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Manufacturing Rebounds

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Manufacturing Rebounds

By The Nebraska Business Forecast Council

U. S. Economic Outlook

National economic conditions will continue to favor growth over the next three years, including sustained increases in manufacturing employment. Higher energy prices, particularly for oil, gasoline, and natural gas, will impact the economy, but probably only will moderate economic growth rather than cause a significant slowdown.

After rapid growth in 2004 and 2005, growth in real gross domestic product is expected to moderate in 2006-2008, due to higher long-term interest rates as well as higher energy prices. Real gross domestic product will grow 3 percent in 2006 and fall to 2.5 percent growth in later years. The housing market will be another factor weighing on the economy. New housing starts are expected to moderate in 2006 through 2008, falling from record levels in 2005.

Growth in gross domestic product will be strong enough to sustain employment growth at a steady 1.5 to 1.7 percent rate, which is in line with recent job growth. The rate of inflation will hit 3.5 percent to 4.0 percent in 2006, but is expected to moderate to around 2.5 percent to 3.0 percent in 2007 and 2008. More rapid inflation, however, remains the main risk to the forecast. Recent energy price increases, which are likely to be sustained, may continue to filter through the economy. This could cause broad-based price increases. There also is a possibility that energy prices

could rise even more, causing higher inflation, and further restricting economic growth. The likelihood of such a high inflation scenario will decline, however, if the Federal Reserve continues to raise short-term interest rates and use other monetary policies to reduce inflation. The new Federal Reserve Board head, Ben Bernanke, appears willing to do so.

Nebraska Outlook

Overview

Given these expectations for the national economy, the panel is optimistic about the outlook for the Nebraska economy. Job growth should continue at a steady pace in 2006, 2007, and 2008. After years of decline, manufacturing employment should grow steadily in 2006, with further gains in 2007 and 2008.

Moderate employment growth will help ensure growth in both income and taxable sales in Nebraska. Growth in nominal income also should be strong as inflation increases. Rising prices also mean rising costs, however, so rapid income growth may not necessarily translate into large improvements in the standard of living or in state and local government budgets. A summary of the Nebraska outlook is reported in Table 1.

Table 1
Key Economic Growth Rates

	Nonfarm Employment	Nonfarm Personal Income	Net Taxable Retail Sales
2005	1.5%	5.2%	3.5%
2006	1.7%	6.4%	2.8%
2007	1.7%	5.8%	3.9%
2008	1.8%	5.5%	4.5%

Employment

Employment growth in Nebraska accelerated in 2005. After growing at a 0.9 percent rate in 2004, employment increased 1.5 percent in 2005. Growth accelerated in 2005 because retail employment finally expanded after years of decline. The growth rate of service employment also accelerated in 2005. The pace of growth is expected to improve even further over the next three years. Job growth is anticipated to reach 1.7 percent or 1.8 percent. Expected strong growth in manufacturing employment will contribute greatly to the overall employment picture in Nebraska over the next three years. After years of decline or stagnation, manufacturing jobs are expected to expand between 1.5 percent and 2.5 percent annually from 2006 to 2008. Details about the outlook for individual industries are provided below.

Construction and Mining

After years of rapid growth, construction employment declined in Nebraska during 2005. The decline was fairly modest, and total employment in construction remains high by historical standards. But 2005 is the year when employment in the industry began to fall from the peak levels achieved in 2003 and 2004. More specifically, job loss in 2005 reflects the completion of a number of major construction projects in the Omaha area and the gradual slowing of the housing market that has occurred throughout the country. This retreat is expected to continue through 2006, with construction sector employment declining another 2 percent during the year, for a net decline of roughly 1,000 jobs. Construction industry employment is expected to stabilize in 2007 before growing at a modest 1 percent rate in 2008. One constant source of growth in the industry is expected to be highway and road construction. Employment in this part of the industry should continue to grow even as industry totals decline.

Manufacturing

Manufacturing employment is finally in for a recovery. The number of manufacturing jobs dropped by 12 percent in Nebraska between the years 2000 and 2004, and only a few hundred jobs were added in 2005 due to an increase in employment among farm machinery and equipment manufacturers. This year, 2006, is the year that manufacturing employment will begin to rebound in earnest. Growth will be sustained through 2008. Manufacturing employment may not reach the high levels of 2000, but a modest rebound is expected. In particular, manufacturing employment is expected to grow at roughly 2 percent in 2006 and then to expand 1.5 percent in 2007 and 2008.

Job growth in manufacturing will be broad based, occurring in both durable and non-durable goods. Despite lay-offs at two Tyson Food plants, the food processing industry should add jobs. Ethanol production also should add some employment, though this industry is very capital intensive. These two sectors will underpin growth in non-durable goods employment. Durable goods employment will benefit from growth in industrial machinery, motor vehicle parts, and medical instruments.

Transportation

The rail and trucking industries will continue to grow at a strong pace in Nebraska. Rail will continue to bounce back from job cuts experienced between 2000 and 2003, adding several hundred workers in 2006. Trucking will continue its unbroken expansion over the last few decades. Nebraska firms and new start-ups will help the state gain an increasing share of a growing national market. Trucking continues to benefit from Nebraska's centralized location and a readily available workforce. The industry also will gain from continued efforts by the Nebraska economic development community to expand the state's warehousing and logistics sector. Industry employment is expected to expand 3.6 percent in 2006, with all aspects of the industry growing, and 3.0 percent in 2007 and 2008. In those years, growth will be concentrated in trucking. The industry should be able to expand job growth despite high fuel prices, but expansion will depend on continued growth in national industrial production.

Table 2

Number of Nonfarm Jobs and Percent Changes by Industry Annual Averages (numbers in 000s)

	Construction Minerals & Nonfarm Total	Natural Resources	Durables	Non- durables	Wholesale Trade	Retail Trade	Transportation & Utilities	Info	Finance	Services	Federal Gov't	State & Local Gov't
2000	914	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	326.8	16.7	143.1
2004	922.3	48.4	47	54	40.8	106.5	48.9	21.1	63.2	332.2	16.5	143.6
2005	935.8	47.5	48.3	53.2	40.6	107.1	52.3	20.4	64.5	340.7	16.3	145.0
2006	951.4	46.6	49.5	54.0	40.9	108.1	54.2	20.4	65.8	349.2	16.3	146.5
2007	967.4	46.6	50.3	54.8	41.3	108.9	55.8	20.5	67.2	357.9	16.3	147.9
2008	984.4	47.0	51.1	55.6	41.6	109.8	57.5	20.6	68.6	366.9	16.3	149.4

Recent Annual Percent Changes

2000	1.8%	2.0%	2.1%	-0.5%	-1.4%	1.0%	1.3%	-0.7%	-0.7%	3.7%	4.4%	1.7%
2001	0.6%	0.2%	-7.3%	1.4%	1.4%	-1.2%	0.2%	-4.1%	-0.5%	2.8%	-3.6%	2.1%
2002	-0.9%	1.8%	-7.3%	-1.4%	-2.4%	-1.4%	-0.7%	-10.1%	2.0%	-0.6%	1.9%	1.3%
2003	0.3%	2.8%	-6.5%	-0.5%	-1.2%	-1.7%	3.3%	-7.3%	1.6%	1.7%	2.5%	0.4%
2004	0.9%	2.1%	-0.6%	-2.0%	-0.5%	-0.2%	5.4%	-1.9%	1.3%	1.7%	-1.2%	0.3%
2005	1.5%	-1.9%	2.8%	-1.5%	-0.5%	0.6%	7.0%	-3.3%	2.1%	2.6%	-1.2%	1.0%
2006	1.7%	-2.0%	2.5%	1.5%	0.8%	0.9%	3.6%	0.0%	2.0%	2.5%	0.0%	1.0%
2007	1.7%	0.0%	1.6%	1.5%	0.8%	0.8%	3.0%	0.3%	2.1%	2.5%	0.0%	1.0%
2008	1.8%	1.0%	1.6%	1.5%	0.8%	0.8%	3.0%	0.5%	2.2%	2.5%	0.0%	1.0%

Various Percent Changes at Annual Rates

1990-1995	2.3%	4.7%	2.8%	2.0%	0.2%	1.4%	2.1%	0.7%	1.8%	3.7%	-2.0%	1.4%
1995-2000	2.3%	4.3%	1.2%	0.3%	1.1%	1.7%	3.3%	3.3%	2.5%	3.6%	0.2%	0.5%
1990-2000	2.3%	4.5%	2.0%	1.2%	0.7%	1.6%	2.7%	2.0%	2.2%	3.6%	-0.9%	1.0%
2000-2005	0.5%	1.0%	-3.9%	-0.8%	-0.6%	-0.8%	3.0%	-5.4%	1.3%	1.6%	-0.4%	1.0%

Retail Trade

The level of retail trade employment is sensitive to total sales in the industry. Employment growth will follow the pattern of net taxable sales, conditioned by the availability of workers. Employment in the industry also is depressed by the increasing tendency of larger retailers, which have higher levels of sales per worker, to capture more and more of total industry sales. Another factor is the increase of sales of non-traditional retailers (on-line sales). All of these factors led to a decline in retail employment in and around the recession of 2001. Retail employment declined 1.2 percent, 1.4 percent, and 1.3 percent, respectively, for the years 2001 through 2003 and did not grow in 2004. Retail employment began to grow again in Nebraska during 2005, when employment grew 0.4 percent. Growth is expected to accelerate to 0.9 percent in 2006, 0.8 percent in 2007, and 0.8 percent in 2008. While much improved, even these growth rates are

below the long-term growth rate of about 1.0 percent, suggesting that retail trade may no longer be the source of strong job growth that it was in previous decades.

Wholesale Trade

Expectations for wholesale trade are similar to those for retail trade. After several years of decline, the industry is expected to begin growing again in 2006. Growth is already evident in employment data for the first few months of 2006. Employment growth, at an annual rate of 0.8 percent, is expected to slightly exceed population growth throughout the 2006 to 2008 period.

Information

The information industry has gone through a sustained period of rapid job loss from 2000 through 2005.

Much of this large decline occurred in the telecommunications and data processing portions of the industry. As losses in these industries abate, growth should return to the industry due to slow expansion in locally-oriented sub-sectors such as newspapers and publishing and radio and television broadcasting. We expect that industry employment will be flat in 2006, before rising modestly in 2007 and 2008 based on the locally-oriented information businesses.

Financial

The financial industry comprises finance, insurance, and real estate activities. The sector has been an engine of growth in the Nebraska economy for decades, averaging 2.2 percent annual growth from 1990 to 2000, and expanding well since 2000, despite the recession of 2001. Conditions are favorable for continuing and broad-based improvement in the industry. While employment in the real estate portion of the industry may be flat due to a moderating housing market, finance and insurance are expected to grow. Banking and financial management has diversified and branched out considerably. The insurance industry continues to be a regional and national leader.

The industry is expected to expand at more than 2 percent per year during the forecast period. This would allow the industry to reach approximately 68,600 workers in 2008.

Services

The services industry is the largest and most diverse industry in the Nebraska economy. Services include health care and education services, professional and business services, management of enterprises, and leisure and hospitality, among others. Services also are the great engine of employment growth in the Nebraska and national economy. The services industry grew at a 2.6 percent rate during 2005, adding nearly 8,500 jobs. This was well over half of Nebraska's total job increase of 13,500 jobs that year. The industry is expected to grow at a similar 2.5 percent rate throughout the outlook period.

Growth will be especially strong in the health care portion of services. As Nebraska's population grows and ages, hospitals and other health and social services will steadily and sizably expand. In fact, the health

care industry may have difficulty finding enough skilled workers (such as nurses), as demand growth exceeds growth in supply. Professional, scientific, and technical services will be another rapidly growing part of services. The accounting, legal, computer, research, consulting, and advertising portions of this sub-sector are pro-cyclical (growth averaged 4.2 percent in 2004 and 2005) and should enjoy strong growth in the future. Accommodations and arts, entertainment, and recreation also are expected to experience above average growth due to rising discretionary incomes and aging of the population with more leisure time.

Among other industries, food services and drinking places are expected to grow at a healthy 2 percent rate during the outlook period. Administrative services and management of companies are expected to grow between 1.5 percent and 2.0 percent per year. Educational services (which include private schools and training facilities) is the only segment where employment may be flat or up only slightly.

Government

Total federal government employment in Nebraska has changed little over the last decade. No change is expected in the future. With large federal deficits, there is little room to expand employment outside of the homeland security arena.

Growth in state and local government employment is more predictable. Employment in education, parks, fire and police protection, and general services tends to expand steadily with population. Growth averages 1.0 percent per year, generally expanding with population, but at a slightly faster rate. Most of the growth occurs in local government, so even changes in state tax and spending practice typically do not influence job growth in the category. Our outlook is that state and local government employment will expand at 1 percent per year over the next three years. The major risk to the forecast lies with local government revenues. The cooling of the housing market suggests that property values may not rise as quickly as in recent years. The sales tax base also is being reduced in 2006. These factors could push employment growth in state and local government below the long-term average of 1 percent per year.

Non-farm Personal Income

Non-farm personal income grew at a solid 5.2 percent rate in 2005 and is forecast to grow at an even faster rate from 2006 to 2008. Improved income growth is consistent with the continued recovery in the state's employment, particularly job growth in higher wage sectors such as manufacturing. Overall non-farm personal income is forecast to grow at a 6.4 percent rate in 2006, at a 5.8 percent rate in 2007, and at a 5.5 percent rate in 2008. Inflation is the main reason for faster growth in 2006. Income will grow about 0.5 percent faster in 2006 because the rate of inflation is also expected to run 0.5 percent more in 2006 than in 2007 and 2008. A similar pattern is seen in wage and salary income, which is expected to grow 5.7 percent in

2006, before falling to 5.2 percent and 5.3 percent growth in 2007 and 2008.

Benefit income, listed as other labor income in Table 3, is expected to grow at a faster rate than wages and salaries. This is consistent with the notion that health and other benefits are taking up a rising share of employee compensation. Other labor income is expected to grow at a 6.7 percent rate in 2006 before slowing modestly in the 2007 and 2008. The strongest rates of growth will be seen in proprietor income. Proprietor income grows quickly during the expansion phase of the business cycle. The Nebraska economy will remain in the expansion phase.

Table 3
Nonfarm Personal Income and Selected Components and Net Farm Income (USDA)
(\$ millions)

	Nonfarm Personal Income	Nonfarm Wages & Salaries (Wages & Salaries—Farm Wages)	Other Labor Income*	Dividends, Interest, & Rent	Total Personal Current Transfer Receipts	Nonfarm Proprietor Income	Contributions to Social Insurance	Net Farm Income (USDA)
2000	\$46,386	\$26,206	\$5,317	\$9,991	\$6,075	\$3,654	\$4,032	\$1,398
2001	\$48,124	\$26,929	\$5,612	\$9,998	\$6,667	\$3,952	\$4,200	\$1,851
2002	\$49,751	\$27,733	\$6,363	\$10,023	\$7,069	\$3,782	\$4,350	\$814
2003	\$51,511	\$28,710	\$6,834	\$10,036	\$7,379	\$3,982	\$4,523	\$2,807
2004	\$54,309	\$29,999	\$7,348	\$10,474	\$7,756	\$4,362	\$4,712	\$3,459
2005	\$57,106	\$31,431	\$7,898	\$10,761	\$8,235	\$4,680	\$4,916	\$3,008
2006	\$60,783	\$33,212	\$8,424	\$11,622	\$8,729	\$5,038	\$5,194	\$2,550
2007	\$64,317	\$34,935	\$8,946	\$12,378	\$9,235	\$5,401	\$5,463	\$2,600
2008	\$67,874	\$36,771	\$9,505	\$12,996	\$9,743	\$5,792	\$5,751	\$2,450

Recent Percentage Changes

2000	6.2%	5.6%	6.4%	9.2%	4.3%	3.9%	4.1%	-18.1%
2001	3.7%	2.8%	5.5%	0.1%	9.7%	8.1%	4.2%	32.3%
2002	3.4%	3.0%	13.4%	0.2%	6.0%	-4.3%	3.6%	-56.0%
2003	3.5%	3.5%	7.4%	0.1%	4.4%	5.3%	4.0%	244.9%
2004	5.4%	4.5%	7.5%	4.4%	5.1%	9.6%	4.2%	23.2%
2005	5.2%	4.8%	7.5%	2.7%	6.2%	7.3%	4.3%	-13.0%
2006	6.4%	5.7%	6.7%	8.0%	6.0%	7.7%	5.7%	-15.2%
2007	5.8%	5.2%	6.2%	6.5%	5.8%	7.2%	5.2%	2.0%
2008	5.5%	5.3%	6.3%	5.0%	5.5%	7.3%	5.3%	-5.8%

Various Percentage Changes - At Annual Rates

1990-1995	5.7%	5.5%	6.2%	4.5%	6.7%	8.1%	5.5%	-7.9%
1995-2000	6.0%	6.3%	4.7%	6.3%	5.5%	5.6%	5.4%	-3.4%
1990-2000	5.9%	6.0%	5.2%	5.4%	6.0%	7.9%	5.4%	-5.3%
2000-2005	4.2%	3.7%	8.2%	1.5%	6.3%	5.1%	4.0%	16.6%

Note: Net Farm Income (USDA Basis) is not added into the Nonfarm Personal Income total.

Dividend, interest, and rent income will be another source of strong growth for non-farm personal income in 2006. Due to rising short-term interest rates, the interest portion of this income stream is expected to grow rapidly between 2005 and 2006. Growth in dividend, interest, and rent income in 2006 is expected to reach 8 percent. Short-term interest rates are expected to stabilize in late 2006, causing growth in dividend, interest, and rent income to moderate in 2007 and 2008. Transfer income is expected to grow at a moderate rate from 2006 through 2008.

Farm Income ¹

Nebraska net farm income is forecast to be \$2,550 million in 2006, down 15 percent from the 2005 income level (Table 3). For Nebraska as well as much of the nation, the two-year period of 2004-2005 was one of relatively higher farm income, with both crop and livestock producers experiencing favorable conditions. Even though the 2006 forecasted net income level represents a fairly significant decline, 2006 farm income still will be well above its 10-year (1996-2005) average.

Several factors contribute to the decline of farm income from near record levels in 2004 and 2005 to merely above-average levels in 2006. First, drought conditions continue into 2006 and have increased in severity across western Nebraska. Drought has reduced crop yields. At the same time, petroleum-based crop input costs such as fertilizer and fuel are rising rapidly. Interest rate charges and equipment costs also are rising. Corn prices are high, but gains from this will be offset by lower farm program payments and higher costs for corn-based feed among Nebraska livestock producers. Livestock producers also face declining cattle prices.

Farm income is expected to stabilize in 2007 and 2008 and should remain above averages for the 1996 to 2005 period. This suggests a long-term increase has occurred in farm income. One reason for this is the state's rapidly expanding ethanol industry. Ethanol production in Nebraska reached over a half a billion gallons in 2005, and output may double by 2008 as existing plants are expanded and new plants built. One

¹ Source: Bruce Johnson, "Nebraska Agricultural Sector Income Trends and Forecasts."

third of Nebraska corn production will be processed as part of ethanol production. This will benefit income not only for corn farmers, but also for livestock producers. Livestock producers experience direct cost savings from using the feed by-product of ethanol production. In addition to the ethanol industry, the state's agricultural production sector is continuing to develop other value-added and direct marketing aspects as there is a steady movement away from a commodity-based agriculture to more of a product-based agriculture.

There is naturally risk associated with this mostly positive outlook for agriculture. The primary risks are (1) severe drought; (2) increasing water deficits for irrigated areas, and (3) demand disruptions for beef and other livestock products.

Net Taxable Retail Sales

There are two components to net taxable sales: motor vehicle and non-motor vehicle. Non-motor vehicle net taxable sales grew a solid 4.6 percent in 2005. The rate of growth, however, is expected to fall in 2006 due to legislative changes exempting from taxation sales of contract labor and manufacturing equipment. These changes will lower the tax base about 3.2 percent for a 12-month period. Due to the decline in the tax base, non-motor vehicle taxable sales are expected to grow just 3.6 percent in 2006 and 3.5 percent in 2007. Growth in 2008 is expected to return to a solid 4.8 percent rate. Growth throughout the outlook period will be supported by solid growth in employment and non-wage income. There are also efforts underway to improve compliance of the so-called non-traditional retailers (i.e., internet retailers). Several factors also will work against sales growth, however. The rate of population growth in Nebraska is expected to be modest. Another factor is the steady shift in consumption pattern away from taxable goods to less broadly taxed services.

Motor vehicle taxable sales are in a period of sustained decline. Taxable sales declined 0.2 percent in 2004 and 4.8 percent in 2005 and are expected to decline another 3.6 percent for 2006. One reason for this sustained decline is that the leasing portion of the motor vehicle purchases is gaining relative to vehicle sales. Leasing is not included in taxable purchases. Beyond this, motor vehicle sales are simply quite variable and

subject to cyclical swings. Ultimately, growth is likely to return. Our estimate is that motor vehicle taxable sales will rebound in 2007, reaching a 7 percent growth rate. Growth will moderate to 3.2 percent in 2008.

Total net-taxable sales is the sum of motor vehicle and non-motor vehicle net taxable sales. Total net taxable sales in Nebraska will grow by 2.8 percent in 2006, 3.9 percent in 2007 and 4.5 percent in 2008.

Table 4
Net Taxable Retail Sales, Annual Totals

	Total Sales	Motor Vehicle Retail Sales	Other Retail Sales
2000	\$20,443,147,008	\$2,605,040,740	\$17,838,106,268
2001	\$21,056,748,756	\$2,896,708,697	\$18,160,040,059
2002	\$21,426,001,233	\$2,926,105,837	\$18,499,895,396
2003	\$22,092,175,638	\$2,893,503,697	\$19,198,671,941
2004	\$23,618,358,536	\$2,885,018,183	\$20,733,340,353
2005	\$24,442,519,011	\$2,751,314,526	\$21,691,204,485
2006	\$25,124,355,050	\$2,652,267,203	\$22,472,087,846
2007	\$26,096,536,828	\$2,837,925,907	\$23,258,610,921
2008	\$27,280,505,171	\$2,928,739,536	\$24,351,765,634
Annual Percent Changes			
2000	3.2%	3.4%	3.2%
2001	3.0%	11.2%	1.8%
2002	1.8%	1.0%	1.9%
2003	3.1%	-1.1%	3.8%
2004	6.9%	-0.3%	8.0%
2005	3.5%	-4.6%	4.6%
2006	2.8%	-3.6%	3.6%
2007	3.9%	7.0%	3.5%
2008	4.5%	3.2%	4.7%
Average Annual Growth Rates			
1991-1995	5.6%	7.0%	5.4%
1995-2000	5.2%	6.7%	5.0%
1990-2000	5.4%	6.8%	5.2%
2000-2005	3.6%	1.1%	4.0%

Thank You Donis ...

The Nebraska Business Forecast Council salutes one of our founding members, Donis Petersan of the Nebraska Public Power District. Donis is stepping down from the council this year after over a decade of service. Throughout this period, Donis served as a key member of the council,

leading efforts to forecast the famously unpredictable manufacturing industry, one of the most volatile industries in the American and Nebraska economy. Donis's keen insights about manufacturing helped the council maintain an accurate forecast record. He will be missed!

BBR is grateful for the help of the Nebraska Business Forecast Council. Serving this session were

*John Austin, Department of Economics, UNL;
Chris Decker, Department of Economics, UNO;
Tom Doering, Nebraska Department of Economic Development;
Ernie Goss, Department of Economics, Creighton University;
Nick Hernandez, Nebraska Department of Labor;
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Ken Lemke, Nebraska Public Power District;
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