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RECESSION COMES TO THE PLAINS

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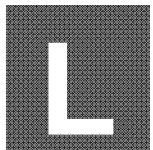
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RECESSION COMES TO THE PLAINS

By the Nebraska Business Forecast Council

U.S. Macroeconomic Outlook



Like clockwork, just a few weeks after the November Presidential election, the National Bureau of Economic Indicators declared the U.S. economy in recession.

This was not news, of course. It had been evident by that time that the U.S. economy had entered recession. Instead, the major news of the last 6 months is that the U.S. recession has entered a second, and more menacing, phase. This “second act” of the recession began in September, with the upheaval on Wall Street and the freezing of global credit markets. At that time, our national housing recession morphed into a global recession precipitated by a credit crunch.

We of course had all hoped that this would be a “one act” recession, particularly in Nebraska. Our state had fared well in the first act of the national recession that ran from December 2007 through August 2008. The Nebraska economy appeared to grow during this period. Several factors worked to Nebraska’s advantage. Nationally, there had been a significant decline in home values, causing a significant contraction in the wealth of households, and anemic consumer spending. The manufacturing industry also declined sharply in the industrial Midwest. By contrast, in Nebraska home values were flat or declined only modestly, and the value of agricultural land was soaring. More generally, the key agricultural sector was booming in Nebraska during the first half of 2008, and much of our manufacturing sector is tied to agriculture. The factors that were dragging down the national economy had only a modest impact in Nebraska.

This will not be true in the second act of the recession. In the second act, household wealth is declining for a new reason – a 40% decline in the value of stock market indexes. This loss of wealth will impact Nebraska as much as it will affect other parts of the nation. Further, 2009 will be only an average year for agriculture. Agriculture will not be a wind at the back of the Nebraska economy. And, Nebraska manufacturing will weaken as a result.

For all of these reasons, the Nebraska economy will likely participate in the second act of the national recession. Employment declined in Nebraska in late 2008, and will decline in 2009. However, the recession will not be as severe in Nebraska as nationwide, and the Nebraska economy should pull out of recession at around the same time as the national economy.

The specific outlook for the national economy is that it will return to GDP growth near the end of calendar year 2009, either the late third quarter or the fourth quarter. The incoming President’s stimulus proposal could affect confidence in the economy, and may be of modest benefit. But, a recovery or at least stabilization of the housing market will be the key factor in the recovery. As in most recessions, the labor market will lag the overall economy. Employment will only begin to recover in 2010. U.S. GDP will decline by 1% in 2008 and by 3% in 2009, before growing 3% in 2010. Non-farm employment is expected to decline by 2% in 2008 and 1.5% in 2009, but should grow by 1.5% in 2010. U.S. unemployment should peak in late 2009 at near 8.5%. Inflation will slow in 2009 and 2010.

Nebraska Outlook

As noted earlier, the panel now expects that Nebraska will fully participate in the national economic recession in 2009. As seen in Table 1, growth slowed sharply in Nebraska in 2008, particularly in the last four months of the year. In 2009, Nebraska will experience significant job losses. Nebraska will lose about 1% of its employment in 2009. Further, in 2009, nonfarm income will grow slowly, and farm income will retreat from the record levels it achieved in 2008.

Table 1— Key Economic Growth Rates

	Nonfarm Employment	Nonfarm Personal Income (nominal)	Net Farm Income (nominal)
2007	1.7%	6.3%	70.1%
2008	0.7%	4.6%	15.6%
2009	-1.1%	2.6%	-26.1%
2010	1.5%	4.8%	3.4%

Note: Nominal income growth includes inflation.

Employment and income growth will return only in 2010. Farm income will rise modestly in 2010. Overall, the economy should rebound in 2010 but growth will only be modest.

Employment

With the Nebraska economy entering recession, job losses will be broad-based. This is because in recession job losses hit the services sectors as well as goods-producing sectors. As seen in Table 2, our outlook for 2009 represents a significant reversal from our previous forecast. In that earlier forecast, we did not anticipate that the national recession would enter a second stage in September 2008, and pull Nebraska and other Plains states into recession. The 2009 forecast now calls for job loss rather than job growth. Growth also has been slower for 2008, given the weak state of the economy during the last 4 months of the year.

Table 2— Comparison of Non-Farm Employment Forecasts

	June 2008 Forecast	Current Forecast
2007	1.7%	1.7%
2008	1.2%	0.7%
2009	1.5%	-1.1%
2010	1.7%	1.5%

Construction and Mining

We anticipate the housing sector will hold steady in Nebraska in 2009. To be sure, a weak Nebraska economy in 2009 will limit growth in the housing sector, particularly given the need to work through an inventory of unsold new homes. But, the industry can avoid further declines in 2009. Several factors work in Nebraska's favor, including falling mortgage interest rates and a stable financial service industry. These factors will eventually allow for a modest recovery in housing, in 2010, but a return to more normal growth will not occur until 2011. The nature of the housing industry also may change. Lending standards will not return to those that were part of the mortgage fiasco of 2008. Don't expect a return of the no doc or no money down mortgages. Instead lenders are likely to require 10 and 20 percent down. This may limit growth in the next few years but in the long run should be beneficial for the sector.

There are mixed signals for the non-residential building sector for 2009. The sector will be held back by a weak Nebraska economy, but major projects that have already begun will proceed during the year. In particular, Omaha is in relatively good shape. Two major projects, Aksarben Village and the midtown project, are continuing and will be major employers for the next several years. Preliminary work has started on a new baseball stadium. Statewide, there will be modest growth in non-residential construction in 2009 with Omaha accounting for most of the growth. In 2010 it is likely that this segment will rebound as the recession ends and financing is returned to normal.

There is also potential for growth in the highway construction sector given the likely level of infrastructure spending that will be included in the new administration's economic stimulus plan. While we expect some growth in spending in 2009, bureaucratic delays imply that spending should increase at a faster rate in 2010.

Overall, construction employment will grow by 1.5% in 2008 and 1.0% in 2009, before returning to a more rapid 4.0% growth rate in 2010.

Table 3—Number of Nonfarm Jobs and Percent Changes by Industry Annual Averages (in thousands of jobs)

	Nonfarm Total	Construction, Mining & Natural Resources	Durables	Non- durables	Wholesale Trade	Retail Trade	Trans- portation and Utilities	Info	Financial	All Services	Federal Gov't	Local Gov't
1998	880.0	42.4	58.5	55.9	42.2	107.2	43.3	26.3	58.8	295.9	16.0	134.9
1999	897.5	44.3	57.7	55.7	42.5	110.1	44.5	27.1	60.9	304.6	15.9	135.6
2000	914.1	45.2	58.9	55.4	41.9	111.2	45.1	26.9	60.5	315.8	16.6	137.9
2001	919.7	45.3	54.6	56.2	42.5	110.5	45.2	25.8	60.2	322.4	16.0	140.8
2002	911.5	46.1	50.6	55.4	41.5	108.9	44.9	23.2	61.4	320.5	16.3	142.6
2003	914.2	47.4	47.3	55.1	41.0	107.2	46.4	21.5	62.4	326.1	16.7	143.1
2004	922.2	48.4	47.0	54.0	40.8	106.9	48.9	21.1	63.2	331.8	16.5	143.6
2005	934.9	47.8	48.4	52.9	40.6	107.2	52.3	20.2	64.5	339.8	16.3	144.9
2006	946.8	48.4	49.7	51.8	40.8	106.4	53.4	19.5	66.7	347.8	16.2	146.1
2007	962.6	50.5	50.0	51.3	40.7	107.7	56.1	19.3	69.0	353.9	15.9	148.2
Forecast Number												
2008	969.5	51.3	48.4	50.4	41.0	108.9	55.9	18.8	70.1	360.3	15.9	148.5
2009	958.5	51.8	44.8	49.2	39.6	105.8	56.0	18.7	70.9	356.7	16.2	148.8
2010	972.6	53.8	43.3	48.4	39.6	106.4	57.8	19.0	72.4	364.9	16.7	150.3
Forecast Number												
2008	0.7%	1.5%	-3.2%	-1.7%	0.7%	1.1%	-0.3%	-2.6%	1.6%	1.8%	0.0%	0.2%
2009	-1.1%	1.0%	-7.4%	-2.5%	-3.3%	-2.8%	0.1%	-0.6%	1.2%	-1.0%	2.0%	0.2%
2010	1.5%	4.0%	-3.3%	-1.5%	0.0%	0.5%	3.3%	1.5%	2.0%	2.3%	3.0%	1.0%

Source: <http://data.bls.gov/cgi-bin/dsrv>, 2008

Manufacturing

Durable goods employment will decline throughout the 2008 to 2010 period, with by far the largest losses in 2009. In 2009, lower farm incomes will reduce demand for the farm machinery, equipment manufacturing, and the fabricated metal products manufacturing industries. The national recession and tight credit conditions will reduce employment in other durable goods sectors, especially those related to the automobile industry, through early 2010.

Job losses are also expected for the non-durable sector in 2009 as growth in foreign demand for protein slows and losses for major ethanol producers force temporary idling of capacity. Any significant rebound in nondurable goods employment depends upon conditions in the food processing sector. By 2010, increases in international demand for meat products are expected to have positive impacts on food processing and job losses will be modest. By mid 2009, increases in energy costs or the requirements for renewable fuels standard will return the ethanol industry to profitability and increased employment.

Transportation and Utilities

The national recession has slowed Nebraska's rapidly growing transportation sector. Trucking, rail, and warehousing experienced modest job losses in 2008. In 2009, employment will be flat as the national economy remains mired in recession. Trucking should add a few new jobs given the long-run strength of key firms and the improved availability of labor but the rail sector has faced some furloughs. Strong growth will only return in 2010. Factors such as favorable demographics, the state's central location, low entry costs and state economic development efforts in trucking and warehousing will foster long-term job growth. Sector employment fell by 0.3% in 2008, and is expected to grow by just 0.1% in 2009, and 3.3% in 2010.

Wholesale Trade

The wholesale trade industry has lost employment during this decade. Rising labor productivity has meant that employment has failed to grow even as industry output expanded. While the sector added jobs in 2008, weak consumer demand will lead to job losses in 2009.

Retail Trade

The year 2009 also will be difficult for the retail trade industry. With consumer demand declining, retail employment is expected to fall by nearly 3% in 2009. Growth also is expected to be anemic in 2010. Like the wholesale trade industry, the long-run outlook for job growth is limited in the retail trade sector due to rising productivity. First, larger retailers, who utilize fewer workers relative to sales, are capturing a growing share of the retail market. Second, there have been increased sales by on-line and other nontraditional retailers. These factors will limit future growth in retail employment. Retail employment is expected to increase by just 0.5% in 2010.

Information

The information industry contains a diverse group of industries including newspapers, movie theatres and sound studios, and technology-oriented industries such as telecommunications, data processing, web site development, and web publishing. In recent years, most of these industries have been shedding employment as improvements in technology raise productivity. This trend is expected to continue in 2009, but employment is expected to increase modestly in late 2009 and in 2010. This is because Nebraska has had some recent success in attracting new employers in the information industry such as Yahoo.

Financial Services

The financial services industry comprises finance, insurance, and real estate. Housing related segments of the industry such as real estate, loan activity, and mortgage brokers are being negatively impacted by weakness in this sector. We expect that these industry segments will be impacted throughout 2009, but should recover as housing recovers beginning in 2010.

The financial services industry has grown rapidly and steadily in Nebraska for the last few decades given the strength of our insurance, banking, and investment industries. This trend is expected to continue. However, the financial services industry will be affected by the recession. Job growth will slow to just over 1% in 2009, before recovering to the trend growth rate of 2.0% in 2010. Still, it must be noted that during this period, the Nebraska financial services industry will perform much better than its counterparts nationwide.

Services

Accounting for 37% of employment in the economy, the diverse and rapidly growing services industry is a key to our employment forecast. During an economic expansion, service sector employment expands at a healthy pace. But, during recession, service sector employment will decline, particularly those segments of the industry that provide services to businesses, such as administrative and support services or professional, scientific, and technical services. This pattern is reflected in our current forecast. Service sector employment is projected to have grown 1.8% in 2008, but will decline by 1.0% in 2009. Then, service sector job growth will rebound as the economy exits recession, and 2.3% job growth is anticipated for 2010.

Most portions of the service sector will follow this pattern of job loss in 2009, and job growth in 2010. Business services such as management of companies, administration and support services, and professional, scientific, and technical services are all expected to shed employment in 2009. Job losses also are anticipated in leisure related services such as arts, entertainment, and recreation, accommodations, and eating and drinking places. The decline in eating and drinking places will occur as households substitute home cooked meals for dining out, or substitute less expensive fast food for sit down meals. Employment growth is expected to return in 2010, however, given the strong long-run growth prospects for these industries. Growth in leisure related industries is aided by long-term demographic trends, particularly increasing leisure time and disposable income among retired and “baby-boomer” age groups.

Health care is the one services sector expected to grow even during the recession. Health care job growth is expected to be 1.5% during 2009. Industry employment continues to expand as an aging population requires more health care services, and as innovation in the industry continually adds new treatments and products. Further, the sector may be aided by the implementation of Federal Government policy to provide broader health insurance coverage and other health care initiatives. Finally, solid health care growth is expected even in difficult times since health care is a necessity rather than discretionary spending that can be curtailed during times of economic stress.

Government

We project no change in federal government employment in 2008. However, employees will be added in 2009 and 2010 in order to conduct the decennial Census. We expect a 2% increase in 2009 and a 3% increase in 2010. Slow growth is anticipated for state and local government employment. Job growth was 0.2% in 2008 and a similar rate of growth is expected for 2009. This unusually weak rate of growth is due to anemic growth in government tax revenue. In 2008 and 2009, the value of existing properties will be flat, or even down slightly. Further, relatively few new homes will be built in both years. Both factors portend slow growth in local property tax revenue. At the same time, sales and income tax revenue will grow little faster than inflation in 2009. Job growth will return to the trend rate of 1.0% in 2010. This trend is achieved in most years as there is a steady increase in the need for teachers, police, fire, and other employees who work directly with the public. This need rises as the state's population rises steadily, and as rising real incomes lead to new demand for government services.

Personal Income

With employment declining, we anticipate that nonfarm income will grow by just 2.6% in 2009. Growth in other years will be moderate and in line with our previous forecast. There are, however, major revisions in our farm income forecast. With falling crop prices in late 2008, we now expect a smaller increase in 2008 farm income. Further, farm income will fall rapidly in 2009. However, in both 2009 and 2010, farm income will remain solid, near average levels for the 2003 through 2006 period.

Table 4— Comparison of Forecasts for Nominal Income

Nonfarm Income		
	June 2008 Forecast	Current Forecast
2007	5.8%	6.3%
2008	4.9%	4.6%
2009	4.8%	2.6%
2010	4.8%	4.8%

Farm Income		
	June 2008 Forecast	Current Forecast
2007	39.4%	70.1%
2008	24.7%	15.6%
2009	-9.3%	-26.1%
2010	-2.4%	3.4%

Note: Nominal income growth includes inflation.

Nonfarm Personal Income

Nonfarm personal income growth will be slow in 2009, as would be expected for a state economy that is in recession. In particular, growth in nonfarm personal income is expected to slow to 2.6% in 2009.

As seen in Table 5, we expect nonfarm wages and salaries to grow by 4.2% in 2008, just 2.3% in 2009 and 4.3% in 2010. Employee benefits (other labor income) are expected to grow 1% faster on average than wage and salary income. Changes in other labor income are primarily driven by increasing health care costs. Both wage and benefit costs are expected to grow more slowly in a “weak” labor market in late 2008 and 2009 where unemployment is higher and there are fewer job openings.

Recession in 2009 will lead to a decline in non-farm proprietor income in that year. Profit income is very sensitive to fluctuations in the business cycle. Growth in dividend and interest income also will be anemic in 2009 given low interest rates.

As is often the case, transfer income will continue to grow at a solid pace even during recession. Transfer income is expected to grow by 7.4% in 2008, 5.1% in 2009, and 6.0% in 2010. All of these growth rates are well above the expected rate of inflation.

Farm Income

In extremely volatile economic times, Nebraska's agricultural sector will probably reach a new record high net farm income for 2008. But despite this situation, there are considerable mixed messages imbedded in the aggregate measure, and even more cautionary flags as we look towards the coming years.

As noted in Table 5, the forecasted income for 2008 will be in the \$3.9 billion range, which would be more than 60% higher than the most recent 10-year average. The preponderance of this advance shows up in the crop sector which helped to propel total agricultural sector cash receipts for 2008 to over \$18 billion – nearly double the level of the year 2000. Record U.S. agricultural exports underlie this surge, in concert with a rapidly expanding ethanol industry.

Table 5—Nonfarm Personal Income and Selected Components and Net Farm Income (USDA) (\$ millions)

	Consumer Price Index	Nonfarm Personal Income	Dividends, Interest, & Rent	Total Personal Current Transfer Receipts	Nonfarm Wages & Salaries (Wages & Salaries — Farm Wages)	Other Labor Income	Contributions to Social Insurance	Residential Adjustment	Nonfarm Proprietor Income	Net Farm Income (USDA)
Millions of Dollars										
1998	163.0	\$41,591	\$9,096	\$5,477	\$23,343	\$4,744	\$3,686	-\$684	\$3,300	\$1,816
1999	166.6	\$43,644	\$9,148	\$5,822	\$24,796	\$4,999	\$3,874	-\$762	\$3,517	\$1,707
2000	172.2	\$46,366	\$9,991	\$6,075	\$26,186	\$5,317	\$4,032	-\$825	\$3,654	\$1,444
2001	177.1	\$48,102	\$9,998	\$6,667	\$26,908	\$5,612	\$4,200	-\$833	\$3,952	\$1,904
2002	179.9	\$49,730	\$10,023	\$7,069	\$27,713	\$6,362	\$4,350	-\$869	\$3,782	\$859
2003	184.0	\$51,441	\$10,002	\$7,426	\$28,688	\$6,753	\$4,520	-\$911	\$4,003	\$2,735
2004	188.9	\$53,547	\$9,835	\$7,710	\$30,051	\$7,181	\$4,724	-\$933	\$4,428	\$3,546
2005	195.3	\$55,800	\$10,062	\$8,122	\$31,306	\$7,606	\$4,970	-\$946	\$4,619	\$2,923
2006	201.6	\$58,869	\$10,618	\$8,703	\$33,014	\$7,874	\$5,304	-\$934	\$4,898	\$1,994
2007	207.3	\$62,584	\$11,697	\$9,183	\$34,829	\$8,133	\$5,512	-\$990	\$5,244	\$3,392
Forecast Number										
2008	215.3	\$65,471	\$12,118	\$9,861	\$36,285	\$8,472	\$5,628	-\$1,036	\$5,400	\$3,922
2009	218.5	\$67,145	\$12,481	\$10,360	\$37,116	\$8,795	\$5,822	-\$1,063	\$5,278	\$2,900
2010	224.0	\$70,377	\$13,204	\$10,980	\$38,701	\$9,248	\$6,153	-\$1,105	\$5,502	\$3,000
Forecast % (nominal growth)										
2008	3.9%	4.6%	3.6%	7.4%	4.2%	4.2%	2.1%	4.7%	3.0%	15.6%
2009	1.5%	2.6%	3.0%	5.1%	2.3%	3.8%	3.4%	2.5%	-2.3%	-26.1%
2010	2.5%	4.8%	5.8%	6.0%	4.3%	5.2%	5.6%	4.0%	4.2%	3.4%

Source: <http://www.bea.gov>, 2008

Note: Nominal income growth includes inflation.

What is noteworthy, however, is the meltdown of commodity prices in the last quarter of the year. Market prices of the major crops have fallen backward to nearly half of the mid-year peak, as the U.S. and global recession has intensified. Clearly what could have been a phenomenal 2008 income level for the state farm sector has been reduced by 10% or more by these recent economic forces.

In short, both the speed and depth of the global recession has caught the State's farm sector by surprise. World food demand has fallen and the ethanol industry has plunged into unprofitable times with falling oil prices. Concurrently, key input costs have risen, particularly for the crop sector, while the livestock sector faces weaker domestic demand and continuing tight margins. Producers across the board now are facing considerable uncertainty going into 2009 and beyond.

While the fundamental forces of food and fuel demand continue regardless of economic times, we may not yet understand the magnitude of the curtailment of demand that could occur, both within the United States and internationally. Certainly, the economic expansion of rapid growth that was occurring in recent years is now on the side tracks if not derailed for the foreseeable future. All this points to a much more muted and cautious future for the agricultural sector in a strong agricultural state like Nebraska. We expect that annual farm incomes in 2009 and 2010 will return closer to 10-year average levels, but there is considerable downside uncertainty in our forecast. Agriculture, along with manufacturing, is the sector that we have downgraded most precipitously in our current forecast. We believe that both industries have a strong future in Nebraska but both will suffer during the current global economic recession, and even in the initial period of recovery from recession.

Net Taxable Retail Sales

In Table 6, data on net taxable retail sales are divided into motor vehicle sales and non-motor vehicle sales. The distinction is important. Motor vehicle net taxable sales are growing over time, but from year to year follow a cyclical pattern. Non-motor vehicle taxable sales rise steadily, but are affected by business cycles and periodic changes to Nebraska's sales tax base.

Table 6 shows non-motor vehicle taxable sales over the 2008 to 2010 period. With a weak economy, especially in the second half of the year, non-motor vehicle taxable sales will grow at just 2.7% in 2008, well below the rate of inflation. This discrepancy also occurs because gasoline and most groceries are not subject to the sales tax, and these goods were large contributors to the spike in inflation in 2008. Growth in non-motor vehicle taxable sales will be just 2.6% in 2009. This weak growth is expected with Nebraska shedding employment in 2009. Growth of 4.5% is expected in 2010 with the economy in recovery.

Motor vehicle net taxable sales, always very cyclical, began a sharp turn-around in 2007, growing by 9% after years of decline. Growth will moderate in 2008, when motor vehicle taxable sales are expected to grow by 4.1%. Given the cyclical nature of motor vehicle net taxable sales in Nebraska, a slowdown would be expected after two such strong years of growth. This is especially true given the current weakness in automobile sales that is so significant throughout the United States. Motor vehicle net taxable sales are expected to grow by just 0.9% in 2009 and by just 0.6% in 2010.

Overall growth in net taxable sales (from both sources) is expected to reach 2.9% in 2008. This is below the estimated inflation rate of 3.9%. Growth will decelerate to just 2.4% in 2009 as the Nebraska economy contracts. Growth in net taxable sales is expected to reach 4.0% in 2010. The State of Nebraska therefore will not see a solid year for real sales tax growth until 2010.

Table 6—Net Taxable Retail Sales, Annual Totals (\$ millions)

	Consumer Price Index	Total Net Taxable Sales	Motor Vehicle Net Taxable Sales	Non Motor Vehicle Net Taxable Retail Sales
Millions of Dollars				
1998	163.0	\$19,005	\$2,417	\$16,588
1999	166.6	\$19,806	\$2,520	\$17,286
2000	172.2	\$20,443	\$2,605	\$17,838
2001	177.1	\$21,057	\$2,897	\$18,160
2002	179.9	\$21,426	\$2,926	\$18,500
2003	184.0	\$22,092	\$2,894	\$19,199
2004	188.9	\$23,618	\$2,885	\$20,733
2005	195.3	\$24,443	\$2,751	\$21,691
2006	201.6	\$24,978	\$2,661	\$22,317
2007	207.3	\$26,237	\$2,902	\$23,335
Forecast Number				
2008	215.3	\$26,989	\$3,021	\$23,968
2009	218.5	\$27,634	\$3,049	\$24,585
2010	224.0	\$28,752	\$3,068	\$25,685
Forecast % (nominal growth)				
2008	3.9%	2.9%	4.1%	2.7%
2009	1.5%	2.4%	0.9%	2.6%
2010	2.5%	4.0%	0.6%	4.5%

Source: Nebraska Department of Revenue, 2008

Note: Nominal taxable sales growth includes inflation.

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