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### Risk and Recovery

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# Business in Nebraska

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## RISK AND RECOVERY

*By the Nebraska Business Forecast Council*

### U.S. Macroeconomic Outlook

**T**he crisis in the housing and financial sectors has led to a dramatic slowdown in U.S. economic growth. Fourth quarter GDP growth and job growth are expected to be anemic and the economy may fall into recession in 2008. Indeed, several of the dozen members of the Nebraska Business Forecast Council do believe that the U.S. economy will likely slip into recession during 2008. However, the overall consensus of the Council is that the U.S. economy will avoid a recession. Economic growth will be slow in the first three quarters of 2008 before recovering in late 2008 and 2009.

The reasons for concern about the economy are well understood. There has been a decline in both new home construction and the sales of existing homes. Housing permits and starts are each down by approximately 25% in 2007. This decline has had a ripple effect not only in construction but in related industries such as real estate, and segments of manufacturing and finance.

Rising mortgage delinquencies, particularly for sub-prime mortgages have led to stress at many financial institutions. This has led some financial institutions to cut back on lending. Recent evidence suggests that weakness in selected industries and these concerns about credit may have slowed consumer spending and lead to a decline in manufacturing activity. Rising oil and gasoline prices also have limited consumer income available to spend on other goods and services. The combined force of all of these factors is what has caused economic growth to slow and raised legitimate concerns that the economy could fall into recession.

However, there is also a case to be made for continued economic growth in 2008. First the housing crisis, while significant, is limited to only a portion of the economy. This may explain why total employment has continued to grow through the end of 2007, at least according to preliminary estimates. Secondly, a weak U.S. dollar has led to a substantial improvement in exports, and an overall improvement in the nation's trade deficit, which supports growth. The third and final reason is the Federal Reserve Bank has shown a willingness to cut interest rates, or take other actions to improve liquidity. Not everyone has been satisfied with the pace of the Fed's actions but the institution stands willing to make further cuts in short-term interest rates in 2008.

Nationwide in 2007, non-farm job growth is thought to have expanded by 1.2 percent. Job growth is expected to slow to 0.9 percent in 2008 before bouncing back to 1.7 percent growth in 2009 as the economic growth accelerates again. Growth in real (inflation-adjusted) gross domestic product (GDP) is expected to have been 2.5 percent in 2007. The rate of growth will dip in the first half of 2008. Overall real GDP growth is expected to be 2.2 percent in 2008. Growth in real gross domestic product will improve in 2009 as the economy recovers, to 3.1 percent.

As noted earlier, there is a significant chance, approaching 40 percent that the economy will fall into recession in 2008. If this occurs, job growth is expected to be negative during 2008. This is not the Council's expectation but it is a possibility.

## Nebraska Outlook



iven strength in the commodity sector, and related industries such as manufacturing and transportation, the panel remains optimistic about the outlook for the Nebraska economy. In

fact, the Nebraska economy is expected to outperform the national economy. Employment will continue to expand in Nebraska. Aggregate farm income grew rapidly in 2007 and farm income is expected to remain high in 2008 and 2009.

**Table 1— Key Economic Growth Rates**

	Non-farm Employment	Non-farm Personal Income (nominal)	Net Farm Income (nominal)
2005	1.4%	4.8%	-24.7%
2006	1.3%	6.3%	1.2%
2007	1.6%	6.0%	35.2%
2008	1.1%	5.3%	5.5%
2009	1.7%	5.8%	1.3%

Note: nominal income growth is the sum of real income growth and the inflation rate.

Both employment and income growth is expected to be weak in 2008, before recovering in 2009. Growth was solid in 2007 as well, though a bit weak as the economy slowed in late 2007. A summary of the Nebraska outlook is reported in Table 1.

### Employment

Nebraska employment will continue to grow through 2009, but the pace of employment growth will slow significantly in 2008 as the economy slows. The construction sector will be weak in both 2007 and 2008. Despite overall weak conditions in the economy, sectors such as transportation will benefit from nationwide strength in the commodity sectors such as agriculture and mining. As is seen in Table 2, this outlook is similar to our previous outlook from June 2007, except that the outlook for job growth in 2008 is significantly lower.

**Table 2— Comparison of Non-Farm Employment Forecasts**

	June 2007 Forecast	Current Forecast
2007	1.4%	1.6%
2008	1.8%	1.1%
2009	1.9%	1.7%

## Construction and Mining

Despite the onslaught of negative news at the national level, Nebraska construction activity is holding its own. While the state’s housing industry has contracted slightly, increases in nonresidential building activity have more than offset the downturn. Preliminary data for 2007 suggests that total construction activity in the state will increase by one-half percent from that of 2006. Expect another small increase in 2008, again due to a weak housing sector. Once the state’s housing activity begins to increase in 2009, total construction activity should begin to return to its historic rates of growth. For 2009 expect an increase of 2.0 percent.

As in most parts of the Midwest, housing construction in Nebraska did not boom as much as on the east and west coasts of the country. Nevertheless, inventories of completed and unsold units in Nebraska are high. It may well be the summer of 2008 before inventories are brought under control. Thus a turnaround in activity may not occur until late 2008. Thereafter demographic and financial conditions should drive the rate of growth in homebuilding. Fortunately Nebraska lenders are and have been more conservative than their national counterparts, and remain in solid shape to meet demand for mortgages by qualified borrowers.

Nonresidential building construction is doing well in comparison to the housing sector. Builders and designers are moderately busy with lists of upcoming projects. Activity is not restricted to Nebraska’s metropolitan areas, but is spread across the state. Fiscal considerations will likely limit growth in the other main component of Nebraska construction activity: road construction. Flat fuel tax revenues, due to high fuel prices, have limited available funding.

### Manufacturing

Preliminary manufacturing employment data for 2007 suggest slow growth in the durable goods manufacturing sector. Slow growth of 0.2 percent is expected in 2008 and 0.3 percent in 2009. Strong crop prices continue to benefit Nebraska’s farm machinery, equipment manufacturing, and fabricated metal products manufacturing sectors. However, the motor vehicle parts, and miscellaneous manufacturing sectors are likely to experience declines in employment.

**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
1997	857.1	40.9	57.3	55.4	41.2	105.3	41.6	25.1	55.7	283.5	16.1	136.1
1998	879.9	42.4	58.5	55.9	42.2	107.5	43.3	26.3	58.8	294.2	16	134.9
1999	897.4	44.3	57.7	55.7	42.5	110.2	44.5	27.1	60.9	303.1	15.9	135.6
2000	914.0	45.2	58.9	55.4	41.9	111.3	45.1	26.9	60.5	314.3	16.6	137.9
2001	919.7	45.3	54.6	56.2	42.5	110	45.2	25.8	60.2	323	16	140.8
2002	911.5	46.1	50.6	55.4	41.5	108.5	44.9	23.2	61.4	321.2	16.3	142.6
2003	914.2	47.4	47.3	55.1	41	106.7	46.4	21.5	62.4	327.3	16.7	143.1
2004	922.3	48.4	47.0	54	40.8	106.5	48.9	21.1	63.2	332.2	16.5	143.6
2005	935.0	47.8	48.4	52.9	40.6	107	52.3	20.2	64.5	340.1	16.3	144.9
2006	946.9	48.4	49.5	52.2	40.8	106.5	53.4	19.5	65.7	348.5	16.2	146.2
<b>Forecast Number</b>												
2007	962.3	48.6	49.6	52.5	41.0	107.7	54.9	19.5	66.4	358.3	16.2	147.7
2008	973.2	48.9	49.7	52.7	41.0	108.3	56.3	19.4	67.0	364.7	16.2	148.8
2009	989.3	49.9	49.9	53.0	41.1	109.4	57.9	19.4	68.4	373.8	16.2	150.3
<b>Forecast Number</b>												
2007	1.6%	0.5%	0.3%	0.6%	0.5%	1.1%	2.8%	-0.2%	1.0%	2.8%	0.0%	1.0%
2008	1.1%	0.5%	0.2%	0.4%	0.0%	0.6%	2.5%	-0.1%	1.0%	1.8%	0.0%	0.8%
2009	1.7%	2.0%	0.3%	0.6%	0.2%	1.0%	2.9%	-0.2%	2.0%	2.5%	0.0%	1.0%

Source: <http://data.bls.gov/cgi-bin/dsrv>, 2007

In the case of non-durable manufacturing, preliminary data suggest that the sector grew by 0.6 percent in 2007. An annual growth rate of 0.4 percent is expected in 2008 and 0.6 percent in 2009. Employment recovery and growth in Nebraska's food processing sector and increased capacity and production in its ethanol industry will be the major contributors to sustained employment growth in non durable goods manufacturing. One key factor is that beef sales to Asia are expected to improve during the period.

Finally, two other trends are expected to impact the manufacturing industry. A weak dollar is expected to improve exports and potential for foreign direct investment. At the same time, labor supply constraints, particularly in nonmetropolitan Nebraska, may limit growth.

### Transportation and Warehousing

Employment growth in 2007 in the Nebraska transportation and warehousing sector has proven to be less robust than originally thought. Trucking employment has grown little due to reduced demand for

construction materials, slow growth in imports (due to the declining dollar), and a general reduction in goods shipments as the economy has slowed. However, other segments of the industry have done well. The rail sector has been aggressively hiring to rebuild its workforce in response to growing exports (exports are said to favor rail, and imports to favor trucking). Warehousing employment also continues to gain.

Overall, transportation and warehousing employment is expected to have grown by 2.8% in 2007. Growth will continue at a similar rate in 2008 and 2009 as growth accelerates in trucking but moderates in other portions of the industry. Factors such as favorable demographics and infrastructure, low entry costs, and state economic development efforts will aid growth in the industry.

### Wholesale Trade

Wholesale trade employment in Nebraska has grown little over the last decade, despite a growing economy in the state. Such a pattern is characteristic of industries with rising labor productivity, where rising productivity causes employment to remain steady even as total

industry activity increases. The industry is expected to add employment in 2007 and 2009, but growth will be modest. Preliminary data suggests that industry employment grew by 0.5 percent in 2007. Industry employment is expected to be flat in 2008 and grow by just 0.2% in 2009.

## Retail Trade

Employment in the retail trade industry is very sensitive to retail sales growth. Further, long term trends have lead to increased labor productivity in the industry, generally dampening employment growth. These trends include the tendency of larger retailers to capture a growing share of the market and the increased sales by on-line and other nontraditional retailers. Retail employment has declined earlier in the decade, including a 1.2 percent decline in 2001, a 1.4 percent decline in 2002, and a 1.7 percent decline in 2003. Industry employment stabilized in recent years, but employment growth has only just returned. Retail employment is expected to have increased by 1.1 percent in 2007. The rate of growth is forecast to slow to 0.6 percent in 2008 and improve to 1.0 percent in 2009.

## Information

The information industry contains a diverse group of industries including newspapers, movie theatres and sound studios. These locally-oriented portions of the industry are stable. The industry also contains high technology or information processing industries such as telecommunications, data processing, web site development, and web publishing. These industries have consolidated and downsized in recent years, losing 6,000 jobs since 2001. We anticipate the loss of another hundred additional jobs in 2007, 2008 and 2009.

## Financial Services

The financial services industry comprises finance, insurance, and real estate. The industry has grown consistently over the last 10 years, but segments of the industry such as real estate, loan activity, and mortgage brokers are being negatively impacted by weakness in the housing sector. For this reason, relatively weak growth is expected in 2007 and 2008. Overall industry job growth will reach 1.0% in 2007 and 2008. Growth will return to the long-term trend rate in 2009, with 2.0% growth.

## Services

Accounting for one-third of employment in the economy, the diverse and rapidly growing service industry is key to our employment forecast. As is evident in Table 3, 65,000 of the approximately 90,000 jobs added to the Nebraska economy from 1997 to 2006 were added in the services sector. When service sector employment grows by more than 2 percent, as it has in the last few years, total Nebraska employment growth handily exceeds 1 percent.

Despite weakness in the overall economy during the second half of 2007, we anticipate that the industry grew in 2007, by 2.8 percent. Employment growth is expected to fall to just 1.8 percent in 2008 before recovering to 2.5 percent growth in 2009. Job growth is expected even in difficult times because the services industry contains one of the largest and most rapidly growing portions of the economy: health services. Other portions of the services industry include professional and business services, education services, personal services, accommodations, food and drinking places, and arts, entertainment, and recreation.

Health care and social assistance comprises the largest part of the services industry and expands steadily as Nebraska's population grows and ages. Ambulatory health care services such as home health care services, ambulance services, blood donor stations, and health screening services are the fastest growing portions of health care. One weak point is the relatively small social assistance part of the industry which has lost employment in 2007. Health care and social assistance employment will grow by about 2.5 percent each year during the forecast period, employing 118,000 Nebraskans by 2009. Food services and drinking places is another industry that consistently generates job growth as population grows, and households spend more of their rising disposable income on dining out. Employment will grow by 2.0 percent per year.

Business and professional services is the pro-cyclical portion of the services industry. Growth in this sector will be weakest in 2008 as the economy slows, but should recover in 2009. The industry contains high wage occupations such as management, legal services, accounting and bookkeeping, architecture and engineering, computer systems design, management consulting, advertising, and market research.

## Government

Our outlook calls for no change in federal government employment through 2009. However, steady growth is expected in state and local government employment, following recent trends. Growth in state and local government employment has tended to exceed, though only slightly, the rate of population growth in Nebraska. State and local government employment historically has grown 1% per year on average, as the need for teachers, police, fire, and other state and local employees who work directly with the public rises with population. Also, as incomes rise, the demand for government services per person also rises. Growth is steady, and not closely tied to business cycles, so solid growth is expected for 2007, 2008, and 2009. Our expectation is that state and local government employment will grow 1.0 percent in 2007. Growth will dip to 0.8 percent in 2008 as the economy slows and budgets tighten but recover to 1.0 percent growth in 2009.

## Personal Income

Personal income growth will be solid in Nebraska over the outlook period, though non-farm income growth will moderate as the economy slows in 2008. Farm income growth was very strong in 2007 and modest gains are anticipated for 2008 and 2009. Table 4 below compares the current forecast for the two major components of personal income to our June 2007 forecast. Non-farm income growth slows significantly in 2008 as the economy slows. The outlook for farm income is even stronger than in the previous outlook.

**Table 4— Comparison of Forecasts for Nominal Personal Income**

Non-Farm Personal Income		
	June 2007 Forecast	Current Forecast
2007	5.8%	6.0%
2008	6.3%	5.3%
2009	6.5%	5.8%

  

Farm Income		
	June 2007 Forecast	Current Forecast
2007	27.8%	35.2%
2008	2.9%	5.5%
2009	2.8%	1.3%

Note: nominal income growth is the sum of real income growth and the inflation rate.

## Non-Farm Personal Income

Non-farm personal income is expected to moderate as economic growth slows. In particular, non-farm personal income growth is expected to slow in 2008 before recovering in 2009. The largest component of non-farm income, wage and salary income, will rise at a slower pace in 2008 as the rate of job growth declines. A weak labor market also will limit growth in wages per job in 2008.

As seen in Table 5, we expect non-farm wages and salaries to grow by 5.1 percent in 2007 slow to 4.6 percent growth in 2008 and snap back to 5.2 percent in 2009. Employee benefits (other labor income) are expected to grow by 6.1 percent to 6.9 percent each year. Changes in other labor income are primarily driven by increasing health care costs.

Slower economic growth in 2008 is expected to impact growth in both non-farm proprietor income and dividend, interest, and rent income. Profits are very pro-cyclical. As a result, non-farm proprietor income growth will slow as the economy slows in 2008. Non-farm proprietor income is expected to have increased by 7.1 percent in 2007, but the rate of growth will decline to 5.6 percent in 2008. The rate of growth in non-farm proprietor income will increase to 7.2 percent in 2009.

Declining profits will affect dividend, interest, and rental income as well. Declining profits will lead some firms to cut their dividend payment to their stockholders. Interest rates on certificates of deposits, money market funds, checking accounts, and other interest bearing accounts also decline as the economy weakens. This is because falling slowing economic growth reduces future inflationary pressures. Lower inflationary pressures mean lower nominal interest rates. All of these factors create an expectation of modest growth in dividend, interest, and rent income. Growth is expected to have reached 6.0 percent in 2007, but will decline to 5.0 percent in 2008. Growth is expected to be 5.5 percent in 2009.

**Table 5—Non-farm Personal Income and Selected Components and Net Farm Income (USDA) (\$ millions)**

	Consumer Price Index	Non-farm Personal Income	Dividends, Interest, & Rent	Total Personal Current Transfer Receipts	Non-farm Wages & Salaries (Wages & Salaries — Farm Wages)	Other Labor Income	Contributions to Social Insurance	Residential Adjustment	Non-Farm Proprietor Income	Net Farm Income (USDA)
<b>Millions of Dollars</b>										
1997	160.5	\$39,053	\$8,272	\$5,132	\$22,236	\$4,456	\$3,462	-\$653	\$3,073	\$2,023
1998	163.0	\$41,932	\$9,096	\$5,477	\$23,684	\$4,744	\$3,686	-\$684	\$3,300	\$1,816
1999	166.6	\$43,966	\$9,148	\$5,822	\$25,117	\$4,999	\$3,874	-\$762	\$3,517	\$1,707
2000	172.2	\$46,719	\$9,991	\$6,075	\$26,540	\$5,317	\$4,032	-\$825	\$3,654	\$1,440
2001	177.0	\$48,511	\$9,998	\$6,667	\$27,316	\$5,612	\$4,200	-\$833	\$3,952	\$1,894
2002	179.9	\$50,103	\$10,023	\$7,069	\$28,086	\$6,362	\$4,350	-\$869	\$3,782	\$857
2003	184.0	\$51,863	\$10,002	\$7,426	\$29,110	\$6,753	\$4,520	-\$911	\$4,003	\$2,785
2004	188.9	\$54,028	\$9,835	\$7,742	\$30,497	\$7,181	\$4,724	-\$930	\$4,428	\$3,542
2005	195.3	\$56,622	\$10,373	\$8,130	\$31,692	\$7,640	\$4,960	-\$940	\$4,687	\$2,667
2006	201.6	\$60,207	\$11,392	\$8,853	\$33,349	\$8,028	\$5,287	-\$982	\$4,855	\$2,700
<b>Forecast Number</b>										
2007	207.4	\$63,811	\$12,075	\$9,517	\$35,059	\$8,560	\$5,559	-\$1,042	\$5,201	\$3,650
2008	212.6	\$67,205	\$12,679	\$10,183	\$36,681	\$9,084	\$5,816	-\$1,101	\$5,493	\$3,850
2009	217.9	\$71,087	\$13,377	\$10,845	\$38,574	\$9,689	\$6,116	-\$1,169	\$5,887	\$3,900
<b>Forecast % (nominal growth)</b>										
2007	2.9%	6.0%	6.0%	7.5%	5.1%	6.6%	5.1%	6.1%	7.1%	35.2%
2008	2.5%	5.3%	5.0%	7.0%	4.6%	6.1%	4.6%	5.6%	5.6%	5.5%
2009	2.5%	5.8%	5.5%	6.5%	5.2%	6.7%	5.2%	6.2%	7.2%	1.3%

Source: <http://www.bea.gov>, 2007

Note: nominal income growth is the sum of real income growth and the inflation rate.

## Farm Income

Rising grain prices over the past year and good crop yield levels lead to a sharp increase in farm income in 2007. These price increases have been driven by the dramatic expansion of ethanol production in America's heartland. This has led directly to rapid increases in corn prices, and corn acreage. More generally, a weak U.S. Dollar has helped with farm exports. Further, ethanol production and higher corn prices and a weak dollar are expected to be maintained throughout the outlook period. Nebraska's prominence in corn production combined with the complement of being a major cattle feeding state makes the state well situated to capture economic opportunities in ethanol production. This is because distiller's grain, a cattle feed, is a by-product of ethanol production. Areas with both corn and feeder cattle production have a competitive advantage as a location for ethanol plants. The price of farm inputs will rise with crop prices. Our outlook for farm income accounts for this increase. High incomes will be maintained in 2008 and 2009.

While income from crop production will increase, income from livestock production is expected to remain steady. Higher production costs for livestock producers will in part be passed on to final consumers and exports. Further, the cattle industry is going through a transition as cattle feeders adjust to greater reliance on distiller's grain in their rations. As a result, Nebraska producers have a distinct advantage over other major cattle feeding states. The state's cattle industry could even experience some future production expansion given the synergy between corn-based ethanol production and feedlots. NIMBY<sup>1</sup> issues may limit the location of feedlots in some areas of Nebraska, however. Nebraska farm income is expected to have jumped by 35 percent in 2007. Nebraska farm income is expected to grow by 5.5 percent in 2008 and 1.3 percent in 2009. This will all occur despite a substantially lower direct government payments.

<sup>1</sup> Not in My Backyard



## 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 very cyclical pattern. Non-motor vehicle taxable sales rise steadily, but are affected by periodic changes to Nebraska's sales tax base.

Table 6 shows growing non-motor vehicle taxable sales over the 2007 to 2009 period. Current year to date non-motor vehicle net taxable sales suggest an estimated increase of 4.8 percent for 2007 as a whole. In 2008, growth is projected to be 3.3 percent, due to slower economic growth and the repeal of the tax on contract labor. Growth will rebound to 4.9 percent in 2009.

Motor vehicle net taxable sales have undergone a sharp turn-around in 2007 after years of decline. Growth is expected to reach 6.7 percent. For 2008 and 2009 only moderate growth is expected. Automotive sales are expected to increase by 3.7 percent and 3.1 percent, respectively.

Overall growth in net taxable sales is expected to reach 5.0 percent in 2007. This is well above the inflation rate of approximately 3 percent. Growth is expected to fall to 3.3 percent in 2008, as economic growth declines. But, net taxable sales will rebound as the economy rebounds in 2009. Growth in net taxable sales is expected to reach nearly 4.9 percent in 2009.

**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
<b>Millions of Dollars</b>				
1997	160.5	\$17,815	\$2,205	\$15,610
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	177.0	\$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
<b>Forecast Number</b>				
2007	207.4	\$26,228	\$2,839	\$23,389
2008	212.6	\$27,105	\$2,944	\$24,160
2009	217.9	\$28,380	\$3,036	\$25,344
<b>Forecast % (nominal growth)</b>				
2007	2.9%	5.0%	6.7%	4.8%
2008	2.5%	3.3%	3.7%	3.3%
2009	2.5%	3.7%	3.1%	4.9%

Source: Nebraska Department of Revenue

Note: nominal taxable sales growth is the sum of real growth and the inflation rate.

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Serving this session were

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