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OUTLOOK 2004

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For the Record:

War. Capture. Plant closings. The digital economy. Flu. Life sciences. An aging baby-boom. Prescription drug bill. A beloved Governor dies. An ex-POW takes the reigns. Morton Marcus "retires" after three decades of service to Indiana, but continues to expound on the good and bad about our state. What a year 2003 has been. What ups and downs will 2004 bring? These pages can't provide an answer to that question. But a cadre of economists provide us with insights into what 2004 will bring in terms of economic growth—worldwide, nationally, and within the environs of Indiana itself. These experts from our institutions of higher education bring a wealth of expertise to the question of how the economy will perform in the coming year as we work through what is dubbed the jobless recovery, a phrase that evokes both concern and optimism. Read on and learn what 2004 may bring.

Please note that more information on the Lafayette and Terre Haute economies is available on the Web at www.ibrc.indiana.edu/ibr. Your comments are most welcome.

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Outlook for 2004

R. Jeffery Green

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Every October, a group of faculty at the Kelley School of Business gathers to discuss the economic outlook for the nation and the state. The discussion begins with the latest forecast generated from the U.S. model developed at the Center for Econometric Model Research (CEMR) at Indiana University. A consensus is then generated around adjustments to the model forecast. The CEMR model of Indiana is used to translate the economic forecast for the U.S. into a forecast for Indiana.

The results of these deliberations are presented at many venues throughout Indiana where the faculty from the Kelley School are joined by a local panelist who discusses the outlook for that part of the state. The following articles summarize the views of the Outlook Panel. They also discuss some potential problems facing us, including a ballooning federal deficit, massive bilateral trade imbalances, and issues of corporate governance and reporting.

Bill Witte gives the details of the national economic forecast, showing that recent strength in consumer spending and housing will be augmented in 2004 by an upturn in business spending on plants and equipment, along with a rise in exports. Andreas Hauskrecht presents the international outlook and explains why large accumulations of dollar reserves overseas raise the risk of dollar depreciation. John Boquist and Bill Sartoris trace recent financial developments, exploring why the outlook for 2004 is positive but not exuberant. Gil Viets examines the important issues of corporate governance and reporting that remain a concern for economic performance. Jeff Fisher takes a close look at the housing industry, which has been such a source of economic strength this year, and finds further grounds for optimism for 2004. Jerry Conover and Jim Smith draw on the international and national forecasts to present their outlook for the Indiana economy in the coming year. And a cadre of economists from universities around the state provide their views and forecasts for their metropolitan economies. ◂

The U.S. Economy

Willard E. Witte

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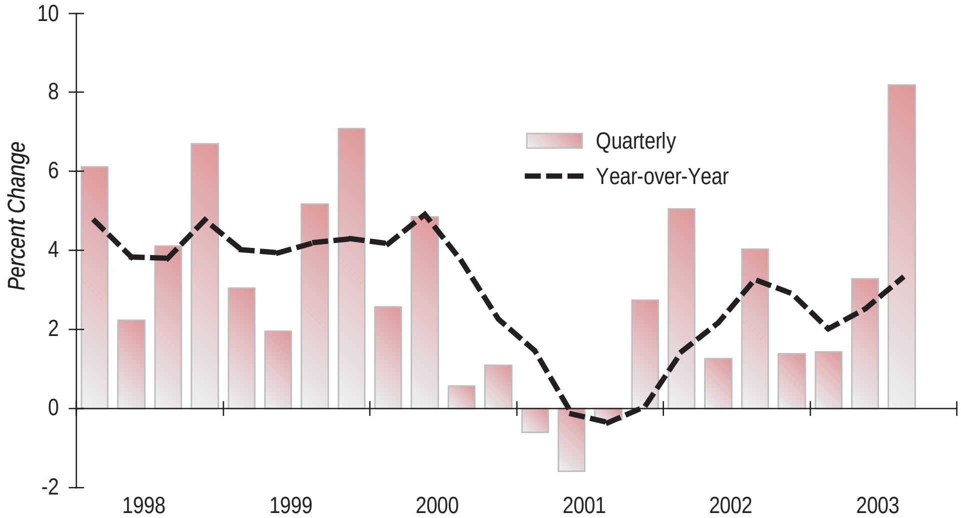
The U.S. economy during 2003 has been an exercise in cognitive dissonance. By most measures, the economy has performed quite well (and quite close to the outlook we presented a year ago). Yet the “man on the street” by most reports believes that things are not going well. In this national overview, I will first look at the good news from last year and dissect the fly in the ointment. Then I will outline our relatively optimistic view of what we can expect in 2004, along with some things that could cause problems during the next year.

Overall, output growth for 2003 will probably come in at about 3 percent, with growth accelerating in the second half of the year. **Figure 1** shows the past six years of real output growth. At the same time, inflation has remained low (about 2 percent for consumer prices), and interest rates dropped at mid-year to levels not seen in over four decades. Household income, driven by rising labor productivity with a boost from the federal tax cut, has registered solid growth. Households have used this income (and funds from mortgage refinancing) to purchase nearly seventeen million new cars and trucks and push housing construction to an all-time high. Since the spring, clear signs of a sustained recovery in business investment exist, especially in the high-tech area. Even the stock market has had an up year.

The U.S. economy has been an exercise in cognitive dissonance—a psychological phenomenon that refers to the discomfort felt at a discrepancy between what one already knows or believes and new information or interpretation.

During the past summer, the National Bureau of Economic Research—a Boston-based group of economists who arbitrate the beginnings and ends of recessions—declared that the “official” end of the recession occurred in November 2001. This means

Figure 1
Real Output: Annual Rate of Change



we are now two full years into the recovery period. Indeed, in terms of output, we are beyond recovery and into a new period of expansion.

Yet there is a continuing string of anecdotal evidence that Americans are apprehensive about the economic outlook. Central to this concern is the labor market. **Figure 2** shows why. During the late 1990s, the economy was adding almost three million jobs each year. For the past two and a half years, job losses have averaged over a million each year. As of September 2003, total employment was nearly 2.6 million below its peak in early 2001. As a result, unemployment has risen steadily to above 6 percent. This is not high by historical standards, but it is far removed from the below 4 percent levels reached prior to the recession.

The situation in the manufacturing sector, an especially important part of the Indiana economy, is even grimmer. Nationally, the sector accounts for all of the job losses and then some. Since July of 2000, employment in manufacturing has declined month after month without a break. Over that period the decline has totaled almost 16 percent. Moreover, much of this contraction represents permanent structural change and not a cyclical phenomenon. In some cases, jobs are being lost to lower cost areas abroad; in others, they are being eliminated by the tide of advancing productivity that permits firms to produce more goods with fewer workers.

Although the labor market situation is troubling, we think that most of the bad news is behind us and are optimistic about the outlook for 2004. While we don't expect to see numbers matching the 8.2 percent growth registered in the third quarter of 2003, we do expect output growth next year to approach 4 percent. This growth should also be more broadly based than during the past two years when household spending on consumption and housing was keeping the economy afloat. Next year, economic growth should have significant help from business investment in new plant and equipment, and probably also from some inventory rebuilding.

Another sector that should experience definite improvement is international trade. Since the beginning of 1997, the U.S. net export deficit (in inflation-adjusted dollars) has quintupled to over $500 billion (more than 5 percent of GDP). This has been partly a reflection of

- A voracious demand by American consumers and businesses for foreign goods
- A strong dollar
- Slow growth (or no growth) abroad, reducing demand for our exports

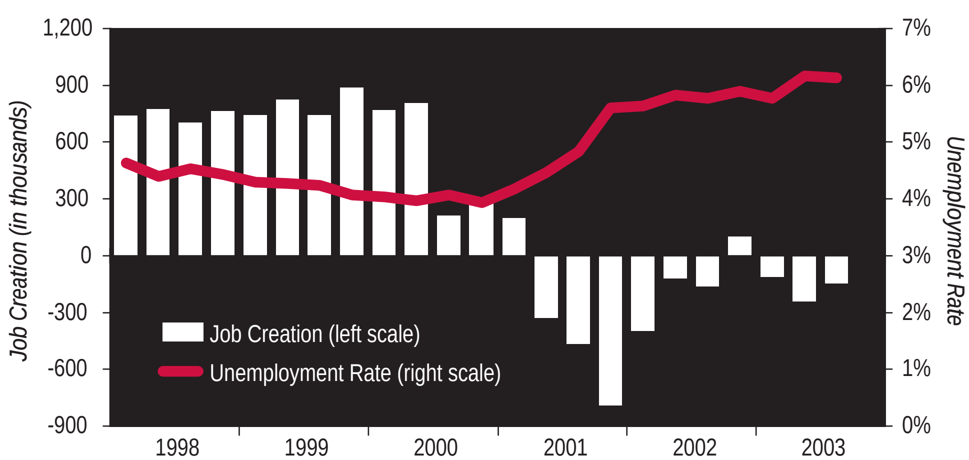
But now two of these factors seem to be changing. The dollar has been falling in the foreign exchange market since 2002, by over 15 percent against other major currencies. More importantly, economies in the rest of the world are looking better than in quite a while.

The continuing expansion we foresee should finally begin to produce improvement in the labor market. We think the economy could generate close to two million new jobs in 2004. This would be sufficient to pull the unemployment rate down to the mid 5 percent range by the end the year.

Our scenario should also make life interesting for the Federal Reserve. The Fed is committed to holding short-term interest rates at their very low current levels for "a considerable period." If our outlook is correct, this considerable period will end sometime after mid-year. By the end of the year, two or three upward movements in short-term rates cannot be ruled out.

One area where things are not likely to show any marked improvement is the federal budget. During the last two years, the deficit

Figure 2
Changes to the Labor Market



has risen at a very rapid pace, as spending (on defense and other things) has increased and tax cuts have held down revenues. A growing economy should yield some expansion of revenue, but only enough for the deficit to stabilize.

Any economic forecast can be upset by unforeseen occurrences. The shift of monetary policy away from its very accommodative stance of the past three years could present difficulties for the expansion. There is a lot of leverage in the U.S. economy, which makes increasing interest rates certain to cause at least a little anguish.

However, the greatest risk during the next year probably lies in the international arena. The situation in Iraq is currently unsettling. If it were to worsen, the impact on the economy would be hard to predict. But it is unlikely that it would be good, especially if the fallout entailed higher oil prices.

But the period since September 11 has shown the enormous resilience of the U.S. economy in the face of external threats. And it is well to remember that since 1982 the U.S. economy has had less than two years of contraction and nearly twenty years of expansion. All signs point to 2004 being added to the expansion side of the ledger. ◂

The International Economy

Andreas Hauskrecht

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Economic growth in the world is likely to come in at 3.2 percent for 2003, measured in terms of real Gross Domestic Product (GDP), compared to growth rates of 2.4 percent in 2001 and 3.0 percent in 2002. The International Monetary Fund in Washington (IMF, *World Economic Outlook*, Fall 2003) forecasts world economic growth for 2004 at 4.1 percent, with a rather high degree of confidence that the worldwide upturn will continue.

The forecast predicts an economic upswing for essentially all world regions, with the significant exception of Japan. As in the last few years, the world depends notably on the U.S. as the economic powerhouse that helps other regions pull out of their economic struggles. The economic growth path in the U.S. is expected to be robust, while recovery in Europe is further delayed and more modest than originally hoped.

Like last year, China and India are expected to show very robust economic growth in 2004; however, their combined GDP adds up to a relatively modest 16 percent of U.S. GDP, clearly not enough to displace the U.S. as the world economic growth locomotive (see **Table 1**).

Europe

Europe had another disappointing year with real GDP growth around 0.5 percent—well below expectations. Germany even experienced another (albeit short) recession. In 2003, German GDP remained flat. France, with an expected real GDP growth of 0.5 percent, and Italy, with 0.4 percent growth, performed only marginally better.

The outlook for 2004 looks slightly brighter with an expected real GDP growth rate of 1.9 percent for the entire euro area. Although on a modest level, the United Kingdom outperformed continental Europe in 2003 with a GDP growth of 1.9 percent and will enjoy a somewhat higher growth rate of around 2.4 percent in 2004.

Clearly, the disappointing German performance pulled down the rest of Europe. The shrinking of the construction sector that exploded during post-unification years alone contributed to a decrease of GDP growth of around 0.3 percent. Although the European Central Bank has further eased monetary policy in 2003, real interest rates in Germany are not particularly low, given the very low inflation of 1 percent. The so-called stabilization pact (ironically a German invention) restricts the use of fiscal policy to stimulate domestic demand. Financial institutions groan under a huge burden of nonperforming loans, a bit similar to the situation in Japan. Consequently, banks are more careful with new lending.

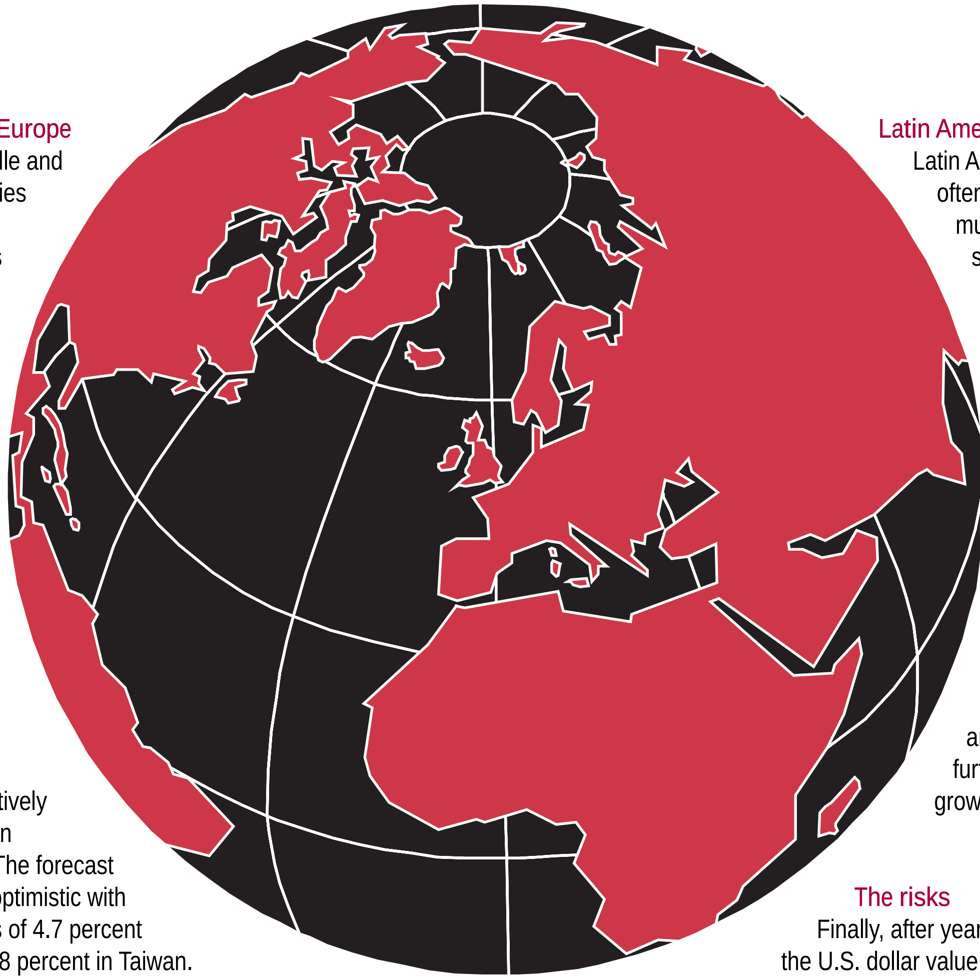
Considering the rapid aging of European society, far-reaching reforms, with the overall aim to reduce nonwage labor costs, of the social insurance schemes and the labor markets are urgently needed. The latter is imperative for the big European countries, such as France, Germany, Italy, and Spain. Several countries have recently introduced or proposed substantial reforms.

Table 1
Growth Comparisons for Selected Countries

Country	GDP		Inflation (Consumer Price Index)		Current Account (Percent of GDP)		Unemployment	
	2003	2004	2003	2004	2003	2004	2003	2004
World Output	3.2	4.1						
United States	2.6	3.5-4.0	1.8	1.3	-5.1	-4.7	6.0	5.5
Canada	1.9	3.0	2.8	1.7	1.6	1.6	7.9	7.7
Mexico	1.5	3.5	4.6	3.4	-2.2	-2.7	3.8	3.3
Brazil	1.5	3.0	15.0	6.2	-0.8	-1.5	-	-
Euro area	0.5	1.9	2.0	1.6	0.8	0.8	9.1	9.2
France	0.5	2.0	1.9	1.7	1.2	1.6	9.5	9.7
Germany	0.0	1.5	1.0	0.6	2.4	2.1	9.5	9.8
Italy	0.4	1.4	2.8	2.0	-1.1	-0.9	9.0	9.0
United Kingdom	1.7	2.4	2.8	2.5	-1.0	-0.9	5.2	5.2
Russia	6.0	5.0	14.4	12.9	8.4	5.2	7.9	7.7
Japan	2.0	1.4	-0.3	-0.6	2.9	2.9	5.5	5.4
China	7.5	7.5	0.8	1.5	1.4	1.3	10.2	9.9
India	5.6	5.9	4.0	4.8	0.6	0.3	9.1	9.0
South Korea	2.5	4.7	3.3	3.0	1.6	1.8	3.4	3.3
Taiwan	2.7	3.8	0.1	0.8	8.5	8.8	5.3	5.0

Russia and Eastern Europe

Russia and most Middle and East European countries are continuing to do well and the outlook is rather optimistic into 2004. Yet the positive effect of a strong world market for crude oil might slowly peter out, revealing how well they (Russia, in particular) have used the oil windfall products to prepare their economies for rougher climates.



Latin America

Latin America had, as so often in the past, another murky year. Cynics might say 2004 can only get better. Although starting from a very low level, Argentina is on an upward path, and Brazil is expected to grow by a respectable 3 percent next year. The significant decrease in its refinancing costs in international financial markets and lower domestic interest rates are a good basis for further robust economic growth.

Asia

The SARS virus negatively impacted several Asian economies this year. The forecast for 2004 is generally optimistic with expected growth rates of 4.7 percent in South Korea and 3.8 percent in Taiwan. The leaders in the region are again China and India, with forecasted growth rates of 7.5 percent and 5.9 percent, respectively. China continues to attract foreign capital and passed the U.S. in 2003 as a major recipient of foreign direct investment. However, more and more voices are warning about a possible Chinese bubble and the dramatic consequences for Asia if this bubble ever bursts. Supporting this pessimistic view are the obvious similarities with former Asian bubble countries:

- Nonperforming loans in the state-owned banking sector are estimated as high as 60 percent of Chinese GDP.
- Several sectors show clear signs of overproduction with extremely low profit margins.
- The real estate market is booming.
- The reliability of officially published data is questionable.

Japan

Japan enjoyed an unexpectedly strong economic upswing in 2003 with a real GDP growth of 2 percent. Yet Japan is still miles away from a sustainable growth path of its nominal GDP because deflation is expected to accelerate in 2004, and real GDP growth is expected to be around 1.4 percent. The titanic stock of nonperforming loans in banks and enterprise balance sheets further suppresses healthy credit growth. While the recent boom in the stock market eased the situation and contributed to the positive performance in 2003, the current strengthening of the yen (particularly against the U.S. dollar) might have the opposite effect on the Japanese economy and damage the fragile upswing.

North America

The economies of the NAFTA members are closely integrated through trade. Canada and Mexico are strongly dependent on U.S. demand for their exports. Real GDP growth for 2004 in Mexico (about 3.5 percent) and Canada (about 3 percent) are expected to be slightly below the world average. However, their export performance into the U.S. depends to a great deal on the exchange rate against the U.S. dollar. Should the dollar further devalue, this trend might impair Mexico and Canada's economic outlook.

The risks

Finally, after years of advanced warnings, the U.S. dollar value on foreign exchange markets has begun to slide. A controlled decrease of the dollar value is, on its own, a welcome and necessary adjustment of exchange rates that might help bring international trade more into balance. However, this necessary adjustment process seems to be hampered by conflicting regional interests.

A closer look at international trade reveals surprising patterns. The U.S. balance of trade is in a deficit of more than $530 billion a year due to trade imbalances with a handful of countries, namely China, Japan, Canada, and a few smaller Asian economies. China's trade balance shows a modest surplus of around 1 percent of GDP, indicating their large surplus with the U.S. is balanced by large deficits with other countries. The Japanese current account surplus, on the other hand, is around 2.9 percent of GDP and shows a rising trend.

Obviously, a major depreciation of the U.S. dollar against the Chinese yuan and the Japanese yen could help correct this imbalance in world trade, but these countries do almost anything to avoid a depreciation of the U.S. dollar against their currency. The yuan is nominally fixed against the dollar at a parity of about 8.2 yuan to the dollar. To avoid pressure on the currency, Chinese monetary authorities buy enormous quantities of U.S. dollars and dollar-denominated securities on the foreign exchange markets. China and Hong Kong together hold central bank reserves of around $495 billion. Taiwan has piled up $190 billion in official U.S. dollar reserves, while South Korea holds $142 billion. Japan also admits to massive dollar purchases. Consequently, the dollar has sharply depreciated by more than 35 percent against the euro since 2002, by around 19 percent against a basket of other rich countries' currencies, but by only 10 percent against a broader basket that includes emerging-market currencies.

Therefore, the U.S. current account, so far, has not adjusted as expected. The burden of adjustment stays with a few industrial countries that allow their currency to freely float against the dollar, including Canada. This might have depressive consequences on the relative competitiveness of those countries' exports and impede their economic growth, particularly in the euro area and Canada. In addition, if a soft landing of the dollar is blocked, markets might one day overreact and enforce a dramatic drop in the dollar exchange rate with devastating consequences for all international trading partners. ◄

If a soft landing of the dollar is blocked, markets might one day overreact and enforce a dramatic drop in the dollar exchange rate with devastating consequences for all international trading partners.

Financial Forecast

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The past three years have been tough on investors with declining stock market returns and low interest rates. Furthermore, notable companies such as Enron, Worldcom, and United Airlines have gone bankrupt, wiping out the entire stock valuations of these companies. Add to this mix the ethical lapses of some managers and investment advisors, as well as the lack of responsible corporate governance at many companies, and it is easy to see why financial markets are now on edge with investors wondering whom they can trust.

Not all the news is bad: housing demand remains strong and families who own their own homes have seen rapid increases in value in many markets. Low interest rates have helped stimulate the real estate market, allowing homeowners to refinance at low rates and fuel their urges to consume. Since we forecast many of these trends will continue next year, financial markets are exhibiting a new reality.

Interest rates

Interest rates have generally fallen during the past twenty years, due in large part to wringing inflation out of the economy. Since short-term rates have fallen much more than the long-term rates, the yield curve is the steepest that we have seen since the early 1990s. Historically, the spread between short- and long-term rates is a precursor to economic activity—the currently observed high spread is generally followed by an expansion and rising interest rates. Thus, we expect to see a slight rise in interest rates over the next year, with the short-term Fed Funds rate in the 1.75 percent to 2.00 percent range and long-term treasury bond yields in the 5 percent to 6 percent range by the end of 2004. Corporate interest rates will also exhibit small increases next year. Mortgage interest rates bottomed out at about 5.25 percent in early summer and have since increased to approximately 6 percent. We expect mortgage rates to also rise over the next year to a level of 6.5 percent. The prime rate will be near 5 percent by the end of the year.

Corporate Profits

Corporate profits are expected to rise about 9 percent next year as the economy continues to grow and recover from the recession. In fact, third quarter earnings this year are expected to be 20 percent above the level of last year. Corporate profits and cash flows continue to be adversely affected by employee health insurance premiums, which rose 14.8 percent last year, and underfunded pension plans, which stand at a $216 billion deficit for the S&P 500 companies. Since stock market value affects the value of many pension funds, an increasing stock market may mitigate this problem slightly. Global competition remains fierce in many markets—particularly autos, light trucks, and sport utility vehicles—but the continued weakness in the dollar will help exporters remain competitive. In addition, productivity increases will offset gains in labor compensation. Fortunately, the continuing low interest rate environment has enabled many companies to refinance their debt at lower rates and rebuild their balance sheets. Overall, there has been a deleveraging of corporate balance sheets. The generally positive outlook for 2004 will encourage firms to expand capital investment and employment to meet the expected increase in demand for goods and services, as well as replenish reduced inventory levels. We see very few reasons to expect a business slowdown or the cataclysmic deflationary scenario some pundits are forecasting for the U.S. economy.

Stock Market

From the early 1990s to 2000, the stock market experienced an incredible and unprecedented bull run—fueled by increased productivity and declining interest rates due to the drop in inflation. That encouraged many investors to fully commit to stocks as their primary investment asset. Unfortunately, from March 2000 through March 2003, the market (as measured by the S&P 500) lost about 49 percent of its value. Even though the S&P 500 is up more than 30 percent since March 2003, it is still 30 percent below the peak in 2000 and many investors are reluctant to dive back into the market. As the economy continues to improve, we expect to see the stock market also continue to make gains, although at a less spectacular rate than the experience this year. In the long run, we expect the stock market will offer returns 6 percent to 8 percent above treasury bonds, which is in line with the market's historical average performance since 1926, but well below the returns investors were experiencing in the 1990s. As always, prudent investors should continue to diversify their portfolios, guarding against too much exposure to any individual stock, market, or asset category.

Summary

The financial markets have clearly changed in the past decade and a new reality must be accepted. We cannot remain passive—action must be taken to align our business and investment strategies with this new reality. As that great philosopher Yogi Berra once said, "When you come to a fork in the road, take it." ◂

So far, the SEC's answers are weak, perhaps demonstrating the depth of the problem…

In the meantime, companies and auditors continue the journey without a good map.

Corporate Governance and Reporting

Gilbert F. Viets

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Overwhelmingly, company financial statements and tax returns are prepared with integrity by honest managers and audited by competent professionals with proper skepticism. Fraud and misleading reporting barely impact economic projections.

Confidence in financial statements has been damaged, though, because a few people took advantage of trust and position, supported by others who did not carefully guard company assets and the sanctity of financial reports. Unfortunately, examples have been prominent and the media properly made certain we did not miss any.

Financial reporting is self-regulated. Managements prepare reports, interpreting how to report results. Reports are seldom immediately reviewed by regulators and may never be reviewed. Managements' greater fear is that analysts, strike lawyers, competitors, or reporters will find errors in the financial statements. Self-regulation will not change, and there is no need to change it.

Notwithstanding this conclusion, we have learned, or have at least been reminded from recent experiences, that certain aspects of the financial reporting system need to be fixed.

Standards for Financial Reporting

We need to fix Generally Accepted Accounting Principles (GAAP), the benchmarks for financial reporting. Accountants are overwhelmed with the standards setting process.

Financial statement readers want reports on assets and liabilities in a world that is trading elements of assets and liabilities. It is difficult to reduce business complexity to simple, transparent financial statements. Assets and liabilities today are carved into elements, dividing shared responsibility and ownership. For example, engineered transactions like special purpose entities have never been dealt with effectively by those who decide GAAP. Today, two years after Enron, a debate continues over variable interest entities, as companies try to understand a proposed standard that is getting old before it is even implemented.

The standards setting process is emotional and political. Debate is less about accounting theory than the impact on financial position and capital allocation.

To address the GAAP problem, a new law, Sarbanes-Oxley, directed the Securities and Exchange Commission (SEC) to do two things: decide who is in charge of GAAP and whether GAAP should be principles-based or rules-based.

So far, the SEC's answers are weak, perhaps demonstrating the depth of the problem. A year after the passage of Sarbanes-Oxley, the SEC has concluded that the Financial Accounting Standards Board (FASB) is in charge, but the SEC directed the FASB to further develop the conceptual framework of accounting, eliminate bright line tests, manage the convergence of U.S. standards with the rest of the world, and complete other difficult tasks.

The SEC answered the question of principles-based versus rules-based by concluding that standards should really be objectives-based. Companies and auditors continue the journey without a good map.

Internal Controls

Sarbanes-Oxley addressed a second problem: internal controls over financial reports. Internal controls are activities that assure companies achieve business objectives, not the least of which is good financial reporting. Some companies do not have good internal controls. But even if they do, bad managers can ignore the controls and initiate improper transactions in financial statements.

Internal controls have never been well documented. They develop more from instinct, similar to the way a person dons a coat when it is cold. Documenting instinct seems to add little value. But many risks needing controls are not as obvious as temperature changes. Formal development and documentation can help.

Sarbanes-Oxley requires new reporting to investors on the effectiveness of internal controls. These new requirements exposed the truth about controls. Documentation does not support evaluations by managements and auditors. As a result, documentation of controls is now done on a crash basis by smart people lacking business school background on what constitutes good internal controls. Required reporting has been delayed one year.

The requirement is controversial because compliance is expensive. Audit fees have increased dramatically and companies are investing heavily in compliance. Many managers wonder if we are preparing for the possible or the improbable.

Auditors

Auditors are a separate, complex problem. Auditors assure investors about the reliability of financial reports, but auditors know there is an “expectation gap.” Auditors cannot accomplish everything expected. Auditors work from a risk model that weights costs of finding problems. The model accepts undiscovered reporting problems when the cost to find them is too high. When the expectation gap becomes a problem, the argument is about auditor negligence, so difficult to defend in hindsight. Accounting firms manage this risk through contracting, legal defense, settlements, stop loss organizational structures, and insurance. If these fail, partners melt into other firms, leaving the damage behind.

Confidence in auditors has suffered. Auditors proudly proclaim their own self-regulation, administered through the American Institute of Certified Public Accountants. Firms use self-inspections and peer reviews. But many suspect they easily pass each other’s work, failing to identify serious deficiencies and independence issues.

The past haunts the accounting profession. Investors are troubled by self-regulation and audit quality. Large firms face huge litigation claims and their nonaudit practices are viewed with suspicion. Smaller firms do not want to assume the responsibility. Sarbanes-Oxley established the Public Company Accounting Oversight Board to qualify and register firms before they can audit public companies and to inspect the practices of firms. But with four firms auditing 99 percent of all public company sales, there is doubt about meaningful regulation. Regulation is premised on fear that failure by any of the four will result in restructuring the profession and may require change in our assurance model.

Conclusion

The problems are difficult, but not addressing them leaves open doors to those who will take advantage of any opening. The overwhelming majority of honest managers and competent professionals are embarrassed and maddened by the actions of those who caused the dramatic changes now being implemented. How can so few cause so much damage for all? Most business people can, and do, make decisions every day against temptation, greed, arrogance, and self-interest.

Knowing the great damage caused by a small minority, the majority must balance that harm with humble, generous service, recognizing that each decision leaves a trail showing a willingness to be open and honest. ◄

Housing

Jeffrey D. Fisher

Director, Center for Real Estate Studies and Charles H. and Barbara F. Dunn Professor of Finance and Real Estate, Kelley School of Business, Indiana University, Bloomington

The jobless recovery has not deterred people from buying homes over the past year and this is expected to continue in 2004. Low interest rates resulted in housing affordability hitting a thirty-year high early in 2003, although rising home prices reduced affordability slightly as the year progressed. Home prices increased about 10 percent for the nation over the past twelve months, pushing the median home price to over $177,000.

The high levels of housing affordability due to low interest rates allowed people to qualify for home mortgages that would not have otherwise qualified, increasing the current homeownership rate to about 68 percent. Many existing homeowners also took advantage of the lower interest rates to purchase larger homes. The average home size has increased steadily in recent years, perhaps partly due to the feeling that one’s home is an investment that may be less risky than the stock market.

Will housing remain strong in 2004? We believe that housing starts will continue near the same level of about 1.7 million to 1.8

Table 1
Housing and Interest Rate Forecast

Housing (in thousands)	2000	2001	2002	2003	2004	2005
Total Starts	1,573	1,601	1,711	1,786	1,700	1,658
Single Family	1,232	1,272	1,364	1,445	1,381	1,358
Multi-Family	341	330	347	341	319	300
New Single Family Home Sales	880	907	977	1,065	994	985
Existing Home Sales	5,158	5,282	5,595	5,986	5,712	5,653
Interest Rates						
Fixed Rate	8.1%	7.0%	6.6%	5.9%	6.3%	6.8%
ARMs	7.0%	5.8%	4.6%	3.8%	4.2%	5.5%
Prime Rate	9.2%	6.9%	4.7%	4.1%	4.1%	5.6%

Source: National Association of Homebuilders million starts (single and multi-family). While a rise in interest rates will dampen housing starts, the continued economic recovery should offset this. And assuming the stock market continues to rise, consumers will feel wealthier and thus more willing to purchase a first home or buy a larger home. Younger people who have been renting or "doubling up" with their parents will be more inclined to purchase a home as the economy improves, and any increase in job growth will be positive for home sales. **Table 1** summarizes the housing and interest rate forecast from the National Association of Homebuilders (www.nahb.org).

The increasing rate of homeownership has taken somewhat of a toll on multi-family housing. The result is declining rental rates and rising vacancy rates as people switch from renting to owning. Yet despite the weakening fundamentals for multi-family housing, investors have put a huge influx of capital into this market, rediscovering the benefits of diversifying their portfolio with real estate. Large institutional investors have bid up the price of real estate to record levels compared to their income. Investors are willing to purchase apartments at much lower rates of return than previously, due to lower return expectations for all asset classes, as well as low interest rates, allowing investors to get very favorable financing. ◂

Indiana

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James C. Smith

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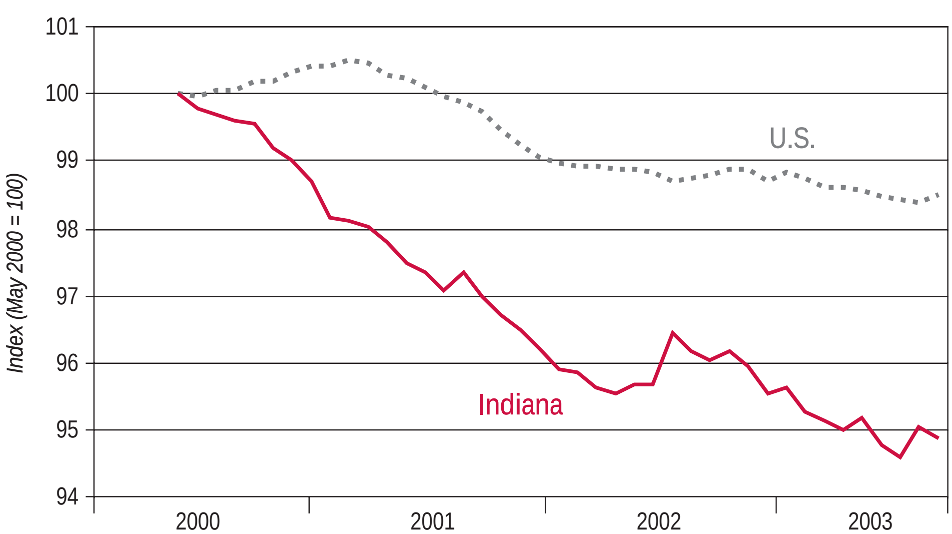
After a long period of uncertainty fed by mixed economic signals, more and more economists are dancing to the tune that the jobless recovery of the U.S. economy is finally turning around. In Indiana, however, clear support for a change in the song's key from minor to major has yet to emerge.

From its May 2000 peak at 3,014,400, total employment in Indiana has fallen by 5.1 percent (154,600 jobs) to 2,859,800 in September 2003. As shown in **Figure 1**, employment at the national level continued to grow for nearly a year after Indiana employment began its downhill slide; since Indiana's peak, U.S. jobs have declined by only 1.4 percent. Moreover, in the past fourteen months, national employment has been relatively flat, slipping by only 0.2 percent, while Indiana's payrolls have shrunk an additional 1.6 percent.

Figure 1
Relative Change in U.S. and Indiana Employment, May 2000 to September 2003



Losers and Gainers

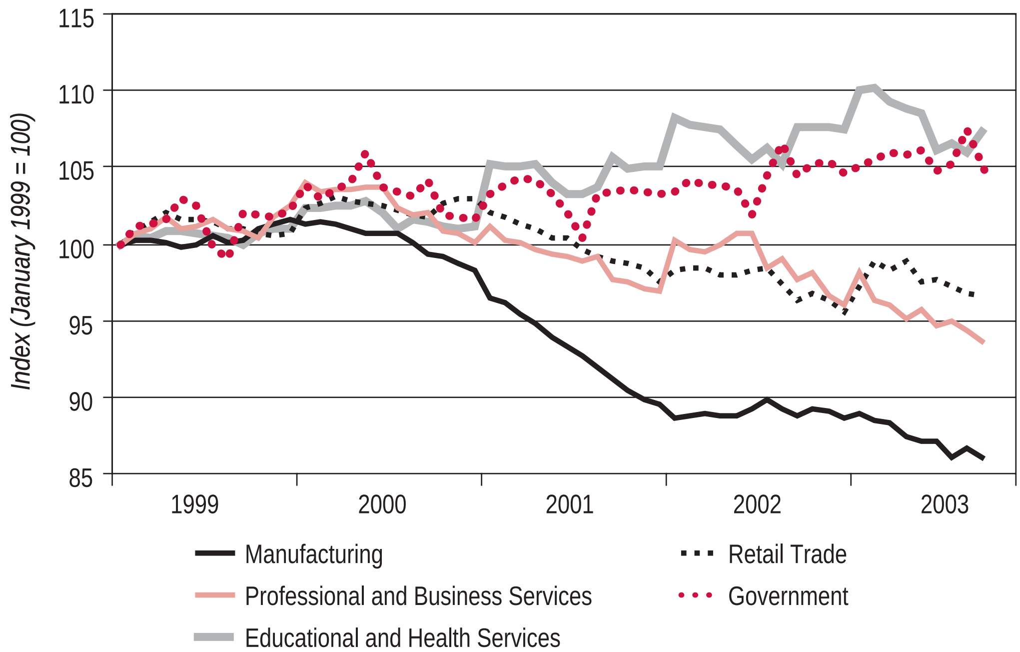
The largest portion (61.3 percent) of the jobs lost since Indiana's employment peak has been in manufacturing—a drop of nearly ninety-five thousand jobs. The manufacturing sector now accounts for 20 percent of all nonfarm jobs in Indiana, down from more than 22 percent in early 2000. Two factors are largely responsible for this shrinkage: manufacturers moving production to places where labor is cheaper (largely overseas) and improvements in productivity. Although much attention has been paid to the outsourcing issue, significant increases in productivity have enabled many factories to hold, or even increase, production volumes without having to replace laid-off workers. In this environment, substantial growth in Indiana factory payrolls is unlikely in the short term.

As shown in **Figure 2**, other sectors losing substantial numbers of jobs include professional and business services (21,600 jobs, or 14.0 percent of the total decline since May 2000) and retail trade (19,800 jobs, or 12.3 percent). Both losses reflect the general impact of a sluggish economy, as businesses and consumers cut out discretionary spending when money and jobs are scarce. On the bright side, employment in educational and health services has actually increased by 17,300 jobs during Indiana's general employment downturn; this sector now accounts for 12.2 percent of all Hoosier jobs. Government was another sector showing significant growth during this period, adding a total of 3,100 workers to payrolls that now account for 14.7 percent of all jobs in the state.

It's All Relative

As **Figure 3** reveals, Indiana ranks near the bottom of the nation in job growth the last two and a half years, with a 5.1 percent loss since the state's employment peaked. Only Michigan lost a larger percentage of its workers, and only four states (Michigan, Ohio, New York, and Illinois) lost larger numbers of workers during this period. On average, employment throughout the nation shrank by 1.4 percent, with losers outnumbering gainers about three to two.

Figure 2
Key Sectors in Indiana's Nonfarm Employment, January 1999 to September 2003



As the national economy picks up steam in the year ahead, Indiana should see a modest upturn before the year is out, with a 1 percent increase in employment, or roughly twenty-eight thousand jobs.

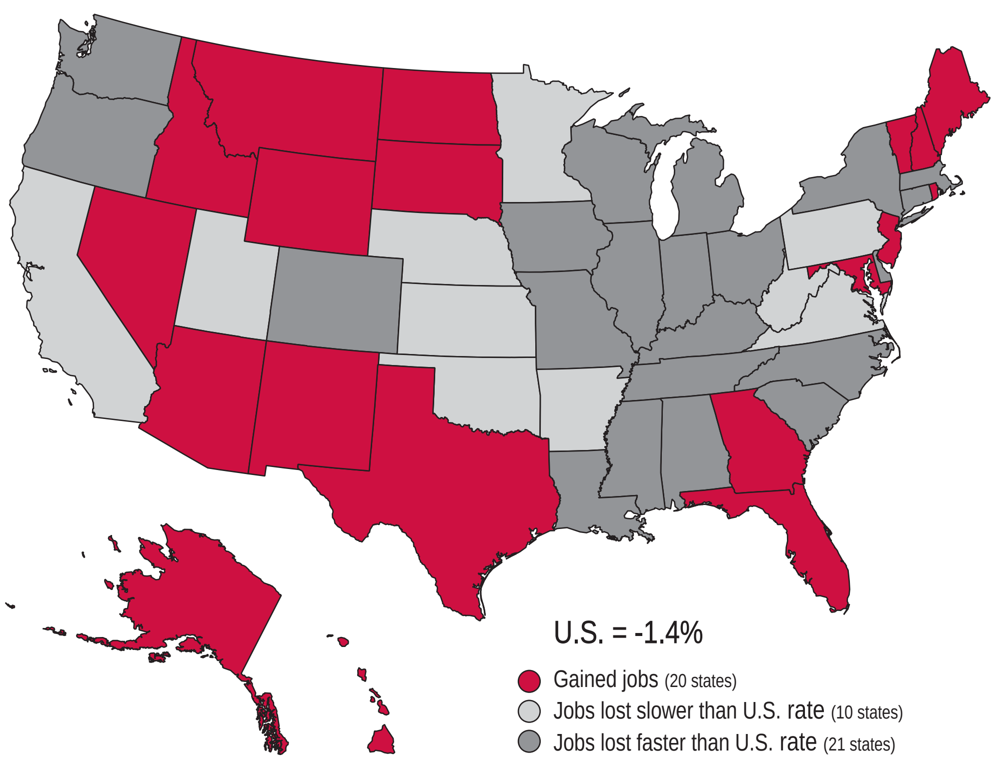
Indiana's Outlook for 2004

As the national economy picks up steam in the year ahead, Indiana should see a modest upturn before the year is out. Indiana entered the most recent recession before the rest of the nation, and it is taking its time climbing out.

Several factors lead to the forecast of only modest improvement in the Hoosier economy. Growth in auto sales nationally, which drive large portions of Indiana's manufacturing activity, may level off from its frenetic pace of the past year. Similarly, home sales (another big driver of the economy) are expected to grow at a more moderate pace, since interest rates may rise slightly and much of the formerly latent demand for housing has been filled. Markets abroad are not expected to pump much life into sales of Indiana companies, and the state's own population is growing slowly.

In light of these considerations, we forecast an increase of only about 1 percent, or roughly twenty-eight thousand jobs, in Indiana employment. The unemployment rate is projected to decline slightly from its current seasonally adjusted level of 5.2 percent, approaching the long-term average of 4.6 percent by the end of 2004. ◀

Figure 3
Percent Change in Jobs, May 2000 to September 2003



Anderson

Barry C. Ritchey

Professor of Economics,
Falls School of Business,
Anderson University,
Anderson

Employment is the big story nationally. Many communities are faced with the difficult task of attracting more jobs. Anderson and Madison County are no exception. The competitive environment brings new demands for creativity and accommodation for communities like ours. The task is not only to attract new jobs but to find ways to retain those jobs that are already in the community.

Total employment in Madison County rose last year, as more Madison County residents were working in 2002 compared to 2001. That number rose from 61,620 to 61,920 (an increase of 300). However, many of those in the labor force found employment in other counties, as the number of jobs in Madison County fell from 45,174 in 2001 to 44,228 in 2002 (a loss of 946). This means more people are working, but fewer of them are finding their jobs in Madison County. Net commuting rose by 1,246.

With the increase in the number of people working, we might make the incorrect assumption that the unemployment rate fell. The unemployment rate in 2001 was 4.8 percent for Madison County, rising to 5.9 percent in 2002. The increase in the number of people working (300) was offset by an increase in the number of people who were unable to find employment (800). With the national economy performing in a rather sluggish fashion, we might have expected the unemployment rate in Madison County to rise above the national level. The 5.9 percent rate for Madison County was only 0.1 percent higher than the national rate for 2002 (5.8 percent). For 2003, the local unemployment rate is running slightly below the national figures. This outcome is somewhat surprising given our historically high rates of unemployment during recessions and national slowdowns (see **Figure 1**). The changing mix of local employment and the uniqueness of automotive labor contracts are the likely explanation for the variation away from these historic trends.

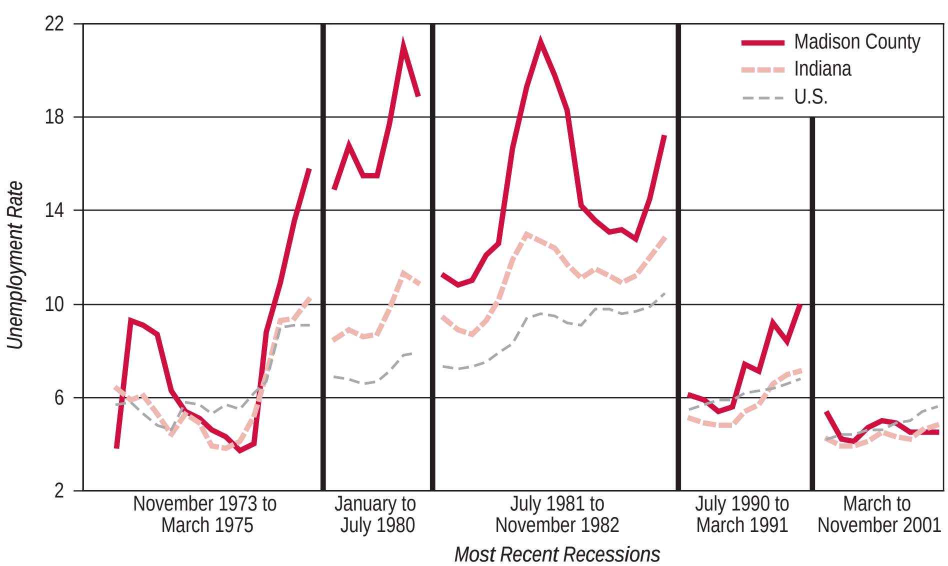
There were significant losses in the county in terms of manufacturing employment. Over the past ten years, manufacturing employment fell from 15,054 in 1992 to 8,928 in 2002. That averages to about 613 lost jobs per year. For 2002, the net loss was 691. In October 2003, over four hundred automotive workers accepted retirement from the local Anderson plants. It is obvious that this trend will continue. The only thing we do not know is the pace of the attrition. Fortunately, job losses have been spread over the past twenty years, helping to avoid the potentially devastating impact of total plant closings.

Still, one in five jobs in the county is in manufacturing. It would be a mistake to ignore the impact of manufacturing on the short-term economic performance of this community. There is a substantial retirement base from the historic presence of manufacturing that supports spending and income in the area. Also, the average manufacturing wages that are paid locally are some of the highest in the state. Last year, the average manufacturing wage paid in Anderson was $53,900. Indiana's average manufacturing wage was only $51,494 in 2002. If we take the nearly nine thousand manufacturing jobs in the county and multiply by the average wage of $43,949, we get some idea of the total impact of manufacturing wages on county income ($481 million).

Some sectors in the county did show employment gains. Employment in education and health services rose over the 2002 numbers (228), as did leisure and hospitality (247).

Income in the county continues to lag behind income for the state, which lags behind income growth for the country. That

Figure 1
Unemployment During Recessions



Note: Due to methodological changes, data for 1994 and later are not comparable with earlier data.

performance is a continuing trend for this community. Per capita county income for 2001 was $25,059, representing only a 3.8 percent increase from 2000 ($24,138). This reflects the changing mix of employment: Employment gains in the county have been in sectors that traditionally pay lower wages than in manufacturing (the source of employment losses). Income for Madison County is still only 91 percent of the average income for the State of Indiana.

There was also some growth in the housing market. In 2002, the number of housing permits issued in Madison County rose to 441. These modest increases in the number of permits during the past two years are an important indication of economic activity in the area. Housing markets tend to be volatile and difficult to predict. Low interest rates have helped to maintain a reasonable pace of new home construction. Those low rates are somewhat tempered by the economic uncertainty that comes with higher unemployment and job losses at the local level.

Retail sales fell in 2001 by 7.5 percent. For 2002, sales maintained the same level as in 2001. Retail sales are still high compared to historic levels. Over 70 percent of all retail sales in the county happen in the city of Anderson.

As the center of economic activity in the county, Anderson is important to the community. In the past year, significant progress has been made in the city's willingness to create a culture of education for its children. Financing has been approved for the improvement of the two high schools, and construction has been ongoing for three new elementary school buildings. Not only are educational opportunities important for the attraction and retention of jobs in the community, but they also improve the overall quality of life for our citizens. This has been an ongoing struggle for Anderson, but it seems as if the community has a plan for educational improvement.

The creation of the Flagship Enterprise Center is another achievement that indicates a movement in the right direction toward an environment of entrepreneurship. While we have yet to see the impact of the new schools and the Flagship, both represent positive movement in the right direction: improvement in the quality of life in Anderson. ◂

Bloomington

Morton J. Marcus

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

A booming housing construction market continues to characterize the Bloomington economy. Year-to-date estimates from the U.S. Census Bureau indicate continuing growth (see **Figure 1**). Added to recent commercial and retail construction throughout the community, Monroe County has been well satisfied with its recent economic performance.

However, in the context of the U.S. economy and in comparison to other college communities, Bloomington does not have the same luster. **Figure 2** shows that the Bloomington metropolitan area (Monroe County) had a 1.8 percent increase in housing units authorized compared to an 8.5 percent increase in the nation's other metro areas. Among the 330 metro areas for which we have data, Bloomington ranked 199th. Although several college communities rank lower than Bloomington, there are also others outperforming Bloomington by substantial rates, notably one that is fixed in our thoughts: Lubbock, Texas.

Despite this continuing addition to the housing stock of the community, many argue that the Bloomington area does not offer sufficient affordable housing. Because of Indiana University, a sizable portion of the demand for housing in Bloomington is not only rented but purchased with funds from outside the area. As parents become more able to subsidize their children's housing, as tax laws encourage ownership of housing by the affluent, and as student loans increase the amount of funding available for students, young people are able to crowd out less-affluent resident families in the area. Although this may seem inequitable, it may not be bad for Bloomington if suitable housing is available in nearby communities.

Figure 1
Estimated Housing Units Authorized in Monroe County, September Year-to-Date

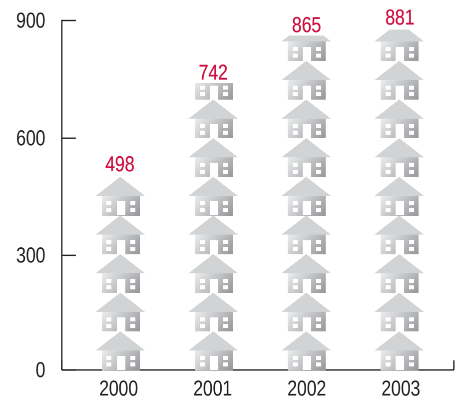
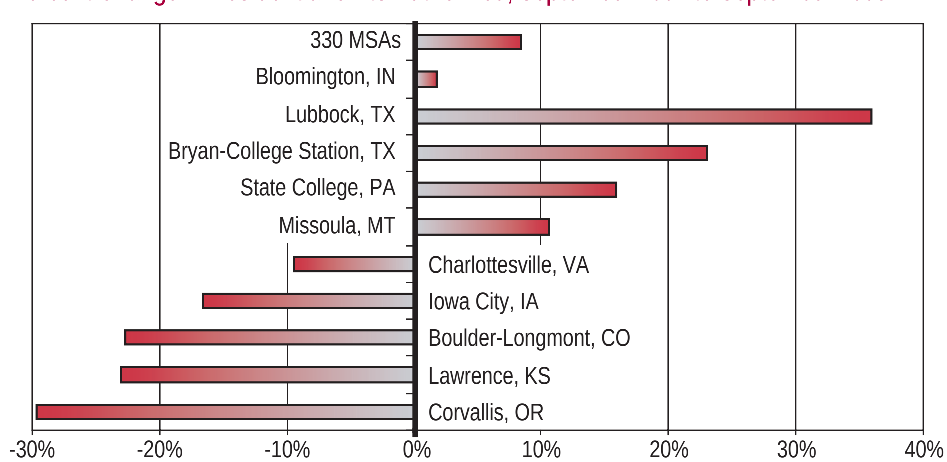
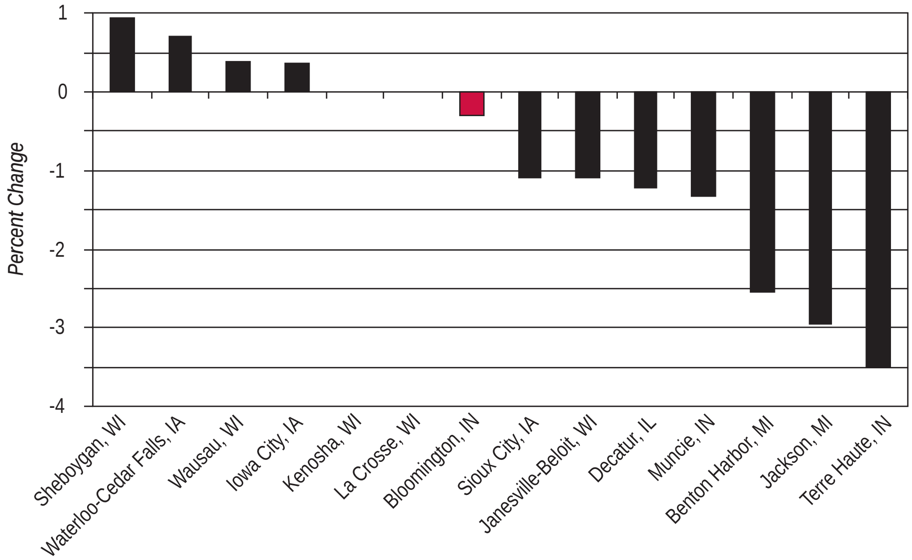


Figure 2
Percent Change in Residential Units Authorized, September 2002 to September 2003*



*Data is not seasonally adjusted

Figure 3
Percent Change in Total Nonfarm Employment for Selected Midwestern Metro Areas, September 2002 to September 2003



Employment

Bloomington falls into an interesting group of Midwestern metro areas, all between 54,000 and 76,000 jobs. Included here are other places that have significant college populations (Iowa City, Terre Haute, and Muncie), as well as places better known for their industrial muscle (Decatur, Waterloo, and Kenosha). **Figure 3** reports the percent changes in employment these metro areas have experienced in the past year. Bloomington sits in the middle of this group and ranks 143rd out of 275 metro areas nationwide. (Lubbock ranked 99th.)

Figure 4 indicates the percent losses and gains made in Bloomington and the U.S. over the past year. Clearly, professional and businesses services were hardest hit in Bloomington, while the greatest gains were posted by the government sector. The deep decline in retail trade is perhaps some cause for concern since it was not consistent with the national picture and retail is one of the more important sectors of the Bloomington economy.

The deep decline in retail trade is perhaps cause for concern since it was inconsistent with the nation and retail is one of the city's more important sectors.

Average Weekly Wages

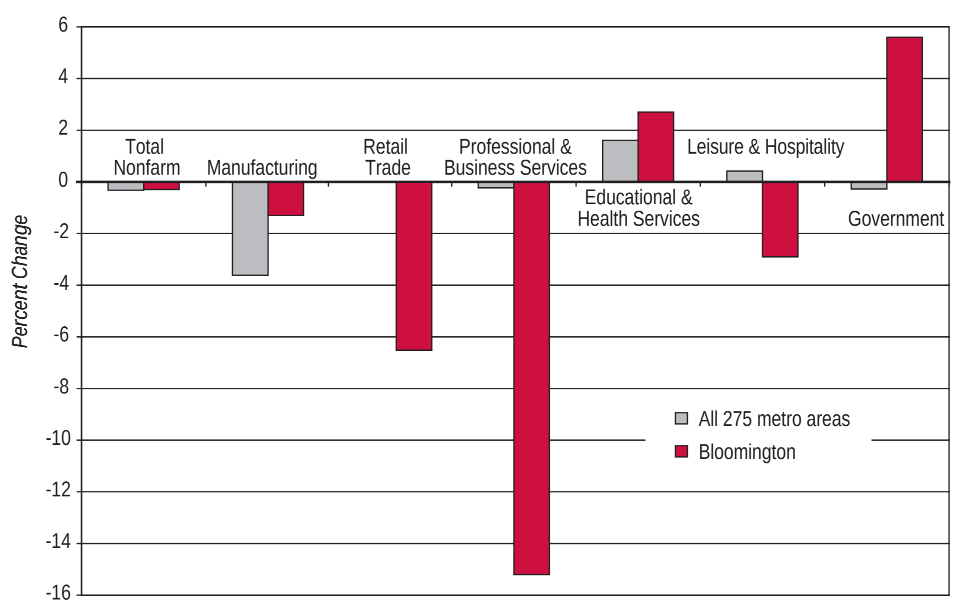
Bloomington ranked tenth in average weekly wages among Indiana's twelve metro areas for the first quarter of 2003 (the latest available data from the Department of Workforce Development). However, it did enjoy the second highest annual growth rate (4.6 percent) behind Gary. Anyone looking to understand why State Road 37 carries so many cars daily to Indianapolis need only look at the fact that the average weekly wage in the state's capital city is 27 percent higher than in Bloomington. That $150 a week is a substantial differential. Even if it means ten extra hours of commuting, the return is $15 per hour.

Prospects for 2004

The fundamentals of the Bloomington economy are unchanged and participation in the generally favorable economic scenario is likely. But a new administration in City Hall always raises interesting prospects for the community. Will something positive, at long last, be done to reduce traffic congestion on Tenth Street? Will the PCB problem that has hung over the area for more than a generation be attacked vigorously? Will the bipolar disorder of the City Council be resolved so that growth and no growth disputes will no longer make Bloomington one of the state's persistent jokes?

There are many opportunities for improvement in Bloomington that rest solely with the people of the community. ◂

Figure 4
Percent Change in Jobs in Selected Sectors, September 2002 to September 2003



Columbus

James C. Smith

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As we look ahead to 2004, the nation is emerging from a different kind of recession. That difference is going to have an important impact on Columbus and Bartholomew County.

The national economic recovery that began in late 2001 has not produced a big upswing in employment. A good explanation for this jobless recovery came out of a study this past summer by the Federal Reserve Bank of New York.

Its economists analyzed postwar recessions and found two kinds of job loss during recessions. Typically, a drop in demand triggers a recession and firms cut employment as a means to reduce capacity temporarily. Employees laid off due to lack of demand are typically rehired soon after demand picks up in the recovery.

A different kind of job loss occurs when firms simply eliminate jobs. The jobs disappear due to productivity gains, shifting jobs to other locations, or subcontracting. This “structural” employment decline typically does not recover when the economy picks up. The jobs are gone forever.

The 2000 to 2001 recession was not a demand-driven recession. In fact, consumer demand remained strong all through it. So the job losses we saw were predominantly structural rather than driven by demand. Many of these jobs won’t come back.

The structural job loss effects will show up in a slow recovery in Columbus and Bartholomew County. Employment here did not plummet during the recession. In fact, the county unemployment rate mostly stayed below 4.5 percent and only briefly pushed above 5 percent (see **Figure 1**).

A factor protecting the local economy from widespread unemployment is the increasing diversity of the economic landscape. Ten years ago, more than 40 percent of all jobs in Bartholomew County were in manufacturing. Today that figure is about 35 percent. The health care sector now provides 13 percent of the jobs in the county, nearly double its share from ten years ago. Employment in banking and finance also has grown, now accounting for more than 3 percent of all jobs.

Our conclusion is that a large portion of the decline in manufacturing employment during the recent recession was structural and will not soon return. Therefore, our overall employment forecast is for a very slow rise in employment during 2004, adding perhaps three hundred jobs in the county. The county unemployment rate is expected to remain above 3 percent for 2004.

Overall economic activity, however, should remain healthy. Interest rates will edge up only very slowly and incomes will stay strong. We expect 2004 motor vehicle sales and retail sales in general to be very close to the high levels seen in 2003. Real estate activity may be slightly below 2003, since mortgage rates appear to have bottomed out.

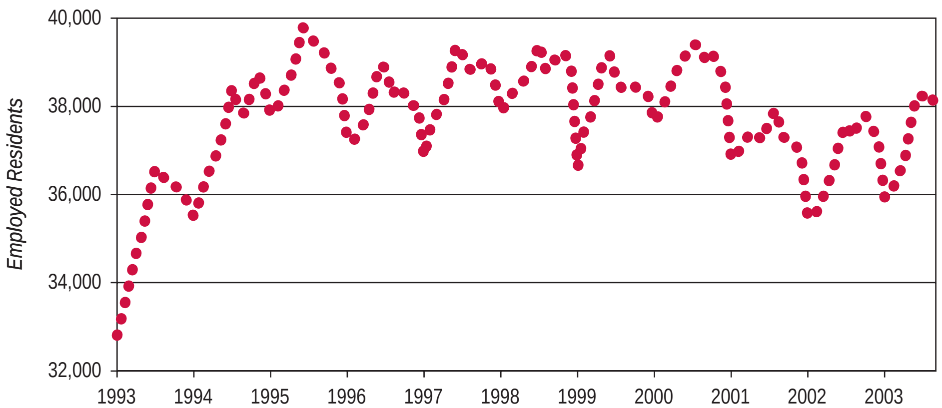
Two concerns about the future should be noted, however. One is that Bartholomew County slipped one spot in the ranking of educational level in Indiana counties. With 17 percent of the workforce holding a bachelor’s degree or higher at the 1990 census, Bartholomew County ranked eleventh out of ninety-two counties. At the 2000 census, while the rate climbed to 22 percent, the ranking dropped to twelfth in the state (Johnson County passed us with a rate of 23 percent).

There is a clear link between educational attainment and income. Keeping the Bartholomew County workforce competitive in education is important for future prosperity.

The second concern has to do with how attractive the county is as a place to live and work. Are we attracting new people to Columbus and Bartholomew County? As **Figure 2** shows, the estimated number of county residents with jobs peaked in 1995.

Figure 1
Monthly Unemployment Rates in Bartholomew County, January 1999 to September 2003

Figure 2
Monthly Employment in Bartholomew County, January 1993 to September 2003



Throughout the remaining boom years of the 1990s, Bartholomew County did not add significantly to its workforce.

Structural shifts continue to drain manufacturing jobs, so it is important for Columbus and Bartholomew County to attract other kinds of employment. The recent data suggest that, although the percentage of employment in other industries has expanded, the absolute numbers of new people living and working in our communities have not risen. ◄

Table 1
Index of Economic Activity in Evansville

Year	Industrial Production	Construction	Trade	Transportation	Finance	Index	Index Growth
1995	0.316	0.040	0.273	0.047	0.240	0.917	
1996	0.330	0.060	0.275	0.051	0.247	0.963	5.0%
1997	0.329	0.048	0.284	0.055	0.250	0.966	0.3%
1998	0.359	0.069	0.277	0.060	0.234	1.000	3.5%
1999	0.385	0.090	0.282	0.062	0.247	1.066	6.6%
2000	0.397	0.072	0.285	0.060	0.254	1.068	0.2%
2001	0.387	0.045	0.288	0.052	0.280	1.053	-1.4%
2002	0.401	0.064	0.287	0.052	0.250	1.055	0.2%
Change From 2001	3.7%	41.9%	0%	0%	-10.7	0.2%	

Evansville

M. Gale Blalock

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

The Evansville economy was stalled for much of 2002, as measured by the index of economic activity maintained at the University of Evansville (see Table 1). Reaching a peak in 1999, it posted an inconsequential decrease in 2000, but fell by 3.4 percent in 2001. There were substantial gains in construction and in industrial production, but declines in trade and finance. Throughout 2002, the index remained at its 2001 level.

Index Defined

- Electricity sold to industrial users = industrial production
- The total value of new construction permits in Vanderburgh County = construction.
- Annual boardings at the Evansville Regional Airport = transportation
- Metropolitan area employment in wholesale and retail trade = trade
- Finance sector employment = finance

With 1998 as the base year for the index, the raw data show industrial production at a record high between 1995 and 2002. Construction permits were up 43 percent over 2001, but have yet to regain their 1999 maximum. Recent changes in the way we use our airport may make comparisons with the transportation variable less informative. The trade and finance employment-based components have been recalculated this year to incorporate the new NAICS classification system.

I am guardedly optimistic about our near-term future, based on the recent performance of the local labor market. Though we lost 2,900 jobs from 2002 to 2003, our unemployment rate (4.2 percent) is less than the state's (5.0 percent), which is less than the nation's (6.0 percent). As the national economy continues to recover, the local economy will likely continue its recovery.

For our area to prosper in the long term, our workers must be able to compete successfully with workers all over the world.

If not, they will lose either their wages or their jobs. Continuous improvement in worker productivity remains a managerial challenge. Should the recent defeat of the referendum to finance the schools signify a long-term lack of support for education in our community, I fear for our long-term success. ◂

Fort Wayne

Thomas L. Guthrie

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Manufacturing is disappearing. No, it's manufacturing employment that's disappearing. As shown in **Figure 1**, the total value of goods manufactured in the U.S. has declined approximately 6 percent since mid-2000, but that's not exactly a disappearing act. Furthermore, when the 6 percent decline is juxtaposed with the almost 60 percent increase in the last decade, it appears modest indeed. Isn't that a typical characteristic of recessions?

Look for the value of goods manufactured to reach new highs in the next twenty-four months as the current recovery gains momentum. That's not exactly a disappearing act.

What's disappearing is manufacturing employment. In 1978, there were over 19.3 million employed in manufacturing in the nation. Last November, there were 14.5 million. That's a total decrease of 25 percent, or essentially 1 percentage point per year.

Between 1978 and last November, the total value of goods manufactured in the U.S. increased 90 percent. It had doubled as of mid-2000. Why the disconnect? Productivity—the increase in output per hour of labor.

Advances in productivity have more than accounted for the economy's post-recessionary growth.

It's why a million jobs have disappeared since the start of the recovery in November 2001.

Between 1978 and 1995 nonfarm business productivity grew at an average annual rate of about 1.2 percent. From 1996 to the fourth quarter of 2001—the end of the last recession—productivity averaged around 2 percent. Since the recession ended, productivity has expanded at an annual rate of more than 5 percent. In third quarter 2003, productivity grew at a seasonally adjusted annual rate of 9.4 percent. In classic understatement, Federal Reserve Chairman Alan Greenspan has described the surge in productivity as "startlingly large."

Frankly, the third quarter 2003 productivity number is too high to be believed, so it more than makes a point. And the point is that advances in productivity have more than accounted for the economy's post-recessionary growth. It's why a million jobs have disappeared since the start of the recovery in November 2001.

In the last three years, manufacturing employment in the Fort Wayne metropolitan area[1] has decreased by approximately fifteen thousand; or more starkly, basically one in every five manufacturing jobs has disappeared over the last thirty-six months (see **Figure 1**).

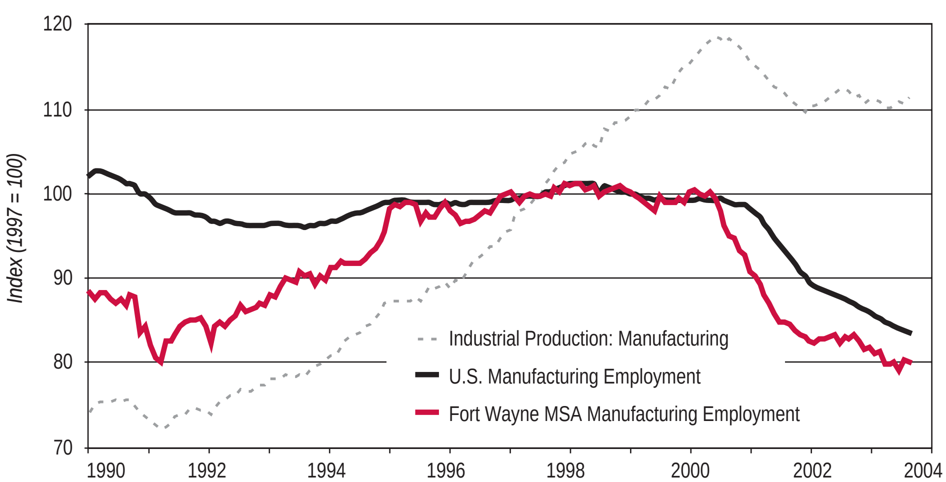
Due to the massive fiscal and monetary stimuli, the U.S. economy is now growing sufficiently fast to begin generating jobs (see "The U.S. Economy" on page 1). When economic growth exceeds productivity growth—which is about to occur—the modest employment gains will accelerate.

For the Fort Wayne area, the immediate question is when will the fifteen thousand laid-off manufacturing workers be called back? According to a recent research note from the Federal Reserve Bank of New York, the answer for many will likely be never:

"The period after the 2001 recession will be remembered as the second jobless recovery.[2] Our inquiry into the reasons for the current labor market slump suggests that structural change has played an important role. Industries that lost jobs during the recession have continued to shrink during the recovery, and permanent job losses have eclipsed temporary layoffs. … An unusually high share of unemployed workers must now find positions in different firms or industries."[3]

Unfortunately, the researchers didn't quantify "unusually high," so I am forced to.

Figure 1
Manufacturing Output and Employment



Let's assume 5,000 of the 15,000 area manufacturing jobs lost return over the next two years; that's 2,500 jobs a year.

During normal times, the Fort Wayne area economy has been generating approximately 2,500 nonmanufacturing jobs yearly.

For 2004, these assumptions yield a forecasted increase of 5,000 jobs, or approximately a 2 percent increase in employment ending in December. This is the most optimistic end of the forecast range. One percent, or 2,500 jobs, is the pessimistic end.

Over the longer run, the capacity of the Fort Wayne area to grow employment is likely about half that of the nation. This is based on the area's relative dominance in the slow growth manufacturing sector[4] and its relatively low population growth. ◂

Endnotes

1. Adams, Allen, DeKalb, Huntington, Wells, and Whitley counties.
2. Actually, they are wrong. Recovery from the 1990–91 recession was job-*less*. Recovery from the 2001 recession has been job-*loss*.
3. Erica L. Groshen and Simon Potter, "Has Structural Change Contributed to a Jobless Recovery?," *Current Issues in Economics and Finance* 9 (August 2003).
4. Actually, the argument above is that the secular trend is for decreased manufacturing employment.

Gary

Donald L. Coffin

Associate Professor of Economics, Indiana University Northwest, Gary

Employment in the northwest Indiana economy (Lake and Porter counties) has remained fairly constant during 2003 (252,100 in January and 252,400 in September), a development comparable to the nation as a whole. Nonetheless, the local economy experienced a sharper decline during the most recent recession, with an employment decline of about 8 percent from the cyclical peak in the fourth quarter of 2000 (compared with a decline in total U.S. employment of about 1.5 percent to 2 percent from the cyclical peak, also in the fourth quarter of 2000).

The projected rapid growth in the national economy, which, given the continuing robust increases in productivity, is likely to produce only modest gains in employment (or reductions in unemployment), will likely lead to some expansion in the local economy as well. However, here that expansion will occur almost, if not entirely, as output, not employment growth. It seems unlikely that local employment will increase noticeably or that the local unemployment rate will fall.

Output and Employment

Establishment employment in northwest Indiana has shown considerable volatility over the past thirteen years (see **Figure 1**), but little long-term growth (employment at the end of 1990 was about 250,000, compared with 252,400 in September 2003). Household employment has shown somewhat more growth (rising from about 270,000 in early 1993 to about 284,000 in September 2003).[1] **Figure 2** provides a comparison between northwest Indiana and the nation, in terms of growth in total employment. Clearly, employment in northwest Indiana has been much more volatile throughout the 1991 to 2003 period than has employment nationally. Equally clear, growth in employment nationally has been much more rapid, totaling more than 20 percent during this period, compared with less than 5 percent growth in local employment.

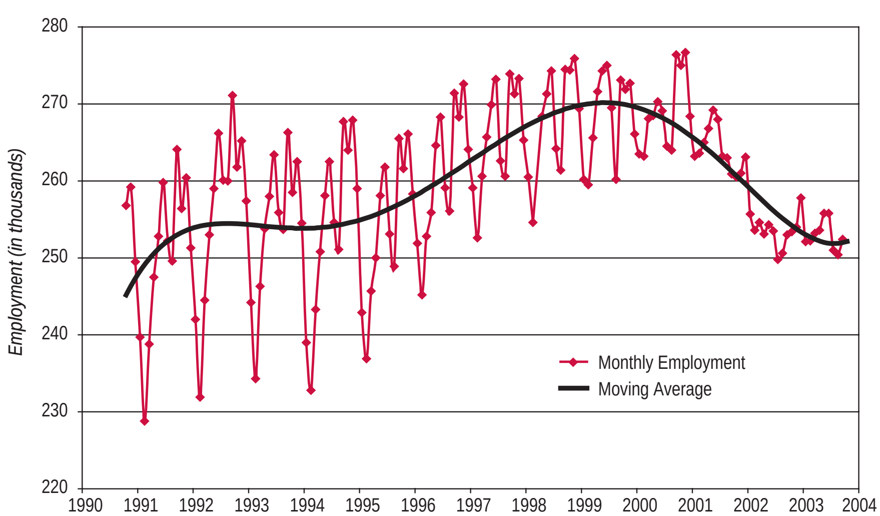
Both for the nation and the local economy, output growth has been considerably more rapid than has employment growth. Productivity growth has averaged more than 2 percent per year nationally over the past twelve years, and has averaged more than 5 percent per year for the past two years. As a consequence, total real output (GDP) nationally has increased by about 46 percent in the past thirteen years. Assuming that productivity growth in northwest Indiana has kept pace with the national trends, this suggests that total local output has increased by about 30 percent over the past thirteen years.[2]

If the relationship between national and local growth remains as it has apparently been in the past, 4 percent growth in output nationally would suggest 2.6 percent growth in output in northwest Indiana. If productivity growth (nationally and locally) averages 3 percent over the next year, total local employment would be projected to fall by about 0.45 percent, or from about 252,400 (September 2003) to about 251,300 (September 2004).

The Manufacturing Sector

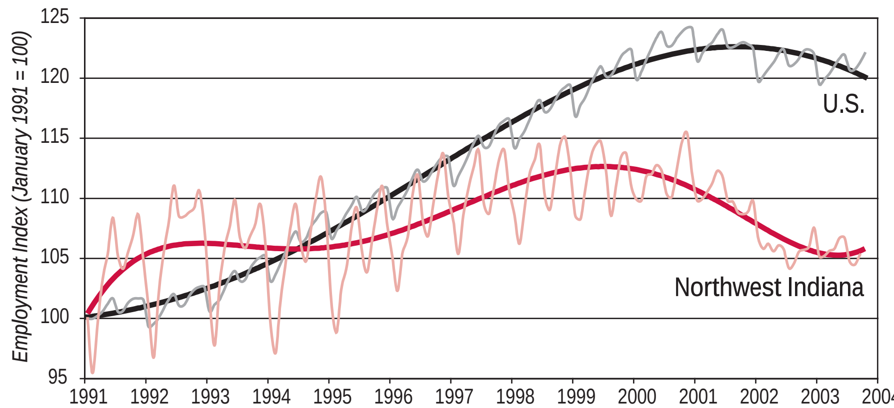
Manufacturing, both locally and nationally, continues its long, slow decline in employment (although not in output), as

Figure 1
Total Employment in Northwest Indiana



shown in **Figure 3**. In 1991, manufacturing accounted for about 22 percent of total employment in northwest Indiana (and about 16 percent nationally). Today, manufacturing accounts for only 16 percent of local employment and about 11 percent of national employment. Manufacturing employment has declined in northwest Indiana at an average annual rate of 3 percent between 1991 and 2003 (the decline nationally has averaged 1.2 percent per year). Nationally, manufacturing productivity has increased at an average annual rate of 3.7 percent. This suggests a growth in local manufacturing output of about 0.7 percent per year (and 2.5 percent nationally). Assuming a continuation of these growth rates, we would expect manufacturing employment to decline by about 3 percent locally over the next year, falling from 38,600 (September 2003) to about 37,400 by September 2004.

Figure 2
Change in Total Employment in the U.S. and Northwest Indiana, 1991 to 2003



Steel

Locally, the decline in employment in the steel industry has been even more precipitate than in manufacturing generally, falling by an average of 4.2 percent per year since 1991. This decline was accelerated by the sale of LTV to ISG and the recent consolidations involving ISG and Bethlehem and, separately, USX and National. (The national decline in steel employment has exceeded that locally, with employment falling at a 4.8 percent annual rate.)

Productivity growth in the steel industry nationally has averaged 3.6 percent per year since 1991, suggesting an output decrease nationally that has averaged about 1.2 percent per year. Local steel output has been roughly constant over the last twelve years, suggesting that productivity has increased slightly more rapidly locally than it has nationally.

Steel output may rise little in the coming year, however. The outlook for steel depends on a number of factors, which are difficult to gauge:

- First, developments in the automobile industry (and durable goods generally) will matter greatly. The auto industry has experienced a run of very strong years of sales that may not continue. Durable goods production and sales, however, usually recover more strongly than the economy as a whole, so there may be grounds for optimism.
- Second, changes in fixed investment, particularly in construction and machinery, will matter. Recent changes in real output in these sectors suggest that they may grow more rapidly than the overall national economy.
- Third, domestic production of steel will depend on developments in the international economy and any changes that may occur in U.S. trade policy. It is not clear at the time of this writing whether the selective tariffs on steel will continue. What is clear, however, is that after a brief (and substantial) reduction in 2001, steel imports have recovered to about the same level as before the imposition of tariffs. Furthermore, the U.S. faces potential World Trade Organization sanctions if we continue with these tariffs.

This all combines to suggest that growth in steel output will be modest at best. If steel output grows 1 percent in 2004, and if productivity growth continues at its historic rate, then we might expect a decline in steel employment in northwest Indiana of about 2.5 percent, down to 18,400 in September 2004 from 18,900 in September 2003.

The Services Sector

Growth in employment in services has, over the past twelve years, provided the only bright spot in employment, growing at an annual rate of nearly 1 percent. This is "bright" only by contrast with the rest of the local economy, however (since service employment nationally has grown by slightly more than 2 percent per year since 1991). Within the services sector, the leading industries locally have been in finance, insurance, and real estate (up from 10,700 in October 1990 to 13,800 in August 2003, a growth of about 2 percent per year) and health services (up at an average annual rate of about 2.3 percent per year, from 23,500 in October 1990 to 31,900 in August 2003). A continuation of this growth in services will add a little over two thousand jobs locally—not nearly enough to offset the employment declines in manufacturing.

It should be noted, however, that the growth sectors in services are generally high-wage sectors, so this shift will not reflect a shift from high-paying manufacturing jobs to low-paying service jobs, but rather a shift to jobs in which people apparently earn even more than the average in manufacturing.

The Labor Market

In the past three years, the local labor market has experienced a rapid increase in unemployment beginning in late 2000, a peak in early 2002 of nearly 8 percent, and a subsequent decline to 6 percent in August 2003[3] (see **Figure 4**). Local labor markets are notoriously volatile, and forecasting unemployment rates, in particular, is difficult.

Labor market conditions will be determined not only by growth in local employment, but also by the extent of employment opportunities in surrounding communities, especially in Chicago and its southern

Figure 3
Manufacturing Employment as a Percent of Total Employment

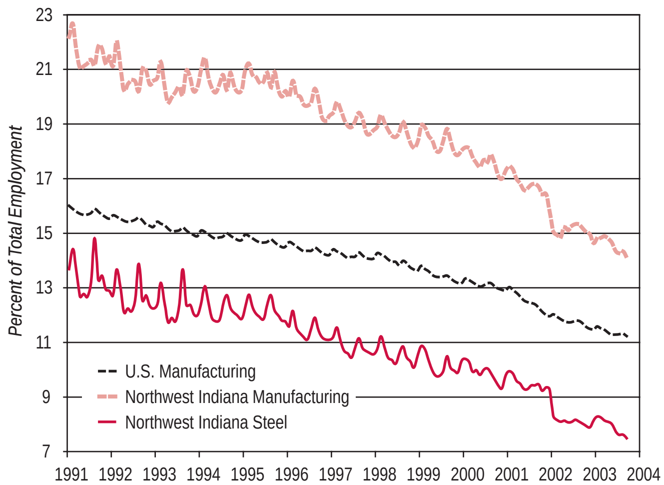
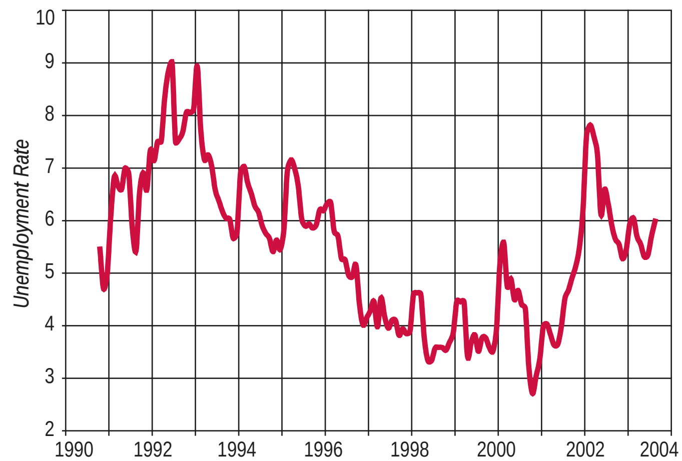


Figure 4
Unemployment Rates for Northwest Indiana, 1990 to 2003



suburbs (strength in La Porte County would also benefit people living in Lake and Porter counties). The Chicago region seems poised to grow at a pace mirroring the national economy. This does not, however, suggest rapid employment growth on the Indiana side of the border. In La Porte County, household employment has decreased by about 0.5 percent between September 2002 and September 2003, a loss of about three hundred jobs.[4] This clearly does not suggest that establishment employment growth in La Porte County has been robust. Combined with the changes in Jasper, Newton, Pulaski, and Starke counties, this does not suggest that changes in the Lake/Porter County labor markets will be driven by favorable changes in the surrounding counties.

An additional factor to consider in the labor market is the growth in the labor force, which is largely a reflection of growth in the working age population. Between 1990 and 2000, the labor force in northwest Indiana grew at an average annual rate of 0.75 percent (0.45 percent in Lake and 1.75 percent in Porter), compared with 1.1 percent per year growth in the labor force nationally. It seems plausible to expect that the labor force in northwest Indiana will continue to grow slowly.

A labor force that is growing slowly has advantages and disadvantages for the labor market developments. The advantage is that even relatively slow employment growth will be consistent with a stable or declining unemployment rate.

The major disadvantage is that a slowly growing labor force will not attract new businesses locating (or relocating) new facilities from outside the region.

If the local labor force continues to grow by about 0.75 percent over the next year, and if household employment tracks with establishment employment (a loss of about 0.45 percent), we would expect a slightly rising unemployment rate, from 6 percent in August 2003 to about 7 percent in August 2004.

Conclusions

The local economy will continue its pattern of slower growth in output and employment than the national and state economies for yet another year. While total local output may be expected to rise by about 2.6 percent, this is likely to translate into a small employment decline. Manufacturing and steel will continue to experience declining employment, even with the possibility of small output growth. As a consequence, it seems likely that the local unemployment rate will rise slightly in the coming year. ◄

Endnotes

1. Establishment employment provides an estimate of employment at firms, organizations, and government agencies located in Lake and Porter counties. Household employment estimates the number of people living in Lake and Porter counties who have jobs, regardless of where those jobs are located. The household employment figures were substantially revised in early 1993 and earlier estimates are not comparable. (In addition, the household employment estimates are subject to larger ongoing adjustments, so short-term changes in household employment may provide little guidance to developments in the local economy.) Establishment employment is the better guide to the output being produced locally, while household employment may be a better guide to the economic wellbeing of residents.
2. Total real personal income in Indiana grew by about 24 percent between 1991 and 1999, the last year for which data are currently available from the U.S. Bureau of Economic Analysis. Estimates of real personal income for Lake and Porter counties are harder to find.
3. It is necessary to exercise caution in using and interpreting local (small-area) unemployment rates. These estimates are not survey based and can be subject to large revisions as additional data become available and, in particular, when annual benchmarking revisions are done.
4. Household employment in Jasper, Newton, Pulaski, and Starke counties combined grew by only slightly over a thousand jobs, and some of that may represent migration out of Lake and Porter counties, not establishment employment growth in excess of that in Lake and Porter counties. In short, the outlying counties in northwest Indiana do not seem likely to provide a strong base for regional employment growth in the coming year.

Indianapolis

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Hyper-fix, a downtown interstate highway project, was completed with such efficiency that it has been forgotten. The relocation of I-70 alongside the airport is in progress and causing few problems. The U.S. 421 and I-465 interchange was finally completed after a seemingly endless period of time. Even the resurfacing of Binford Boulevard is being undertaken with minimal disruption. These have been the most visible changes in Indianapolis during 2003.

Employment

Less visible was the loss of 17,600 jobs in the nine-county Indianapolis area between September 2002 and the same month this year. This was a 2 percent decline, compared to a national employment drop of just 0.3 percent and a 1.7 percent decline for all eleven Indiana metro areas.

The Indianapolis 2 percent decline ranked 243rd among the nation's 275 metro areas. Milwaukee ranked 250th, but other competitive areas in the Midwest all surpassed Indianapolis (see **Figure 1**).

Contrary to the popular notion, manufacturing was not the prime cause of job losses in the Indianapolis metro area. As seen in **Figure 2**, the biggest percentage declines in the metro area were not in manufacturing but in professional and business services, as well as in leisure and hospitality.

Professional and business services include travel agents, computer systems designers, custom computer programming, advertising, and telemarketing—all activities that have been most adversely affected by the business cycle, major restructuring, or regulatory changes. Manufacturing lost only 1,800 jobs in the past year, while business and professional services lost 7,900 jobs and the leisure and hospitality sector dropped 4,700 jobs.

Building Permits

Residential construction seems to be booming everywhere in the metro area. Yet, despite appearances, it has been down in 2003 from 2002 levels. Of 330 metro areas for which we have building permit data, Indianapolis ranked 225th with a 1.7 percent decline in units authorized. As seen in **Figure 3**, this does not compare favorably with other metro areas in the U.S. (8.5 percent) or the Midwest.

Establishments and Wages

Less recent data also confirm a weaker performance in the Indianapolis metro area than might have been expected. Employer

Figure 1
Percent Change in Jobs in Twelve Largest Midwestern Metro Areas, September 2002 to September 2003

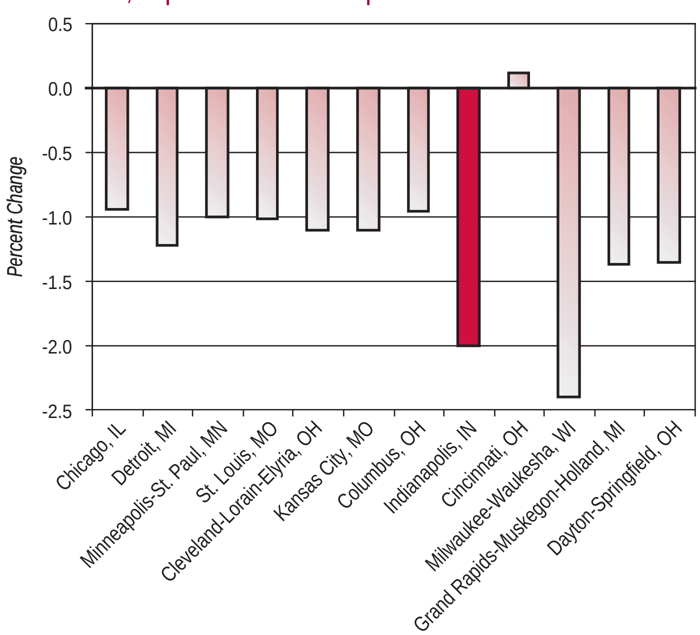
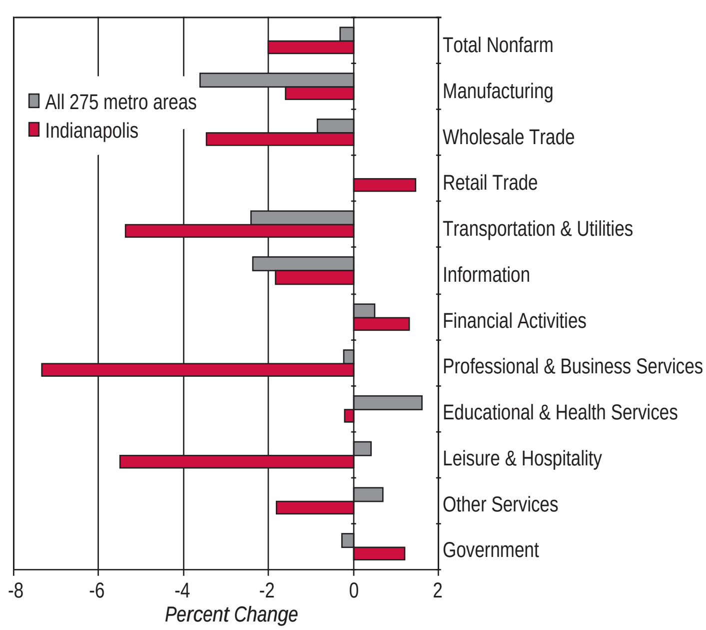


Figure 2
Percent Change in Jobs, September 2002 to September 2003



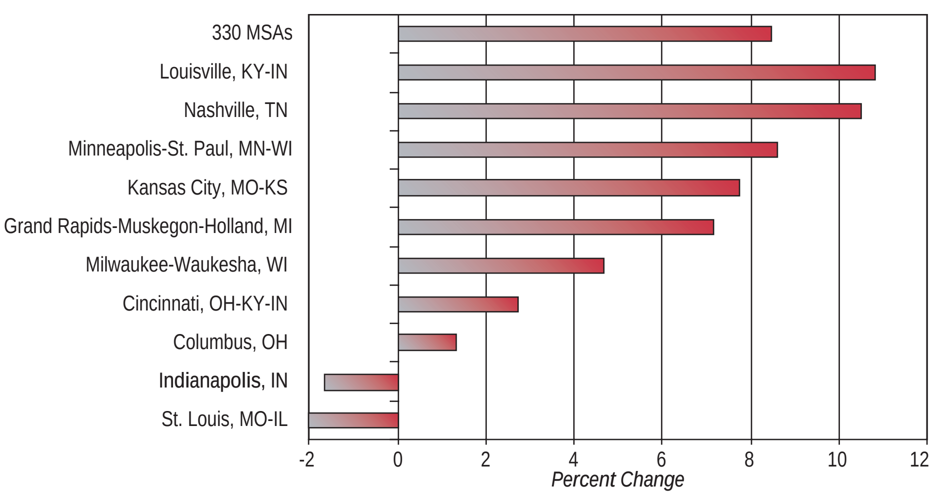
reports from the Department of Workforce Development for the first quarter of 2003 indicate that the Indianapolis metro area added 610 establishments over the course of the year when compared with the same quarter in 2002. This was a prodigious 53 percent of the total increase in establishments for the twelve metro areas of the state (New Albany-Jeffersonville is counted as a metro area for these purposes). But when we look at the total payroll of all establishments in these twelve metro areas, the Indianapolis area contributed only 7 percent to the increase they enjoyed. Average weekly wages in the Indianapolis area rose by a mere 0.6 percent, the lowest increase of all twelve areas.

Prospects for 2004

Despite a lagging economic performance in the past year, Indianapolis may be better positioned for growth in the coming year than other Indiana metro areas. With a diversified employment base, the Hoosier capital stands to gain from major ongoing construction at the airport and an attractive retail environment, which continues to attract shoppers from a wide radius.

Even if the Indianapolis area were to add jobs only at the same rate as the rest of the state (forecast to be a modest 1 percent), the metro area would see a growth of 7,700 jobs. If the state were to grow faster, say 2 percent, there is a good chance that Indianapolis would grow faster than the state and could see 18,000 net new jobs in 2004. ◂

Figure 3
Change in Residential Units Authorized, Year-to-Date September 2002 to September 2003



Kokomo

Kathy Parkison

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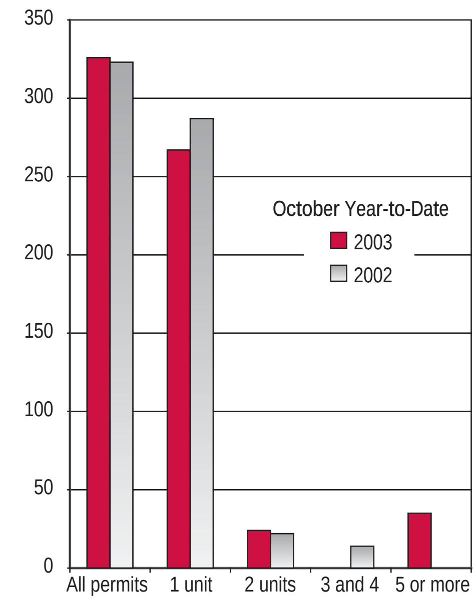
As noted in the international, national, and state economies, the recovery is officially on, the economy is perking upward, and we expect continued growth. However, the Kokomo economy, while improving, is still lagging a bit behind Indiana and the nation.

Kokomo's economy remains heavily weighted toward manufacturing. Employment in manufacturing industries peaked statewide in May 2000, and while recent losses have been much less than before (with some months even posting gains), employment is still not anywhere close to its peak. So like the rest of the state, individuals and firms in the area remain apprehensive about the economy and what it holds for them personally. While unemployment in the area peaked in 2002 and has since dropped to about 5 percent, those numbers are still up from the pre-recession lows of about 2.5 percent. Many of these job losses will be permanent due to increasing productivity and job losses to overseas.

On the local front, the moves by the Fed to keep the lower interest rates and the incentives offered by the automobile manufacturers have kept auto sales fairly robust. This has protected jobs and

Figure 1
Kokomo Metro Area Building Permits



production at the DaimlerChrysler plants—an important part of this local economy. In addition, low interest rates have allowed consumers to continue buying homes, refinancing, and making home improvements. This can be seen all over the area in new home construction, building permit numbers, and new building construction (see **Figure 1**). Help wanted signs are even beginning to appear in store windows. While these may not be the high-dollar manufacturing jobs that the area would like to see, it is at least encouraging to see hiring occurring and firms looking for employees.

Although the state and local loss of manufacturing jobs is still troubling, we think that the worst of the economic news is behind the region and we are optimistic about 2004. Given the latest productivity numbers, GDP and labor figures, it seems that the national and state economies are poised to grow and this will certainly also be true of the local economy. Unlike last year's forecast which was rather wishy-washy, this next year is predicted to be much better for the region. ◂

Muncie

Patrick M. Barkey

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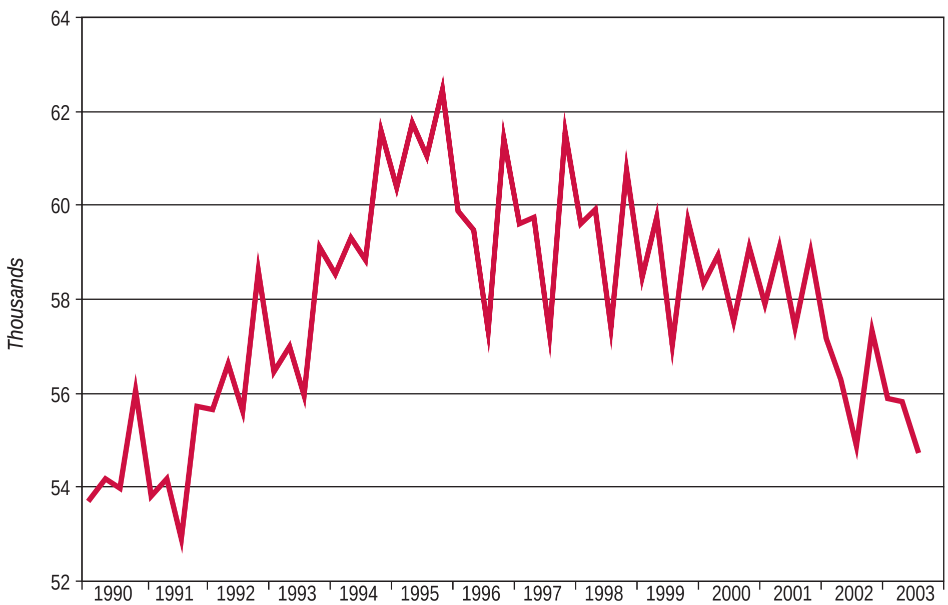
The recession of 2001 may have been one of the mildest on record for the national economy, but try telling that to a Muncie area business, particularly in manufacturing. The two-year long cratering of business spending nationwide, now seemingly at an end, produced empty order books and worried faces for countless companies. The result has been a bump down amidst the slow decline the Muncie economy has experienced since the midpoint of the last decade.

Total employment bore the brunt of the recession in the latter half of 2001 and the first half of 2002, when year-over-year job losses topped out at about 4.7 percent (see **Figure 1**). Since that time, the job total has essentially remained constant. Indeed, in the first ten months of 2003, the 1.1 percent decline in Muncie's job base was better than half of Indiana's other metropolitan areas (MSAs).

The event that contributed the most to the downward dip in employment was the closing of Burlington Motor Carriers. In the early 1990s, employment in transportation and warehousing in Muncie averaged about 4,000 jobs, peaking as high as 6,500 jobs in 1995. Now those industries account for only about 1,000 jobs, with nearly 2,000 of that total loss occurring in the beginning of 2002.

Figure 1
Muncie's Total Employment, 1990 to 2003



When combined with the slow attrition in other manufacturing jobs, this amounts to a 1,500 job loss in total manufacturing employment since 2000. This was more than could be offset by job growth in services industry employment, which has continued to grow. Education and health services, and professional services employment, in particular, have continued to grow throughout the economic downturn.

The different directions of change in the goods and services-producing segments of the economy in recent years have produced a remarkable result: Delaware County is now the most diversified economy in east central Indiana, with a significantly lower fraction of its employment base in manufacturing than any of its neighbors, as well as the state.

Delaware County has a significantly lower fraction of its employment base in manufacturing than any of its neighboring counties.

However, It is also an economy, as **Figure 1** demonstrates, that has been in a slow decline for almost a decade. There are some rays of sunlight through all this darkness, however.

In the last several years, an awareness that new engines of economic growth were needed for the local economy culminated in the launching of a new economic development effort that placed emphasis on technology and knowledge-intensive industries. Ball State University has played a higher profile role in economic development than in the past, with a business incubator, contributions to venture capital funds, and large increases in external funding for research accomplishments to date from its efforts.

Those seeds may bear fruit in the near future, but households and businesses in the meantime must operate in the economy of the present. Certainly, an acceleration in the national economy will help the Muncie economy, but our experience of the last ten years tells us that it will take more than that for us to prosper. ◄

New Albany

Dagney Faulk

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During 2003, the economy of southern Indiana continued to perform better than state and national economic trends. The New Albany area actually experienced a net job gain over the past year, as the unemployment rate has begun to decrease. 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. In 2003, the U.S. Census Bureau redefined the counties in the Louisville metropolitan area to include Clark, Floyd, Harrison, and Washington counties in southern Indiana and Bullitt, Henry, Jefferson, Meade, Nelson, Oldham, Shelby, Spencer, and Trimble counties in Kentucky (see **Figure 1**). Since most of the metro area statistics do not yet use the new definition, the following analysis uses the 1999 MSA configuration to examine various measures of economic growth in the Louisville MSA and its component counties. Three additional Indiana counties—Crawford, Jefferson, and Orange—in the southern Indiana labor market area are included when data is available.

Labor Markets

The 2003 unemployment rate in the counties of the Louisville area have continued to decline over the year, and with the exceptions of Washington and Orange counties, the unemployment rate continues to be below that of Indiana as a whole and below that of Kentucky and the United States, as shown in **Table 1**. The total number employed has steadily increased over the course of the year. The unemployment rates in Clark and Floyd counties are 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 indicates that the average level of nonagricultural employment was 568,100 for January to September 2003, an increase of just over 1,000 jobs from the same period last year (see **Table 2**). The Indiana portion of the MSA contributed just over 600 jobs to this increase. Total nonagricultural employment in the southern Indiana counties averaged 95,300 well below the May 2001 peak of 98,200 jobs. Contrary to the state and national situation, employment growth in southern Indiana was actually led by manufacturing, which increased by an average of 1,300 jobs. The service sector was hit hard over the past year, decreasing by an average of 1,200 jobs. The decrease in service employment was led by professional and business services, followed by trade, transportation and utilities, both decreasing by over 800 jobs.

The average level of government employment increased approximately 700 jobs over this same time period. The increase

Figure 1
Louisville Metropolitan Area

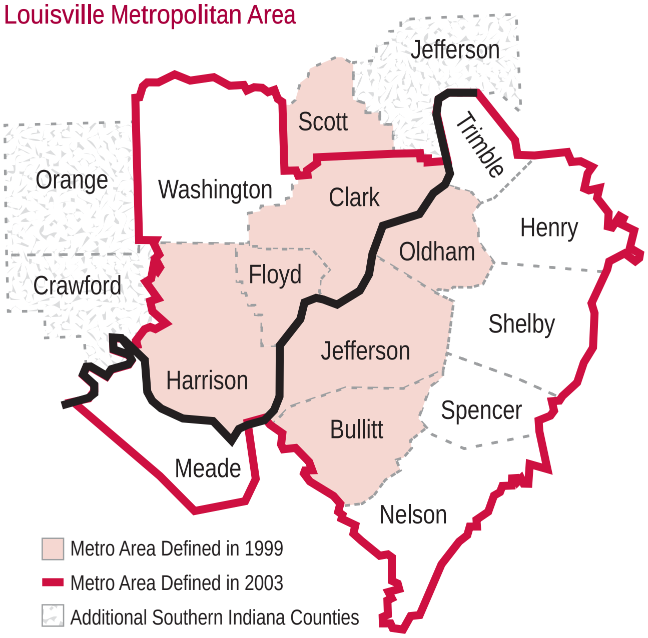


Table 1
September Unemployment Rates

Area	1999	2000	2001	2002	2003
Clark, IN*	2.8	2.9	4.0	4.3	3.7
Crawford, IN	3.9	3.3	4.4	4.8	4.6
Floyd, IN*	2.3	2.5	3.2	3.7	3.4
Harrison, IN*	2.3	2.0	3.2	3.2	3.9
Jefferson, IN	2.5	3.3	4.7	4.7	4.7
Orange, IN	5.6	3.4	8.8	8.2	7.9
Scott, IN	2.9	2.6	5.1	5.0	4.2
Washington, IN*	3.7	3.7	7.2	6.7	6.4
Louisville MSA	3.3	3.2	4.3	4.7	5.2
Indiana	2.9	2.4	4.2	4.6	4.8
Kentucky	4.0	3.9	5.1	5.0	5.4
U.S.	4.1	3.8	4.7	5.4	5.8

* Counties in the Louisville Metropolitan Statistical Area, as defined in June 2003.

is attributable to state and local governments, with state government employment increasing by about 240 jobs and local government employment increasing by about 490 jobs.

Recent commuting data released from the 2000 census indicates that 35,532 workers commuted daily between southern Indiana and Jefferson County, Kentucky, in 2000. Approximately 3,475 more workers commuted from southern Indiana to Jefferson County, Kentucky, in 2000 relative to 1990 (a 10.8 percent increase). **Table 3** shows the proportion of commuters originating in each county and commuting to other counties.

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 have increased over the past year, but remain consistently below that of the MSA as a whole. 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, which would boost wages.

Average weekly hours worked in the manufacturing sector averaged 43.2 hours per week for the first three quarters of 2003, slightly below the 2002 average of 43.7 hours in southern Indiana, suggesting a portion of the increase in average earnings is due to overtime pay (see **Figure 2**). Manufacturing hours peaked at 44.1 hours per week in April 2003.

Consumer Activity

Sales and Marketing Management magazine's 2003 survey of buying power shows that changes in retail sales are mixed (see **Table 4**). Total retail sales in the Louisville MSA decreased by 3.8 percent, from $12.9 billion in 2002 to $12.4 billion in 2003—a smaller decrease than for the previous period. Jefferson County, Kentucky, had the largest change with over a $404,000 decrease between 2002 and 2003. Floyd, Harrison, and Scott counties show substantial growth in retail sales. Harrison County is the only county in the MSA where retail sales have increased over the past four years. The increase in retail spending in Floyd, Harrison, and Scott counties may indicate a redistribution of spending patterns. As more retail establishments have opened in these counties, consumers shop there rather than traveling to Clark County, Indiana, or Jefferson County, Kentucky.

Activity in the residential housing market increased slightly over the past year. Housing sales through October 2003 in the southern Indiana area[1] totaled 2,441 compared with 2,144 for January to October 2002. The average sales price was $130,224 for January to October 2003, up 0.5 percent from the year before. The average amount of time for a house to sell was 113 days, up slightly from the 2002 average.

Residential construction as measured by residential building permits for new single and multi-family residential units continues to be strong increasing by 9 percent and 20 percent, respectively, for the MSA counties for the January to September period (see **Table 5**). Clark and Harrison counties experienced a decrease from the same period in 2002. Other

Table 2
Nonagricultural Employment and Components, January to September Average

In Thousands	2001	2002	2003*	2002-2003 Difference
NONAGRICULTURAL EMPLOYMENT				
Southern Indiana Counties[1]	95.8	94.7	95.3	0.62
Louisville MSA[2]	582.6	567.0	568.1	1.03
GOODS PRODUCING				
Southern Indiana Counties	26.0	24.9	26.8	1.86
Louisville MSA	112.5	105.0	105.7	0.63
Natural Resources, Mining, and Construction				
Southern Indiana Counties	5.5	5.5	5.9	0.49
Louisville MSA	31.3	29.7	31.5	1.83
Manufacturing				
Southern Indiana Counties	20.5	19.5	20.8	1.37
Louisville MSA	81.2	75.3	74.1	1.83
SERVICE-PROVIDING				
Southern Indiana Counties	69.8	69.7	68.5	-1.23
Louisville MSA	470.1	462.0	462.4	0.40
Trade, Transportation, and Utilities				
Southern Indiana Counties	21.8	21.5	20.7	-0.86
Louisville MSA	132.4	127.4	125.5	-1.90
Information				
Southern Indiana Counties	0.8	0.6	0.7	0.06
Louisville MSA	13.0	11.5	11.5	-0.08
Financial Activities				
Southern Indiana Counties	3.3	3.3	3.3	-0.06
Louisville MSA	36.7	37.2	38.1	0.83
Professional and Business Services				
Southern Indiana Counties	6.1	6.7	5.9	-0.88
Louisville MSA	66.2	64.4	62.6	-1.72
Educational and Health Services				
Southern Indiana Counties	7.0	7.2	7.1	-0.08
Louisville MSA	64.7	67.0	69.3	2.37
Leisure and Hospitality				
Southern Indiana Counties	10.8	10.8	10.6	-0.28
Louisville MSA	54.7	53.0	53.3	0.24
Other Services				
Southern Indiana Counties	3.4	3.9	4.1	0.16
Louisville MSA	29.3	29.9	30.7	0.84
Government				
Southern Indiana Counties	16.6	15.5	16.2	0.70
Louisville MSA	73.1	71.6	71.4	-0.19

[1] Clark, Floyd, Harrison, and Scott counties. The Indiana Department of Workforce Development refers to this as the New Albany area.
[2] Clark, Floyd, Harrison, and Scott counties in Indiana and Bullitt, Jefferson, and Oldham counties in Kentucky.
* September 2003 figures are preliminary.

Table 3
Census Commuting Flows, 2000
Percent of Workers Age Sixteen and Older

Reside In \ Work In	Clark	Crawford	Floyd	Harrison	Jefferson, IN	Orange	Scott	Washington	Bullitt	Jefferson, KY	Oldham
Clark, IN	51.1	0	10.9	0.6	0.3	0.1	0.6	0.3	0.3	33.7	0.3
Crawford, IN	4.8	37.3	4.6	15.1	0.1	3.3	0.1	0.7	0.2	12.9	0
Floyd, IN	18.5	0	42.1	2.8	0.2	0	0.3	0.3	0.1	33.5	0.3
Harrison, IN	10.6	1.5	14.5	43.3	0.4	0.1	0.2	0.6	0.1	25.0	0.3
Jefferson, IN	2.0	0	0.3	0.1	78.3	0	2.2	0	0	2.3	0.1
Orange, IN	1.7	1.9	1.3	0.8	0.2	64.3	0.1	4.0	0.0	1.8	0
Scott, IN	9.4	0	1.9	0	3.7	0.2	57.1	1.0	0.0	7.1	0
Washington, IN	13.7	0.2	7.9	2.7	0.2	2.5	3.7	52.2	0.0	9.8	0.1
Bullitt, KY	1.4	0	0.5	0.2	0	0	0	0.0	27.5	64.4	0.8
Jefferson, KY	2.1	0	0.8	0.2	0	0	0	0	0.6	92.3	0.9
Oldham, KY	1.5	0	0.6	0.1	0	0	0.1	0	0.2	58.4	33.2

counties show increases. Floyd and Scott counties have particularly strong growth in percentage terms for single family permits (30.3 and 36.7 percent, respectively). This growth in residential housing should lead to a continued increase in retail spending in these counties. Interest rate increases, as projected in the last half of 2004, are likely to dampen growth in residential building permits.

Gaming at Caesar's Casino continues to expand. The turnstile count for January through September 2003 was over 2.5 million, a 12.7 percent increase over the same period in 2002. Tax payments totaled $68.53 million for the January to September 2003 period, a 31 percent increase over the same period in 2002.

During 2003, Louisville and southern Indiana entered a period of moderate growth. While retail spending remains sluggish in several of the metro counties, single family residential building permits and housing sales have increased relative to the previous year, but will likely taper off over the coming year as interest rates increase. Unemployment rates have declined and employment growth in the nonagricultural sector is creeping upward, although the numbers are still quite volatile from month to month. Moderate employment growth should continue. The coming year should generate an additional nine hundred jobs on average in the nonagricultural sector of southern Indiana, and unemployment rates should continue to decrease slightly. ◄

Endnotes

1. Data on home sales from the Southern Indiana Realtors Association Multiple Listing Service, which covers Clark, Crawford, Floyd, Harrison, Jefferson, Scott, and Washington counties.

Figure 2
Manufacturing Earnings and Hours

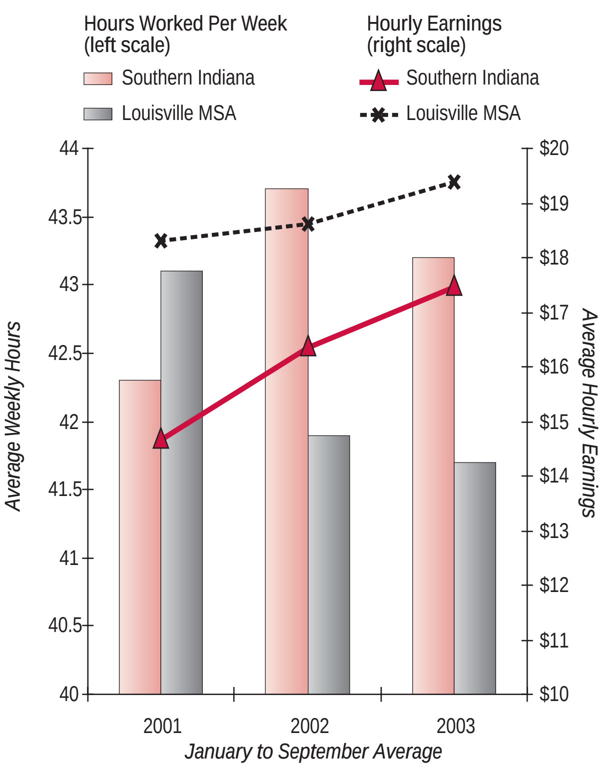


Table 4
Total Retail Sales, 2000 to 2003

Area	2000	2001	2002	2003	2002–2003 Change	2002–2003 Percent
Louisville MSA	13,106,414	13,535,653	12,925,845	12,439,422	-486,423	-3.8%
Bullitt	363,515	385,269	379,800	361,388	-18,412	-4.9%
Jefferson, KY	9,874,800	10,186,603	9,672,799	9,267,922	-404,877	-4.2%
Oldham	250,598	258,058	251,359	248,450	-2,909	-1.2%
Clark	1,617,183	1,659,740	1,615,787	1,505,735	-110,052	-6.8%
Floyd	484,762	507,804	471,606	492,401	20,795	4.4%
Harrison	318,975	338,155	339,518	354,175	14,657	4.3%
Scott	196,581	199,934	194,976	209,401	14,425	7.4%

Table 5
Residential Building Permits Issued for Privately-Owned Structures*

County	Single Family				Multi-Family			
	2000	2001	2002	2003	2000	2001	2002	2003
Clark, IN	547	561	689	621	18	189	76	122
Floyd, IN	282	282	254	331	72	6	10	8
Harrison, IN	173	144	162	146	26	0	4	6
Scott, IN	n/a	94	90	123	n/a	73	72	15
Bullitt, KY	534	498	493	588	56	37	76	92
Jefferson, KY	2,036	2,382	2,242	2,476	531	321	540	673
Oldham, KY	446	469	449	491	46	90	61	92

* Data from January to September of each year

Richmond

Ashton I. Veramallay

Professor of Economics and Director, Center for Economic Education, Indiana University East, Richmond

The Richmond-Connersville-New Castle (RCNC) area economy can expect a rebound in 2004. Business activity will pick up from its current lackluster performance. This is predicated upon national economic performance, which, in turn, will influence the local economy.

The recession of 2001 meant the usual cutbacks and closings in manufacturing. The manufacturing sector is still experiencing soft demands, especially in the automobile and technology industries. However, other firms producing components to the housing, pet, plastic, and casket industries have strong demands even in the wake of the Iraq war.

Manufacturing firms tend to make their largest "job-destruction" decisions during economic downturns. Job losses from contracting establishments rose sharply while job gains from expanding establishments fell sharply. The net result of these two gross flows moving in opposite directions is the loss of jobs during the recession-recovery period.

The September 2003 figures released by the Indiana Department of Workforce Development show that the unemployment rates in Wayne, Fayette, and Henry counties, were 5.3 percent, 9.2 percent, and 4.9 percent, respectively (see Figure 1). These unemployment rates were higher than the state rate of 4.8 percent, but lower than the national rate of 5.8 percent, with the exception of Fayette County, which is intricately tied to the automobile industry.

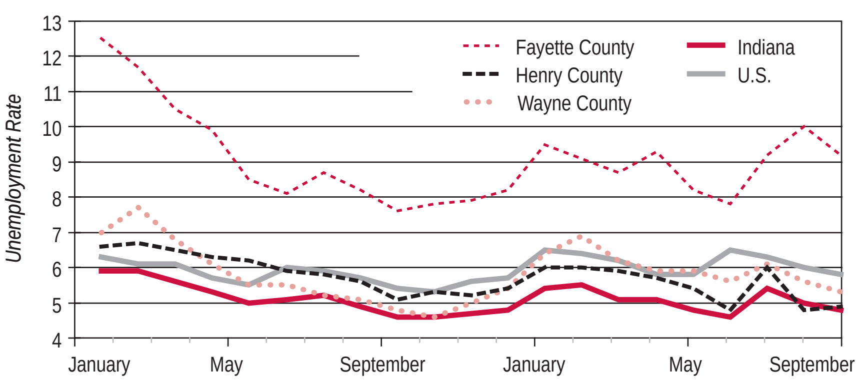
Despite nearly two years of steady gains in U.S. production and income, total employment is still below the peak of the previous business cycle in March 2001. Manufacturing jobs seem particularly vulnerable, having declined by roughly 13 percent since the recession began. As U.S. firms adjust to import competition from low-wage companies, they increase plant capacity and hire skilled workers. Consequently, there is increased productivity, which also translates into worker displacement because it takes fewer workers to produce the same output. The current jobless recovery may be due to structural, rather than cyclical, changes and RCNC is not immune to it.

Unlike manufacturing, the housing sector is doing extremely well. Home sales have surpassed last year's. There is strong demand for new homes, priced between $160,000 and $170,000, especially in the southeast quadrant of Richmond and Centerville. The local median price of a home is $90,000, compared to the nation's $177,000. Housing affordability is increasing because of low interest rates. At the end of October 2003, local financial institutions offered rates of 5.38 percent, 6.06 percent, and 3.91 percent, respectively, for fifteen-year, thirty-year, and one-year adjustable mortgages. These rates were much lower than last year's and, along with the tax cuts, are boosting consumption and investment. In Richmond, there were 1,448 permits with an estimated investment value of $39 million. Large commercial construction projects were undertaken by Reid Hospital and Health Care Services, Richmond Community Schools, Old National Bank, and First Bank Richmond.

The nonmanufacturing sector, including services, retail/wholesale trade, and government, is expected to have moderate growth. It is important to note that this sector accounts for most of the total employment in RCNC. Rising employment in some industries (such as health care, education, and food) will offset job losses in the manufacturing sector. Also, successful business prospects, negotiated by the Economic Development Corporation of Wayne County, will help in job creation. The prospects are Richland, Osborn International, and Contract Industrial Tooling. These firms will bring good-paying jobs to Richmond.

As the national economic expansion continues, it will have a positive effect on RCNC in terms of employment, income, and growth provided there are no adverse external shocks or heightened geopolitical uncertainties. ◂

Figure 1
Unemployment Comparisons, January 2002 to September 2003



South Bend/Mishawaka and Elkhart/Goshen

Paul A. Joray

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Paul S. Kochanowski

Professor of Economics, Indiana University South Bend

To help understand how we came to where we are today, **Table 1** and **Figure 1** chart the longer term progress of the Michiana region, of which South Bend/Mishawaka and Elkhart/Goshen are a major part. The index numbers in **Table 1** and **Figure 1** use 1986 as the base period and employ monthly averages of seasonally adjusted index numbers. They highlight how much the growth, volatility, and nature of the Elkhart/Goshen and South Bend/Mishawaka economies have differed over the past decade. For example, the South Bend/Mishawaka economy's growth (as measured by employment) over the past decade has mirrored that of the State of Indiana. Indeed, the patterns of growth—the strong expansion from 1993 to 1996, followed by a period of more moderate growth from 1996 to 2000, and then a period of declining employment from 2000 to 2002—are nearly identical for South Bend/Mishawaka and the State of Indiana. In comparison, Elkhart/Goshen grew more rapidly than South Bend/Mishawaka and the State of Indiana during the1993 to 1996 and 1998 to 2000 periods, declined more sharply from 2000 to 2001, and has started to rebound more strongly since then.

Basic Industries

These contrasting results largely reflect the diversity of South Bend/Mishawaka and Elkhart/Goshen's basic industries. Basic industries produce goods or services that are purchased by buyers outside the metropolitan statistical area (MSA), and in the short-term, a smaller economy's basic industries tend to be the driving force that determines its growth or decline. All eleven of Indiana's metropolitan areas are sensitive to the ups and downs of manufacturing industries, particularly to the transportation equipment sector (SIC 37). But for Elkhart/Goshen, manufacturing represents one-half of its total employment and constitutes virtually all of its basic employment. It follows, as seen in **Table 1** and **Figure 1**, that strong overall employment growth or decline in Elkhart/Goshen closely parallels periods of growth or decline in recreational vehicles, manufactured housing, band instruments, and other Elkhart/Goshen-based manufacturing industries. Manufacturing in South Bend/Mishawaka, on the other hand, accounts for only about one-sixth of its total employment and one-half of its basic employment; and South Bend/Mishawaka's employment growth thus depends on a much broader range of basic activities.

Research on South Bend/Mishawaka's basic industries reveals that, in addition to various manufacturing industries, South Bend/Mishawaka's major basic industries include medical care services, business services, a variety of retail services, higher education services, and services related to tourism (such as services to fans who come to South Bend/Mishawaka for Notre Dame football games or conventions). Some of these buyers, for example those who come to South Bend for higher education, arrive from all corners of the United States, as well as from many international countries. Other buyers, who reside in the surrounding Michiana area, travel to South Bend/Mishawaka to shop at its various shopping malls, to dine at its restaurants, or to consult its medical specialists. Many of South Bend/Mishawaka's outside buyers drive over from Elkhart/Goshen; and workers commute to and from Elkhart/Goshen and South Bend/Mishawaka—activities that bring about significant linkages between the two economies. Indeed, in the 2002 tax year, nearly 9,900 workers commuted from South Bend/Mishawaka to Elkhart/Goshen, whereas about 3,300 other workers commuted in the

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

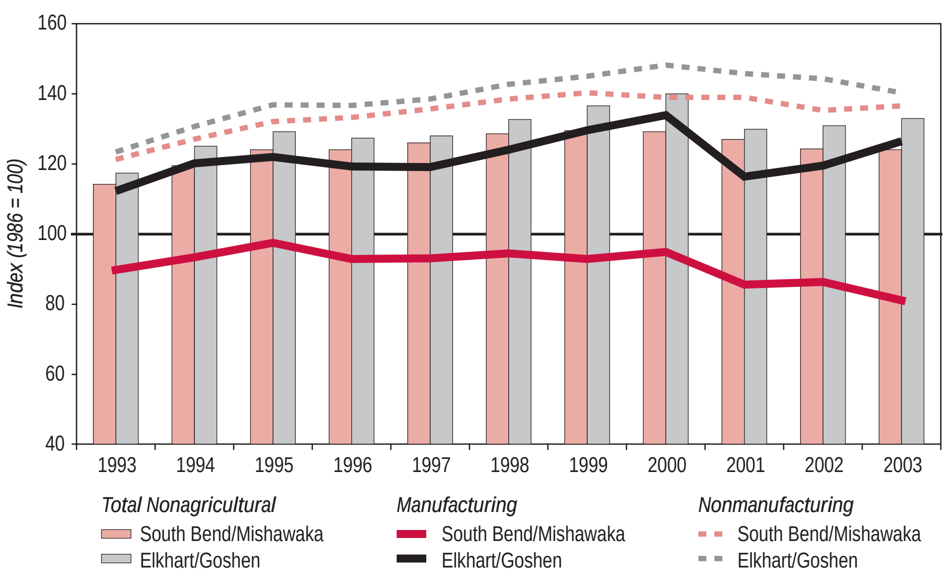

Table 1
Indexed Employment and Unemployment Rates, 1993 to 2003

	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003*
South Bend/Mishawaka											
Total Nonagricultural	114.2	119.5	124.1	124.1	126.0	128.6	129.5	129.2	127.0	124.3	124.1
Manufacturing	89.8	93.4	97.5	92.9	93.1	94.5	92.9	94.9	85.6	86.4	81.1
Nonmanufacturing	121.3	127.1	132.1	133.3	135.7	138.5	140.3	139.0	139.0	135.3	136.6
Unemployment Rate	6.1%	4.4%	4.3%	4.0%	3.3%	2.7%	2.9%	3.2%	4.1%	5.0%	4.9%
Elkhart/Goshen											
Total Nonagricultural	117.4	125.1	129.2	127.4	128.0	132.7	136.6	140.0	129.9	130.9	133.0
Manufacturing	112.3	120.2	122.0	119.3	119.1	124.1	129.6	133.9	116.4	119.5	126.5
Nonmanufacturing	123.4	130.7	136.9	136.7	138.5	142.7	145.0	148.2	145.8	144.3	140.3
Unemployment Rate	5.9%	3.8%	4.5%	3.8%	3.3%	2.6%	2.1%	2.7%	4.6%	4.8%	4.9%

*2003 figures cover the first six months of the year.
All employment figures are seasonally adjusted index numbers with 1986 = 100.
The underlying employment data are derived from a monthly survey of employing establishments, published by the Indiana Department of Workforce Development.

opposite direction. Though the data break out the South Bend/Mishawaka and Elkhart/Goshen economies, it is better to think of these economies as highly interdependent in both consumption and production.

Employment

The more recent data in **Table 1** and **Figure 1** show some similarities and some differences when compared to earlier years. Total nonagricultural employment evidenced weakness during 2002 for both the South Bend/Mishawaka and Elkhart/Goshen economies, continuing the decline that began in 2000 and persisted throughout 2001. In 2002, Elkhart County's nonagricultural total employment grew by 0.8 percent and St. Joseph County's nonagricultural total employment decreased by 2.1 percent. Both of these local growth rates were in line with national and state total nonagricultural growth rates of -0.9 percent and -1.2 percent, respectively.

In contrast to the national and state economies, where manufacturing employment continued to contract, manufacturing employment in South Bend/Mishawaka and Elkhart/Goshen grew by 1.0 percent and 2.7 percent, respectively. This upsurge derived largely from the growth in transportation equipment (SIC 37). In South Bend/Mishawaka, transportation equipment remained strong throughout the entire year, ending the period with an 11 percent increase (500 more jobs). This upswing likely resulted from the strong sales of the Hummer H2 sport utility vehicle. A decline in manufacturing employment in South Bend/Mishawaka's other durable and nondurable manufacturing industries offset some of these gains, however. In Elkhart/Goshen, SIC 37 increased from December 2001 to December 2002 by 5,200 jobs—a 24.8 percent boost that primarily reflects the robustness of the recreational vehicle market during much of 2002.

During 2002, nonmanufacturing employment shrank in both South Bend/Mishawaka and Elkhart/Goshen by 2.6 percent and 1.1 percent, respectively. These contractions were broad-based, covering the wholesale, retail, and service sectors. Wholesale and retail trade employment fell in both economies by about 5 percent, with professional services, health care services, and other services also suffering setbacks. Nonmanufacturing employment also diminished in the nation and state, but these declines were smaller than those experienced by the local economies.

The most recent data from the Indiana Department of Workforce Development (through August 2003) indicate lingering weakness in the national, state, and South Bend/Mishawaka economies but strong growth in the Elkhart/Goshen economy. The South Bend/Mishawaka economy continues to lose jobs in the nonmanufacturing trade and service sectors. Elkhart/Goshen, however, has experienced strong gains in both the manufacturing and nonmanufacturing sectors. The Elkhart/Goshen advances in manufacturing again reflect the enduring strength of the recreational vehicle market. Though the recreational vehicle market suffered weakness in the early part of 2003, a downturn that most experts attribute to the uncertainties related to the Iraqi war, the industry has rebounded strongly throughout the summer months. In addition, modular home sales in August 2003 have also been running ahead of August 2002 sales, implying strength in this sector and contributing to Elkhart/Goshen's strong showing in 2003.

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 tend 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.

In the fall of 2003, the A.J. Wright distribution center in South Bend started hiring for 150 jobs. A.J. Wright is a relatively new and growing discount retail chain with ninety-five stores nationwide. The stores sell apparel, home furnishings, footwear, and giftware targeting moderate income customers. TJX, the parent company, hopes to build A.J. Wright into a one thousand store chain, with the South Bend center distributing products to its Midwestern stores. The 150 jobs are the first of a total of 800 jobs that will be hired if things go as planned. Since almost all of the income for these jobs comes from outside our area and no local jobs will be lost, the multiplier effect will be substantial.

The University of Notre Dame announced in the fall of 2003 that it would proceed with approximately $100 million in construction projects. The projects had been on hold for about a year due to the recession and its impact on the stock market. Since the funding for these projects comes from outside the community (the university's endowment), this spending will also have a substantial multiplier effect during the construction phase.

For the last couple of years, the manufactured housing industry has been in a serious slump. In 1999, the industry nationwide shipped 348,000 units. In 2002, the industry nationwide shipped 168,500 units, and this year shipments are at a 135,000 unit pace.

Several factors have helped to increase the severity of the slump:

- A large number of repossessed homes
- Rising inventories
- The failure of a major financing firm

This is an important industry in our area and the negative multiplier effect has been substantial. The slump contributed to the large drop in jobs in 2000 and 2001. It appears that the industry is stabilizing and we are hoping for a recovery beginning in 2004. The drop in inventories, along with recent increases in real GDP, consumer confidence, and employment, should bolster the demand for durable goods, including manufactured housing.

The recession hit the recreational vehicle industry hard, as shipments nationwide fell from 321,000 units in 1999 to 300,000 in 2000 and 257,000 in 2001, but the industry has recovered quickly. In 2002, shipments increased to 311,000, an increase of 20 percent, and the second highest level of shipments since 1999. The industry will have the third highest level of shipments in 2003 with nearly 308,000 shipments projected. Several factors contributed to this rapid recovery:

- Very low interest rates
- Strong consumer demographics
- Changes in recreational travel
- Increasing consumer confidence
- A recovering economy

Since these factors will continue in 2004, we expect the level of RV shipments to be in the 310,000 to 315,000 range, which would be the second highest just below the 321,000 in 1999.

Indiana produces more than 50 percent of the recreational vehicles shipped nationwide and most of these vehicles are produced in northern Indiana. One example of the positive impact on our local economy is the new Coachman factory in Middlebury, which will employ approximately three hundred workers. Since these vehicles are sold nationwide, the multiplier effect of increased production is strong. The RV industry has had an important positive impact on our local economy's recovery from the recession.

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 is important as automobiles, recreational vehicles, manufactured housing, and steel industries are major employers. The Elkhart economy, with its substantial manufacturing employment, is especially tied to the national economy. The national forecast calls for real GDP growth of 4 percent, low interest rates, low inflation, increased consumer spending, and increased employment. This optimistic outlook should lead to continued growth in both local economies. We should see reasonable growth in employment and a reduction in the unemployment rates to the 3.5 percent to 4.5 percent range during the year, with lower rates near the end of the year. ◄

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Outlook Summary for 2004

The Big Picture

By the Kelley School of Business

- **Bill Witte on the National Forecast:** Gross Domestic Product is to approach 4 percent next year. This growth should be more broadly based than during the past two years, with significant help from business investment in new plant and equipment, and probably also from some inventory rebuilding. The economy could generate close to two million new jobs in 2004.

- **John Boquist and Bill Sartoris forecast the Financial Picture:** We expect to see a slight rise in interest rates during 2004. The stock market will continue to make gains, although at a less spectacular rate than in 2003.

- **Jeff Fisher on Housing:** Housing starts will continue near the same level of about 1.7 million to 1.8 million starts (single and multi-family). While a rise in interest rates will dampen housing starts, the continued economic recovery should offset this.

- **Jerry Conover and Jim Smith on Indiana:** We forecast an increase of only about 1 percent, or roughly 28,000 jobs. The unemployment rate should decline slightly, approaching 4.6 percent by the end of 2004.

- **Andreas Hauskrecht's Global Forecast:** World economic growth will be around 4.1 percent, with an economic upswing for essentially all world regions, except Japan.

Indiana Metro Areas

By Faculty from Academia Statewide

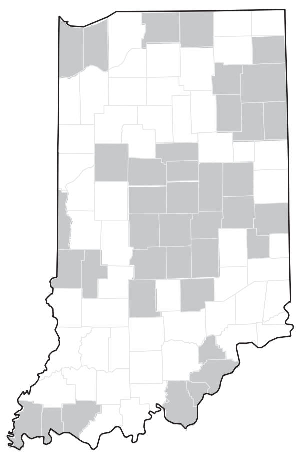
- **Barry Ritchey on Anderson:** Income in the county continues to lag behind income for the state, which lags behind income growth for the country. That performance is a continuing trend for this community.

- **Morton Marcus on Bloomington:** The fundamentals of the Bloomington economy are unchanged and participation in the generally favorable economic scenario is likely.

- **Jim Smith on Columbus:** Our overall employment forecast is for a very slow rise in employment during 2004, adding perhaps 300 jobs in the county, with the unemployment rate expected to remain above 3 percent.

- **Gale Blalock on Evansville:** Our unemployment rate is less than the state's and the nation's. As the national economy continues to recover, the local economy is also likely to continue its recovery.

- **Tom Guthrie on Fort Wayne:** For 2004, the forecast is an increase between 2,500 and 5,000 jobs. Over the longer run, the capacity of the area to grow employment is likely about half that of the nation.



- **Don Coffin on Gary:** The local economy will continue its pattern of slower growth in output and employment than the national and state economies for yet another year. While total local output may be expected to rise by about 2.6 percent, this is likely to translate into a small employment decline.

- **Morton Marcus on Indianapolis:** Indianapolis stands to gain from major ongoing construction at the airport and an attractive retail environment, which draws shoppers from a wide radius. Even if the Indianapolis area were to add jobs at a 1 percent rate, the metro area would see a growth of 7,700 jobs.

- **Kathy Parkison on Kokomo:** Although the state and local loss of manufacturing jobs is still troubling, the national and state economies are poised to grow. This should also be true of the local economy.

- **Pat Barkey on Muncie:** An acceleration in the national economy will help the Muncie economy, but our experience of the last ten years tells us that it will take more than that for us to prosper.

- **Dagney Faulk on New Albany:** The coming year should generate an additional 900 jobs in the nonagricultural sector of southern Indiana, and unemployment rates should continue to decrease slightly.

- **Ash Veramallay on Richmond:** Rising employment in some industries (such as health care, education, and food) will offset job losses in the manufacturing sector, although certainly won't offset loss in wages.

- **Paul Joray and Paul Kochanowski on South Bend and Elkhart:** We should see reasonable growth in employment and a reduction in the unemployment rates to the 3.5 percent to 4.5 percent range during the year, with lower rates near the end of 2004.

OUTLOOK 2004

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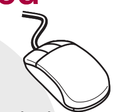

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