

Business in Nebraska

Volume 60 No. 682

Presented by the Bureau of Business Research (BBR)

December 2005

The Recovery is Sustained

The Nebraska Business Forecast Council

U.S. Macroeconomic Outlook

In September and October of this year, Hurricanes Katrina and Rita combined with an already-stretched world oil market to generate a spike in energy prices throughout the United States. The price spike naturally generated concern for the economy. Most recent recessions in the U.S. economy have been preceded by peaks in oil prices. Did the energy price spikes following Katrina and Rita derail the quickly-growing U.S. economy? The early evidence, and the economic outlook, suggest that the answer is no.

Despite the hurricanes, third quarter GDP growth continued to be very strong, exceeding 4%. Further, strong job growth returned to the national economy in November after slow growth in the proceeding months due to heavy job losses in the Gulf Coast region. Even the spike in gasoline prices abated in November. By December, gasoline prices were slightly lower than in the period before the hurricanes struck.

The hurricanes were a terrible human tragedy and devastated the economy of the affected regions. Like most natural disasters, however, the hurricanes were not a major drain on the national economy. The effects were modest and likely temporary, with a few months of slow job growth and a modest up tick in inflation at the end of 2005, and most likely, the beginning of 2006. In fact, the main threat for the economy may lie in the

policy reaction to these events. Necessary spending to rebuild the Gulf Coast may exacerbate a yawning federal budget deficit, particularly if this spending reignites natural tendencies toward free spending among leaders in Washington.

The outlook calls for GDP growth of 3.7% in 2005 before growth slows to 3.3% in 2006 and falls to the 2.5% to 3.0% growth range in 2007 and 2008. Job growth is expected to continue to be modest, averaging about 1.5% annually for the 2005 through 2008 period. The national unemployment rate should remain around 5%. Inflation will continue to run around 3% in 2005 and 2006 before moderating to a 2% rate in 2007 and 2008.

Nebraska Outlook

The panel remains optimistic about the outlook for the Nebraska economy. While farm incomes are expected to moderate, employment is expected to expand next year and through 2008. Manufacturing employment is expected to expand robustly in 2007 and 2008. Employment growth is expected to average roughly 1.6% per year over the 2006 through 2008 period.

Moderate employment growth will help generate growth in both income and taxable sales in Nebraska.

Income growth is expected to average 5.7% per year over the outlook period. Net taxable sales growth will average 4% per year over the 2006 through 2008 period.

Table 1— Key Economic Growth Rates

	Nonfarm Employment	Nonfarm Personal Income	Net Taxable Sales
2004	1.1%	5.4%	6.9%
2005	1.1%	5.5%	3.7%
2006	1.6%	5.8%	3.2%
2007	1.6%	5.7%	4.6%
2008	1.5%	5.6%	3.9%

Employment

Employment growth in Nebraska expanded at a modest 0.9% rate in 2003 and a 1.1% rate 2004 after declining earlier in the decade. In 2005 growth is expected to have reached a 1.1% rate. Employment growth is forecast to reach an average of 1.6% in 2006 through 2008. Robust job growth is expected to return to the manufacturing industry beginning in 2007, while job growth in the construction industry will average from 1.0% to 1.5% per year during the outlook period. This is solid growth, but below the 4.5 compound annual growth rate in construction during the 1990s.

Construction and Mining

Residential construction activity has slowed from the furious pace of the last several years. There is a claim that Omaha alone has a surplus inventory of several thousand houses available. Future activity largely will be based on new family formations and net immigration into the state. Residential construction employment will be flat this year, will increase only marginally next year, and will increase modestly in 2007 and 2008.

Nonresidential building construction was given a great boost by major new building programs in Omaha over the last five years. This activity is now slowing. Construction in the remainder of the state, while healthy, cannot fully replace the activity of the boom in Omaha's construction. Nonresidential building construction will fall this year from its previous high level, but begin to recover in 2006. One construction component expected to remain strong throughout the outlook period is road construction. The funding of road construction comes from a reliable source: the gasoline tax. The widening of I-80, highway maintenance, and other projects will continue to generate growth in heavy construction employment.

Overall, construction employment will reach a tepid growth rate of 0.5% in 2005. Growth will accelerate to moderate rates in future years, reaching 1.0% in 2006 and 1.6% in 2007 and 2008.

Manufacturing

Manufacturing employment data for 2004 and preliminary data for 2005 indicate the decline in durable goods employment may be approaching the bottom. With significant improvement in farm income, the farm machinery and equipment manufacturing sector appears to have stabilized and has started to experience employment growth. Nebraska's durable goods manufacturers also have benefited from an improving national economy. Employment in the durable goods sector is forecast to increase 0.2% for 2005, with the growth rate accelerating in subsequent years to 0.9% in 2006, 1.3% in 2007, and 1.5% in 2008.

In the case of nondurable manufacturing, the decline in employment is expected to continue in 2005 (-2.2%), to stabilize in 2006, and to increase in later years to 0.8% in 2007 and 1.1% in 2008. Growth in 2005 and 2006 is hampered by uncertainty regarding international trade; in particular, limits on importing live cattle from Canada, and limits on exports to Japan.

Transportation

The Nebraska transportation industry contains a large rail industry and a large and rapidly-growing trucking industry. Recent spikes in diesel fuel costs are expected to temper rapid job growth in truck transportation in the near term, but growth will remain strong. Long-term industry issues include labor supply for long-haul truckers, worker's compensation rules for owner-operators in Nebraska, and compliance with 2007 federal regulations on engines. Transportation industry employment is expected to expand 2.5% in 2005 and 2006 and to rise 3.0% in 2007 and 2008.

Wholesale Trade

Since 2001 wholesale trade employment in Nebraska gradually has declined. Preliminary data for 2005 suggest that employment in the wholesale trade industry in Nebraska will fall slightly in 2005. Growth will bounce back to a 0.6% rate in 2006, before falling to modest growth of 0.2% to 0.3% in 2007 and 2008. The outlook for job growth is limited because of growing productivity. The Bureau of Labor Statistics reports that the wholesale trade industry has increased its labor

productivity more than have the retail trade industries in recent years.

Retail Trade

Employment in the retail trade industry has been declining or stagnant over the last four years. Employment declined in 2001, 2003, and 2003 and did not grow in 2004.

Job growth was limited due to a combination of moderate sales growth, a growing share of sales in large retailers that generate more sales for each worker, and the growth of online sales. Looking forward, moderate employment growth in line with population growth is expected as the economy continues to expand. For the current year employment is expected to increase at a

1.3% rate. For the years 2006 through 2008 the employment growth is expected to remain at 0.8% per year, which is roughly the rate of population increase.

Information

The outlook for the Nebraska information industry calls for steady employment growth. Employment in the industry began to grow again in 2005. With most of this industry in locally-oriented industries such as broadcasting and publishing, the information industry should match the overall growth in the Nebraska economy, barring any major changes in the handful of large data-processing firms. Industry employment growth is expected at 1.2% in 2005, while averaging 1.0% per year from 2006 through 2008.

Table 2—Number of Nonfarm Jobs and Percent Changes by Industry Annual Averages (in thousands of jobs)

	Construction, Mining & Natural Resources				Wholesale Trade	Retail Trade and Utilities			Info	Financial Services	All Gov't	Local Gov't
	Total	Durables	Non-durables	Non-durables		Trade	Utilities	and				
2000	914.9	45.2	58.9	55.4	41.9	111.3	45.1	26.4	60.2	314.3	16.6	137.9
2001	919.1	45.3	54.6	56.2	42.5	110	45.2	25	60.6	323	16.0	140.8
2002	910.9	46.1	50.6	55.4	41.5	108.5	44.9	21.5	61.8	321.2	16.3	142.6
2003	916.3	47.4	47.3	55.1	41	106.7	46.4	21.5	62.5	326.9	16.7	143.1
2004	926.1	48.2	46.9	53.8	40.9	106.7	48.7	21.5	63.4	333.2	16.6	143.5
2005	936.3	48.4	47.0	52.6	40.7	108.1	49.9	21.8	65.0	341.5	16.6	144.6
2006	950.9	48.9	47.4	52.6	40.9	109.0	51.2	22.0	66.8	349.7	16.6	145.8
2007	965.8	49.7	48.0	53.0	41.0	109.8	52.7	22.2	68.3	357.4	16.6	147.0
2008	980.5	50.5	48.8	53.6	41.1	110.7	54.3	22.4	69.8	364.6	16.6	148.1

Recent Annual Percent Changes

2000	1.8%	2.0%	2.1%	-0.5%	-1.4%	1.0%	1.3%	-0.7%	-0.7%	3.5%	4.4%	1.7%
2001	0.5%	0.2%	-7.3%	1.4%	1.4%	-1.2%	0.2%	-4.1%	-0.5%	2.6%	-3.6%	2.1%
2002	-0.8%	1.8%	-7.3%	-1.4%	-2.4%	-1.4%	-0.7%	-4.3%	2.0%	-0.9%	1.9%	1.3%
2003	0.9%	2.6%	-6.5%	-0.5%	-1.2%	-1.7%	3.3%	-13.0%	0.8%	1.1%	2.5%	0.5%
2004	0.9%	1.9%	-0.8%	-2.4%	-0.2%	0.0%	5.0%	0.0%	1.8%	5.1%	-0.6%	0.1%
2005	1.1%	0.5%	0.2%	-2.2%	-0.5%	1.3%	2.5%	1.2%	2.5%	2.5%	0.0%	0.8%
2006	1.6%	1.0%	0.9%	0.0%	0.6%	0.8%	2.5%	1.0%	2.8%	2.4%	0.0%	0.8%
2007	1.6%	1.6%	1.3%	0.8%	0.2%	0.8%	3.0%	1.0%	2.2%	2.2%	0.0%	0.8%
2008	1.5%	1.6%	1.5%	1.1%	0.3%	0.8%	3.0%	1.0%	2.2%	2.0%	0.0%	0.8%

Various Percent Changes at Annual Rates

1990-1995	2.3%	4.7%	2.8%	2.0%	0.2%	1.4%	2.1%	0.5%	1.9%	3.7%	-2.0%	1.4%
1995-2000	2.1%	4.3%	1.2%	0.3%	1.1%	1.7%	3.3%	3.0%	2.2%	3.6%	0.2%	0.5%
1990-2000	2.2%	4.5%	2.0%	1.2%	0.7%	1.6%	2.7%	1.7%	2.1%	3.6%	-0.9%	1.0%
2000-2004	0.3%	1.6%	-5.5%	-0.7%	-0.6%	-1.0%	1.9%	-5.0%	1.3%	1.5%	0.0%	1.0%

Financial

The financial industry is composed of banking and financial services, real estate, and insurance. Each of these sub sectors has performed well over the last four years, and continued growth is expected. Overall

industry employment growth should reach 2.5% in 2005, rise to 2.8% in 2006, and return to trend growth rates of 2.2% in 2007 and 2008.

Banking and financial services have been growing nicely since the downturn of the stock market in 2000 and its subsequent sluggishness. Stabilization in the stock market should underpin further growth in the financial services sub sector. Growth also will be aided by diversification in the banking industry.

The real estate subsector is expanding rapidly, and growth should continue despite expected slight increases in mortgage rates and housing costs. The customer base for this industry should continue to expand with population and commercial growth. The customer base also will expand as an aging and increasingly wealthy baby-boom generation searches for new types of housing later in life.

The insurance subsector has grown over the recent period at a modest but steady rate. This pattern is expected to continue, but employment patterns in the industry will be affected by recent events. Insurance adjusters from Iowa and Nebraska (and other states) have been traveling to the Gulf Coast to work on claims related to Hurricanes Katrina and Rita. Forecasts for the current and next year therefore are expected to exceed trend rates in this subsector before returning to trend in 2007 and 2008.

Services

The services industry will continue to be the main engine of employment growth in the Nebraska economy. The industry includes large and steadily expanding sub sectors such as health care and eating and drinking places. Arts and recreation, administrative support, professional services, and personal services are the other main subsectors of the services industry. Much of the services industry is tied to growth in demand from Nebraska households. These services subsectors such as eating and drinking places, personal services, and arts and recreation grow as Nebraska population and household income grows. Tourism also influences these sectors, but in-state demand is the major factor in Nebraska.

An aging population, population growth, and rapid advances in medical technologies will fuel strong growth in health care employment in Nebraska. Strong growth also is expected in the professional services industry. Professional services businesses such as legal, accounting, engineering, and consulting services primarily serve business customers rather than

households. Professional services are therefore cyclical and expand rapidly during the expansion phase of the business cycle.

These factors together suggest strong growth in the services industry over the 2005 to 2008 forecast period. Growth is expected at 2.5% in 2005, 2.4% in 2006, and to fall to around 2% in 2007 and 2008.

Government

Growth in state and local government employment will be fueled by steady growth in tax revenues. Recent strong growth in state tax revenues will be coupled with strong growth in property values and local property tax revenues. Revenue growth is therefore sufficient for state and local government employment to grow with the rate of population. State and local government employment is expected to grow at an average of 0.8% per year.

Federal government employment in Nebraska has not grown for the last decade. Similarly, no growth is anticipated in federal government employment during the 2005 to 2008 period, despite rapid increases in federal spending.

Non-Farm Income

Solid job growth and rising income from interest, dividends, and transfer payments suggest solid expansion of non-farm income in Nebraska. Non-farm personal income is projected to expand 5.5% to 6.0% per year over the 2005 through 2008 period. Income growth is expected to reach 5.5% in 2005, to rise to 5.8 in 2006, and to fall slightly in 2007 and 2008. Note that all of these income growth figures refer to nominal income growth before adjusting for inflation.

Most income growth will occur due to income from work—that is, wage and salary income, growth in benefits (other labor income), and proprietors income. Growth in wage and salary income is expected to be steady, with rapid growth in both benefits and proprietors' income. Wage and salary income is expected to expand roughly 5% per year. Worker benefits (other labor income) will be driven by growth in health care benefit costs. Worker benefits are expected to expand 6% per year. Non-farm proprietors' income is forecast to grow 7% per year on average from 2005 through 2008. Proprietors' income is cyclical and should grow rapidly during the current expansion.

Growth in transfer income is expected to match overall non-farm income growth. Dividend, interest, and rent income is expected to grow quickly. Continued increases in short-term interest rates due to Federal Reserve policy and recent increases in long-term interest rates due to market forces will lead to rising interest

income for savers in 2006. Growth will moderate in 2007 and 2008, however. Dividend, interest, and rent income is expected to grow 6.5% in 2006, 6.0% in 2007, and 5.5% in 2008.

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

	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	Nonfarm Proprietors' Income	Net Farm Income (USDA)
2000	\$46,386	\$9,991	\$6,075	\$26,206	\$5,317	\$4,032	\$4,032	\$1,398
2001	\$46,844	\$10,085	\$6,218	\$26,323	\$5,369	\$4,056	\$4,056	\$1,851
2002	\$49,703	\$10,023	\$7,069	\$27,735	\$6,361	\$4,380	\$4,380	\$814
2003	\$51,463	\$10,036	\$7,378	\$28,711	\$6,832	\$4,550	\$4,550	\$2,807
2004	\$54,219	\$10,474	\$7,743	\$29,997	\$7,344	\$4,738	\$4,738	\$3,459
2005	\$57,216	\$11,207	\$8,200	\$31,376	\$7,755	\$4,956	\$4,650	\$2,750
2006	\$60,512	\$11,935	\$8,692	\$32,965	\$8,226	\$5,207	\$4,979	\$2,500
2007	\$63,948	\$12,651	\$9,222	\$34,634	\$8,724	\$5,470	\$5,330	\$2,250
2008	\$67,503	\$13,347	\$9,785	\$36,374	\$9,250	\$5,745	\$5,705	\$2,200

Recent Percentage Changes

2000	6.2%	9.2%	6.4%	5.6%	6.4%	4.1%	3.9%	-18.3%
2001	3.7%	0.1%	5.6%	2.8%	5.6%	4.2%	8.1%	33.0%
2002	1.5%	-6.0%	11.1%	2.7%	11.1%	4.1%	-4.6%	-55.0%
2003	3.4%	-2.1%	8.1%	3.6%	8.1%	3.9%	7.3%	292.7%
2004	5.3%	4.4%	7.5%	4.5%	7.5%	5.6%	8.5%	23.2%
2005	5.5%	7.0%	5.9%	4.6%	5.6%	4.6%	6.6%	-20.5%
2006	5.8%	6.5%	6.0%	5.1%	6.1%	5.1%	7.1%	-9.1%
2007	5.7%	6.0%	6.1%	5.1%	6.1%	5.1%	7.1%	-10.0%
2008	5.6%	5.5%	6.1%	5.0%	6.0%	5.0%	7.0%	-2.2%

Various Percentage Changes - At Annual Rates

1990-1995	5.7%	4.5%	6.7%	5.5%	6.2%	5.5%	8.1%	-7.9%
1995-2000	6.0%	6.3%	5.5%	6.3%	4.7%	5.4%	5.6%	-3.4%
1990-2000	5.9%	5.4%	6.0%	6.0%	5.2%	5.4%	7.9%	-5.3%
2000-2004	3.7%	1.0%	5.6%	3.3%	8.1%	4.0%	4.0%	16.9%

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

Farm Income¹

The year 2004 represented a unique set of circumstances where both the crop and the livestock sectors were enjoying phenomenal conditions. Forecasts for the current year indicate strong farm income, but roughly 20% below levels in 2004. Farm income is expected to equal \$2.75 billion in 2005.

The downward shift in 2005 income over the previous year is largely being felt in the crop side of the industry. Crop yields are lower this year for many areas of the state, while major commodity prices have plunged for all producers. Energy and fertilizer costs are higher.

By contrast, the state's livestock sector remains in a more robust economic situation this year and will, in the aggregate, enjoy favorable net annual earnings. Lower feed-grain costs have benefited livestock producers.

Farm income is expected to trend slightly downward in 2006, 2007, and 2008, due to modest declines in crop and livestock income and the expectation of declining government payments to agriculture. Upcoming negotiations on a new federal farm bill come at a time of rising concern over large federal budget deficits. With these budget constraints, the renewed legislation may erode the safety-net features of the current program, leading to declines in farm payments later in the outlook period. Farm income is expected to drop to \$2.5 billion in 2006, \$2.25 billion in 2007, and \$2.2 billion in 2008. This 2008 value would be just above the average farm income over the last decade from 1995 through 2004.

Net Taxable Sales

Net taxable sales are expected to grow at a moderate rate in the current year and over the forecast period. Growth is supported by expanding employment and increases in non-wage income. A number of factors, however, will act to moderate growth. Inflation is expected to be moderate throughout the forecast period, so price increases in taxable retail goods will be minimal. A long-term shift in consumption patterns away from taxable goods to less broadly taxed services is expected to continue. There also will be some special factors. In the near term high home heating prices will displace some of the purchases subject to sales tax. In addition, on January 1, 2006 manufacturing equipment will be exempted from the sales and use tax. This will lower the expected taxable base in future years to the extent that the item was taxed at the time of sales. In terms of growth, the rule change will retard growth in taxable sales in 2006, the year the rule change takes effect.

The forecast is for nonmotor vehicle taxable sales to grow 4.7% in 2005. This is consistent with tax receipts for 2005 year to date. Year-to-date nonmotor vehicle taxable sales are 4.6% higher through July 2005. For reasons discussed above, growth in nonmotor vehicle taxable sales is expected to fall in 2006. Growth for 2006 is forecast to reach 3.3%, before rebounding to 4.3% and 4.1% in 2007 and 2008.

Motor vehicle net taxable sales are expected to decline in 2005. Current year-to-date motor vehicle net taxable sales have declined at a 3.6% rate. For 2005 overall, motor vehicle net taxable sales are expected to decline 3.7%. Improvements are expected in subsequent years with growth rates of 2.6% in 2006, 7.0% in 2007, and 2.3% for 2008. Motor vehicle sales tend to follow a three year cycle, which is the reason why growth is negative in the current year and a peak is anticipated for 2007.

Combining the above results leads to an expectation of 3.7% in total net taxable sales in 2005. The outlook for net taxable sales is for 3.8% growth in 2006, 4.6% in 2007, and 3.9% in 2008.

¹ Source: Bruce Johnson, Downturn in Nebraska Net Farm Income Expected for 2005 (October 2005).

Table 4—Net Taxable Retail Sales, Annual Totals (\$ millions)

Year	Total Sales	Motor Vehicle Net Taxable Sales	Nonmotor Vehicle Net Taxable 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	\$24,488,964,878	\$2,781,157,528	\$21,707,807,350
2006	\$25,277,632,616	\$2,853,467,624	\$22,424,164,992
2007	\$26,441,614,445	\$3,053,210,358	\$23,388,404,087
2008	\$27,470,762,850	\$3,123,434,196	\$24,347,328,654

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	3.7%	-3.6%	4.7%
2006	3.2%	2.6%	3.3%
2007	4.6%	7.0%	4.3%
2008	3.9%	2.3%	4.1%

Average Annual Growth Rate Changes

1991 to 1995	5.6%	7.0%	5.4%
1995 to 2000	5.2%	6.7%	5.0%
1990 to 2000	5.4%	6.8%	5.2%
2000 to 2004	2.9%	-0.1%	3.4%

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

Scott Hunzeker, Nebraska Department of Labor;

Bruce Johnson, Department of Agricultural Economics, UNL;

Donis Petersan, Nebraska Public Power District;

Franz Schwarz, Nebraska Department of Revenue;

Eric Thompson, Bureau of Business Research UNL;

Keith Turner, Department of Economics, UNO (emeritus);

Ernie Goss, Department of Economics Creighton University;

John Austin, Department of Economics, UNL.

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