction. The contagious shock waves from such an event would be devastating for the whole continent. ◀



If you put money in the S&P in 1995, your average return over the next seven years was 7.5%.

Robert S. Neal

Associate Professor of Finance, Kelley School of Business, Indiana University-Purdue University, Indianapolis

William L. Sartoris

Professor of Finance and Director, Investment Banking Academy, Kelley School of Business, Indiana University, Bloomington

The financial outlook for 2003 is cautiously optimistic. We think the market has reached its lows and is now poised to return to the positive column. As we all know too well, since peaking in March of 2000, the performance of the equity markets has been abysmal. The Dow Jones 30 Industrials has fallen 24 percent, the S&P 500 has declined 41 percent, and the Nasdaq Composite has plummeted a stunning 73 percent. As investment professionals who advocate a long-term investment strategy, we have suffered the decline with everyone else. In fact, our 401k plans have been reduced to 301k's!

From a historical perspective, the behavior of the markets over the last seven years has been highly unusual. From 1995 to 2000, the S&P 500 increased an average of 21 percent per year, well above the long run growth rate of roughly 11 percent. These growth rates, of course, are not sustainable. Many have characterized this period as a "bubble" and indeed, after the fact, the description seems appropriate. However, suppose that as a long-term investor you had put your money in the S&P in 1995 and not paid any attention to the markets. Your average return over the seven-year period would be 7.5 percent per year. That's a bit lower than the historical average, but still a decent overall return.

As students of financial markets, we know that stock prices are influenced by three fundamental factors: interest rates, earnings, and attitudes toward risk. Our outlook toward interest rates is generally favorable for the next year. While interest rates are at historically low levels, the market does not expect a large increase over the next year. The Federal Funds rate—the interest rate set by the Federal Reserve for very short-term borrowing—is currently 1.75 percent, an

extremely low interest rate. Does this mean that interest rates will rise in the near term? In fact, the opposite is expected to occur. The interest rate on short-term Treasury Bills is now about 1.5 percent. The only way for the Treasury Bill rate to be below the Federal Funds rate is for investors to expect the Fed to announce additional rate cuts in the near future.

A different logic applies to long-term interest rates. The ten-year rate is currently about 4 percent, also at the bottom of its historical range. Do we expect this rate to rise? Yes, but forecasting long-term rates is a bit like forecasting next year's Super Bowl Champion—a very imprecise process. Long-term interest rates are driven by expectations of future inflation and expectations of future growth. On the inflation side, recent data suggest little evidence of price pressures. Over the past 12 months, the Consumer Price Index has risen 1.5 percent and the Producer Price Index has fallen 1.2 percent. Both of these measures, however, tend to overstate the true inflation rate because they don't adequately reflect technological improvements. The second factor, expectations of future growth in the economy, influences the slope of the yield curve. As the expected future growth rises, the yield curve becomes steeper. If corporate earnings reflect future growth, then an anticipated increase in earnings may contribute to a rise in long-term rates.

The outlook for corporate earnings is generally positive. After terrible earnings momentum in 2001, the decline has finally stopped. In the first quarter of 2002, S&P 500 earnings fell 12 percent from the previous year. By the second quarter, however, positive growth had returned and reached 6 percent during the third quarter, compared to the previous year. Earnings for the fourth quarter of 2002 are expected to rise 15 percent from year earlier levels. Overall, 2002 earnings should show a growth of roughly 2 percent. The outlook for 2003 is much more positive. According to estimates from First Call and industry analysts, 2003 earnings will rise 15 percent, with growth rates increasing as the year progresses.

While low interest rates and a return to normal earnings growth would be a welcome sign to investors, an important factor

Housing

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influencing the market is the risk premium. Investors need to be compensated for the risk of their investments. There is some evidence that during the last half of the 1990s investors were less wary of risk. In the past two years, this has been reversed. As investors grow more cautious, they require a higher expected return for their investments. One way this risk premium is revealed is through the Price/Earnings ratio. Holding everything else constant, a lower P/E ratio implies a higher risk premium. As investors become more risk averse, the price they are willing to pay for a given stream of earnings declines, and this means the P/E ratio will fall. In the past year, investors have grown more risk averse and the P/E ratio has fallen from 21.0 to 18.4.

In reality, however, P/E ratios are influenced by other factors, such as interest rates, business cycles, and expected earnings. A common approach for industry analysts is to compute the forward P/E, the current price divided by the expected earnings over the next year. This approach incorporates fluctuations in earnings due to business cycles. Based on the expected earnings for 2003, the P/E is 16.7. While this is much closer to the historical average, is it still too high? One commonly used comparison on Wall Street is to contrast the P/E ratio of the S&P 500 index with the inverse of the long-term Treasury Bond rate. If the P/E is below this target, it suggests the stock market is undervalued. With the 30-year bond rate currently at 5 percent, the inverse of the bond rate is 20.0. Since this exceeds 16.7, it suggests that stocks are moderately undervalued.

What does this all mean for the investor? We are cautiously optimistic that 2003 will provide a decent rate of return for stock market investors. Only once since 1926—during the depression era of 1929 to 1932—has the market declined for four consecutive years. However, the economic conditions surrounding that period are virtually absent in today's economy. What could derail our predictions? The most likely area of concern is corporate earnings. If the economy falters in 2003, earnings will diminish and stock prices could fall from their existing level. ◀

Existing home sales have continued to be strong and should finish 2002 at a record level. The National Association of Realtors projects existing home sales of 5.44 million units in 2002 and the National Association of Home Builders projects 5.53 million units for 2002. This compares with 5.29 million units during 2001. Existing home sales should remain strong during 2003 although they may be slightly off the record pace of 2002.

Housing starts for 2002 will be at about 1.69 million units, which is the highest level since 1986, when housing starts peaked at 1.81 million units. Prior to that the highest level was a record 2.02 million units in 1978. The National Association of Home Builders projects housing starts to total 1.63 million units in 2003, just slightly off the 2002 level.

Table 1 summarizes the housing and interest rate forecast from the National Association of Home Builders, which is consistent with the forecast from the IU econometric model. Mortgage rates are likely to start 2003 at a slightly lower level than

the average for 2002, as rates recently dropped to record lows during the end of 2002 following the lowering of interest rates by the Fed. For the year 2003 mortgage rates are not likely to differ significantly from those during 2002 (see **Figure 1**).

The low mortgage interest rates in 2002 resulted in a record level of home mortgage refinancings, with more than half of the borrowers taking cash when they refinanced. This has helped fuel consumer spending. It isn't likely that this level of refinancings will continue during 2003, since most homeowners have already refinanced.

It is interesting that the market value of the residential housing market is now greater than the stock market. Of course, a large part of this is the declining stock market. The market capitalization of stocks listed on the New York Stock Exchange and the Nasdaq Composite dropped during 2002 to about \$11.4 trillion, down from a peak of \$17 trillion in March 2000. Over the same time period rising home values and increasing housing stock from new home construction boosted the value of the residential housing market to about \$13.1 trillion. Of that amount, homeowner's equity (after subtracting mortgage debt) was about \$7.5 trillion.

As suggested from the discussion above, home prices have risen significantly on a national basis with double-digit annual

Table 1
Housing and Interest Rate Forecast

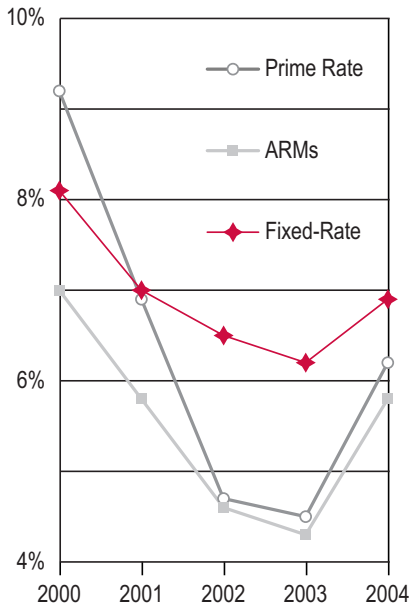
<i>Housing (in thousands)</i>	2000	2001	2002	2003	2004
Total Starts	1,573	1,603	1,687	1,630	1,618
Single-Family	1,232	1,273	1,337	1,302	1,284
Multi-Family	341	330	350	329	334
New Single-Family Home Sales	880	908	953	931	917
Existing Home Sales	5,159	5,291	5,533	5,349	5,274
<i>Interest Rates</i>					
Fixed-Rate	8.1%	7.0%	6.5%	6.2%	6.9%
ARMs	7.0%	5.8%	4.6%	4.3%	5.8%
Prime Rate	9.2%	6.9%	4.7%	4.5%	6.2%

Indiana

Morton J. Marcus

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Figure 1
Average Mortgage Rates



increases in median existing home prices in many metropolitan areas. In the Midwest, the median resale home price rose 5.6 percent during 2002. This strong rise in some areas of the country spurred some talk about whether a “housing bubble” was developing, but most economists do not think this is the case. However, price appreciation should return to normal patterns during 2003, rising at one or two points faster than the general rate of inflation.

Apartment rental rates have been falling and vacancy rates rising, due in large extent to low interest rates. This has allowed more new home buyers, who would not have qualified at the higher interest rates of previous years, to qualify for a mortgage. Despite the weaker fundamentals for apartments, investor demand for apartments has been extremely strong during the past year as investors have considered real estate an attractive alternative to stock and bond investments and increased their allocations to real estate. This has increased prices for apartments, despite falling rents and rising vacancy rates. Assuming the stock market improves during 2003, the demand for apartments may drop off, although there appears to be a renewed appreciation for the role that real estate can provide in diversifying an investor’s portfolio. ◀

Old truths seem to have been verified again. Indiana went into the recent recession before the rest of the nation and has had a harder time emerging from the recession than other states.

In May 2000, Indiana reached its employment peak at 3,013,700 jobs (see Figure 1). The low for this business cycle was in June 2002 at 2,891,400, a decline of 122,300 jobs or 4.1 percent. During the same twenty-five-month period, the nation lost only 0.9 percent of its jobs. As of October 2002, Indiana’s employment was 112,600 (3.7 percent) below the peak of May 2000.

The recession of 2000–01 seemed very similar to the recession of 1991–92 when it started (see Figure 2). Seven months from the prior employment peak both cycles were down 2.0 percent to 2.5 percent in jobs. But, where the 1991–92 cycle began to reverse and head up from the eighth month onward, the more recent cycle has continued down. By the twentieth month, the 1990–91 cycle had reached the recovery point, where the number of jobs were once again at the previous peak. After twenty-nine months, this recession remains 122,600 jobs below the prior peak.

Figure 1
Indiana’s Total Non-Farm Employment

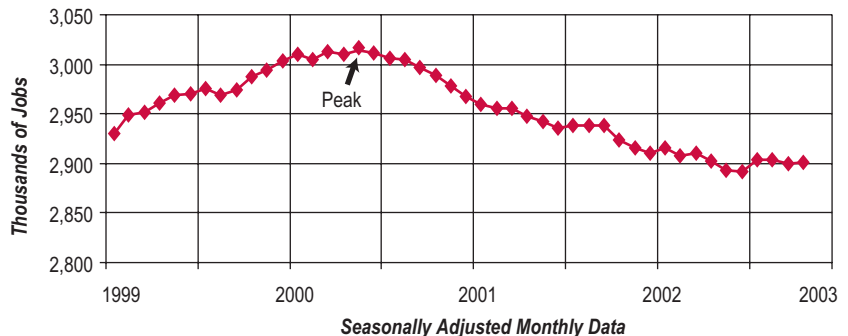
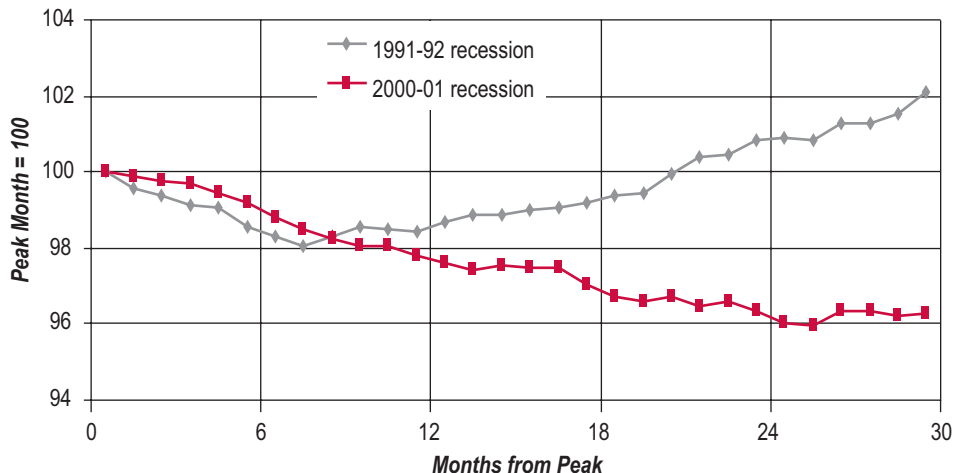


Figure 2
Indiana’s Total Non-Farm Employment in Two Recessions



During 1999 and the first few months of 2000, employment growth in Indiana and the U.S. seemed to be identical. But as the nation continued to expand jobs, Indiana's growth slowed and began to decline in mid-2000 (see **Figure 3**). When national employment topped out in March 2001, Indiana had been in decline for ten months. The nation reached its low point in jobs in April 2002, with Indiana's low being recorded two months later in June.

The Indiana and U.S. economies were advancing harmoniously in 1999. In the first quarter of 2000, that pattern came apart. From January 2000 to October 2002 Indiana's employment declined by 3.6 percent while the nation's employment crept up a miniscule 0.1 percent. **Table 1** shows the changes for each major industrial sector.

Why Did Indiana Diverge from The Nation So Sharply?

The problem was not particularly in manufacturing. Although Indiana's manufacturing firms lost nearly 77,000 jobs during this thirty-four-month period, this was consistent with Indiana's share of U.S. manufacturing employment. (Indiana had 3.8 percent of the nation's manufacturing jobs in January 2000 and 4 percent of the decline in manufacturing jobs.) **Figure 4** shows that Indiana's manufacturing employment may have led the nation in decline, but lately it has been advancing relative to the nation, and the two are almost at parity.

The divergence of Indiana from the nation seems to be more secular than cyclical. Consider **Figure 5**. Here manufacturing and retail trade are contrasted. The index difference is the vertical distance between the Indiana index and the U.S. index. It is easy to see that manufacturing in Indiana declined before the nation, but the difference has been decreasing. The same appeared to be the case with retail trade through March 2002. Then retail trade in Indiana began to diverge from the nation once again.

A similar pattern is found in **Figure 6**, where the finance, insurance, and real estate sector is shown along with the services sector. Indiana fails to keep pace with the nation throughout the period and is on a clear downward trend relative to the nation.

Thus, Indiana's problems over the past two years have been a recession manifested

Figure 3
U.S. and Indiana Total Non-Farm Employment

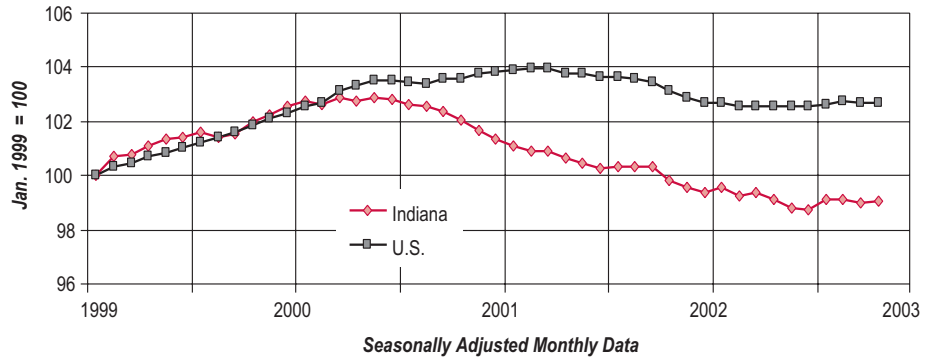


Table 1
Changes in Sector Employment

Employment in Thousands of Jobs	United States		Indiana		Change		Percent Change	
	Jan '00	Oct '02	Jan '00	Oct '02	U.S.	Indiana	U.S.	Indiana
Total	130,728	130,895	3,010.2	2,901.1	167	(109.1)	0.1%	-3.6%
Construction & Mining	7,181	7,093	160.6	149.5	(88)	(11.1)	-1.2%	-6.9%
Manufacturing	18,503	16,602	695.3	618.7	(1,901)	(76.6)	-10.3%	-11.0%
Transportation & Public Utilities	6,952	6,726	149.2	140.8	(226)	(8.4)	-3.3%	-5.6%
Wholesale Trade	6,973	6,652	146.6	138.2	(321)	(8.4)	-4.6%	-5.7%
Retail Trade	23,174	23,298	561.9	544.0	124	(17.9)	0.5%	-3.2%
Finance, Insurance & Real Estate	7,572	7,803	141.8	140.3	231	(1.5)	3.1%	-1.1%
Services	39,922	41,404	744.0	753.0	1,482	9.0	3.7%	1.2%
Federal, State & Local Government	20,451	21,317	410.8	416.6	866	5.8	4.2%	1.4%

Figure 4
U.S. and Indiana Manufacturing Employment

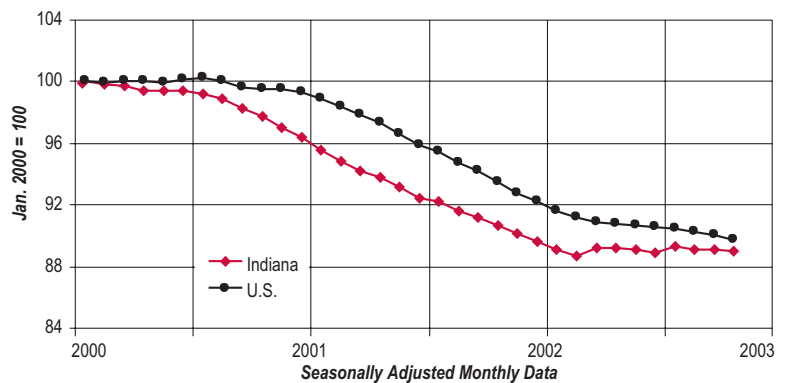


Figure 5
Indiana Compared to the Nation

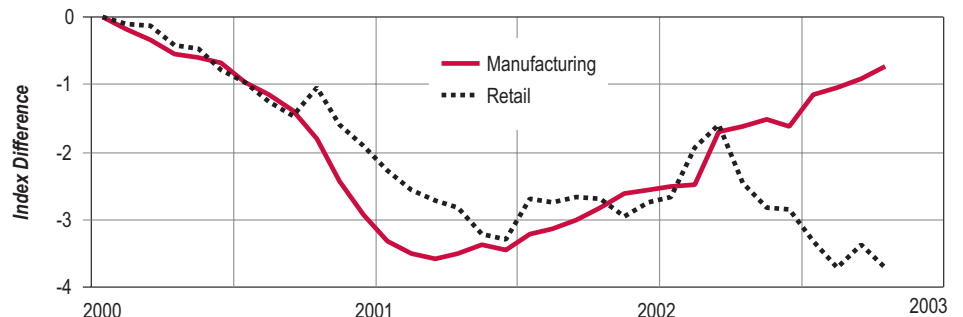
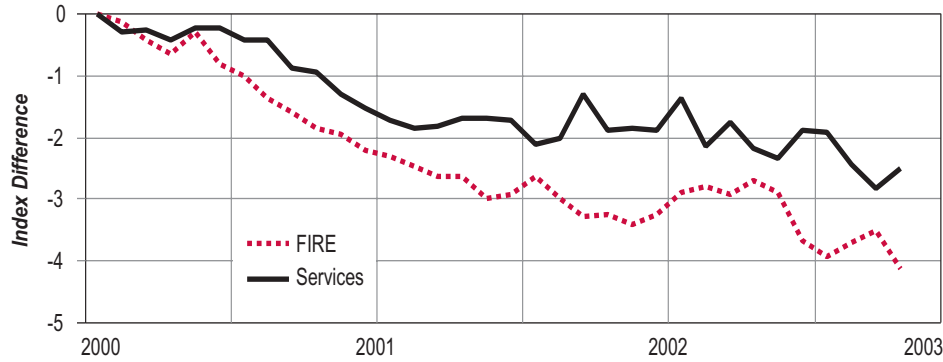


Figure 6
Indiana Compared to the Nation



in the manufacturing sector and an ongoing relative decline in finance, insurance, real estate, retail trade, and services. Some of this is related to the loss of headquarters activities and some to slower population growth than is being experienced nationwide.

How Bad Is Indiana's Economy Compared to Other States?

Between September 1999 and the same month in 2000, only Mississippi lost jobs. Alabama that year had a 0.2 percent growth and ranked forty-ninth in the nation. Indiana ranked forty-eighth in job growth with a 0.8 percent increase. The next year, from September 2000 to September 2001, Indiana ranked fiftieth in the nation with a 2.2 percent decline in number of jobs. In the most recent year, September 2001 to September 2002, Indiana lost jobs at a 1.3 percent rate, which was twenty-eighth in the nation. For the past three years combined, Indiana has a combined job loss percentage of 2.7 percent, ranking forty-ninth in the nation between Missouri and last place Mississippi.

Figure 7 shows Indiana among the ten states with declining employment over the past three years. **Figure 8** is designed for those who need to see the more pleasant side of our difficulties. Here Indiana is shown as one of ten states with an improvement in their job picture during 2002. Although the Hoosier state did not gain jobs, it cut the rate of job losses. Other states, such as Nevada, Wyoming, and Rhode Island, continued to increase the number of jobs, but at a decreasing rate. Sometimes we take whatever joy is to be taken.

Figure 7
Change in Employment, 2000–2002

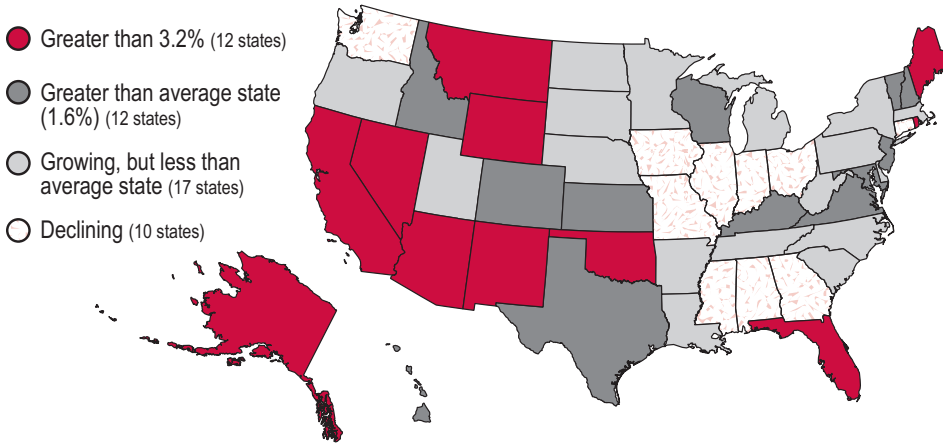
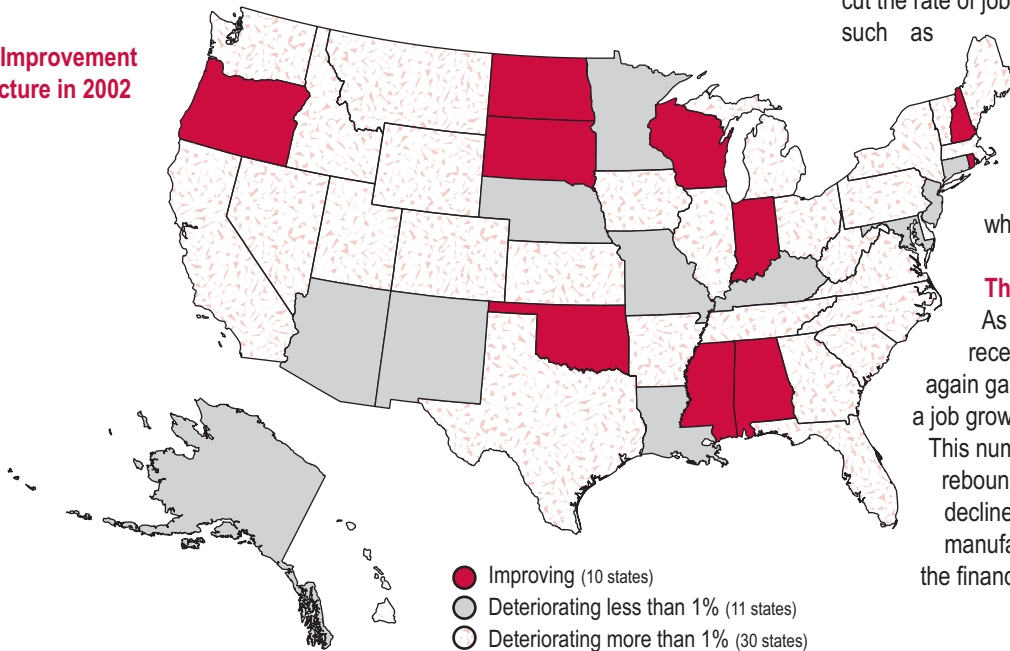


Figure 8
States with an Improvement in Their Job Picture in 2002



The Year Ahead

As the nation emerges from the recession, Indiana should once again gain jobs. We are forecasting a job growth of 30,000 during 2003. This number is based on a cyclical rebound subdued by the secular decline in employment in manufacturing, public utilities, and the financial sectors. ◀

Anderson

This year, the local economy is driven by events at the national level. The biggest part of the story is the national economic slowdown. For Anderson and Madison County, the most volatile component of the local economy is the automotive manufacturing sector. Typically, when national recessions hit, Anderson's local economy is driven into the depths of the national trough. Whether the national recession is mild or severe, we have had some difficult experiences with unemployment and falling income as a result of our reliance on the automotive industry. Since the recession of 1981–82, that volatility has been changing.

Unemployment in the county has been following the national trend, with increases in 2001 and 2002 (see **Figure 1**). Madison County's unemployment in 2001 rose to an average of 4.6 percent, an increase over 2000 but lower than the U.S. unemployment rate of 4.8 percent in 2001. With the economy slowing down even more in 2002, we would expect the local rate to rise above the national rate as in years past, but that has not happened. For the first eight months of this year, the local rate has averaged 5.8 percent. The national monthly average has risen to 5.9 percent. Despite the local history of deep reactions to national economic slowdowns, our recent experience is encouraging.

The local labor market has continued to reflect the diminishing presence of manufacturing. Through 2001, there were fewer jobs available in the county. Covered employment in the county fell to 45,173 by the

end of 2001. There were still 64,023 residents of the county working in 2001. The disparity in the number of people working versus the number of jobs available is due to a number of factors, including the commuting patterns of workers (see **Figure 2**). Nearly 20 percent of the employed people who live in Madison County have jobs outside the county. Approximately half of the commuters travel to Marion County for employment. The employment losses we have experienced are clearly driven by manufacturing. For 2001, there were 1,200 fewer jobs in manufacturing in the county. This was one of the largest job losses for a one-year period over the past twenty years. The job losses can be attributed to the closure of Magnaquench and the ongoing attrition in the remaining automotive facilities (retirees are not being replaced at a 100 percent rate).

Income growth was modest through 2000 (the most recent year for which information is available). Per capita income in the county grew to \$24,483. This is a modest increase from the year before. Income in the county is still below the average for the state of Indiana. On average, income for Madison county residents is 91 percent of the state average. There are two obvious contributing factors: manufacturing wages fell, and the share of manufacturing for total employment in the county also fell. The income numbers for 2001 will likely show the impact of the national slowdown. Since the manufacturing wages in the county fell (from \$53,480 in 2000 to \$51,494 in 2001), and the share of

Barry C. Ritchey

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Anderson University,
Anderson

Figure 1
Unemployment Comparisons
September 1990 to September 2002

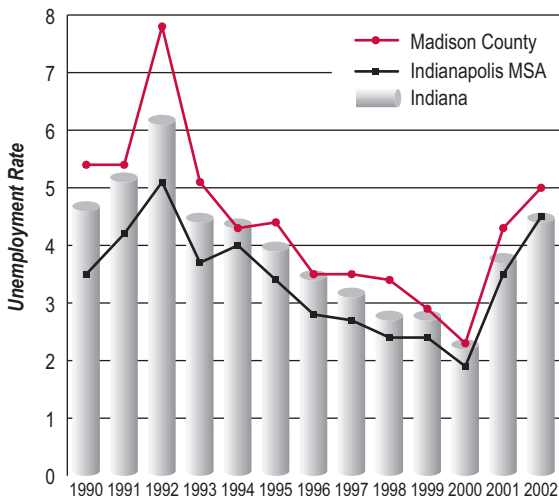
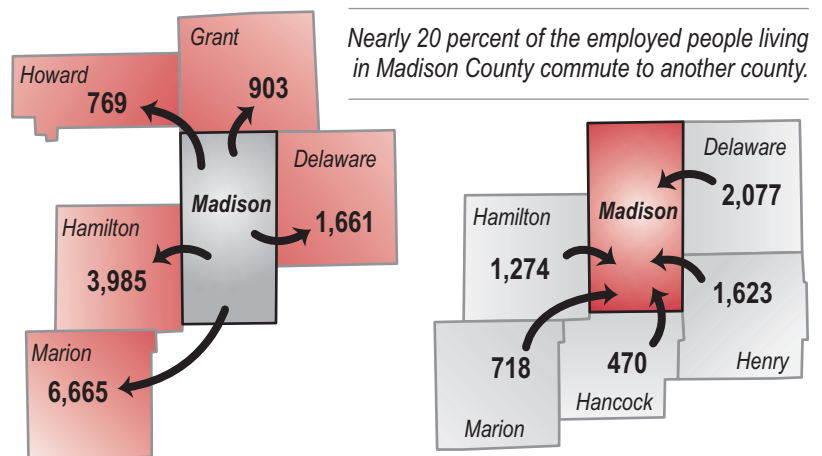


Figure 2
Madison County Commuting Flows, 2000



Bloomington

income earned from manufacturing has also been falling (to only 35 percent in 2000), we should expect near zero income growth for 2001 and 2002.

The housing market has been maintaining a modest growth rate since 2000. The number of housing permits issued in 2000 was only 355. That number increased to 373 in 2001. Overall, the number of permits continues to be modest in comparison to the performance of the mid-1990s. As many as 774 permits were issued in the middle of that decade. We continue to see the opposing forces of low mortgage rates pushing against slow income growth and slack job markets.

Retail sales fell in 2001 by 7.5 percent compared to 2000 but remain at historically high levels. Compared to retail sales in 1999, sales increased over the two-year period by 11.5 percent. The loss in retail sales from 2000 is not so much a local issue as it is a reflection of the national economic slowdown.

In the short term, we would expect more of the same for the near future: losses in manufacturing jobs, unemployment rates that move within 0.5 percent to 1 percent of the national rate, slow to near zero income growth, and an unpredictable housing market.

The long term future for the City of Anderson and Madison County may be revealed in part by a recent article published in the *Herald Bulletin*. In this article, a study from IUPUI reported that the most urbanized corridor out of Indianapolis over the next forty years will be the I-69 corridor from Indianapolis through Anderson as far as Muncie. The question facing our future is, will the City of Anderson and Madison County accommodate that growth? Will we move forward to welcome this expected economic expansion? The article suggested that public school performance and the availability of city services are critical to economic growth. Improvements in our public schools now seem possible with the change in leadership in Anderson. Hopefully, the city will also be willing to accept a change in business focus, from the large automotive mentality of the past to an expanded willingness to facilitate small business or large and more technologically-based enterprises. A change like this would brighten the future for Anderson and Madison County. ◀

Thayr Richey, Ph.D.

President, Strategic Development Group, Inc.,
Bloomington

In many ways Bloomington is to Indiana what California is to the United States: the tenth most populous city in the state often serves as Indiana's harbinger. It appears that what is happening in this community might likely show us what is in store for Indiana.

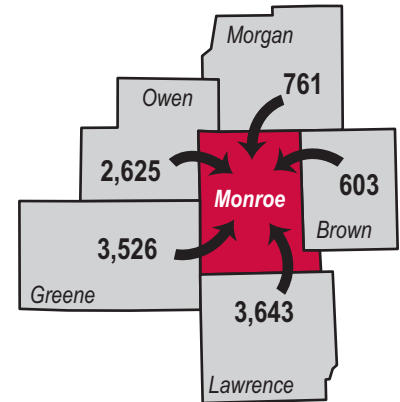
Economically, this has been a rough year for the Bloomington Metropolitan Statistical Area (MSA). However, the community remains one of the economic leaders in the state. This is an economy that is in transition, but it is not clear what Bloomington's economy is moving toward.

Reviewing changes in population, employment and wealth provides a quick evaluation of Bloomington's overall economic health. In terms of population change, the Bloomington MSA continues to grow (see **Figure 1**). In recent years, its rate of growth has slowed somewhat from the previous twenty years, but the population is still growing. Bloomington's population growth rate between 1990 and 2000 is slightly above the state average.

In terms of employment, the community has shown a strong performance over the past twelve months. The September 2002 unemployment rate for the Bloomington MSA was 2.9 percent, in contrast with the state average of 4.6 percent. Bloomington had the third lowest unemployment rate in the state.

With a residential labor force of 61,390 in 2001, the community is also important to the economies of Greene, Owen, and Lawrence

Figure 2
Commuting Patterns, 2000



counties. This residential labor force has remained stable. Bloomington continues to serve as a regional employment center. Over 11,000 people commute to the community to work (see **Figure 2**).

While employment has remained strong in Bloomington, the nature of that employment is changing. After years of expansion, manufacturing employment in the county has shrunk over the past several years (see **Table 1**).

Manufacturing now represents a smaller part of the Monroe County employment base than it does in any metro area in Indiana.

A trend that Bloomington has been experiencing for the past four years continues. Earnings from manufacturing declined from \$390 million in 1998 to \$360 million in 1999. Bloomington experienced a net loss of approximately 2,400 manufacturing jobs in the past twelve months.

Figure 1
Monroe County Population

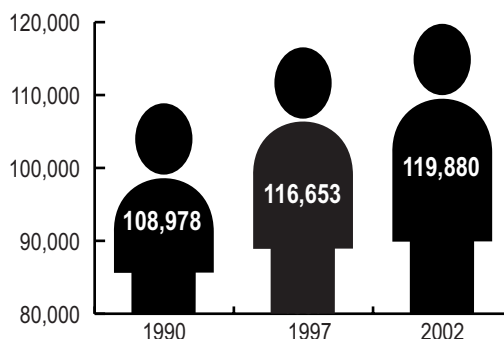


Table 1
Percent of Manufacturing Employment

Year	Monroe County	County Rank (out of 92)
1970	25.1%	51
1980	16.1%	66
1990	14.9%	70
2000	12.34%	74

Columbus

James C. Smith

Senior Lecturer in Finance
and Research Fellow in the Indiana Business
Research Center, Kelley School of Business,
Indiana University, Indianapolis

However, despite the substantial loss of manufacturing employment, Bloomington's economy has remained relatively stable. The community has partly compensated for the loss of manufacturing employment with the growth of service and government jobs. Government now accounts for approximately 25 percent of the employment base, and service sector jobs make up over 25 percent of the employment base in Monroe County. Wages from government in 2000 totaled approximately \$665 million; this includes employment at Indiana University Bloomington. This is an increase of almost 5 percent from the previous year. Wages in the service sector saw a stronger growth of approximately 8 percent, with growth in the health, business services, and engineering subsectors.

Bloomington continues to be an economy in transition. The community remains a locus of manufacturing, but the growth in higher wage employment appears to be coming from the government and service sectors. It will be interesting to see if the Bloomington experience reveals a new approach to the Indiana economy: retain a core manufacturing base, but grow the overall economy through higher paying jobs in education and service. ◀

No dramatic boom is waiting for Columbus and Bartholomew County in 2003. Business activity next year will look much like it did in 2002, according to forecast data from the Kelley School of Business at Indiana University.

If economic conditions turn out as forecast, Bartholomew County will do reasonably well. A double-dip recession is unlikely, as long as political or international events don't derail the U.S. recovery. But we also won't see the frantic pace of business expansion that took place in the late 1990s.

Bartholomew County's economic activity did not drop as much as in many other Indiana counties during the 2001 recession, so it won't experience as much of a bounce during the economic recovery. Total employment may rise but not very fast.

Throughout the recent recession, the unemployment rate in Bartholomew County almost always stayed below the state and

national average (see **Figure 1**). Since conditions in the area are already better than in much of the state, Columbus and Bartholomew County don't have a gap to make up.

A continuation of very low interest rates is likely to fuel car sales in Bartholomew County. Low interest rates typically are good for the housing sector too. But many economists believe that much of the demand for home upgrades and refinancings has already been met. A gentle slowing of real estate demand will be offset by the general economic expansion. So the level of real estate activity in Columbus and Bartholomew County should be about even with 2002.

Health Care

One of Bartholomew County's main growth sectors has been health care (see **Figure 2**), and that should continue strong in 2003. Cost management and streamlining work in favor of regional health care centers—that's what Columbus is becoming. Total employment in the county runs just over 40,000 jobs. The number of jobs in health services is nearly 3,700, which gives the sector close to 10 percent of total county employment.

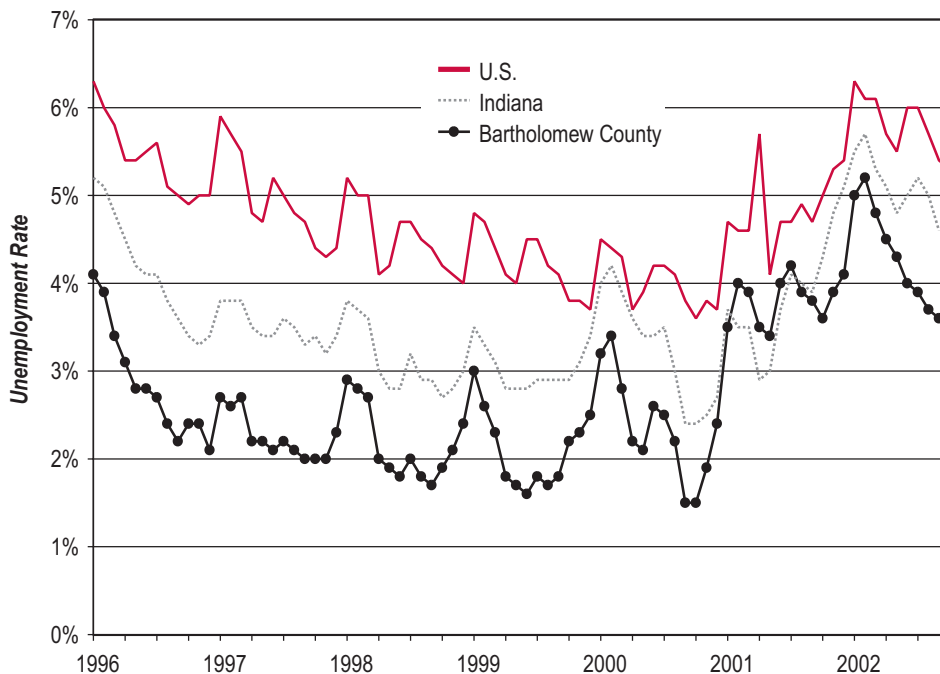
Manufacturing

In the coming year, however, Bartholomew County's manufacturing sector faces significant economic uncertainties. While the county's employment base has diversified in recent years, 38 percent of all jobs still come from manufacturing, according to ES-202 reports from the Bureau of Labor Statistics.

And most of the major manufacturing companies are not growing in Bartholomew County. Five years ago, there were thirty-one firms in Bartholomew County which employed more than 200 people each. At last count (at the end of 2001), there were only twenty-six. Compared to fourth quarter 1996, manufacturing employment in the county at the end of 2001 was lower by about 1,100 jobs (see **Figure 2**). But the top ten manufacturing employers lost nearly 2,000 jobs. Smaller firms and the health services sector made up for some of the loss, but not all of it.

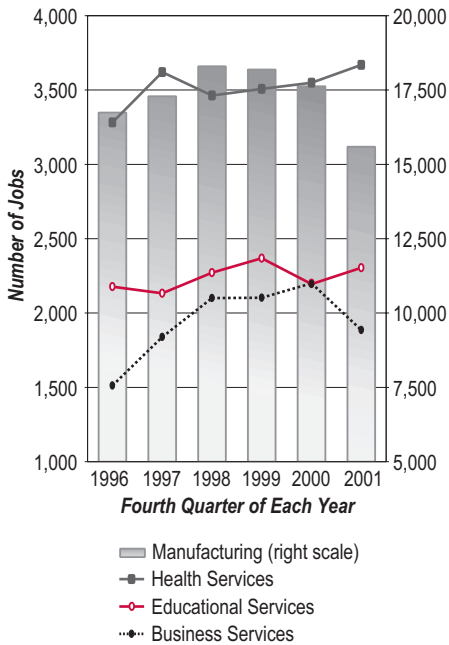
Random events affecting just one big company can have a tremendous effect on Bartholomew County. Right now, highway

Figure 1
Bartholomew County Unemployment



Evansville

Figure 2
Bartholomew County Jobs



freight tonnage is expected to show modest growth in 2003, indicating a stable demand for diesel engines. Any number of factors, though—economic, political, or competitive—could change that.

Education

Another area of uncertainty for the long-term future of the county will be the education sector. At the 2000 census, 22 percent of the Bartholomew County adult population age 25 and older held bachelor's degrees. That was the twelfth highest rate of all Indiana's ninety-two counties. But Indiana as a state ranks near the bottom among all states in the nation. Indiana was in forty-third place, with a level of education on a par with Alabama, Louisiana, and Tennessee. If Bartholomew County were a state, it would have ranked about thirty-second, alongside North Dakota, Wyoming, and Pennsylvania, but well below the rates near 30 percent found in Virginia, Vermont, and Minnesota.

Employment in the educational services sector has risen gradually in recent years (see **Figure 2**). The area's ability to raise the level of education in the workforce will be important in determining whether economic prosperity comes to Bartholomew County or gets diverted to Minnesota and Vermont. ◀

M. Gale Blalock

Professor of Economics and Chair, Department of Accounting and Business Administration, University of Evansville, Evansville

The Evansville economy has slowed significantly since the turn of the century. The index of economic activity maintained at the University of Evansville reached its maximum in 1999, posted an inconsequential decrease in 2000, but fell by 3.4 percent in 2001. This compares to a 0.3 percent growth in national real Gross Domestic Product (GDP) over the same time period. The decline was spread broadly, but there were sharp declines in the construction and transportation sectors. The only component of the index to show positive growth was the financial sector.

The index uses electricity sold to industrial users as its proxy for industrial production. The total value of new construction permits in Vanderburgh County is used to measure construction activity. Transportation is measured by annual enplanements at the

Evansville Regional Airport. The index uses metropolitan area employment in wholesale and retail trade to measure the level of activity in the trade sector, and employment in finance, insurance, and real estate as the finance component of the index. The base year for the index is 1998 (see **Table 1**).

The future is uncertain, but it can be viewed with guarded optimism. Recent announcements of the expansion of Toyota and its suppliers, the arrival of Ford in Gibson County, and the recognition of the area labor force's work ethic all speak well for the future of our area. The obvious downside risks include the uncertainties of international terrorism, the engagement of our military forces abroad, and the effects of further uncovered financial chicanery on the financial markets. ◀

Table 1
Index of Economic Activity in Evansville

Year	Industrial Production	Construction	Trade	Transportation	Finance	Index	Index Growth
1995	0.32	0.04	0.27	0.05	0.23	0.90	
1996	0.33	0.06	0.27	0.05	0.24	0.94	4.53%
1997	0.33	0.05	0.28	0.06	0.23	0.94	-0.28%
1998	0.36	0.07	0.28	0.06	0.23	1.00	6.21%
1999	0.38	0.09	0.29	0.06	0.26	1.08	8.10%
2000	0.40	0.07	0.29	0.06	0.26	1.08	-0.06%
2001	0.39	0.04	0.28	0.05	0.28	1.04	-3.40%
Change From 2000	-2.61%	-37.45%	-1.51%	-13.41%	4.94%	-3.40%	

Fort Wayne

After two years of decline (2000–2001) and a year of essentially no growth (2002), the Fort Wayne metropolitan area economy is forecast to have a significant cyclical bounce in 2003. The area economy consists of six counties: Adams, Allen, De Kalb, Huntington, Wells, and Whitley.

In reality, the area economy's malaise began in the summer of 1998 when manufacturing employment began a precipitous decline. Between then and the end of 2001, manufacturing employment decreased almost 13,000—or 16.8 percent (see **Figure 1**). The precipitous decline in manufacturing employment was not just an area phenomenon. Both Indiana and U.S. manufacturing employment declined approximately 11 percent (see **Figure 1**).

But the Fort Wayne area's greater percentage decline in manufacturing employment, combined with the fact that the area has a greater percentage of jobs in manufacturing, produced the almost 13,000 job loss.

Total payroll employment in the Fort Wayne area did not begin to decrease until March 2000, when the continuing decreases in manufacturing employment finally swamped the secular increases in services employment.

Area total payroll employment declined over 17,000 (6.2 percent) in twenty-five months. Starting in May 2000, payroll employment in Indiana declined 4.2 percent

in twenty-five months. Starting in March 2001, U.S. payroll employment declined 1.3 percent in thirteen months.

In 2002, total payroll employment is not likely to change (from December to December). The decline in the first quarter will be offset by gains in the remaining three quarters. The U.S. recovery to date has been characterized as jobless (just as it was emerging from the 1990–91 recession). Ditto for the area recovery to date.

With respect to 2003, area payroll employment will increase between 2.0 and 2.5 percent (from December to December). That's equivalent to between 5,000 and 7,000 jobs. A principal rationale for the forecasted recovery is that because the recession was so severe locally, we will get a robust cyclical bounce.

A significant turnaround in business investment in plants and equipment during 2003 is another more fundamental reason. But to the extent that the turnaround probably will not occur before at least the second quarter of 2003, the forecasted job increase will be back-loaded.

Assuming it does occur, a robust cyclical recovery doesn't eliminate the secular problem the Fort Wayne area economy now faces. Through the last half of the 1980s and most of the 1990s, the area economy defied gravity by increasing manufacturing employment while manufacturing employment nationally continued its now three-decade decline.

Thomas L. Guthrie

Director, Community
Research Institute and
Associate Professor of
Economics, Indiana
University-Purdue University,
Fort Wayne

Figure 1
Manufacturing Employment in Fort Wayne, Indiana, and the Nation

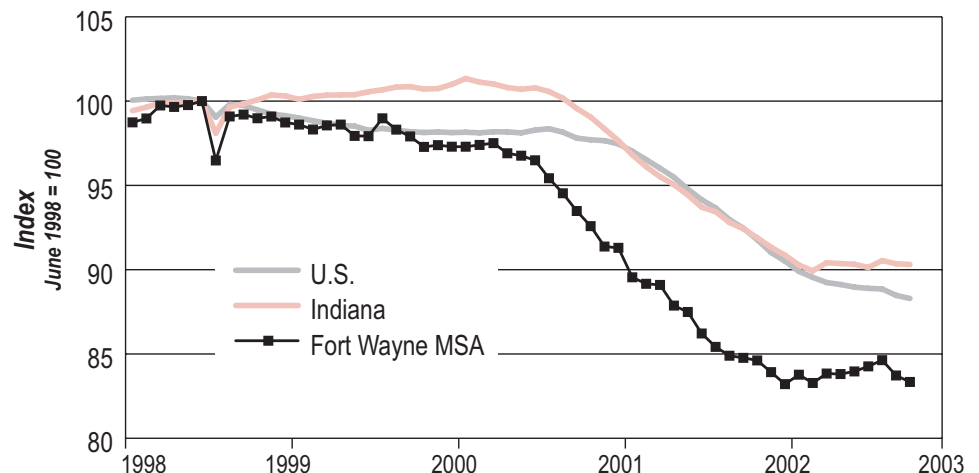
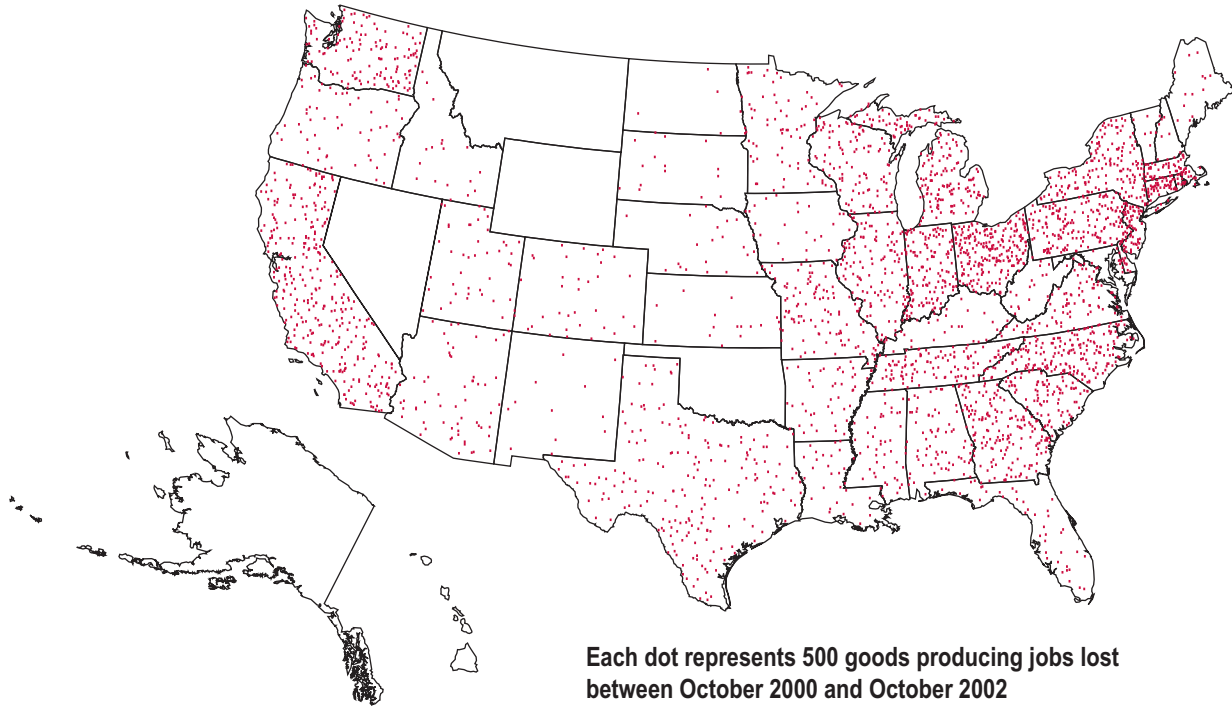


Figure 2
Job Losses in Goods Production, October 2000 to October 2002



Gravity now has the area economy firmly in its grasp. Of those over 17,000 jobs lost in the twenty-five-month downturn, 10,000 were in manufacturing. As already documented, the recent recession was brutal to manufacturing, both nationally and locally. **Figure 2** illustrates the job losses in goods production nationally, while **Figure 3** shows the percentage change for Indiana and the surrounding states.

Will the area economy again escape gravity as it did in the eighties and nineties? More importantly, why did it escape gravity? Certainly one important factor was the favorable cost of doing business in Indiana—especially vis-à-vis Michigan and Ohio. This economist will always believe that one reason General Motors chose Fort Wayne for its light-truck assembly plant in 1985 was to send a loud message to state officials in Michigan that their business costs were way out of line. That light-truck assembly plant became the flagship of a huge fleet of border-hopping manufacturing companies and entrepreneurs in northeast Indiana.

What about the current cost of doing business in Indiana? Did the recently passed tax legislation again give Indiana a competitive advantage vis-à-vis neighboring

states or did it simply level a playing field that had become more and more tilted toward those states? The neighboring states got GM's message. The question fifteen years later is, "Does Indiana get the message?"

In northeast Indiana we have learned over the last four-plus years that transitioning a traditional manufacturing-based economy from 27.4 percent manufacturing employment to 24.1 percent is arduous and painful.

My hope—and my forecast—is that this latest round of transitioning has been completed. ◀

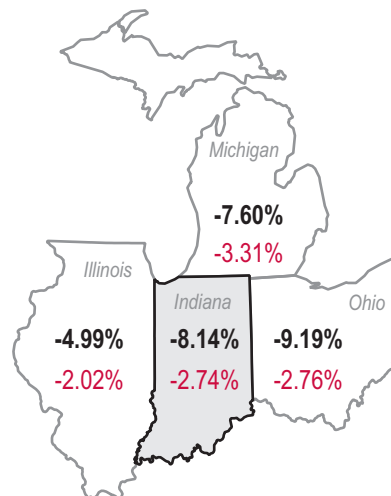
A robust cyclical recovery doesn't eliminate the secular problem the Fort Wayne area economy now faces.

Figure 3
Percent Change in Employment, October 2000 to October 2002

LEGEND

Percent Change in Goods Producing Employment

Percent Change in Total Employment



Gary

The last three years were more difficult for northwest Indiana than any period since 1993–96. Establishment employment peaked in November 2000 at about 277,000 jobs (it was, however, essentially stagnant between mid-1999 and mid-2001). Since then, it has declined by nearly 10 percent to about 250,000 jobs. That decline has occurred across the entire regional economy and has affected construction, manufacturing, and service jobs. The decline in the number of jobs available in northwest Indiana was relatively modest through most of 2001 and has been steepest during 2002.

Donald L. Coffin

Associate Professor of
Economics, Indiana
University Northwest, Gary

Using an alternative measure of employment—household employment—the number of people in northwest Indiana with jobs also peaked in late 2000 and has declined fairly steadily since (down from around 290,000 people with jobs to around 275,000, a decline of only 5 percent). Furthermore, household employment bottomed out in March 2002 and has increased modestly since.

Not surprisingly, unemployment has also increased. The monthly reported unemployment rate reached an unprecedented low level of 3.3 percent in September 2000 and peaked at 7.8 percent in February 2002. (It has since declined to 5.5 percent.)

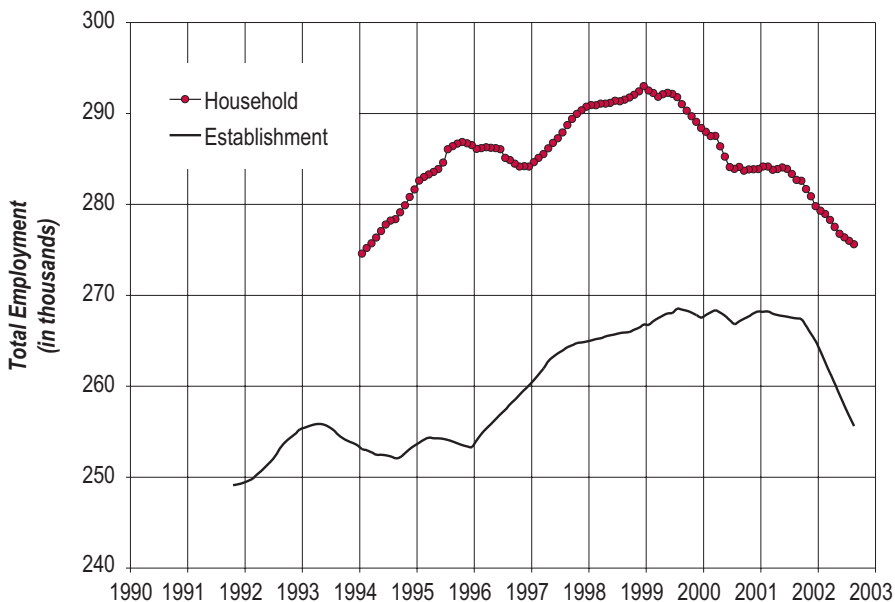
The data (through August 2002) show limited signs of strength, with only business services and health services posting even modest employment gains over the past year. Construction employment also increased modestly beginning in June. This suggests that the coming year will continue to be a difficult one for businesses and residents of northwest Indiana. At best, employment may stabilize at around 250,000 jobs (and at a household employment level of around 275,000). More realistically, we may expect a continued, albeit slower, decline in employment, to around 245,000 jobs in northwest Indiana. It seems unlikely that the unemployment rate will fall below 6 percent, unless a growing number of northwest Indiana residents find jobs outside Lake and Porter counties. In this respect, the continued strength of the Chicago economy, and the apparent modest growth in the less urbanized counties of northern Indiana, is a hopeful sign.

The Overall Performance of the Northwest Indiana Economy

Figure 1 shows the path of total employment in northwest Indiana. This diagram shows a twelve-month moving average of total employment, which reduces the month-to-month swings in employment caused by seasonality and also allows us to see the trend in employment more clearly by smoothing the effects of one-time changes. (While the diagrams show twelve-month averages, the employment and unemployment data referred to in the text use the actual month-to-month data.) The local economy stagnated in the early 1990s with little change in establishment employment from 1991 through 1996. Beginning in 1996, however, total employment rose significantly for about five years, increasing by about 5.5 percent in four years (from about 254,000 to about 268,000). While employment growth in northwest Indiana was significantly slower than in the nation as a whole (nationally, employment rose from 119.6 million in 1996 to 132.2 million in 2001, an increase of 10.5 percent), it was nonetheless a good performance for the local economy.

Employment fell modestly in the second half of 2001, but the decline accelerated in 2002. By August 2002, total employment had declined to a level last reached when

Figure 1
Total Employment in Northwest Indiana (12-Month Moving Average)



the economy was expanding in 1995. Over the past few months, employment has been declining at an annual rate of about 5 percent. Such rates of decline are almost unheard of nationally and represent a serious state of decline for the local economy.

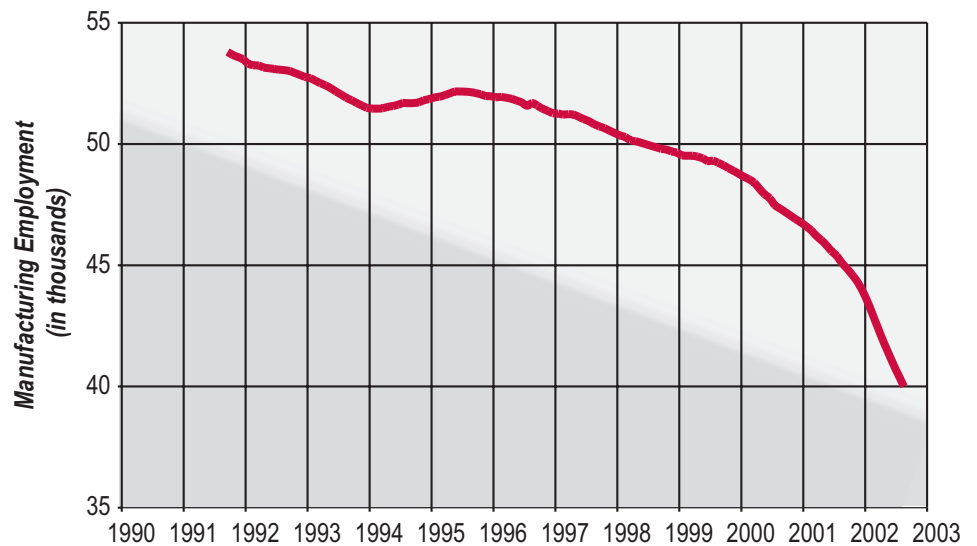
The decline affected all sectors of the local economy. Manufacturing employment declined (from August 2001 to August 2002) by 5,300 jobs, a loss of 12 percent. Steel employment fell by a rapid 18 percent, a decline most clearly attributable to the bankruptcy and sale of LTV Steel. The declines in sectors outside manufacturing were slower, but still relatively large. Construction employment fell by 3 percent (down from 16,800 to 16,300). Service sector employment declined by less than 1 percent overall, but retail trade declined by 3.5 percent and wholesale trade by 4.5 percent (a combined loss of 2,500 jobs). Given the strong performance of the service sector over the last decade (an 18 percent gain from October 1991 to October 2001 with almost no periods of decline), the recent weakness is noteworthy. It should be emphasized that much of the local decline in 2002 resulted from the closing of LTV and a continued weakness in the local economy. That is, little or none of the weakness of the local economy is a direct (or indirect) consequence of the terrorist attacks on September 11.

All these changes compare unfavorably with the national economy. Employment also declined nationally, but at a much slower rate. Total national employment fell by less than 1 percent, construction by 1.9 percent, manufacturing by 4.8 percent, services by 0.1 percent (wholesale and retail trade both declined by slightly more than 1 percent).

Furthermore, national employment hit its low in April and has begun to increase since. Locally, employment has continued to decline, with a loss of 3,200 jobs since April.

It is not surprising to discover that the unemployment rate in northwest Indiana has also increased. From its low of 2.7 percent in October 2000 (an unemployment rate so low for this region that one may reasonably express skepticism about the accuracy of that estimate), the unemployment rate peaked at 7.8 percent in February 2002. It has declined since. The decline in the unemployment rate is a consequence of the fact that

Figure 2
Manufacturing Employment (12-Month Moving Average)



household employment has recently not behaved in the same way as establishment employment. Recall that establishment employment measures the number of jobs provided by employers in northwest Indiana, while household employment measures the number of people living in northwest Indiana who have jobs, regardless of where they work. In general, household employment and establishment employment move closely together. However, since the beginning of 2002, establishment employment has remained essentially unchanged, while household employment has increased by 1 percent to 2 percent (this does not show up in the twelve-month moving average because it is too recent and too small to overcome the declines in previous months). There are two possible explanations for the increase, either of which is credible:

1. The local household employment estimates are less reliable than the establishment employment estimates.
2. An increasing number of northwest Indiana residents are finding jobs outside Lake and Porter Counties.

Assuming the second of these is the correct explanation, the decline in local unemployment is more attributable to the strength of the surrounding region than to the strength of the economy in Lake and Porter counties.

The local economy continues to be more concentrated in manufacturing (15 percent locally in August 2002 compared with 13 percent nationally), and specifically in steel (8 percent locally and 0.15 percent nationally). Thus, changes in manufacturing, and more specifically in steel, will have a greater effect locally than nationally.

This suggests that 2003 will not be a strong year for the local economy. While motor vehicle sales have remained strong through 2002, the outlook for 2003 is for sales to remain essentially flat, thus failing to add to the demand for steel. Construction activity nationally also seems likely to recover only modestly, again not adding to the demand for steel. As a result, the demand for steel will grow slowly, if at all. It seems reasonable to expect, as a best-case scenario, a stabilization of the local economy with establishment employment hovering around 250,000. In this case, we might expect the unemployment rate also to stabilize between 6 percent and 6.5 percent. However, a sluggish national recovery (or a double-dip recession nationally) could drive local employment down by between 1 percent and 3 percent; this could lead the unemployment rate to increase to around 7 percent.

Manufacturing and Steel

In a continuation of a decade-long (or longer) trend, manufacturing employment in

northwest Indiana fell by 5,300 between August 2001 and August 2002, a decline of 12 percent (see **Figure 2**). This represented an accelerated job loss from the 3,500 jobs lost between August 2000 and August 2001. As has been the case for some years, most of the decline occurred in steel (and directly related) industries; steel mill employment fell by 4,500 during the past year. Last year, a decline to about 41,000 manufacturing jobs by the end of 2002 seemed reasonable. Now it seems likely that by the end of 2002, the number of manufacturing jobs will fall to 38,000. By the end of 2003, manufacturing employment may fall as low as 36,000 (an additional 5 percent decline).

But this is contingent on what happens in steel. Steel mill employment fell from 24,900 in August 2001 to 20,400 in August 2002 (see **Figure 3**). The (relatively) good news, however, is that almost the entire decline occurred with the closing of LTV in late December. Steel mill employment has remained almost constant during 2002. The difficulties of the steel industry remain, however. Despite severe import restrictions imposed in early 2002, imports of steel fell only temporarily (from 3,356 tons in February to 1,896 tons in May, increasing again to 3,080 tons in July and 2,777 tons in August). The resilience of steel imports in the face of the tariffs imposed on them suggests that the

domestic steel industry will continue to face strong competition from non-U.S. suppliers well into the future. In addition, the position of Bethlehem Steel remains clouded. And the industry as a whole still must address its cost structure, in particular the level of retiree costs borne by most of the integrated producers.

It is also important to note that steel output in the Chicago region has recovered most of its lost ground. Weekly steel output in the Chicago region fell quite abruptly from 461 tons to 407 tons when LTV shut down its blast furnaces in late 2001. It continued to decline to 310 tons by the end of 2001. It has increased fairly steadily since and averaged about 460 tons per week in September. This 50 percent increase in weekly steel output during 2002 has occurred without any increase in steel mill employment. This suggests that the best that is likely to occur in steel in 2003 is stable employment. The new ownership of the former LTV is likely to find it easier to reduce employment

during downturns, and the industry as a whole seems now better able to accommodate increased production without significant employment increases. Productivity will also continue to increase in the steel industry,

so even if output holds steady, it seems that steel mill employment will decline, albeit modestly, to about 19,000 in 2003.

Manufacturing's contribution to local income declined in 2002, despite increases in weekly real earnings. This resulted from increased weekly hours, because average hourly earnings remained unchanged. For manufacturing as a whole, weekly earnings rose about 3 percent (see

Table 1). However, the 12 percent decline in the number of jobs, combined with a 3.2 percent increase in weekly hours, suggests that the total income generated in manufacturing declined by about 6.5 percent. Given manufacturing's 15 percent share of total employment, this suggests that the loss in manufacturing income by itself resulted in a reduction in total local income of about 1 percent. This is actually an improvement on the 11 percent decline in manufacturing income that occurred in 2001.

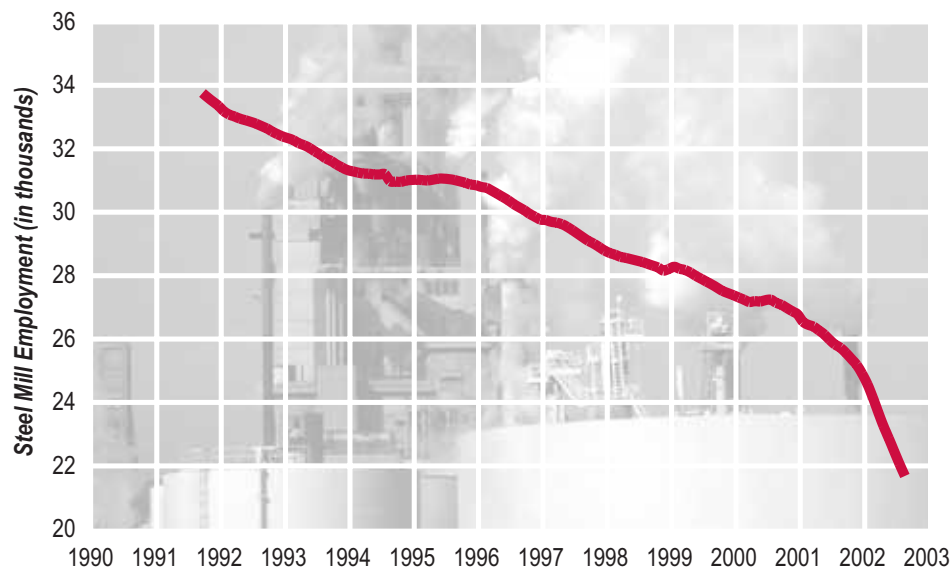
The recovery in hours was something of a surprise, as was the increase in real weekly earnings. In fact, the average real straight-time hourly wage in manufacturing probably fell (as a result of declining employment in the highest-paid industries) but was offset by some additional overtime. It is reasonable to expect total manufacturing income to decline in 2003 as well, although perhaps at a slower rate.

Services

After a decade of rapid growth (as these things go in northwest Indiana), service sector employment stumbled in the past year. Employment fell by 1,600 jobs (less than 1 percent) and is down from a peak of 206,600 jobs near the end of 2001 to 195,200 jobs in

By the end of 2003, manufacturing employment may fall as low as 36,000 jobs.

Figure 3
Steel Mill Employment (12-Month Moving Average)



August 2002 (slightly more than 5 percent). This is wholly accounted for by weakness in wholesale and retail trade (where employment fell by 2,500 jobs), which was not offset by continued growth of business services (up about 2.5 percent, only 300 jobs) and health services (up 2.8 percent, or 700 jobs). Local government employment also increased (about 1.8 percent, or 500 jobs). State employment fell by 100 and federal government employment did not change. The seasonal decline in retail employment was even more pronounced in 2002 than usual (and it was unusually pronounced in 2001 as well), but the usual strength of retail in the spring did not show up. The mid-year decline did appear, however, just as in past years. While we can expect the usual end-of-the-year increase in retail employment in 2002, we cannot expect any early impetus from retail activity in early 2003. In fact, the last two years argue for a larger-than-usual decline in January and February.

It is clear that the state government faces a serious budget situation over the next two years. State government employment, as a consequence, is unlikely to rise and may well fall. In addition, there will be downward pressure on compensation of state government employees, so even stable employment is unlikely to generate increasing

incomes. These pressures may well affect local governments because they derive significant revenues from the state (such as in education). Growth in the government sector, then, seems unlikely to provide a stimulus to local economic activity.

Overall, we cannot count on the service sector to generate significant employment (or income) increases during 2003. A gain of between 1,000 and 2,000 (0.5 percent to 1 percent), probably concentrated in business and health care services, seems the most probable outcome.

Conclusions

The local economy has not shared to any noticeable extent in the tentative national recovery. There is no particular reason to expect a strong, or even a weak, recovery in 2003. Continued weakness in manufacturing and stagnation in the service sector will likely combine to drag local employment down modestly (a 1 percent to 2 percent decline) in 2003. Local unemployment rates will probably rise slightly in response.

In the longer term, the ability of the steel industry to cope adequately with a non-competitive cost structure and aggressive foreign competition will have a larger influence locally than nationally. The restructuring that is likely to occur in steel

will almost certainly have consequences for employment practices and may well have consequences for compensation. In addition, the ability of northwest Indiana to prove a hospitable location for new or relocating firms, and the ability of the region to generate new locally-owned and controlled firms, will be crucial to sustaining a strong local economy. While undiscussed here, population and demographic issues—especially the age structure of the local population and the education of the local labor force—will affect local economic development.

While the immediate future does not look terribly bright, the longer-term future can be what we decide to make of it. ◀

There is no reason to expect a strong, or even a weak, recovery in 2003.

Table 1
Earnings and Hours in Manufacturing, August 2001 and August 2002

Industry	Weekly Earnings			Hourly Earnings			Weekly Hours		
	2002	2001	% Change	2002	2001	% Change	2002	2001	% Change
All Manufacturing	\$895	\$868	3.1%	\$21.17	\$21.18	0%	42.3	41.0	3.2%
Durable Goods	\$949	\$885	7.2%	\$22.11	\$21.70	1.9%	42.9	40.8	5.1%
Primary Metals	\$1,053	\$969	8.6%	\$24.67	\$23.77	3.8%	42.7	40.8	4.7%
Steel Mills	\$1,064	\$985	8.1%	\$24.98	\$24.08	3.7%	42.6	40.9	4.2%
Industrial Machinery	\$764	\$709	7.8%	\$18.81	\$17.89	5.2%	42.6	39.6	2.5%
Non-Durable Goods	\$702	\$794	-11.6%	\$17.47	\$19.03	-8.2%	41.7	41.7	-3.6%
Chemicals	\$725	\$676	7.2%	\$19.91	\$19.03	4.6%	36.5	36.5	-0.1%

Indianapolis

To write of Indiana is to ignore the three divisions within the state that are of importance. For example, between October 1999 and the same month in 2002, the state lost 81,700 jobs. But none of these jobs were lost in the Indianapolis Metropolitan Statistical Area (MSA). Data from the Bureau of Labor Statistics and the Indiana Department of Workforce Development show that 65 percent (52,900) of that job loss occurred in the other metro areas of Indiana

(see Figure 1). The combination of Indiana's counties that are not part of an MSA, what we will call non-metro areas, accounted for the other 35 percent, a loss of 28,800 jobs. These losses are disproportionate to the distribution of employment in the state (see Figure 2). If Indianapolis had borne its "fair share" of job losses, that nine county area would have lost 24,000 jobs.

Even among the other metro areas, the record of job losses over the past three years

Morton J. Marcus

Executive Director, Indiana Business Research Center, Kelley School of Business, Indiana University, Bloomington, Indianapolis, and Gary

Figure 1

The Three States of Indiana

The Indianapolis Metro Area, Other Metro Areas, and Non-Metro Areas

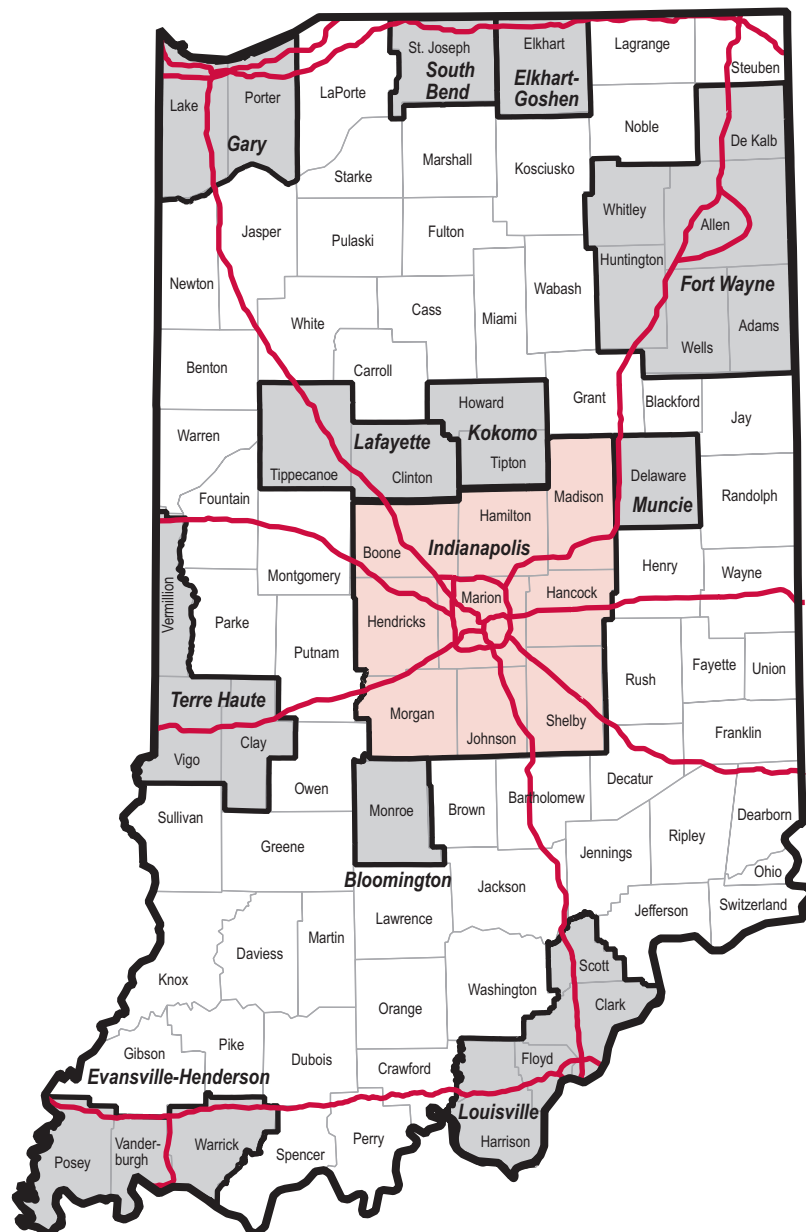
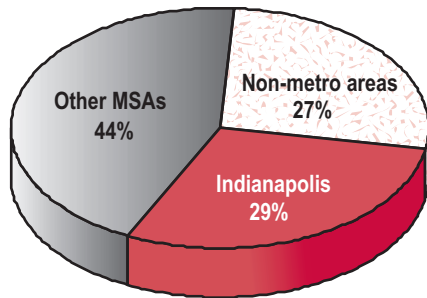
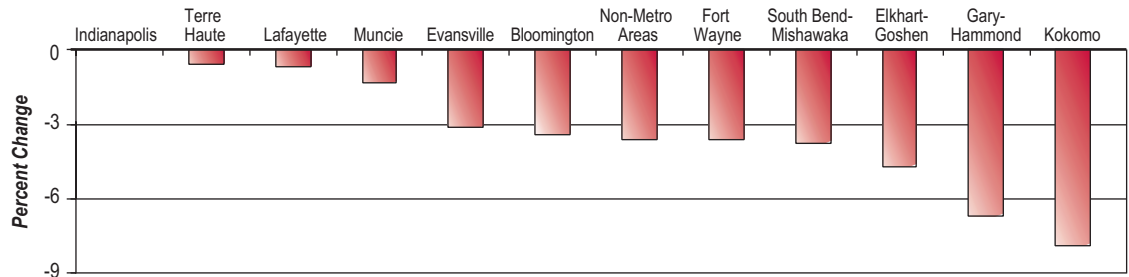


Figure 2
Indiana's Non-Farm
Employment, October 1999



Of the 30,000 jobs expected to be gained in Indiana next year, more than half are likely to be in the Indianapolis area.

Figure 3
Percent Change in MSA
Non-Farm Employment,
October 1999 to
October 2002



is diverse. **Figure 3** shows that the non-metro areas fall in the middle of the metro areas, which range from no change in Indianapolis to a negative 7.9 percent change in Kokomo.

Not only are the rates of job loss different in these three areas of Indiana, but the pattern or time of decline is also different. See **Figure 4** where the decline begins in other metro areas before it hits Indianapolis or the non-metro areas. But the detailed data in **Figure 5** reveal an unambiguous slowing of the economy for each of the three regions beginning in January 2000. In the other metro areas, employment was running 4 percent below a year earlier at the end of 2001. At the same time, job losses in non-metro areas of Indiana were at 2 percent and those in the Indianapolis metro area were 1 percent or less.

Looking Ahead

As 2002 ends, the Indianapolis area seems poised for job increases once again. The rest of the state, although moving in the same direction, is still lagging behind. Of the 30,000 jobs expected to be gained in the entire state over the course of the next year, more than half are likely to be in the Indianapolis area itself. ◀

Figure 4
Percent Change in Non-Farm Employment, October 1999 to October 2002

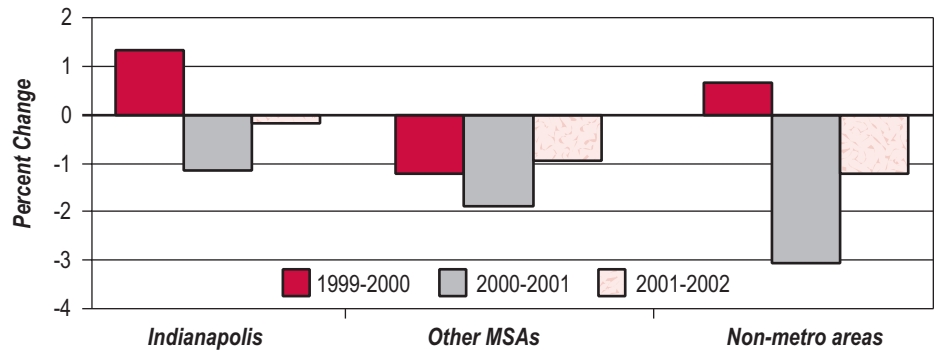
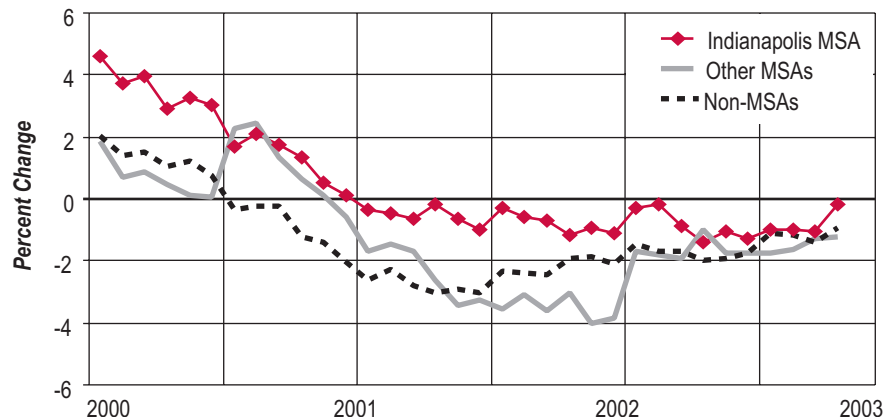


Figure 5
Percent Change in Non-Farm Employment from Same Month a Year Earlier



Kokomo

Kokomo's economy is heavily weighted toward manufacturing. Employment in manufacturing industries peaked statewide in June 2000. While recent losses have been much less than before and some months have even posted gains, employment is still not anywhere close to its peak. Many firms in the Kokomo area are still seeing a slow business climate and general economic malaise (see **Figure 1**). This hits especially hard since Kokomo has been one of the economic powerhouses of the area. The Kokomo Metropolitan Statistical Area (MSA) has long had the distinction of being one of the top MSAs in the country in terms of average salary, despite being the smallest of the eleven MSAs in Indiana. Nationwide, the economy has been somewhat sputtering, as consumers worry about things, such as a possible war or layoffs. The situation with Iraq remains volatile, and the effects of a war on the economy are difficult to predict for many reasons, including the length of the war, the involvement of other nations in the fighting, and the number of U.S. reserve troops activated.

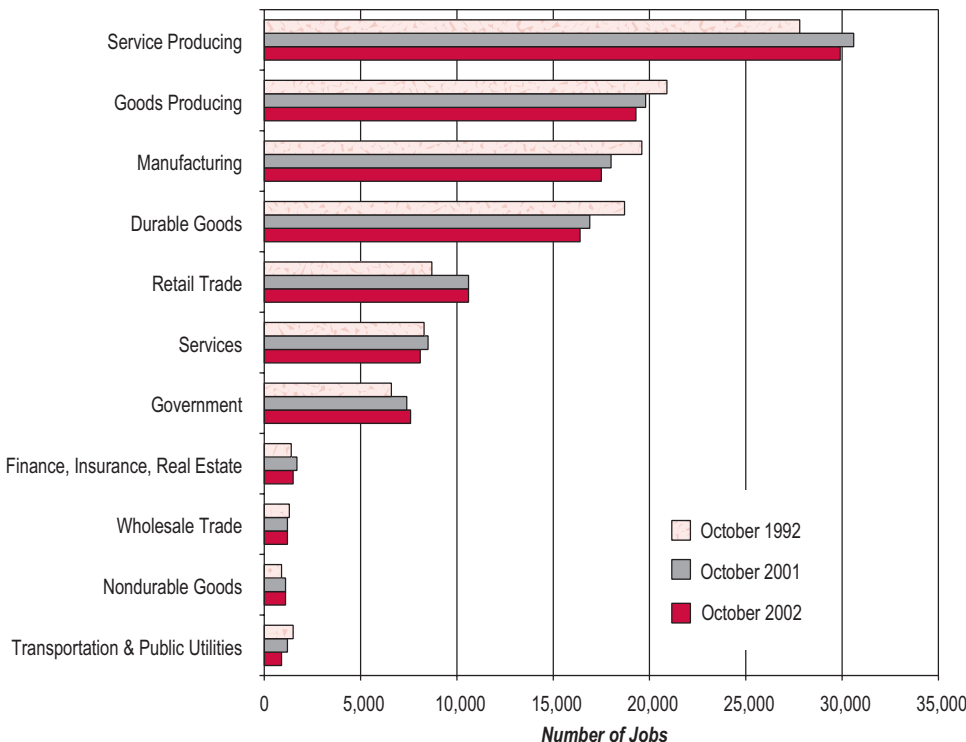
Kathy Parkison

MBA Director, Associate Professor of Economics and Director, Center for Economic Education, Indiana University, Kokomo

On the local front, the moves by the Fed to lower interest rates (and keep them low) have allowed automobile manufacturers to offer zero percent financing. This has protected jobs and production at the DaimlerChrysler plants, which are an important part of the local economy. In addition, low interest rates have led to increases in home sales, refinancing, and borrowing for home improvements. Consumer spending has been the true engine of the economy in the recent past and is likely to continue to be so in the future. But as interest rates rise, as they are likely to do, consumer spending will be pinched somewhat.

There have been some specific signs that the economy, while not growing gangbusters, has at least held its own in Kokomo. Unemployment has increased from the September 2000 levels of 2.7 percent to September 2001 levels of 5.4 percent. The average work week has increased, meaning more overtime pay. Last year at this time, the average weekly earnings had fallen to \$996, but these earnings have regained ground and are now at \$1,251.

Figure 1
Kokomo MSA Employment by Industry



Prospects for the Future

Kokomo remains highly dependent on the automobile industry. The zero percent financing has worked very well and enticed many to purchase a new vehicle. These special financing deals may have taken care of pent-up demand for vehicles, so the zero percent financing may fail to entice as many new sales. DaimlerChrysler has been doing better in meeting analysts' forecasts for sales and profits. But the company still has a ways to go in their cost cutting measures. This will presumably pressure the local economy as the company cuts wage and benefit packages.

In summary, the Kokomo economy, like much of the rest of the country, is in a holding pattern. Small business owners report that their business is just doing okay and most are in a wait-and-see mode for the future. ◀

Lafayette

The Lafayette metropolitan area (Tippecanoe and Clinton counties) was the third fastest growing metro area in Indiana, based on the change in population between the censuses of 1990 and 2000. At a rate of population growth of 13.2 percent, it was nearly identical to the nation's growth of 13.1 percent and considerably exceeded Indiana's 9.7 percent growth rate.

Like most of Indiana, the majority of jobs in the Lafayette metro area are now in the services sector (24.3 percent). Over the ten-year period from October 1992 to October 2002, Lafayette gained 13,400 new jobs, with 9,400 in the service producing sectors. During the more recent past, between October 2000 and October 2002, the service producing sectors managed to post a small gain of 700 jobs while other sectors of the area's economy lost jobs (see **Table 1**).

A still considerable 20 percent of jobs are in manufacturing, with average earnings per job of \$48,490 (based on Bureau of Economic Analysis data from 2000). This despite Isuzu pulling out of Subaru-Isuzu Automotive, which just a few years ago had considered building a second plant in the county. However, news reports indicate that Subaru sales remain strong and that Subaru was responsible for 80 percent of the jobs at the plant anyway. More current monthly data show average weekly earnings in manufacturing at \$655 for October 2002 (see **Table 2**). There was also a 100 job increase in durable goods manufacturing

between October 2001 and October 2002, while nondurable goods job levels remained constant. Taking a somewhat longer view and using annual averages, jobs in the primary metals industry increased 22 percent between 1995 and 2000 in Tippecanoe County, ranking it sixty-eighth out of 3,141 counties nationwide in percent increase. Positive percentage increases also occurred during that time (from 1995 to 2000) in the industrial machinery and transportation equipment industries.

Unemployment in the area remains at low levels, despite the recent recession and slowing economy. The Lafayette metro area unemployment rate in September was 26 percent lower than the state's rate of 4.6. While this might not seem to bode well for business prospects seeking a large labor supply, the commuting patterns for the region show large numbers of workers continue to be drawn to the area from other counties, such as White, Carroll, Benton, Warren, and Clinton. More than 20,000 workers reported living elsewhere but working in Tippecanoe County, based on state income tax returns for the year 2000 (see **Figure 1**).

Will Lafayette experience more of the same in 2003? With the state expected to see an increase of 30,000 jobs in 2003, Lafayette can be expected to gain a small share of those jobs, most likely in services, government, and some key manufacturing areas. ◀

Carol O. Rogers

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Figure 1
Commuting into Tippecanoe, 2000

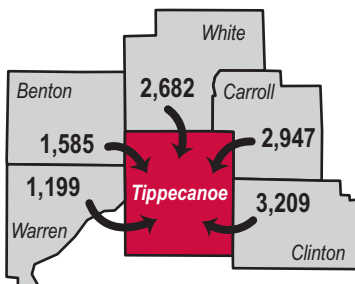


Table 1
Jobs in the Lafayette MSA: Ten-Year Comparison of October

Industry	2002	1992	Ten-Year Change	2000	Two-Year Change
Total Nonfarm	98,600	85,200	13,400	99,000	-400
Goods Producing	26,200	22,200	4,000	27,300	-1,100
Service Producing	72,400	63,000	9,400	71,700	700
Manufacturing	21,900	19,000	2,900	23,100	-1,200
Durable Goods	15,400	12,500	2,900	16,500	-1,100
Nondurable Goods	6,500	6,500	0	6,600	-100
Transportation & Public Utilities	2,100	2,300	-200	2,300	-200
Wholesale Trade	2,000	1,900	100	2,500	-500
Retail Trade	17,600	14,700	2,900	18,000	-400
Finance, Insurance, Real Estate	3,800	3,600	200	3,600	200
Services	17,700	15,600	2,100	19,400	-1,700
Government	29,200	24,900	4,300	25,900	3,300

Table 2
Comparison of Jobs and Wages in Manufacturing in MSAs

MSA	Job Levels			Average Weekly Earnings			
	Oct '02	Oct '00	Change	Oct '02	Oct '00	Change	Rank
Lafayette	21,900	23,100	-5.19%	\$655.52	\$721.10	-9.09%	12
Bloomington	5,800	9,300	-37.63%	\$531.17	\$544.27	-2.41%	10
Elkhart-Goshen	60,000	61,600	-2.60%	\$625.92	\$566.09	10.57%	3
Evansville-Henderson	30,400	31,700	-4.10%	\$656.26	\$694.70	-5.53%	11
Fort Wayne	63,700	70,900	-10.16%	\$682.21	\$674.45	1.15%	9
Gary	38,200	46,700	-18.20%	\$897.57	\$879.80	2.02%	7
Indianapolis	118,900	128,900	-7.76%	\$686.16	\$675.40	1.59%	8
Kokomo	17,500	20,100	-12.94%	\$1,287.73	\$1,095.97	17.50%	2
Muncie	8,800	9,300	-5.38%	\$672.49	\$620.78	8.33%	4
New Albany	19,400	21,200	-8.49%	\$741.64	\$556.00	33.39%	1
South Bend	21,200	21,700	-2.30%	\$545.71	\$509.53	7.10%	5
Terre Haute	11,300	12,000	-5.83%	\$629.76	\$611.60	2.97%	6

Muncie

Only a few years ago, the short-term problems of the Indiana economy were largely solved. Jobs were plentiful, unemployment rates were scraping the ground, and the state's revenue coffers were flush. That left us in the unusual—and unfamiliar—situation of facing up to the larger, long-term problems facing the state economy, including the deterioration of our relative standard of living and the net out-migration of our educated population.

Patrick M. Barkey

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The recession of 2001 has only partially changed that situation. It has delivered to us—ahead of the U.S. economy as is the Indiana custom—a taste of the familiar cutbacks and closings in manufacturing, which have hit Muncie and East Central Indiana as hard as anywhere else. But coming on the tail of a seven-year stretch that has seen job growth locally stagnate even as the national economy charged ahead, it has been difficult to sort out which of the recent woes are due to the recession and which represent the outgrowth of trends that precede that event.

The East Central Indiana region, defined as Blackford, Delaware, Grant, Henry, Jay, Madison, Randolph, and Wayne counties, experienced zero population growth over the last decade. Terre Haute is the only other urban area in Indiana with a similar experience. Thus, the backdrop for our recession experience of 2001–02 is one of relative decline.

Total Employment

This decline is clearly evidenced from the behavior of total employment over the last twelve years, as shown in **Figure 1**. The data, which are seasonally adjusted quarterly averages of the monthly DWD reports on payroll employment, depict an economy that peaked in mid-1995, more than six years before the U.S. economy slowed down. Since its high point of more than 62,000 jobs at the last decade's midpoint, Muncie business establishments have steadily contracted payrolls, to just under 58,000 employees in the third quarter of 2002.

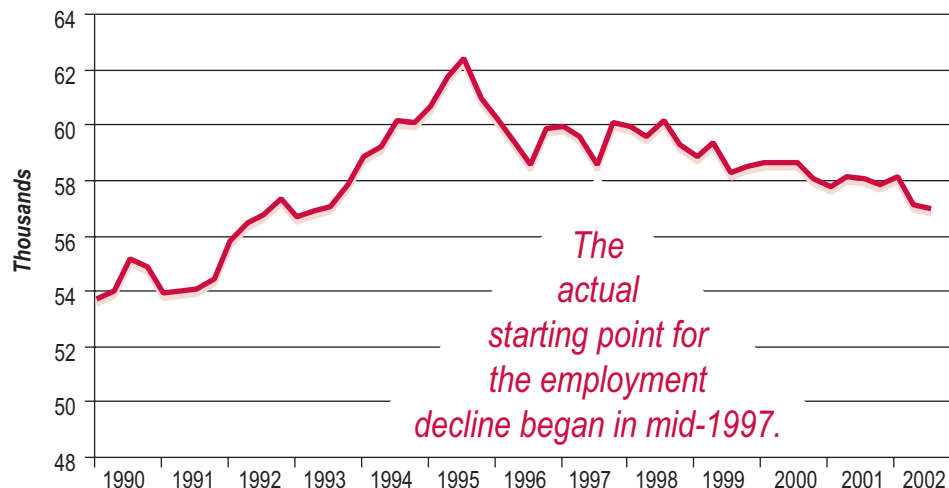
The picture is a bit misleading, however. Changes in accounting and ownership at a single large employer, the now-defunct Burlington Motor Carriers trucking company, caused a pre-1995 buildup in total employment and a sharp decline immediately thereafter that were more apparent than real. A closer examination of the data reveals that the true starting point for the downward trend preceding the 2001 recession was in mid-1997, when the economy suffered four setbacks in the manufacturing sector in quick succession.

Manufacturing

The closure of GM's Delphi battery plant and the sale and shutdown of Borg-Warner's manual transmission business were just two of the largest disruptions that ultimately led to a net job loss of 1,500 jobs in Muncie's manufacturing sector, as shown in **Figure 2**. Some new developments created new manufacturing jobs since that time, most notably the construction and expansion of the Keihin vehicle components facility. But those were not enough to offset job declines elsewhere, with the slow decline leading up to the beginning of the recession bringing factory employment down to about 9,500 jobs.

The manufacturing recession, nationally as well as in Indiana, began in the late spring of 2000, almost twelve months before the national recession was officially declared. Its pain has been fully shared by facilities and workers in the Muncie Metropolitan Statistical Area (MSA). In the four quarters following the third quarter of 2000, the manufacturing sector quietly shed almost 1,000 additional jobs.

Figure 1
Muncie MSA Establishment Employment



Those declines occurred during a period that saw national manufacturers contract payrolls by nearly two million jobs for many of the same reasons. The contraction in capital spending by businesses that has been the hallmark of this recession was devastating to manufacturers in the business of producing capital goods. The unrelenting price pressure caused by global competition and cost consciousness of large OEM's has forced companies everywhere to find ways to cut their own costs, which often translates into cutting payrolls.

The question faced by Muncie's leaders, much as in everywhere in Indiana, is simply, how many of these lost jobs are likely to come back? Given that the hoarding of skilled labor has probably kept these cuts from being even worse, the unpleasant answer to that question is that probably very few jobs will return in our short-run future.

Non-Manufacturing

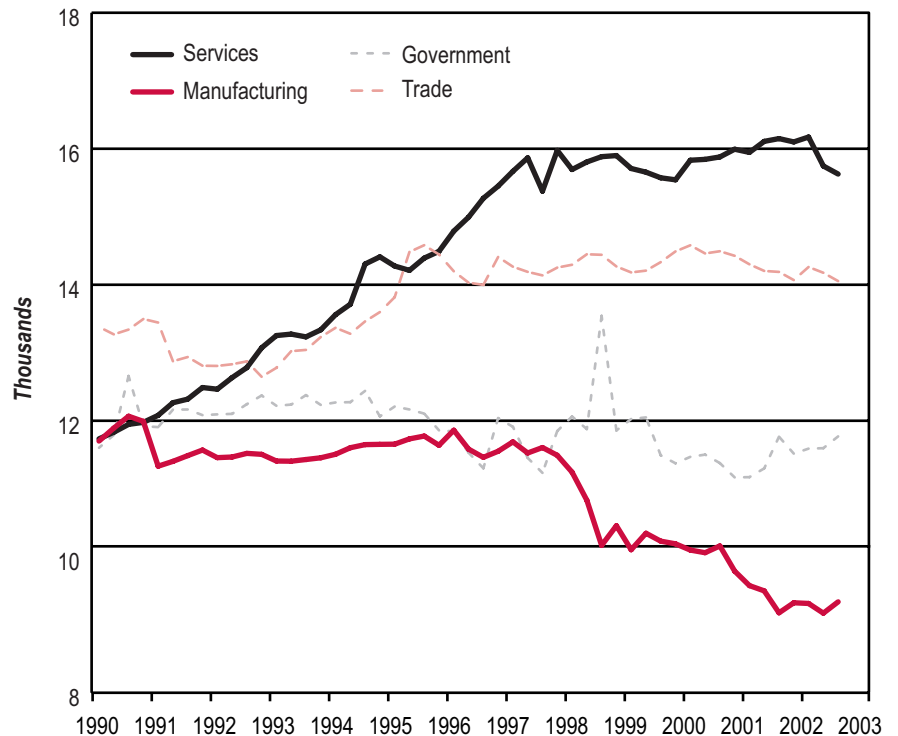
It may surprise some to learn that the services, retail/wholesale trade, and government sectors are the three largest employers in the Muncie MSA. Although they have largely avoided the sharp, recession-induced declines suffered by the manufacturing sector, their longer-term movements largely reflect the same pattern of the area's overall population base.

Steady growth in Muncie's services industries employment in the 1990s was interrupted by the manufacturing declines of 1997, as seen in **Figure 2**. After growing by about 4,000 jobs—more than 30 percent—in the first seven years of the last decade, services industry payrolls have remained at, or near, 16,000 jobs ever since. This behavior is at odds with the industry's growth in the rest of the state and nation.

The stagnation occurred as rising employment in health care industries was offset by lower payrolls in business services, particularly in temporary help supply. The latter no doubt reflects the decreased demand coming from the manufacturing sector.

The wholesale and retail trade sector experienced a disappointing performance in 2001–02 as well. While retail trade continues to provide the most visible signs of new growth in the arrival of new stores, the data in the figure suggest that additions to the

Figure 2
Employment for Selected Sectors in the Muncie MSA



employment base from new openings have been offset by layoffs and declines elsewhere. There was some increase in the size of the retail pie in the mid 1990s, with the arrival of stores like Meijer, Walmart, and Lowe's increasing the geographic scope of the Muncie market. But the trend since that time has been largely sideways, as the growth and refurbishing of retail outlets has squeezed out, rather than added to, those already here.

Trends in government sector employment, shown in **Figure 2**, reflect the population-related declines in public schools and the situation at Ball State University (BSU), the area's largest single employer. While largely stable, there has been some decline in this sector's employment since the mid-1990s, reflecting both the loss of school-aged children and the softness in BSU enrollment during that time. The latter has moved, unsurprisingly, in a pattern that is opposite to the direction of the national economy, with stronger growth occurring thus far in the current recession.

Assessment and Outlook

The Muncie MSA, much like the rest of the state, has clearly suffered the effects of the

national economic recession. Those effects, especially in manufacturing, began in 2000, well in advance of the national downturn. The timing and severity of the recession here has been approximately the same as what has occurred in the Indiana economy.

The distinguishing pattern in the Muncie employment data has been the absence of growth in the years leading up to the new decade. Even as the national economy soared at the height of the technology boom, both employment and population here declined or grew very slowly at best. The recession-induced declines in employment since 2000, while no more painful than any other Indiana city has experienced, come on top of this pre-existing trend.

With improvement in the national economy, such as what is forecast by economists at Indiana University and elsewhere, the Muncie economy can hope to regain some portion of the approximately 1,000 jobs lost since the downturn began. Unfortunately, if the slow secular decline in the local economy continues into next year, the best that we can hope for in 2003 is an increase of only a few hundred jobs. ◀

New Albany

In 2002, the economy of Southern Indiana and the Louisville metropolitan area continues to perform better than national economic trends. To date, employment losses and increases in the unemployment rate in the Louisville area have not been as extreme as in other parts of Indiana, Kentucky, and many parts of the U.S. The seven counties in the Louisville Metropolitan Statistical Area (MSA) are Clark, Floyd, Harrison, and Scott counties in Southern Indiana, and Bullitt, Jefferson, and Oldham counties in Northern Kentucky. The following analysis examines various measures of economic growth in the Louisville MSA and its component counties. Three additional Indiana counties—Crawford, Orange, and Washington—in the Southern Indiana labor market area are included when data are available.

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Table 2
Non-Agricultural Employment and Components, September 1999 to September 2002

<i>In Thousands</i>	1999	2000	2001	2002 [*]
NON-AGRICULTURAL EMPLOYMENT				
Southern Indiana Counties ¹	95.2	94.2	94.9	94.4
Louisville MSA ²	584.2	593.4	603.1	583.9
MANUFACTURING EMPLOYMENT				
Southern Indiana Counties	20.6	20.2	20.4	19.9
Louisville MSA	89.1	88.0	84.4	83.1
Durable Goods				
Southern Indiana Counties	11.3	10.8	11.2	11.0
Louisville MSA	50.6	50.9	48.1	47.7
Nondurable Goods				
Southern Indiana Counties	9.3	9.4	9.2	8.9
Louisville MSA	38.5	37.1	36.3	35.4
NON-MANUFACTURING EMPLOYMENT				
Southern Indiana Counties	74.6	74.0	74.5	74.5
Louisville MSA	495.1	505.4	518.7	500.8
Wholesale Trade				
Southern Indiana Counties	3.4	3.4	3.5	3.1
Louisville MSA	33.0	34.3	34.5	32.4
Retail Trade				
Southern Indiana Counties	20.2	20.3	19.5	19.1
Louisville MSA	111.6	109.6	114.7	105.3
Finance, Insurance & Real Estate				
Southern Indiana Counties	2.8	2.7	2.6	3.0
Louisville MSA	29.6	35.0	35.8	34.4
Services				
Southern Indiana Counties	18.5	18.9	19.7	19.1
Louisville MSA	173.2	171.9	179.5	175.5
Government				
Southern Indiana Counties	16.4	15.1	16.0	17.6
Louisville MSA	71.9	75.1	74.8	74.2

¹ Clark, Floyd, Harrison, and Scott counties

² Clark, Floyd, Harrison, and Scott counties in Indiana, and Bullitt, Jefferson, and Oldham counties in Kentucky

* September 2002 figures are preliminary.

Table 1
Unemployment Rates Around Louisville

Area	1999	2000	2001	2002
Clark, IN*	2.8	2.9	4.0	4.2
Crawford, IN	3.9	3.3	4.2	4.3
Floyd, IN*	2.3	2.5	2.5	3.4
Harrison, IN*	2.3	2.0	3.1	3.0
Jefferson, IN	2.5	3.3	3.3	4.6
Orange, IN	5.6	3.5	8.5	8.1
Scott, IN*	2.9	2.5	4.9	4.8
Washington, IN	7.1	3.6	7.1	6.4
Louisville MSA	3.3	3.2	4.4	4.5
Indiana	2.9	2.4	3.9	4.6
Kentucky	4.0	3.9	5.2	4.8
U.S. (seasonally adjusted)	4.2	4.0	5.0	5.6

* Counties in the Louisville Metropolitan Statistical Area

Labor Markets

The 2002 unemployment rates in the counties of the Louisville metropolitan area have declined over the year and continue to be below, or even with, that of Indiana as a whole and below that of Kentucky and the United States, as shown in **Table 1**. Clark and Floyd counties have higher unemployment rates than for the same period in previous years. Unemployment in Harrison County is currently among the lowest in the state, while the unemployment rate in Orange County is among the highest in the state.

Recent data for the Louisville MSA indicate that the average level of non-agricultural employment decreased by about 19,000 jobs between September 2001 and September 2002 (see **Table 2**). The vast majority of job losses occurred on the Kentucky side of the river. Manufacturing employment decreased by 500 jobs in Southern Indiana and about 1,300 jobs in the MSA. Non-manufacturing employment remains steady in Southern Indiana but decreased significantly (by 17,900 jobs) in the MSA during this period. The MSA job losses in the non-manufacturing sector were led by decreases in the service and retail sectors. Several major retail chains are expanding operations into Southern Indiana, which has kept retail employment steady at around 19,000 workers during 2002.

Recent data from the Indiana Department of Revenue indicate that 36,300 workers commuted daily between Southern Indiana

and Kentucky in 2000. This is about 1,200 fewer workers commuting from Southern Indiana to Kentucky than in 1999. The proportion of commuters originating in each county is shown in **Table 3**.

Wages and Hours in Manufacturing

Manufacturing is the only sector for which wage and salary information is collected for the Southern Indiana area. Average hourly manufacturing earnings in Southern Indiana remain consistently below that of the MSA as a whole. Average hourly earnings in manufacturing industries in Southern Indiana have been consistently below that of Indiana as a whole for years (see **Figure 1**). Beginning in May of 2002 that trend changed, and hourly manufacturing earnings rose above the state average. This is most likely a fluctuation rather than inflationary pressure. While there is no standard measure of labor productivity for metropolitan areas, national averages suggest that labor productivity in

manufacturing has increased substantially over the past decade, thus holding output prices and wages down.

Average weekly hours worked in the manufacturing sector were stable at around 40 hours per week in the Southern Indiana counties until May 2002 when weekly hours began creeping up. They peaked at 45.1 hours per week in August and averaged 42 hours per week over the past year. This suggests that the increase in average earnings is due to overtime pay.

Consumer Activity

Sales and Marketing Management magazine's 2002 Survey of Buying power shows that retail sales declined over the past year. Total retail sales in the Louisville MSA decreased by 4.51 percent from \$13.5 billion in 2001 to \$12.9 billion in 2002. Jefferson County, Kentucky and Floyd County, Indiana had the largest decreases (on a percentage basis) between 2000 and 2001. Harrison is the only county in the MSA to show positive growth in retail sales.

Activity in the residential housing market decreased slightly over the past year. Housing sales through October 2002 in the Southern Indiana area totaled 2,144 compared with 2,242 for the January–October 2001 period and 1,840 for the same period in 2000. The sale of existing homes in 2001 totaled 2,568, which is among the highest levels of sales since 1990, suggesting that this indicator peaked in 2001. The average sale price was \$123,917 for January–October 2002 sales, down 5.9 percent from the year before. The average amount of time for a house to sell was 110 days.

In contrast to housing sales, residential construction, as measured by residential building permits for new single-family units, decreased from the 2001 in Jefferson and Floyd counties and increased in Clark and Harrison counties. As shown in **Table 4**, the largest decrease in the number of single-family permits (146) occurred in Jefferson County. The largest percent decline occurred in Floyd County with a 9.9 percent decrease. The number of multi-family permits increased in Jefferson County.

Gaming at Caesar's Casino continues to expand. The turnstile count for September of 2002 was 272,262 patrons, a 28.8 percent increase over September 2001. The turnstile count for January through September 2002 was 30.8 percent higher than the same period last year. Admissions and gaming tax revenues totaled \$51.72 million for the January–September 2002 period, a 7.7 percent increase over the same period in 2001.

Table 3
Commuting Flows, 2000
Commuters as a Percent of County Workforce

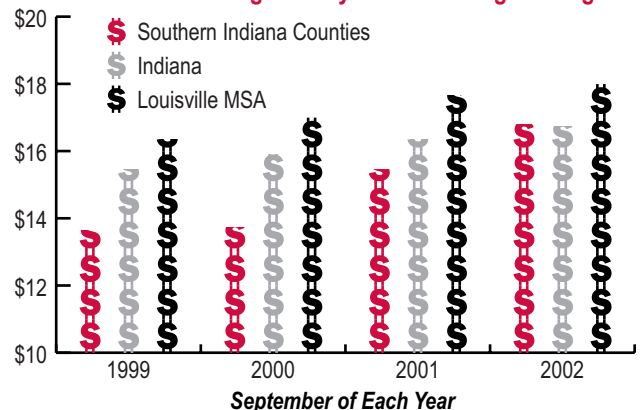
Living in	Working In								
	Kentucky	Clark	Crawford	Floyd	Harrison	Orange	Scott	Washington	
Clark	42.73	79.31	0.30	12.28	2.54	0.08	2.51	1.35	
Crawford	1.74	0.33	88.08	0.55	4.25	1.34	0.00	0.20	
Floyd	34.41	10.28	0.41	76.83	4.70	0.14	0.60	0.90	
Harrison	14.63	2.77	3.75	5.61	83.39	0.15	0.17	0.84	
Orange	0.42	0.04	2.68	0.11	0.37	87.44	0.00	1.62	
Scott	2.16	1.50	0.00	0.49	0.11	0.00	86.48	0.86	
Washington	3.91	3.00	0.32	2.11	1.61	1.94	3.47	91.80	
Kentucky	NA	1.44	0.18	1.37	1.85	0.10	0.20	0.10	
Other	NA	1.34	4.29	0.65	1.18	8.81	6.57	2.33	

Table 4
Residential Building Permits Issued for Privately-Owned Structures

County	Single-Family			Multi-Family		
	2000	2001	2002	2000	2001	2002
Jefferson, KY	2,032	2,382	2,236	43	23	56
Clark, IN	204	219	222	2	15	9
Floyd, IN	282	282	254	6	3	2
Harrison, IN	80	124	146	0	0	1

*Data from January to September of each year

Figure 1
Average Hourly Manufacturing Earnings



Demographic Trends

Recently released data from the 2000 Census show that educational attainment for the adult population has increased from the 1990 level in the Louisville metropolitan area and the surrounding counties (see **Figure 2**).

Income statistics from Census 2000 (see **Table 5**) reveal that both per capita income and median family income have grown after adjusting for inflation. The income statistics indicate substantial gains in some counties, particularly Floyd. However, income for many of the counties—Crawford, Orange, Scott, and Washington—continues to lag behind the national figures.

The growing Hispanic population has become a focus for local social service agencies and nonprofit groups. **Table 6** shows the growth in the Hispanic population from 1990 to 2000. A substantial increase has occurred in the Louisville MSA, particularly in Clark and Jefferson counties.

In the last few months of 2002, Louisville and the Southern Indiana area have settled into a period of sluggish growth. Unemployment rates are a bit higher than in 2001 but have been declining in most counties for the past few months and are

still relatively low compared to the state and national averages. After a decline from the 2001 levels, employment growth in the non-agricultural sector reached a low point during the summer of 2002 but has been increasing for the past few months. Employment in several industries (nondurable goods and finance, insurance, and real estate) has remained stable over the past year. Consumer activity—as measured by retail sales, single-family residential building permits, and housing sales—decreased relative to the previous year. ◀

Figure 2
Educational Attainment
Percent of Population Age 25 and Older

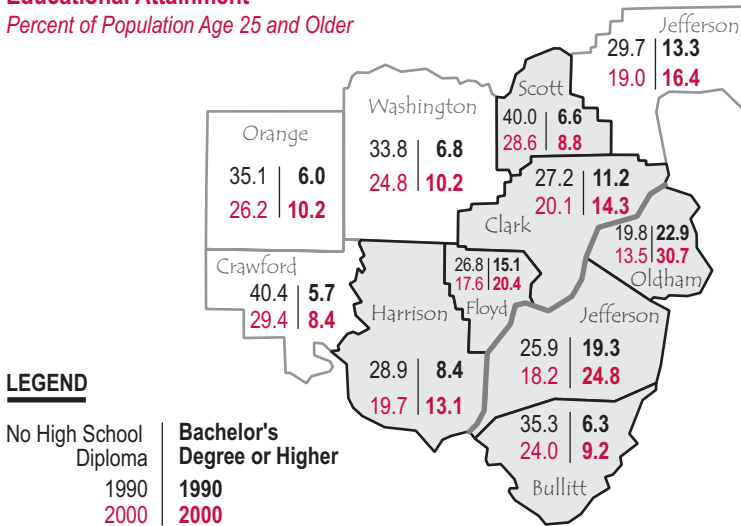


Table 5
Income Statistics by County

County	Per Capita Income		Median Household Income	
	1989*	1999	1989*	1999
Indiana	17,666	20,397	38,689	41,567
Clark	16,213	19,936	36,793	40,111
Crawford	11,873	15,926	27,363	32,646
Floyd	17,738	21,852	38,236	44,022
Harrison	14,992	19,643	36,594	43,423
Orange	12,390	16,717	28,234	31,564
Scott	13,121	16,065	29,185	34,656
Washington	13,686	16,748	30,762	36,630
Kentucky	14,984	18,093	30,274	33,672
Bullitt	14,654	18,339	39,573	45,106
Jefferson, KY	18,899	22,352	36,398	39,457
Oldham	20,838	25,374	51,612	63,229
Louisville MSA	18,272	21,756	37,079	40,821
Louisville city	15,487	18,193	27,059	28,843
U.S.	19,373	21,587	40,380	41,994

* Adjusted for inflation using the CPI-U

Table 6
Hispanic Population Trends

Area	Total Population		Hispanic Population		Change in Total Population		Change in Hispanics		Percent Change in Hispanics		Hispanics as Share of Population	
	1990	2000	1990	2000	1990-2000	1990-2000	1990-2000	1990-2000	1990	2000		
Indiana	5,544,159	6,080,485	98,788	214,536	536,326	115,748	117%	1.8%	3.5%			
Clark, IN	87,777	96,472	560	1,799	8,695	1,239	221%	0.6%	1.9%			
Floyd, IN	64,404	70,823	254	772	6,419	518	204%	0.4%	1.1%			
Harrison, IN	29,890	34,325	126	331	4,435	205	163%	0.4%	1.0%			
Scott, IN	20,991	22,960	148	222	1,969	74	50%	0.7%	1.0%			
Bullitt, KY	47,567	61,236	93	383	13,669	290	312%	0.2%	0.6%			
Jefferson, KY	664,937	693,604	4,813	12,370	28,667	7,557	157%	0.7%	1.8%			
Oldham, KY	33,263	46,178	129	602	12,915	473	367%	0.4%	1.3%			
Louisville MSA	948,829	1,025,598	6,123	16,479	76,769	10,356	169%	0.6%	1.6%			
Crawford, IN	9,914	10,743	16	100	829	84	525%	0.2%	0.9%			
Jefferson, IN	29,797	31,705	123	332	1,908	209	170%	0.4%	1.0%			
Orange, IN	18,409	19,306	59	108	897	49	83%	0.3%	0.6%			
Washington, IN	23,717	27,223	108	200	3,506	92	85%	0.5%	0.7%			

Richmond

The Richmond-Connersville-New Castle (RCNC) area economy is sputtering given its interdependence with the national economy. The sluggish recovery is spilling over into the local economy in terms of employment, income, and growth.

The manufacturing sector continues to be affected in varying degrees by current economic conditions. Firms producing durable goods, such as wire, machine tools, heavy-duty truck parts, and other transportation-related equipment, have weak demands and below target sales. The machine tool industry has overcapacity and a lack of capital spending. Also, the new emission requirements for diesel truck engines translate into low new orders. Consequently, some firms have laid off employees, while others have maintained employment levels expecting to have a good year.

The rebates and zero or low interest rate financing offered by DaimlerChrysler, Ford, and General Motors are helping the automobile industry. Sales of both 2002 and 2003 model vehicles are at a robust pace, which helps to cushion the severity of the economic slump. With lean inventories and a fairly optimistic industry outlook, auto makers expect a turnaround.

Most manufacturers, however, expect orders, production level, investment, and employment to either increase or stay the same during the first half of 2003. They foresee little change in most indicators before the end of 2002.

On a positive note, Grand Vehicle Works of Union City reported that its subsidiary, Workhorse Customs Chassis, plans to manufacture diesel chassis for recreational vehicles in the closed Dana plant in Hagerstown. The company plans to make an initial investment of at least \$3 million, which will create 100 new jobs at an average wage rate of \$10.50 to \$13.00 an hour for nonsalaried workers and \$51,000 a year for salaried workers. This investment will give a tremendous boost to Hagerstown and the surrounding communities.

Employment growth in Wayne, Fayette, and Henry counties was slow in 2001 and 2002 (see **Figure 1**). In September 2002, the numbers of employed workers were 34,040 in Wayne, 9,310 in Fayette, and 22,520 in Henry, and the unemployment rates were 4.8 percent, 7.6 percent, and 5.1 percent, respectively. These unemployment rates were higher than the state rate of 4.6 percent but below the national rate of 5.4 percent, with the exception of Fayette County (see **Table 1**).

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Figure 1
Unemployment Comparisons for 2001

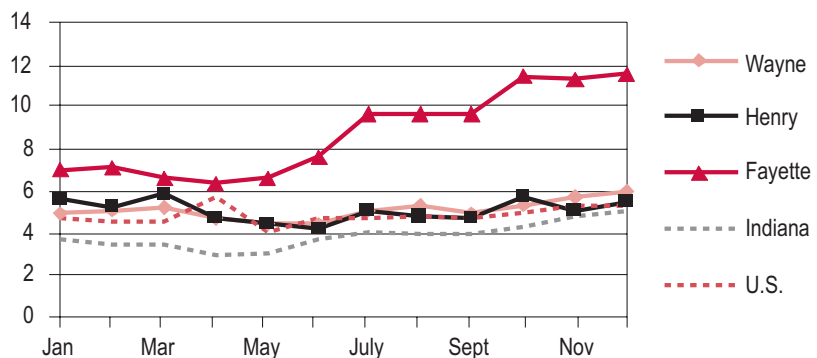


Table 1
Labor Force Estimates,
September 2001 and September 2002

Area	Labor Force		Employment		Unemployment		Rate	
	2002	2001	2002	2001	2002	2001	2002	2001
Fayette	10,080	10,460	9,310	9,440	770	1,020	7.6	9.7
Henry	23,740	23,510	22,520	22,410	1,220	1,100	5.1	4.7
Wayne	35,770	36,420	34,040	34,600	1,730	1,820	4.8	5.0
Indiana	3,151,037	3,110,483	3,005,442	2,990,052	145,595	120,431	4.6	3.9
United States	142,745,000	141,576,000	135,063,000	134,868,000	7,683,000	6,708,000	5.4	4.7

Fayette County continues to experience high unemployment given its manufacturing intensity vis-à-vis the sluggish recovery.

It is important to note that of all the employment categories, manufacturing continues to have the most significant impact on the local economy because of its high average wage rates. Income declines in manufacturing affect total local income.

On the bright side is the housing sector. There is strong growth as evidenced by new subdivisions and home improvements. There were 3,099 building permits in RCNC during the first nine months of 2002 with an estimated investment value of \$119.2 million. In Richmond, there were 1,164 permits, of which 30 were residential and 8 were commercial, with an investment value of \$8.3 million. The overall investment value is estimated at \$18 million which is much lower than last year (see **Table 2**).

The drop in mortgage rates from a peak of 8.7 percent in May 2000 is making home buying more affordable. At the end of October, local financial institutions had 15-year, 30-year, and 1-year adjustable mortgage rates averaging 5.48 percent, 6.16 percent, and 4.52 percent, respectively

(see **Table 3**). Rates for fixed mortgages remain near historic lows, allowing home buyers and people refinancing their homes favorable mortgaging financing terms. There is increased activity for homes priced between \$75,000 and \$120,000. Also, some upscale movement is occurring between local and new residents for homes priced at \$200,000 and above. An increase in home buying always lifts consumer spending for home-related goods and services.

Home buyers seem to be forward looking by taking advantage of current mortgage rates. They expect mortgage rates to edge up when financial markets incorporate higher inflation. Inflation is currently subdued. But low interest rates could be a symptom of deflation that could have far-reaching consequences for households awash in debt. A fall in the price level raises the real amount of debt and redistributes wealth between debtors and creditors.

Like housing, the service sector is growing. RCNC's health care services, business services, and management services are not as adversely affected by current conditions as manufacturing. As the service sector expands, it will stimulate employment

Table 2
Building Permits Issued in 2002

Area	Total Permits	Total Amount
Richmond	1,164	\$18,014,036
<i>January</i>	51	\$1,039,324
<i>February</i>	53	\$2,317,827
<i>March</i>	60	\$1,399,628
<i>April</i>	168	\$1,950,147
<i>May</i>	168	\$1,823,471
<i>June</i>	180	\$4,631,799
<i>July</i>	161	\$1,363,763
<i>August</i>	176	\$2,073,571
<i>September</i>	147	\$1,414,506
Fayette County	251	\$21,687,428
New Castle	867	\$14,833,389
Henry County	454	\$43,209,667
Wayne County	363	\$21,446,347
RCNC Total	3,099	\$119,190,867

and income in the region with spillover effects on food and entertainment outlets.

Personal income in RCNC showed a slight increase of 5.5 percent in 2000. The per capita personal incomes for Wayne, Fayette, and Henry counties were \$24,839, \$23,412, and \$25,345, respectively. Per capita personal income remained below the state level of \$26,933 and the national level of \$29,469. The recession that began in March 2001 has reduced income growth. Nominal per capita income growth for the U.S. as a whole last year was less than half the pace set in 2000.

Furthermore, in its annual survey of local firms, the Center for Economic Education found that 93 percent of the firms are adversely affected by current economic conditions, 59 percent have hired new employees in 2002, 33 percent plan to expand in 2003, 53 percent do e-commerce, and 40 percent rate the education level of their workforce as good. Only 58 percent of the firms are optimistic about 2003. This could change since the midterm elections are over, but there are still financial and political uncertainties, especially if there is another Gulf war.

Overall, the fundamentals are in place for RCNC to have an uptick in economic activity in 2003. Growth could be uneven due to swings in capital spending, consumer confidence, and other transitory developments. This forecast depends on economic conditions at both the national and international levels. ◀

Table 3
RCNC Area Mortgage Rates in October 2002

Bank	October 27, 2002			October 20, 2002		
	15-yr.	30-yr.	1-yr. ARM	15-yr.	30-yr.	1-yr. ARM
Advantage Home Mortgage	5.375	6.125	4.75	5.625	6.25	5.25
Capitol Mortgage	5.50	6.00	N/A	5.875	6.25	N/A
Eaton National and Trust	5.50	6.00	4.25	5.875	6.375	4.50
Edward Jones	5.50	6.25	4.00	5.875	6.50	4.375
First Bank Richmond	5.625	6.125	5.5	N/A	N/A	N/A
First National Bank and Trust	5.75	6.50	4.50	5.75	6.50	4.50
Flagstar Bank	5.375	6.00	4.875	5.75	6.25	4.875
Galaxy Mortgage	5.375	6.125	5.50	5.75	6.375	5.50
Kenrick Financial	N/A	N/A	N/A	5.75	6.25	4.50
Main Source Bank	5.50	6.25	4.50	5.875	6.625	4.50
Merrill Lynch	5.829	6.405	N/A	6.229	6.53	N/A
Old National Bank	5.375	6.125	4.00	5.875	6.50	4.00
Premier Mortgage	N/A	N/A	N/A	5.75	6.375	5.00
Union County National Bank	5.375	6.00	4.625	5.875	6.375	4.625
US Bank Home Mortgage	5.50	6.25	4.00	5.875	6.375	4.00
Wayne Bank & Trust	5.50	6.125	3.75	5.625	6.375	3.75

South Bend/Mishawaka and Elkhart/Goshen

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In the early 1950s, both the South Bend/Mishawaka and Elkhart/Goshen local economies featured very strong manufacturing sectors. More than half of all employment in both economies was in manufacturing. In the 1960s and 1970s, employment in the South Bend/Mishawaka local economy, like most local economies in the U.S., shifted from manufacturing to non-manufacturing. By 2000, manufacturing employment made up only 16 percent of total employment. In contrast, manufacturing employment in the Elkhart/Goshen economy, led by the recreational vehicle and manufactured housing industries, continued to grow as fast as non-manufacturing employment. In 2000, manufacturing employment made up 51 percent of total employment, the highest percentage of any metropolitan statistical area in the U.S. **Table 1** shows average unemployment rates and uses seasonally adjusted index numbers to show average levels of employment for the years 1995 through the first half of 2002. **Figure 1** indicates the trends mentioned above were continuing until 2002, with manufacturing employment in South Bend declining 2.7 percent from 1995 through 2000, and manufacturing employment in Elkhart growing 9.8 percent during the same period. Recently, manufacturing employment has declined in both local economies.

The South Bend/Mishawaka economy performed well from 1995 through 2001 but started to decline significantly in the first quarter of 2002. Total employment grew slowly from 1995 through the first quarter of 2001, increasing by 13 percent during this period. It leveled off for the rest of 2001 before declining sharply in January 2002. Non-manufacturing employment increased slowly from 1995 through the second quarter of 2001, growing by 16 percent, before declining in the third and fourth quarters. Manufacturing employment was up and down depending upon the national economy and the specific situations facing local firms. The recent recession at the national level is reflected locally by a nearly 9 percent drop in total employment, a 14 percent drop in manufacturing employment, and a nearly 5 percent drop in non-manufacturing employment from March 2001 to January 2002. Manufacturing employment has increased by 5 percent and total employment has increased by 2.3 since January 2002. Unemployment rates dropped from an average of 4.3 percent in 1995 to 2.3 percent in 1998 and remained at very low levels until the recent recession. The local labor market was very tight from 1997 through 2000, but the recent recession has increased monthly unemployment rates significantly since early 2001.

The Elkhart/Goshen economy performed well from 1995 through 2000, except for a dip in 1996. From 1995 through 2000, total employment grew 12 percent. Total employment declined in 2001, with the rate of decline picking up in the third and fourth quarters. Manufacturing jobs increased each year from 1997 to 2000 until declining in 2001. The decline was modest for most of 2001, but it increased significantly in the fourth quarter of 2001 and the first quarter of 2002. Non-manufacturing jobs increased every year until 2001, except for a slight decline in 1996. The level of non-manufacturing employment held up reasonably well until it declined in the fourth quarter of 2001. It increased slightly in the first quarter of 2002 before declining again in the second quarter. Unemployment rates dropped from 4.5 percent in 1995 to 2.1 percent in 1999 and remained at very low levels, until increasing to 4.7 percent in 2001. The monthly rates rose to an average of 6.3

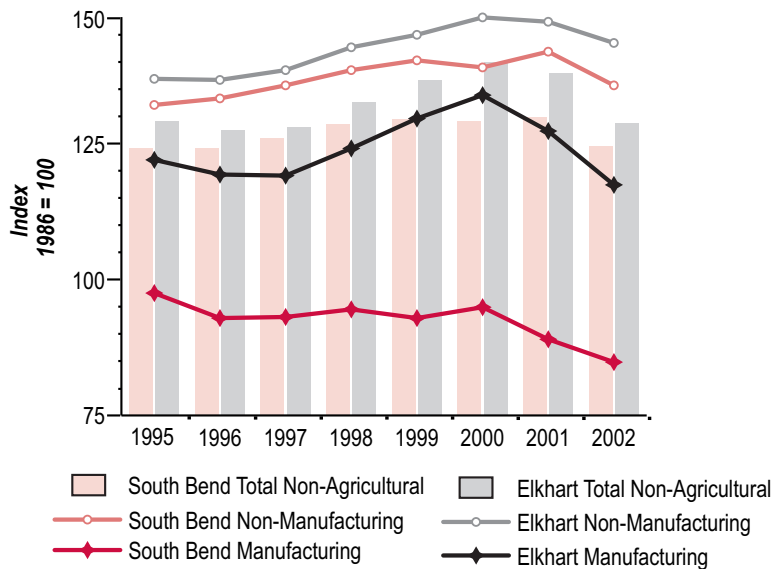
Table 1
Indexed Employment and Unemployment Rates, 1995–2002

	1995	1996	1997	1998	1999	2000	2001	2002 ¹
South Bend/Mishawaka								
Total Non-Agricultural	124.1	124.1	126.0	128.6	129.5	129.2	129.9	124.6
Manufacturing	97.5	92.9	93.1	94.5	92.9	94.9	89.0	84.8
Non-Manufacturing	132.1	133.3	135.7	138.5	140.3	139.0	141.9	135.7
Unemployment Rate	4.3%	4.0%	3.3%	2.7%	2.9%	3.2%	4.1%	5.2%
Elkhart/Goshen								
Total Non-Agricultural	129.2	127.4	128.0	132.7	136.6	140.0	137.9	128.8
Manufacturing	122.0	119.3	119.1	124.1	129.6	133.9	127.3	117.4
Non-Manufacturing	136.9	136.7	138.5	142.7	145.0	148.2	147.4	143.5
Unemployment Rate	4.5%	3.8%	3.3%	2.6%	2.1%	2.7%	4.7%	5.2%

All employment figures are seasonally adjusted index numbers with 1986 = 100

¹2002 figures cover the first six months of the year.

Figure 1
Employment Index for South Bend/Mishawaka and Elkhart/Goshen



percent for the fourth quarter of 2001 and 5.8 percent for the first quarter of 2002 as the recession really impacted manufacturing.

Data from **Table 1** for the first six months of 2002, together with recently released data for August 2002, suggest that both local economies are recovering from their troughs in January, although Elkhart's recovery is much stronger at this stage. Total employment in South Bend is up less than 1 percent for the first eight months of 2002, while in Elkhart it is up almost 4 percent. In South Bend, manufacturing employment is up 5.7 percent for the first eight months of 2002 versus an increase of 6.4 percent for Elkhart. The average unemployment rate in South Bend is down from 5.5 percent in the first quarter of 2002 to 5.0 percent for August, and in Elkhart it is down from 5.8 percent in the first quarter to 4.5 percent for August 2002. Employment levels are rising in both local economies, but faster in the Elkhart economy.

Outlook

Accurately forecasting economic conditions for local economies is very difficult for two reasons. First, we have much less economic information available for local economies than for larger economies, and the data we do have tends to be less accurate. Secondly, special situations affecting individual firms, which would have little impact on a regional or

national forecast, can have a major impact on a local economy. The uncertainty surrounding these special situations creates uncertainty about the forecast. At the present time, we have several special situations that have the potential to impact our local economies over the next couple of years. AM General is producing H-2 vehicles (Hummers) in St. Joseph County for General Motors. Approximately 1,000 workers have been hired at wages well above the local average for production workers. Since almost all of the sales will be outside our area, and since it is likely additional new jobs will be created to supply this plant, the multiplier effect will be substantial. This development is having a substantial impact on local employment and local income.

Crowe Chizek and Company, one of our largest local employers, announced an expansion in South Bend last year. While some firms in the accounting industry have faced difficulties this year, Crowe Chizek's expansion continues to move forward. The company plans to hire a significant number of new employees in this area over the next two to four years. Work on the expanded headquarters is completed and employees have begun moving into the new areas of the facility. Since this is the company's national headquarters, much of the income supporting these new positions will come from outside

our area. Many of these jobs will be high paying with excellent fringe benefits. While the multiplier effect will be smaller than the General Motors one, it will still be substantial. Local employment and income will increase from Crowe Chizek's expansion, although some of the impact will occur beyond our forecast period.

Finally, the recreational vehicle industry is recovering very quickly from the recession, increasing production at a 15 percent rate for 2002. This is one of the largest local industries, and it is having a major impact, especially in Elkhart. This industry's impact is magnified by the large number of local firms supplying the recreational vehicle producers. The combined effect of these special situations is clearly positive for our local economy.

On the negative side, Bayer Corp. is shutting down its consumer care division in Elkhart. This shutdown will result in the loss of approximately 350 high-paying production jobs. Since almost all of the production is sold outside our local economy, there will be a sizable multiplier effect. In addition, our area has lost many jobs over the last two years in the auto supply industry. While most of the failing firms have been small, the total number of jobs lost is more than 1,000. This lost income will also have a negative multiplier effect on the local area.

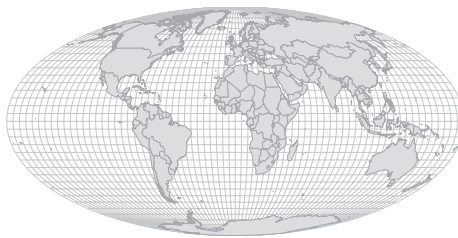
Like most local economies, the South Bend/Mishawaka and Elkhart/Goshen economies are greatly influenced by the national economy. The durable goods component of the national economy, and especially the automobile, manufactured housing, recreational vehicle, and steel industries have a big impact on our local economies. Since the Elkhart economy has very substantial manufacturing employment, it tends to be affected quickly and significantly by movements in the national economy. The Elkhart economy, led by the growth in recreational vehicle production, has recovered more quickly than the South Bend economy. The national forecast shows declines in durable goods spending in the fourth quarter, and relatively slow growth for all of 2003. The model calls for little growth in domestic automobile production and in new housing starts. As a result, we expect both local economies to continue their recoveries, but at a modest rate. ◀

Outlook Summary for 2003

The Big Picture

By the Kelley School of Business

- ▶ **Jeff Green and Bill Witte on the National Forecast:** Gross Domestic Product is expected to increase by 3.2 percent, with consumer spending and federal spending leading growth. After mid-year, business investment will become a positive force as well. Exports will struggle to keep pace with rising imports.
- ▶ **Rob Neal and Bill Sartoris forecast the Financial Picture:** We are cautiously optimistic that 2003 will provide a decent rate of return for stock market investors. Only once since 1926—during the depression era of 1929 to 1932—has the market declined for four consecutive years.



- ▶ **Jeff Fisher on Housing:** New and existing home sales should remain strong, although slightly off the record pace of 2002. Assuming the stock market improves, the demand for apartments may drop off (as related to investor demand).
- ▶ **Morton Marcus on Indiana:** As the nation emerges from the recession, Indiana should once again gain jobs and we are forecasting job growth of 30,000 during 2003. This number is based on a cyclical rebound subdued by the secular decline in employment in manufacturing, public utilities, and the financial sectors.
- ▶ **Andreas Hauskrecht's Global Forecast:** World economic growth will be around 2.8 percent, with the European Union growing at 2.3 percent and China at 7.2 percent.

Indiana Metro Areas

By Faculty from Academia Statewide

- ▶ **Barry Ritchey on Anderson:** *Short-term:* continuing losses of jobs in manufacturing and slow to zero income growth. *Long-term:* this area could become one of the most urbanized corridors in the state.
- ▶ **Thayr Richey on Bloomington:** The Bloomington experience may reveal a new approach to the Indiana economy: retain a core manufacturing base but grow the overall economy through higher paying jobs in education and service.
- ▶ **Jim Smith on Columbus:** This area's ability to raise the education level of the workforce will be important in determining whether economic prosperity comes to Bartholomew County or gets diverted to Minnesota and Vermont.
- ▶ **Gale Blalock on Evansville:** Recent announcements of the expansion of Toyota and its suppliers and the arrival of Ford in Gibson County bode well for the future.
- ▶ **Tom Guthrie on Fort Wayne:** After two years of decline (2000 and 2001) and a year of essentially no growth, the Fort Wayne metro economy is forecast to have a significant cyclical bounce in 2003.
- ▶ **Don Coffin on Gary:** The metro economy has not shared in the tentative national recovery. There is no particular reason to expect a strong, or even a weak, recovery in 2003. While the immediate future does not look terribly bright, the longer-term future can be what we decide to make of it.
- ▶ **Morton Marcus on Indianapolis:** As 2002 ends, the Indianapolis area seems poised for job increases once again. Of the 30,000 jobs expected to be gained in Indiana in 2003, more than half are likely to be in the Indianapolis area.
- ▶ **Kathy Parkison on Kokomo:** As an economy that relies on manufacturing, Kokomo is in a holding pattern, much like the rest of the country. There have been some specific signs that the Kokomo economy, while not growing gangbusters, has at least held its own.
- ▶ **Carol Rogers on Lafayette:** Barring any enormous shifts in the national economy, Lafayette will likely experience a year similar to 2002—not great but not bad—and it will likely gain a small share of the 30,000 jobs projected for Indiana.
- ▶ **Pat Barkey on Muncie:** With improvement in the national economy, Muncie can hope to regain some portion of the approximately 1,000 jobs lost since the downturn began. But if the slow secular decline continues in 2003, the best we can hope for is an increase of a few hundred jobs.
- ▶ **Dagney Faulk on New Albany:** The economy of Southern Indiana and the Louisville metro area continues to perform better than national economic trends; gaming at Caesar's continues to expand; income has grown; and in the last few months of 2002, the area has settled into a period of sluggish growth.
- ▶ **Ash Veramallay on Richmond:** The fundamentals are in place for this area to have an uptick in economic activity, although growth could be uneven due to swings in capital spending, consumer confidence, and other transitory developments.
- ▶ **Paul Joray on South Bend and Elkhart:** Both of the economies of South Bend/Mishawaka and Elkhart/Goshen will continue their recoveries, but at a modest rate.

OUTLOOK 2003

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