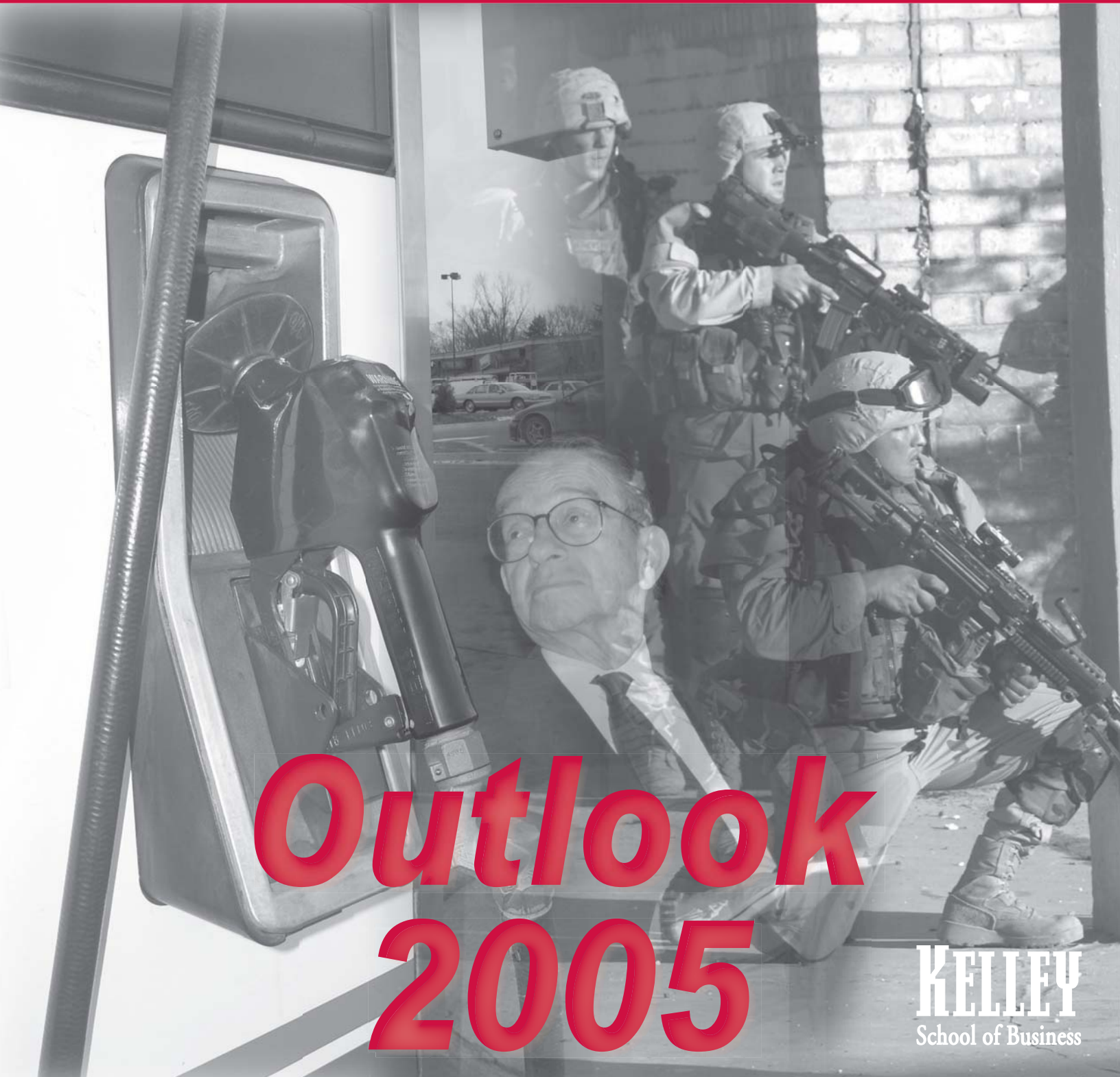


Indiana Business Review

Winter
2004



***Outlook
2005***

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For the Record:

The forces of nature (read weather) and man (read war, oil prices, and interest rates) make forecasting a challenge, to put it mildly. A particularly harsh winter, unstable oil prices, a devalued dollar, and lingering problems in Iraq can wreak havoc on our economists' and econometricians' meticulously researched and modeled predictions. But the need of Indiana's businesses and policy makers for insight into the probable direction of our economies has long compelled us to publish these economic insights from some of the best economic minds at Indiana's universities. The Kelley School of Business faculty (with the blessing and encouragement of Dean Smith) travel throughout Indiana each year, partnering with local economists to share their expertise with thousands of Hoosiers, and now with many more thousands as we print their work in this, the forty-ninth annual outlook edition of the *Indiana Business Review*.

—COR

Outlook for 2005

R. Jeffery Green

Professor of Business Economics and Public Policy,
Kelley School of Business, Indiana University, Bloomington

In October 2004, a group of economists gathered at the Kelley School of Business to discuss the economic outlook for the nation and the state. The discussion began with an analysis of the October forecast from the U.S. model developed at the Center for Econometric Model Research (CEMR) at Indiana University. A consensus was then generated concerning assumptions behind the forecast and adjustments to the model forecast. Thus, the U.S. outlook presented here reflects the combined thinking of almost a dozen IU faculty members. The CEMR model of Indiana was used to translate the economic forecast for the United States into a forecast for Indiana.

These and other faculty then traveled throughout Indiana presenting the forecast and answering questions. They were joined by a local economist who discussed the outlook for that part of the state. The articles that follow summarize the 2005 outlook and in some cases expand upon what was presented by the traveling panel.

The forecast we made last year was quite accurate. Real growth will likely come in at 3.9 percent for 2004, only slightly above the 3.5 percent rate we forecast last December, and inflation will be near 2.2 percent again, only slightly above the 2 percent forecast last

December. The biggest surprise this year was the sharp increase in world oil prices.

The key economic assumption for the coming year is that world oil prices will remain high. This assumption is based on the premise that demand (particularly among emerging economies) will remain strong and supply will be constrained by continuing political turmoil in many oil-producing regions.

In the articles that follow, economists discuss various aspects of the outlook. Bill Witte explains why the U.S. outlook for 2005 will be less rosy than what we've experienced in 2004. It's not a recession by any means, but it is a slowdown in the rate of growth. Andreas Hauskrecht reports on the world economy and analyzes many of the risks to our forecast. These risks are very real and could darken the outlook next year. John Boquist, Robert Neal, and William Sartoris analyze where financial markets are likely to go next year, making for a challenging year for policy makers. Jeffrey Fisher looks at housing markets and the outlook remains quite good. Jerry Conover discusses how the national and international outlook will affect Indiana. Finally, a key group of economists from around the state offer views and forecasts for their metropolitan economies. ◀

The U.S. Economy

Willard E. Witte

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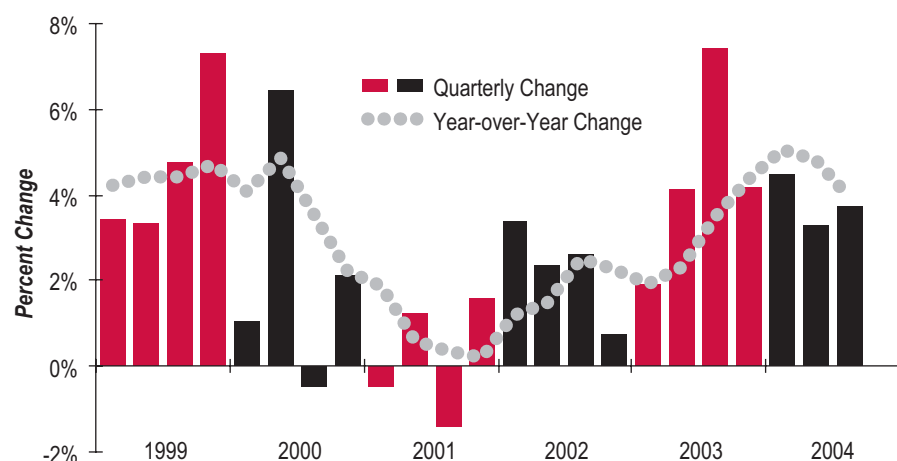
The U.S. economy during 2004 brings to mind Charlie Brown, Lucy, and the football. From experience, Charlie knows he should temper his enthusiasm. But the possibility of putting the ball through the uprights seems to be there, and he thinks maybe now is the time. And then Lucy snatches the ball away and Charlie is flat on his back (again).

For the economy, the past several years certainly counsel caution. But as things unfolded in the latter stages of 2003 and the first part of 2004, the possibility of the economy soaring upward on a perfect trajectory into a clear blue sky was hard to resist. More recently, sadly, reality has intervened. To be sure, the Charlie Brown metaphor is not perfect. The economy is not flat on its back by any means. But the dream of perfect trajectory is probably not in the cards, at least not in 2005.

Earlier this year, a broad range of economic indicators were sending out positive signals. By March, output had registered four straight quarters of growth above 4 percent, with the full period over 5 percent. Figure 1 shows the growth rate for real output both quarter by quarter and relative to the same quarter a year earlier. At the sectoral level, the growth of business spending on equipment accelerated over the same period from about zero to well into double-digits, while growth in consumption spending went from below 3 percent to above 4 percent. In the labor market (which tends to lag slightly), employment began to expand in September and increased by an average of 225,000 per month during the first five months of this year. Figure 2 shows employment growth and the unemployment rate. Rising employment is a manifest indication of business optimism. It implies rising income and does wonders for consumer confidence. It seemed that finally the economic football was ready to really take off.

But as the weather turned warmer, signs that the ball might be snatched away started to appear. The initial problem was the labor market. In June, payroll employment rose

Figure 1
U.S. Real Output: Annual Rate of Change



only 96,000, and then this disappointing performance was repeated the next month with an increase of only 85,000. The evidence of deceleration was reinforced when second quarter output growth came in at 3.3 percent, more than a full percentage point below the first quarter. Even more troubling, consumption advanced at only a 1.6 percent rate.

Other events over the summer raised more concerns. The Federal Reserve started to push short-term interest rates upward in June and continued to do so in August and September. The situation in Iraq seemed to be worsening. Due partly to this and also to a variety of other concerns, crude oil prices rose dramatically, reaching the fifty-five dollars per barrel level. In nominal terms, this is uncharted territory. High oil prices are in many ways like a large tax on the entire economy. And then during the fall, even the weather turned perverse, especially for Floridians. Faced with all of this, consumer confidence fell in August, and then further in both September and October. Thus, the possibility that the main support under the expansion is a little wobbly cannot be totally dismissed.

All is not bleak, however. While the household sector may be a little shaken, it is not down and out. Consumption spending bounced back in the third quarter of 2004, with growth at an annual rate of 4.6 percent, and business investment in new equipment continues to rise rapidly (up to nearly a 15 percent rate in the third quarter). Partly reflecting this investment, productivity growth remains strong. Higher productivity fuels growth in income and profits.

Looking ahead to 2005, we are guardedly, and apprehensively, optimistic. We think the economy will continue to expand, but probably not quite as strongly as during the past year. Employment will also continue to rise, but again short of 2004 levels. There is a higher than normal amount of uncertainty surrounding the outlook. If a number of things break right, the year could be better than we expect. If they don't, things could turn out worse than expected. Some details:

- We expect output to grow between 3 and 3.5 percent in 2005. This is less than 2004, but close to the long-run potential of the economy.

- Employment will expand by about 1.5 million. This will mean only a little progress in lowering unemployment.
- Productivity will rise about 1.9 percent, also somewhat below 2004.
- Inflation will remain moderate, although up a little from this year. The consumer price index will increase about 3 percent.
- The Federal Reserve will continue to raise short-term interest rates, by at least 100 basis points during 2005.

We think that the behavior of oil prices will be a key element in the outcome. Our outlook is based on a slightly pessimistic view of the prospects in this regard. We expect crude prices to remain at or above fifty dollars per barrel at least into early 2005, and then to come down some, but only to the vicinity of forty dollars. These relatively high levels produce a significant headwind for the economy through the year.

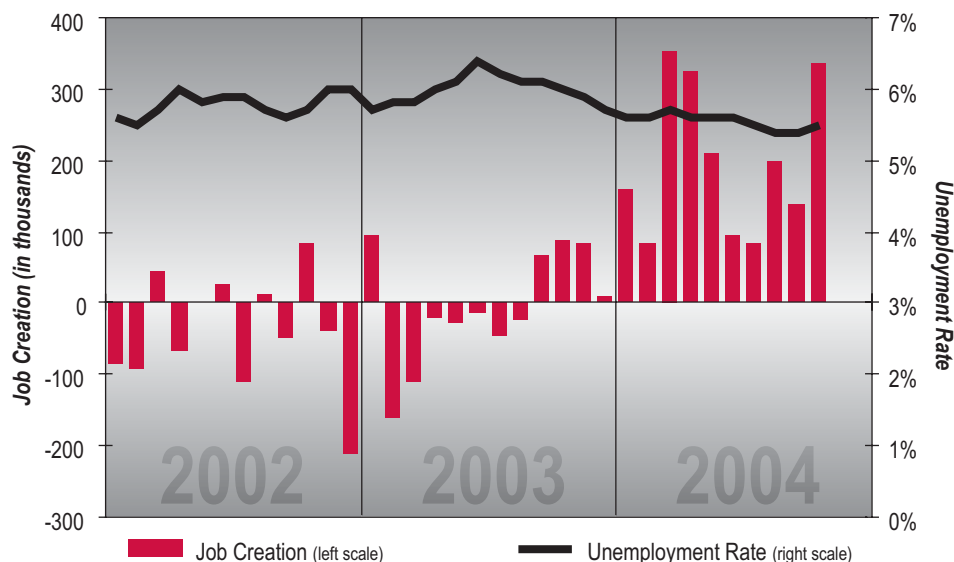
Policy makers will face a multifaceted dilemma next year. With the economy growing below its potential and unemployment remaining uncomfortably high, stimulus might seem to be in order. But fiscal policy will be seriously constrained by the federal budget deficit (which the president promised to reduce during his re-election campaign). This probably precludes any significant further tax cuts or new spending.

The Fed, meanwhile, seems unlikely to reverse its recent course toward restraint. High oil prices are an element here, since they represent an inflation threat. Another problem for the Fed is the magnitude of our trade deficit, which is now approaching 6 percent of GDP. The economic corrective for the deficit is a depreciation of the dollar. A real problem arises if the depreciation occurs rapidly in a crisis situation. This would raise a very significant danger of seriously higher inflation.

There is no shortage of potential problems in the year ahead. If things go badly in a few crucial regards (for example, deterioration in Iraq, lack of discipline by Congress leading to larger budget deficits, problems in the foreign exchange market, or a further ratcheting up of oil prices), the economy would be unlikely to meet the expectations laid out above. On the other hand, if things break for the better in some of these areas, we could be writing a year from now that 2005 turned out to be a pleasant surprise.

To summarize, we anticipate that the economy will muddle through 2005. The year will be nothing to write home about, but given the potential pitfalls in the current economic landscape, it is far from the worst possible outcome. And if we have some luck, we could muddle through with some style. ◀

Figure 2
Monthly Changes to the Labor Market, 2002 to 2004



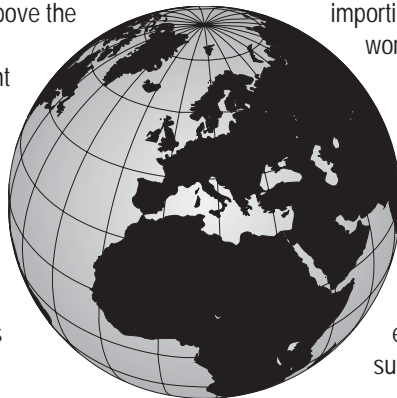
The International Economy

Andreas Hauskrecht

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World economic growth for 2004 is projected at 5 percent (measured in terms of real gross domestic product [GDP]), compared to growth rates of 2.1 percent in 2002 and 3 percent in 2003. The International Monetary Fund in Washington forecasts world economic growth for 2005 at 4.3 percent,¹ slightly lower than this year but still significantly above the historical average of 3 percent.

The forecast predicts a slight economic slowdown for most world regions (see Table 1), although the Euro area² and Japan will grow at a pace close to their respective potential long-term output growth rates. These regions support the U.S. economy in its role as world growth engine.



Like last year, China and India are expected to show robust economic growth in 2005, close to or even above 7 percent. Their resulting demand for energy, particularly Chinese demand for crude oil, has been one key factor explaining its high price. Should the oil price remain at current levels, output growth will be significantly lower for oil-importing economies and the world economy as a whole.

Europe

Recovery in Europe has finally gained momentum in 2004 and economic output is expected to rise by 2.2 percent. While this economic upswing was supported by an increase in

domestic demand in countries like Spain and France, in other European countries (such as Germany and Italy), domestic demand is still lackluster. The expected slowdown of world GDP growth will likely hit Germany, by far the biggest economy in Europe, and cause, at best, a stagnation of the current output growth rate. Overall risks appear tilted to the downside, and a high crude oil price will have a significant impact on economic activity. Unemployment is expected to remain relatively high for the entire region. Several factors contribute to this sobering outlook for the Euro area:

- ▶ First, while several Asian countries try to limit a devaluation of the dollar against their currencies, the appreciation of the euro caused significant losses in competitiveness for European exports.
- ▶ Second, rising inflation limits the scope for the European Central Bank to reduce interest rates.
- ▶ Third, the so-called Financial Stability Pact does not allow national governments to use fiscal policy more actively in order to stimulate the economy.

Asia

Japan enjoyed an unexpectedly strong economic upswing in 2004 with a real GDP growth of 4.4 percent. However, while the economy was growing, the price level was further declining by 0.2 percent. On the plus side were a significant reduction in debt/equity ratios (reduced leverage), a reduction of nonperforming loans for banks, and increased exports to Asian countries. This should not obscure Japanese dependence on exports to the United

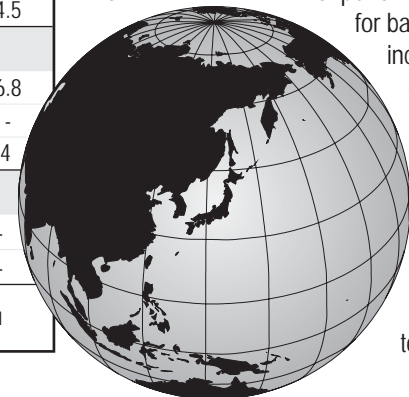


Table 1
Growth Comparisons for Selected Countries

Country	GDP		Inflation Consumer Price Index		Current Account Percent of GDP		Unemployment	
	2004	2005	2004	2005	2004	2005	2004	2005
Europe								
Euro Area	2.2	2.2	2.1	1.9	0.8	0.9	9.0	8.7
France	2.6	2.3	2.4	2.1	-0.6	-0.6	9.4	9.0
Germany	2.0	1.8	1.8	1.3	4.4	4.8	9.7	9.5
Italy	1.4	1.9	2.1	2.0	-1.1	-0.8	8.3	8.2
United Kingdom	3.4	2.5	1.6	1.9	-2.0	-1.9	4.8	4.8
Asia								
China	9.0	7.5	4.3	3.0	2.4	2.8	9.8*	-
India	6.4	6.7	4.7	5.0	0.5	-	-	-
Japan	4.4	2.3	-0.2	-0.1	3.4	3.2	4.7	4.5
South Korea	4.6	4.0	3.8	3.8	3.1	3.3	3.5	3.6
Taiwan	5.6	4.1	1.1	1.5	6.9	6.0	4.7	4.5
North America								
Canada	2.9	3.1	1.9	2.2	2.9	2.4	7.2	6.8
Mexico	4.0	3.2	4.4	4.0	-1.2	-1.5	3.6**	-
United States	4.4	3.0	2.3	3.0	-5.4	-5.1	5.5	5.4
Additional Countries								
Brazil	4.0	3.5	4.0	3.5	1.2	0.4	-	-
Russia	7.3	6.6	10.3	8.9	9.9	7.8	-	-

*Average second quarter **Second quarter
Sources: Center for Econometric Model Research, Indiana University; International Monetary Fund World Economic Outlook, Fall 2004; The Economist Intelligence Unit Country Reports

States. The Bank of Japan, its central bank, intervened massively on the foreign exchange market to support the dollar and avoid a stronger appreciation of the yen against the dollar. Currently, the Japanese central bank sits on foreign exchange reserves of almost \$850 billion, and still the yen has significantly appreciated against the dollar. As central bank purchases of the dollar sooner or later will have to come to an end, a further appreciation of the yen is likely and exports to the United States will be harmed. At almost 160 percent of GDP, Japan has by far the largest government debt of all industrial nations. This, in addition to a rapidly aging population, puts a large burden on taxpayers and future generations, which hurts the economic outlook.

The recent recovery of emerging Asian countries was impressive, reaching a growth rate close to 10 percent through mid-2004.

Of course, the overall performance of the region is dominated by China and India. Following the example of the Bank of Japan, other central banks heavily intervened in foreign exchange markets in order to avoid an appreciation of their currencies against the U.S. dollar. The Chinese, Taiwanese, South Korean, and Indian central banks sit on historically high levels of foreign exchange reserves—mostly in dollars. As inflation is increasing in this region of the world, this policy will come to a natural end and a future appreciation of their currencies against the dollar seems unavoidable. While the forecast for the region still looks bright, the prospect for China is shadowed by many risks (see section on risks). A sharp slowdown of the Chinese economy or a change of the Chinese exchange rate regime from its current peg of the yuan to the dollar would have significant repercussions in the region.

North America

The economies of the NAFTA members are increasingly integrated. Strong demand from the United States further increased Mexican

and Canadian exports to the country and contributed to a robust economy in both nations. Unlike Canada, Mexico, as a petroleum exporter, benefits from high crude oil prices. Yet, accelerating inflation is a concern and motivated the central bank to recently tighten monetary policy. Both economies are expected to grow in real terms slightly above 3 percent in 2005.

Russia and East Europe

Russia and most Middle and East European countries are continuing to do well, and the outlook is optimistic into 2005. The common explanation is, of course, the booming crude oil price. Yet, the Russian economy shows signs of severe imbalance, such as accelerating inflation and an unhealthy reliance of the federal budget on revenues from oil exports, while significant structural problems are not addressed.

South America

Overall, Latin America did very well in 2004 and the prospects for 2005 look rather bright. However, the picture looks more diverse as some oil exporting countries like Mexico, Venezuela, and Columbia gain from the current oil price boom while other countries are hurt. Relatively high public debt remains a concern while external finance conditions will probably deteriorate as U.S. interest rates rise. In addition, accelerating inflation might force the central banks to tighten monetary policy.

The Risks

The high oil price is the biggest risk for world economic activity in 2005. The numbers presented in **Table 1** are all based on an assumed yearly average crude oil price below forty U.S. dollars. Every five dollar increase

in the price of oil reduces world economic growth by 0.3 percent. Continuation of the current oil prices would decrease world GDP growth by roughly 0.7 percent in 2005. Unfortunately, a persistently high oil price for 2005 is likely. One reason is the huge Chinese hunger for oil and other commodities. In 2004 alone, Chinese demand for oil increased by 15 percent, accounting for one third of the growth in global demand. Meanwhile, oil production has almost no unused capacities and any increase in output in 2005 will be very moderate. As the exploration of new oil fields takes several years, no easy solution is on the agenda for the coming year.

A second risk for the world economy is the effect of policies designed to slow Chinese economic growth to sustainable levels, such as increased interest rates and other lending restrictions for banks. A hard landing of the Chinese economy would have significantly harmful effects, particularly for other Asian countries. On the other hand, if successful, these policies would help cool down the world oil price.

The huge U.S. current account deficit, now close to \$600 billion, is worth mentioning.

The question is not if the deficit will decline, but rather when and how fast. The most likely scenario is a further depreciation of the dollar against the currencies of major U.S. trading partners and a correction of the deficit. Yet, a rapid depreciation of the dollar would have devastating effects, not so much directly for the United States, but rather indirectly—by damaging the economies of our major trading partners such as China, Japan, Canada, Mexico, and Europe. ◀

Notes

1. International Monetary Fund, *World Economic Outlook: The Global Demographic Transition* (September 2004). Available from: www.imf.org/external/pubs/ft/weo/2004/02/index.htm.
2. The Euro area includes Austria, Belgium, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Holland, Portugal, and Spain.

Financial Forecast

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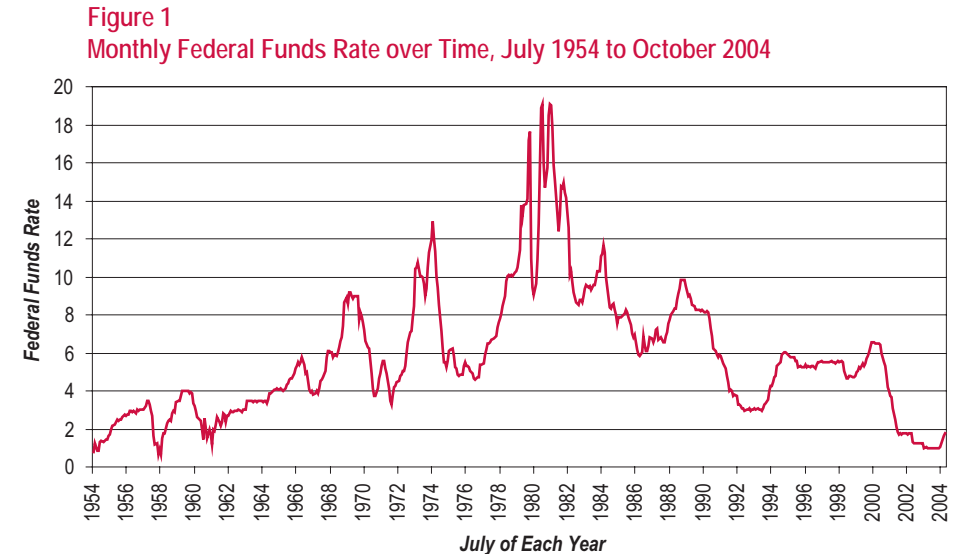
As usual, the condition of U.S. financial markets is bipolar. The optimistic side is that the financial markets have been able to absorb tremendous shocks during the past three years: the trauma of 9/11; declining stock market returns from the incredible highs of 2000; the bankruptcies of Enron, Worldcom, United Airlines, and others; sweeping legislation to reform corporate governance practices at companies; and unrelenting global competition. The depressed side is that many new challenges now face the markets: the war in Iraq, massive budget and trade deficits, and record high oil prices. Given these new challenges it is easy to see why financial markets are on edge with investors wondering which direction the markets will go. Fortunately, there are some notable bright spots:

- ▶ Housing demand remains strong and families who own their own homes have seen rapid increases in value in many markets.
- ▶ Relatively low interest rates have helped sustain the markets, particularly real estate.

The question on everyone's mind is what does the future hold?

Interest Rates

Interest rates have generally fallen for the past twenty years, due in large part to wringing inflation out of the economy. In addition, foreign governments have been buying Treasury securities to shore up their currencies, and domestic investors have been improving the quality of their portfolios in the face of erratic stock market returns. Since short-term rates have fallen much



more than the long-term rates, the yield curve continues to be very steep. Historically, the spread between short- and long-term rates is a precursor to economic activity and the currently observed high spread is generally followed by an expansion and rising interest rates. Also, the Federal Reserve has been increasing interest rates in small steps to combat inflationary pressures in the economy. We expect this policy to continue and, as a result, we expect the short-term Fed Funds rate will rise to 2.75 percent by the end of 2005 (see Figure 1). Since we forecast inflation to be 3 percent in the upcoming year, the implication is that short-term real rates of interest will be negative or close to zero, which reduces the effective cost of the use of debt to the borrower. The anticipated inflation will carry long-term Treasury yields up from the current 5 percent level to the 5.5 percent range by the end of 2005. Corporate interest rates will exhibit similar increases next year. Mortgage interest rates bottomed out at about 5.25 percent last year, and we expect that mortgage rates will also rise over the next year to 6 percent. The prime rate is expected to be near 5 percent by the end of the year.

Corporate Profits

In the four quarters ending in June, the government reported that corporate profits increased by 18.5 percent, reaching a level of \$876.7 billion, or 7.7 percent of gross domestic product (GDP). This is the highest profit percentage since 1966 and

indicates a positive force for future growth. Corporate profits and cash flows continue to be adversely affected by high oil prices, high commodity prices for inputs like steel and copper, and rising costs of health care and pensions. These forces, along with higher interest rates, will dampen corporate profit growth next year. As the economy continues to grow (albeit at a slow 3 percent real rate), we expect corporate profits to rise only about 8 percent during 2005, less than half the rate of growth in 2004. Global competition remains fierce in virtually all markets, but the continued weakness in the dollar will help exporters remain competitive. In addition, a productivity increase of 1.9 percent will offset the small gains in labor compensation.

The weak but positive outlook for 2005 will encourage firms to expand capital investment and employment to meet the expected increase in demand for goods and services, as well as replenish reduced inventory levels. Unfortunately, these increases will be modest because current capacity utilization is 77.3 percent, which is below the 82 percent to 84 percent that is normally considered to be full capacity utilization. Although we see few reasons to expect a major business slowdown at this time, we also do not see a major upturn either. The recently passed American Jobs Creation Act of 2004 contains provisions that should help many manufacturing companies (broadly defined). The act includes provisions to repeal the tax exclusion for extraterritorial income (which is offset by a lower tax rate

Housing

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of 3 percent for domestic manufacturers), to increase the small business expensing limit to \$100,000 through 2007, and to initiate a one-year tax holiday to repatriate foreign profits at a 5.25 percent tax rate. Such a low tax rate may encourage as much as \$500 billion in undistributed overseas earnings to find its way back to the United States.

A major wildcard in the business sector is what corporations will do with the massive hoards of cash they have amassed. At the end of the second quarter, the Commerce Department estimated that U.S. corporations (not including farming and financials) held \$1.27 trillion in liquid assets, representing 10.9 percent of GDP. This is the highest percentage since 1959. At this point, companies are very cautious in spending the hoard on capital investment or hiring until economic uncertainty is resolved. Furthermore, special accelerated depreciation allowances enacted in 2002 are set to expire at the end of the year, diminishing a tax incentive for capital spending. If corporations are reluctant to spend the money, the imperative of shareholder value suggests that the cash will likely be dedicated to increased dividends or share repurchases.

Stock Market

The best way to describe recent stock market activity is “choppy”—up, down, sideways. As the economy slowly continues to improve, we expect the stock market to also continue making gains. If corporations divest their cash hoard by paying increased dividends or buying back stock, the market will benefit. In the long run, we expect the stock market will offer returns 6 percent to 8 percent above Treasury bonds, which is in line with the market's historical average performance since 1926, but well below the returns investors were experiencing in the 1990s. As always, prudent investors should continue to diversify their portfolios to guard against too much exposure to any individual stock, market, or asset category.

Summary

The financial markets will mirror the economy—slow growth in valuations because of the global and domestic challenges outlined above. Unfortunately, it will be a bumpy ride. ◀

Because interest rates have remained at unexpectedly low levels during 2004, it appears that housing starts for 2004 will be slightly higher than we forecasted last year. Rates are expected to rise slightly during 2005 as the economic recovery continues, but there should also be continued job recovery. The thirty-year fixed-rate mortgage should gradually rise to 6.4 percent in the fourth quarter. The average rate for all of 2004 is expected to be 6.1 percent, only modestly above 2003's 5.8 percent.

While rising interest rates tend to dampen the demand for housing, job growth increases the demand. On balance, we expect housing starts to fall slightly for 2005 to a level of 1.85 million units, down from the 1.93 million units expected for 2004. This is still quite strong by historical standards. The single-family component of housing starts is likely to set a record during 2004. Multi-family is not quite as strong because more families can afford to own rather than rent.

Existing home sales have been strong during 2004, after setting a record of 6.1 million in 2003, and should also remain strong during 2005. The National Association of Realtors (NAR) forecasts existing-home sales to rise 5.7 percent in 2004 to 6.45 million. New-home sales should also hit a record, increasing 10.8 percent to 1.20 million in 2004.

Expenditures for home additions and alterations are expected to be strong because homeowners' equity has increased with rising home prices. High oil prices could produce a further rise in prices for certain building materials.

Low interest rates and the strong housing market during the past year put upward pressure on home prices. The median

existing-home price will continue to show above normal appreciation, rising 7.3 percent in 2004 to \$182,400. The median new-home price should increase 8.3 percent this year to \$211,100. The rising cost of building materials has been partly responsible for upward pressure on home prices.

The low mortgage rate environment has also led to a strong demand for condominiums (condos) by people who might otherwise rent because they could not afford a home mortgage—especially first-time homeowners. In many areas of the country, condo converters have been buying apartments at unprecedented prices and converting them into condominiums.

Primarily due to low mortgage interest rates, housing has been relatively affordable, with the NAR Housing Affordability Index at 127. This means a family at the median income level is earning 27 percent more than needed to qualify for the median-priced home.

Interest in commercial real estate by investors has also been unusually strong during 2004 and is expected to continue during 2005. Investors who have been disappointed with the performance of the stock market and have a renewed appreciation for the importance of diversification are looking to commercial real estate as a way to balance their portfolios. This can be done in a number of ways, including direct real estate investments or purchasing shares of publicly traded real estate companies, such as real estate investment trusts (REITs). The share price of REITs like Simon Property Group, which owns malls, and Duke Realty, which owns office and industrial properties, has risen significantly over the past year. ◀

Housing starts should fall slightly to a level of 1.85 million units, down from the 1.93 million units expected for 2004. This is still strong by historical standards.

Indiana

Jerry N. Conover

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Indiana University, Bloomington and Indianapolis

As the nation's most manufacturing-intensive state, Indiana often feels the effects of economic downturns earlier than other states, and those effects tend to last longer. That was the case for the most recent recession and recovery period, but Indiana now appears to be slowly regaining the ground it lost over the past few years.

The most-watched indicator of Indiana's economy is total monthly nonfarm employment (which does not include self-employment). As shown in **Figure 1**, Indiana's employment bottomed out in April 2002 at 2,888,000 workers, a decline of 128,000 jobs from the state's peak employment in May 2000. Since hitting that minimum, Indiana has regained 28,500 jobs as of September 2004—a modest increase to be sure, but an increase nonetheless. Moreover, employment growth is becoming more regular. The state has experienced nine consecutive months of job gains compared to figures from the previous year, the first such streak since 2000. In comparative terms, however, forty-two states have higher job growth rates than Indiana, whose employment growth was 0.5 percent over the past twelve months.

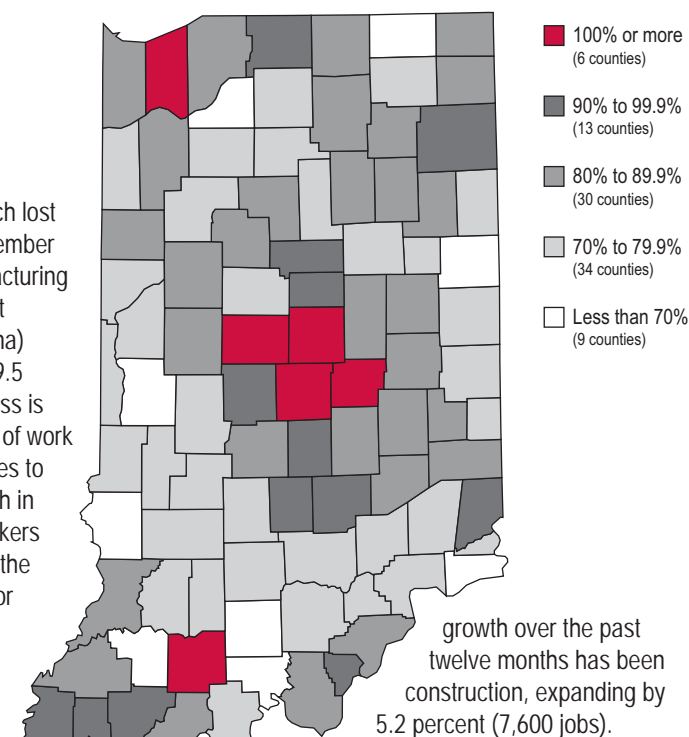
An End to Manufacturing Losses?

The largest share of Indiana's job loss in recent years has come from the

manufacturing sector, which lost 104,100 jobs from its December 1999 zenith (when manufacturing accounted for 22.4 percent of all employment in Indiana) to its March 2004 nadir (19.5 percent). Part of this job loss is attributable to outsourcing of work from the payrolls of factories to other organizations (though in some cases the same workers continue to operate under the same roof as before, but for a new vendor firm); while perhaps a larger impact has come from increased productivity. Fortunately, the shrinkage of Indiana's manufacturing employment appears to have subsided, and the state weighed in with 1,300 more factory jobs in September than in March 2004.

Service sector growth has counteracted shrinkage in manufacturing. Since Indiana's total employment bottomed out in April 2002, the education and health services sector has shown the largest gains, adding 23,100 jobs; the government sector has added 13,500 jobs; and the business and professional services sector has grown by 7,700. More recently, the sector with the strongest

Figure 2
PCPI Relative to the Nation, 2002



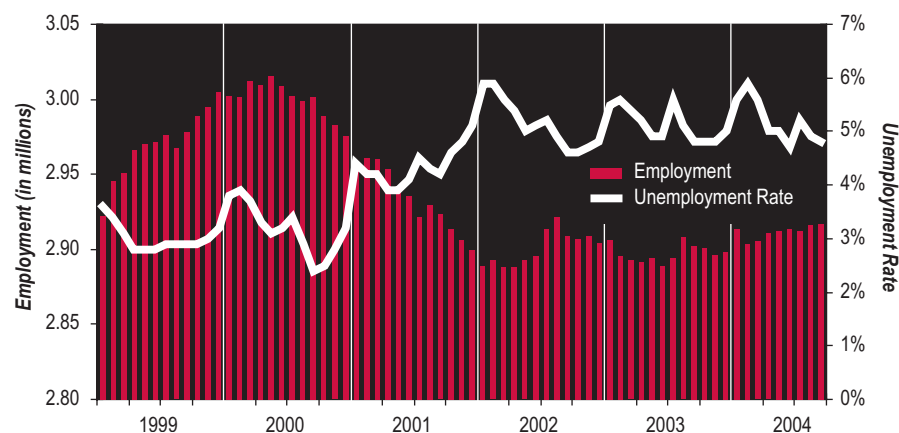
Personal Income

Though closely watched, employment does not fully capture the impact of economic change in a state, especially as workers migrate from higher-paying factory jobs to positions in lower-paying industries. A better indicator from this perspective is per capita personal income (PCPI), which shows the average of incomes received from a variety of sources. In this respect, Indiana's residents earn only 91.5 cents for each dollar earned by the average U.S. resident, according to the latest state and national figures for 2003. This gap has gradually widened over many years. In the state's rural areas, the gap is even wider, while Indiana's metro areas have PCPI's closer to (but still below) the national average (see **Figure 2**).

Indiana's Outlook for 2005

On balance, Indiana's economic downturn has begun a slow recovery, and the outlook for 2005 is for modest growth. Several factors argue for a conservative forecast, including rising interest rates, slow growth in the state's population, and slowing demand for housing and automobiles. In light of these factors, we anticipate that Indiana's employment will grow by about 15,000 jobs, and the state's unemployment rate should be near its current level of 4.8 percent by the end of 2005. ◀

Figure 1
Indiana Seasonally Adjusted Employment and Unemployment, January 1999 to July 2004



Anderson and Muncie

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The last decade has not produced good economic results for Anderson and Muncie. Like most of Indiana, both of these regions failed to keep pace with national growth beginning in the mid-1990s and continuing through the most recent recession; but these counties suffered a performance gap that was especially severe.

NAICS-based employment and earnings records from the Quarterly Census of Employment and Wages (formerly known as ES-202 data) were made available in October that allow us to track economies back to 1990. What they show us in east central Indiana is not very pretty.

There has been a general downward trend in payroll employment of business establishments in Delaware County (the Muncie metro area) and Madison County (the Anderson metro area) since the mid-point of the last decade, as depicted in Figure 1. For the Muncie economy, the downturn came on the heels of a period of very strong net hiring in the first half of the decade. Yet the long duration of the job slump, together with an increased rate of job loss during the recent recession, have brought employment totals down to just a fraction above where they stood in 1990.

Anderson's downturn was even more severe. Its growth in the first half of the 1990s was much less pronounced, and the pace of its job loss during the latter half was more severe. As a result, Madison County firms employed about 4,300 fewer workers in 2003 than were on payrolls in 1990, a contraction of 9 percent.

The losses were especially large in manufacturing. In 1996, there were 9,000 workers employed in just one manufacturing industry—transportation equipment—in Madison County. In 2003, that same industry employed just 4,500 workers. That mirrors the slide in total manufacturing employment in Anderson, shown in Figure 2, which fell from 16,000 workers in 1990 to just half of that total fourteen years later.

The experience of Muncie's manufacturing sector was only slightly better. After hovering between 10,000 and 11,000 workers until 1997, the closings and setbacks of that year precipitated a pattern of decline that has continued to the present. In 2003, Delaware County manufacturing payrolls dipped below 8,000 jobs for the first time.

Establishment survey data (CES) is available for the Muncie metro only (due to its MSA status) and show this decline continuing through 2004. The most recent numbers put

October 2004 manufacturing employment at just 6,700 jobs, down 11 percent from 2003.

Causes and Consequences of the Economic Declines

It is difficult to know with certainty what these disappointing results can be attributed to. Although Anderson and Muncie's manufacturing job losses were among the worst in the state, they took place in a period when almost 20 percent of factory jobs were eliminated nationwide. Despite this, in the national economy, there was significant job growth.

Thus, the search for answers to the problems that have challenged the Anderson and Muncie economies over the past ten years should seek not only to understand why manufacturing jobs have declined, but also why there were not enough nonmanufacturing jobs created to replace them.

A glance at the population profiles produced by the 2000 Census provides some insights. The educational profile of the adult population in both Anderson and Muncie reflects the lower educational requirements of a traditional manufacturing base (see Figure 3). Within their respective city limits, more than one out of every five adults in Anderson

Figure 1
Metro Area Employment Since 1990

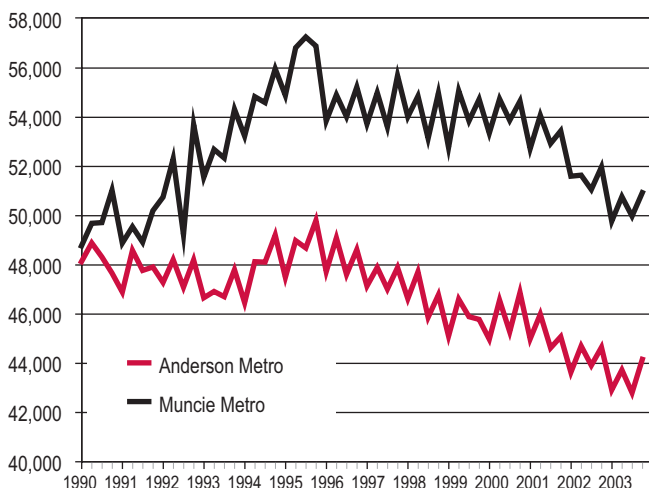
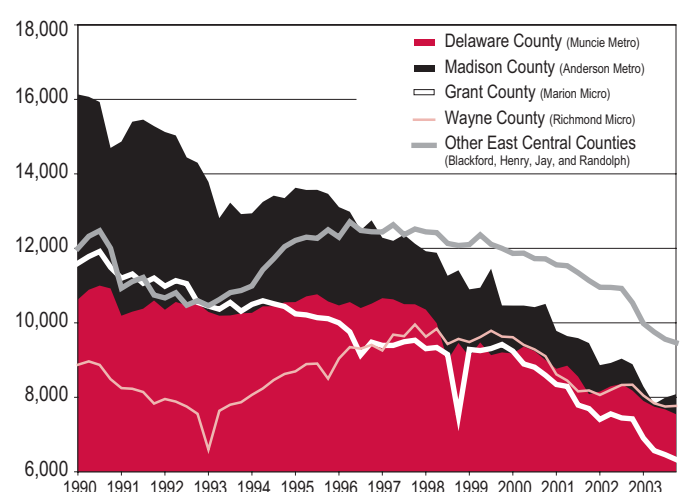


Figure 2
Manufacturing Employment Since 1990



Bloomington

Thayr Richey, Ph.D.

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and Muncie do not have a high school diploma.

At the other end of the spectrum, Madison County has fewer college graduates than the state average, and Delaware County has fewer than what one would expect since it is home to a large university. Given the emphasis on training and education in the higher-paying service industries, labor force development will be a key part of future economic success.

The Outlook for 2005

The rebound of manufacturing in the national economy through the first three quarters of 2004 gives some hope that the declines in factory employment suffered by Anderson and Muncie will soon come to an end. The decline of the dollar, the surge in corporate profits, and the revival of business spending at least provide an environment in which a reversal of these unfortunate trends can take place.

But three years beyond the official end point of the 2001 recession, no positive sign of an end to that decline has been reached. Until the economic base of these two counties transforms itself to take better advantage of growth opportunities outside of manufacturing, the most likely outcome is a continued decline in the coming year. ◀

In many ways, Bloomington is transitioning. The most obvious evidence of change is downtown. Like mushrooms after a spring rain, the new apartments lining downtown streets are changing the skyline and nature of downtown Bloomington.

Economically, this has been a mixed year for Bloomington and Monroe County. However, the community remains one of the economic leaders in the state. This is an economy in transition; however, it is not clear what Bloomington's economy is transitioning into.

Let's look at three factors that suggest the health of the Bloomington economy:

1. **Population:** We are growing but our growth rate has slowed. Population growth has increased in neighboring counties.
2. **Employment:** We continue to lose traditional manufacturing jobs (although we will see ups and downs in this sector); these jobs are being replaced by service sector jobs.

3. **Income:** The challenge will be to grow new economy manufacturing and service sector jobs sufficiently to replace the high-paying manufacturing jobs that we have lost and will continue to lose.

Population

In terms of population change, Monroe County continues to grow. In recent years, the growth rate has slowed somewhat from the previous twenty years, but the population still is growing (see Figure 1).

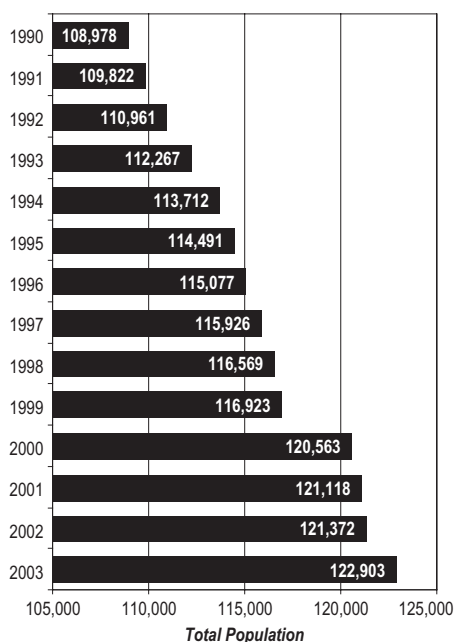
The county's population growth rate between 1990 and 2003 is above the state average. Although between 2000 and 2002 the county's growth rate (0.6 percent) was lower than the state average (1.3 percent). However, looking at the whole Bloomington metro area, which includes Greene and Owen counties, we ranked ninth among sixteen metro areas in the state.

However, we have not kept up with the population growth leaders in the state.

Figure 3
Educational Attainment in Muncie and Anderson, Census 2000



Figure 1
Monroe County's Population, 1990 to 2003



Monroe County was the eleventh most populous Indiana county in 1990; today we are the twelfth most populous.

Commuting Patterns for Monroe County

With a residential labor force of 66,289, the community is also important to the economies of Greene, Owen and Lawrence counties. This residential labor force has remained stable. Bloomington continues to serve as a regional employment center, as nearly 15,000 workers commuted to Monroe County to work, according to Census 2000 (see **Figure 2**).

Monroe County's unemployment rate is regularly among the lowest in the state. In September 2004, the county's unemployment rate was 2.5 percent.

Employment

While employment has remained strong in Bloomington, the nature of that employment is changing. After years of manufacturing employment expansion, manufacturing employment in the county has shrunk over the past several years. As of 2003, the manufacturing sector represented just 12.5

percent of Monroe County employment (see **Table 1**).

For the past several years, Bloomington has been a leader in an economic transition. We continue to lose traditional manufacturing jobs and gain jobs in less traditional manufacturing areas and in the service sector. We actually gained manufacturing jobs between 2002 and 2003. But overall, we have had a net loss of about 1,500 manufacturing jobs between 1994 and 2003. The job losses will probably continue in manufacturing, with a number of jobs likely to be lost in the next twelve months.

However, the decline of manufacturing employment is not a simple issue. For example, one manufacturing company in Bloomington is in the middle of an expansion that projects 250 new jobs. And the life sciences manufacturing sector has great promise here.

Despite the substantial loss of manufacturing employment, Bloomington's economy has remained relatively stable. The community has partly compensated

for the loss of manufacturing employment with the growth of service and government jobs.

The community is seeing strong small business growth in sectors such as information services and life sciences. For example, the health care and social services sector now makes up approximately 10 percent of the county's employment,

with average earnings per job exceeding \$36,000 per year. Information and professional technical services accounts for approximately 6 percent of the county's workforce, based on 2002 data, with average earnings per job between \$30,000 and \$49,000.

The government sector (this includes employment at Indiana University) now accounts for approximately 25 percent of the employment base, and service sector jobs

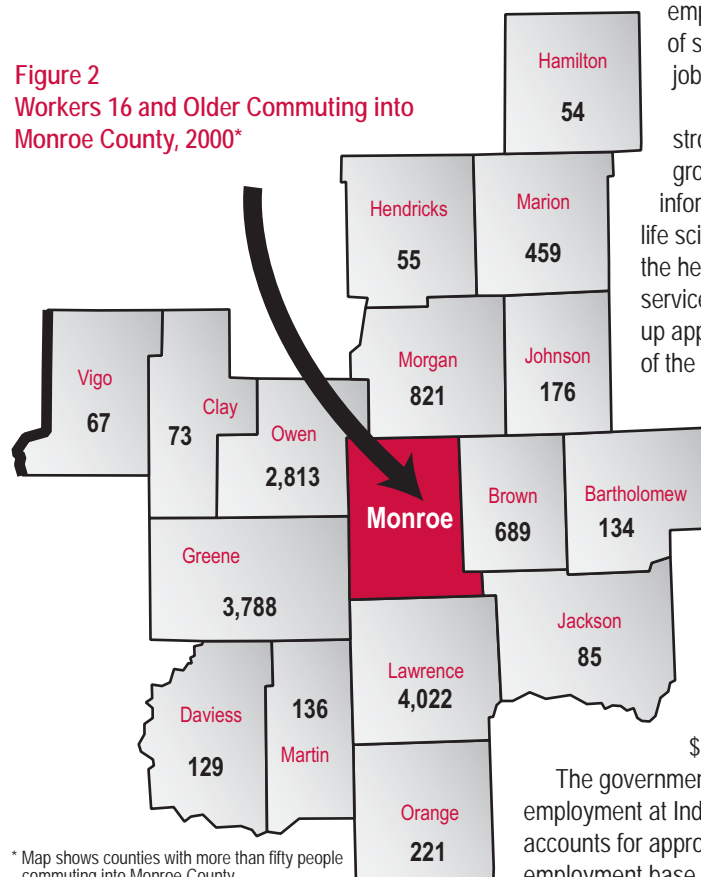
Table 1

Monroe County Manufacturing Employment as a Percent of All Jobs

Year	Percent	Rank (of 92 counties)
2000	13.9%	80
2001	13.5%	80
2002	12.8%	82
2003	12.5%	82

Despite the substantial loss of manufacturing employment, Bloomington's economy has remained relatively stable. The community is seeing strong small business growth in sectors such as information services and life sciences.

Figure 2
Workers 16 and Older Commuting into Monroe County, 2000*



* Map shows counties with more than fifty people commuting into Monroe County.

make up over 25 percent of the employment base in Monroe County.¹ Wages from government in 2002 totaled approximately \$731 million.

Bloomington continues to be an economy in transition. The community remains a regional locus of manufacturing, but the growth in higher-wage employment appears to be coming from the government and service sectors. It will be interesting to see if the Bloomington experience reveals a new approach to the Indiana economy: retain a core manufacturing base but grow the overall economy through higher-paying jobs in education and service. ◀

Notes

1. Service sector jobs included in this percentage include accommodation and food services; arts, entertainment, and recreation; health care and social services; information; and professional and technical services.

Columbus

James C. Smith

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Candidates for political office all promise more jobs and more prosperity. In the real world, individual politicians don't have much effect on the economy. Trends in economic activity typically take many years to develop, much longer than any politician's term of office.

Trends emerging in Columbus and Bartholomew County, however, raise concerns. The Columbus metro has historically been one of Indiana's more prosperous regions. Per capita personal income (PCPI) was 103 percent of the national average in 1997, fifth highest among Indiana's ninety-two counties (see **Figure 1**). By 2002, though, per capita income had dropped below the national average (to 98

percent), and the county's ranking in the state was down to ninth. That year was a recession year, of course, but it was a recession all over Indiana. Yet Bartholomew County's ranking within Indiana went down.

This decline in relative prosperity is reflected in the wages earned in the county. **Figure 2** shows quarterly wages per job in Bartholomew County as a percent of the Indiana state average. From its former level of more than 110 percent of the state average, the county drifted down to near 105 percent in the most recent five years. (The spike in 2000 may have been influenced by the ArvinMeritor merger that year). What's even more troubling is that in real terms, after adjusting for inflation, wages per job in the county are no higher than they were in 1998 and 1999.

Recessions often hit hard in Bartholomew County. Heavy manufacturing has at times accounted for more than 40 percent of Bartholomew County employment, though now that figure has shrunk to 35 percent. But recoveries have been good to the area too. Not this time. The current economic recovery, a weak one nationally, has been even weaker in the Columbus area.

The level of employment is shown in **Figure 3**, indexed to the fourth quarter of 1997 in order to make a comparison to total

employment in the state. While employment statewide declined during the recession in 2000 and 2001, by the end of 2001 the worst of the drop was over. In Bartholomew County, however, after a brief bounce in 2002, the downward trend in employment continued, widening the gap between the performance of Bartholomew County and that of Indiana as a whole. So far, whatever recovery that has taken place nationally has not boosted employment around Columbus very much.

Bartholomew County businesses have long been a draw for residents of surrounding counties. The commuting patterns show far more people commuting into Bartholomew County to work than commuting out. But that pattern, too, is weakening. In 1997, the ratio of commuters into the county to commuters out of the county was 3.3 to 1 (see **Figure 4**). Three people drove into the county to work for every one Bartholomew County resident commuting to a job outside the county. By 2002, that ratio was down to 2.5 to 1. There were fewer inbound commuters and more people leaving the county to work.

These local trends indicate Bartholomew County's economic climate in 2005 will not improve as much as the national average. And the outlook at the national level is for only lukewarm (and highly uncertain) expansion.

Figure 1
Bartholomew County PCPI

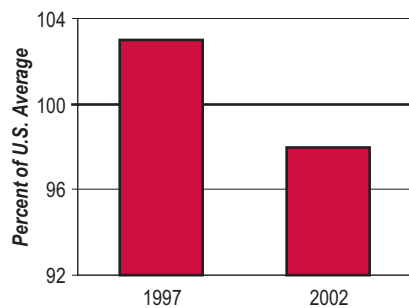


Figure 2
Bartholomew County Real Wages per Job as a Percent of State

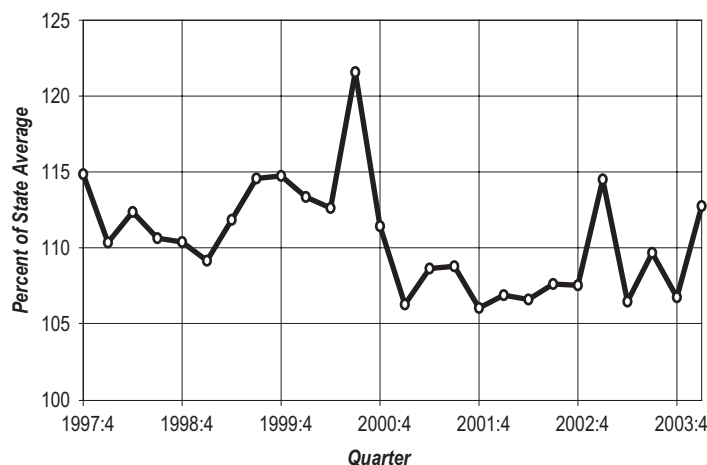
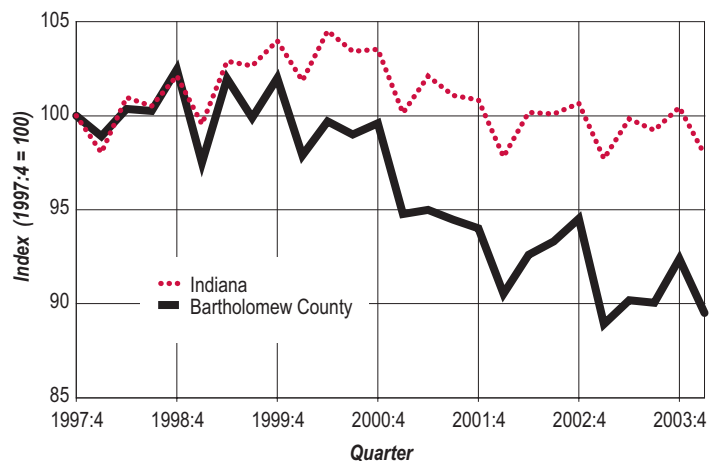


Figure 3
Quarterly Payroll Employment Index

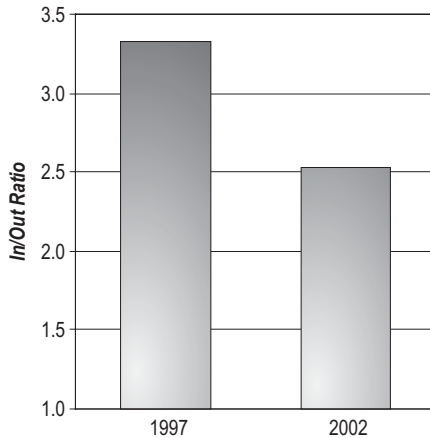


Evansville

M. Gale Blalock

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Figure 4
Bartholomew County Commuting Ratio



Some sectors of the Columbus area economy surely will do better than others. While real wages per job were flat countywide in the last five years, they grew by more than 30 percent in the financial services sector. And despite the recession, employment in health care jumped 10 percent from 2001 to 2004.

In general, though, don't look for 2005 to be much different from 2004. Based on forecast data from the Kelley School of Business, here's what to expect:

- ▶ **General level of business activity:** About the same as in 2004. Not much growth.
- ▶ **Wages:** Flat. Any increases will just about cover inflation.
- ▶ **Number of jobs:** Not much improvement over 2004. Countywide, an increase of perhaps 600 jobs, or about a 1.5 percent rise in payrolls.
- ▶ **Unemployment rate:** The average may be a little better than 2004. But the early months typically have the highest unemployment rate of the year. So expect the rate to approach 4 percent in the first quarter, improving to 3 percent by the fourth quarter. ◀

Sources

Indiana Business Research Center, Kelley School of Business, Indiana University; U.S. Bureau of Economic Analysis; and the U.S. Census Bureau

Our area has enjoyed economic stability over the last several years. The U.S. Bureau of Economic Analysis reports Evansville per capita income at \$29,116. This was 94 percent of the national per capita income for 2002. In 1969, per capita income in Evansville was 89 percent of the national per capita income. The number of jobs was recently measured at 162,100, which compares favorably with last year's 161,900. Unemployment in our city is 4.0 percent, compared to 4.8 percent in Indiana and 5.1 percent in the nation.

As measured by the index of economic activity maintained at the University of Evansville, the Evansville economy did not show substantial growth during 2003 (see Table 1). The index has yet to return to the peak set at the turn of the century. There was a substantial gain in both construction and finance, an insignificant decline in trade and a substantial decline in electricity sold to industrial users, the index's proxy for industrial production. The transportation component of the index, boardings at the local airport, continued to decline.

Table 1
Index of Economic Activity in Evansville

Year	Industrial Production	Construction	Trade	Transportation	Finance	Index	Index Growth
1995	0.316	0.040	0.273	0.047	0.240	0.917	n/a
1996	0.330	0.060	0.275	0.051	0.247	0.963	5.0%
1997	0.329	0.048	0.284	0.055	0.250	0.966	0.3%
1998	0.359	0.069	0.277	0.060	0.234	1.000	3.5%
1999	0.385	0.090	0.282	0.062	0.247	1.066	6.6%
2000	0.397	0.072	0.285	0.060	0.254	1.068	0.2%
2001	0.387	0.045	0.288	0.052	0.280	1.053	-1.4%
2002	0.401	0.064	0.284	0.052	0.254	1.054	0.1%
2003	0.385	0.071	0.283	0.050	0.260	1.049	-0.5%
Change from 2002	-3.9%	10.5%	-0.4%	-2.8%	2.6%	-0.5%	n/a

Index Defined

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

In my opinion, the expansionary effects of our nation's fiscal policy have likely run most of their course. Monetary policy is returning to neutral after a long period of expansion. Interest rates will move away from historic lows to levels near their historic averages. These increased interest rates are not likely to make doing business in the durable goods sector or the construction sector any easier. The effects of higher interest rates on the finance sector are uncertain. We can thank the employers of our area for substantial job growth in the past and hope for stability in the future. Barring any unexpected national or international developments, I expect next year to be much like this year. ◀

Fort Wayne

John Stafford

Director, Community Research Institute,
Fort Wayne

The economic downturn during the early portion of this decade hit the northeast Indiana employment base with a hammer. The Fort Wayne Metropolitan Statistical Area (MSA)—for purposes of this article, we will use the old definition of the MSA (including Adams, Allen, De Kalb, Huntington, Wells, and Whitley counties)—lost jobs at a rate approximately twice that of the state of Indiana from the point of peak employment (March 2000 for the Fort Wayne MSA and May 2000 for the state) through September 2004. The MSA lost 6 percent of its employment base, as identified in the Bureau of Labor Statistics' Current Employment Statistics (CES), compared with a 3.3 percent drop in employment across all of Indiana. For the Fort Wayne MSA, that represented a loss of 16,750 jobs.

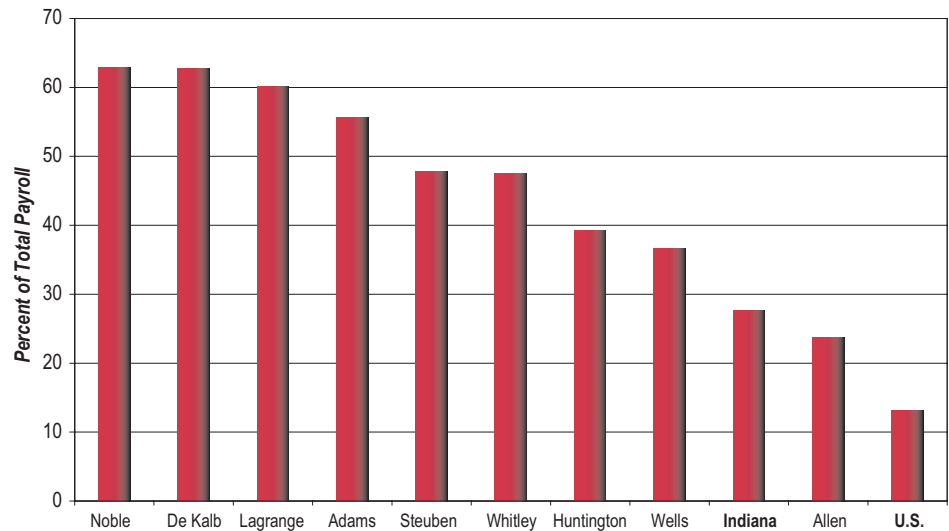
Not surprisingly, the vast majority of jobs lost were in the manufacturing sector—both statewide and in northeast Indiana. Between February 2000 and September 2004, manufacturing employment in the Fort Wayne MSA was down by 15,740 jobs. That is a 21 percent decline in the industrial sector—even steeper than the 15 percent manufacturing employment decline experienced statewide. Durable goods manufacturing was hit the hardest, losing 13,600 jobs in the MSA between March 2000 and September 2004.

Job loss in Indiana began to level off in late 2002 and throughout 2003. Between September 2002 and September 2003, Indiana experienced a net loss of 6,000 jobs; but the Fort Wayne area continued to lose jobs at a much faster pace, with a net loss exceeding 6,500. For the twelve-month period leading up to last year's forecast, job loss in Indiana (after factoring out the Fort Wayne MSA) had come to a halt. But the pain continued in this corner of the state.

However, during the past twelve months, the news has been better—modestly better—for both the state and for northeast Indiana. During that period, Indiana gained approximately 14,000 jobs, and the Fort Wayne MSA gain included 2,475 of that total. Given that this MSA represents about

Figure 1

Northeast Indiana Manufacturing Payroll as a Percentage of Total Payroll By County, 2003



8.3 percent of the total state population, the Fort Wayne area more than doubled the proportion of state employment growth it might have expected to share. Nearly half of that regional gain was in the educational and health services sector. Another 500 jobs were created in the leisure and hospitality sector.

The key question for northeast Indiana is whether we can regain a significant portion of those manufacturing jobs lost in the downturn. We have done it before. Most recently, the MSA increased manufacturing employment by 8,800 between 1994 and 1998. Our strong industrial base, our location, and a labor force suited to the industry needs at that time supported such an increase—an increase more than four times the manufacturing employment growth rate experienced nationally over those five years. Will those factors prevail in our favor again, or will the dual pressures of constantly improving productivity in the industrial sector and the globalization of supply networks dictate that the majority of those lost manufacturing jobs are gone forever? This question is being strongly debated among regional economic development professionals and public policy leaders.

For the longer haul, I will weigh in on the side of those whom suggest that northeast Indiana must get very serious about diversifying our economic base. As seen in Figure 1, several counties in this part of the

state derive more than 50 percent of their total payroll from manufacturing jobs (compared with the 27 percent statewide and 13 percent nationally). Given the fundamental economic transformation that has been, is now, and will continue to occur in this country, it is simply too great a risk to just bet on manufacturing to remain that high of a percentage of our economic base.

For the shorter haul (2005), the core economic assets of northeast Indiana will provide for continued modest employment growth. While the statewide forecast suggests that Indiana will experience a net job growth of only 15,000 over the next twelve months, the Fort Wayne MSA will again see net job growth at a rate approximately twice that projected statewide. This would give the MSA another 2,500 net additional jobs—a growth rate just under 1 percent. We will continue to experience churn in the industry—both losses and gains in manufacturing jobs throughout the region. The net result may be a slight gain, so long as the automotive industry does not see a significant downturn nationally. Gains should also continue in the educational and health services sector and in professional and business services. The MSA has a higher proportion of educational and health services jobs per capita than nationally or statewide—and this proportionality has been growing over the past five years. ◀

Gary

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The northwest Indiana economy has not performed well over the past three years. Establishment employment¹ peaked in September 1999, a level that was maintained with little change until September 2001. Since September 2001, establishment employment has declined by about 7 percent (see Figure 1).² It stabilized at about 264,000 throughout 2003 but has declined again in 2004. Household employment³ peaked nearly two years earlier and was, in fact, roughly stable throughout 2001 and 2002, rose somewhat during 2003, and recently began to decline. The difference in the patterns of establishment employment and household employment mirrors, although not precisely, similar developments at the national level.⁴

The unemployment rate fell steadily throughout the 1993 to 1998 period and began to rise noticeably near the middle of 2001 (see Figure 2). It has been mostly stable (between 5.5 percent and 6 percent) during the past year.

The recent monthly changes in employment and the unemployment rate do not suggest that robust growth will occur in

the immediate future. While establishment employment was higher in September than in July and August, that has occurred largely because of the return of elementary and secondary teachers to the classroom (they are not counted as employed during the summer), and employment remains below its September 2003 level by about 1 percent. (Employment has been lower than the year-earlier level in most months in 2004.) The unemployment rate has continued its usual pattern of rising in January and falling through the spring. The normal pattern has been for the unemployment rate to “bottom out” in September or October and rise during the holiday season (as people seek seasonal employment).

It seems unlikely that the local economy will experience rapid employment growth over the next twelve months. Indeed, a further decline appears more likely than any substantial growth. Over the past twelve months (to September 2004), establishment employment has averaged about 261,000. That seems a likely average over the next twelve months as well (my sector-by-sector

analysis suggests a gain of perhaps 700 to 1,000 jobs). Household employment has averaged about 287,000, but has been trending slightly downward. Again, stability at about 287,000 seems more likely than growth, although the recent downward trend should be a concern. The unemployment rate has averaged about 5.9 percent over the past twelve months. A stable unemployment rate also seems likely over the next year.

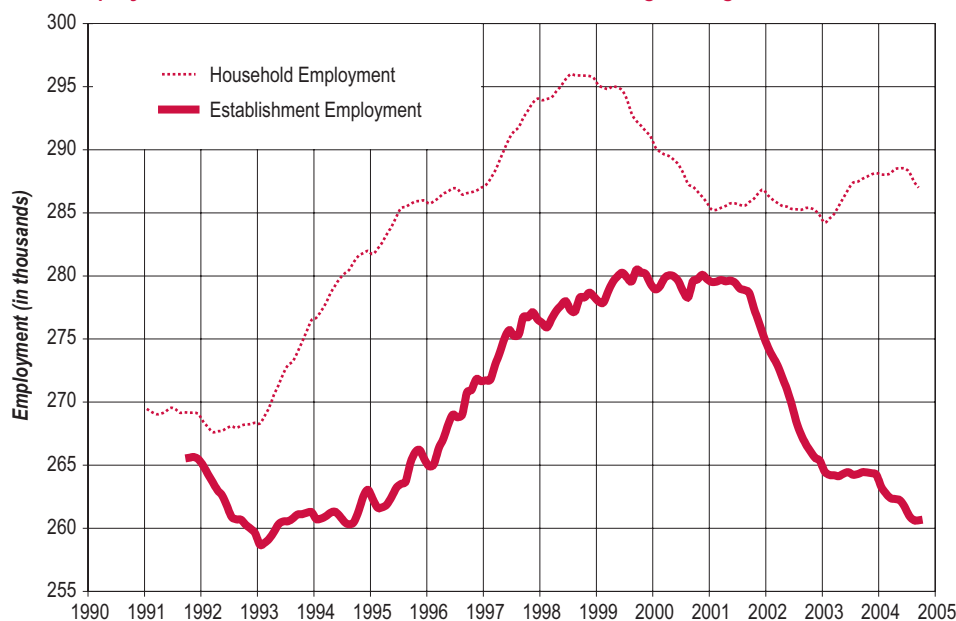
The Goods-Producing Industries

Construction: Construction has been a local bright spot. Despite strong seasonal fluctuations, employment in construction has increased by nearly 2,000 jobs since the middle of 2001 (about 12 percent total, or about 4 percent per year). This increase seems plausible in light of the continued strength of residential construction in northwest Indiana and the ongoing highway construction projects throughout the region. It seems likely that construction employment will grow by 4 percent over the next year, a gain of about 700 jobs.

Manufacturing: Between the beginning of 2001 and the beginning of 2004, northwest Indiana lost about 7,200 manufacturing jobs (a 16 percent decline—about 5 percent per year). In 2004, however, manufacturing employment appears to have stabilized at around 37,000 and durable goods manufacturing has shown very slight growth (gaining about 400 jobs during the year). Even employment in steel has stabilized at about 19,000 jobs. Considering the declines in manufacturing over the prior three years, this is, perhaps, a better-than-expected set of numbers.

The strength of the steel industry, manifested in stable employment and continued growth in output, will continue as long as the world steel market remains strong. However, the Chinese central bank recently increased interest rates, which may lead to a slowing of growth in China and a moderation in Chinese demand for steel. Over the longer term, as China adds to its steel capacity, their demand for imported

Figure 1
Total Employment in Northwest Indiana (Twelve-Month Moving Average)



steel may stabilize or decline. This will almost certainly lead, by the end of this decade, to another period of excess capacity worldwide, with resulting downward pressure on steel prices and profits.

The merger of ISPAT-Inland and ISG (to form Mittal Steel) is unlikely to have any immediate consequences for northwest Indiana. As long as world demand remains strong, the merged company will find uses for all its capacity and output, and employment in northwest Indiana will not decline. There might be extremely modest reductions in management positions here, and perhaps larger reductions in Chicago, but these will not have any large consequences for northwest Indiana.

By the end of the decade, however, as China's new capacity comes on line, things may well be different. Should world demand cease to grow and should steel prices decline, then all steel manufacturers will begin to look again at their capacity and their facilities. Older, less technically advanced and productive facilities will then be at risk of output reductions or closings. The implications of that for northwest Indiana are not clear at this time.

So long as steel demand remains strong, manufacturing employment in northwest Indiana is likely to hold its own. Any significant growth in employment, however, seems unlikely.

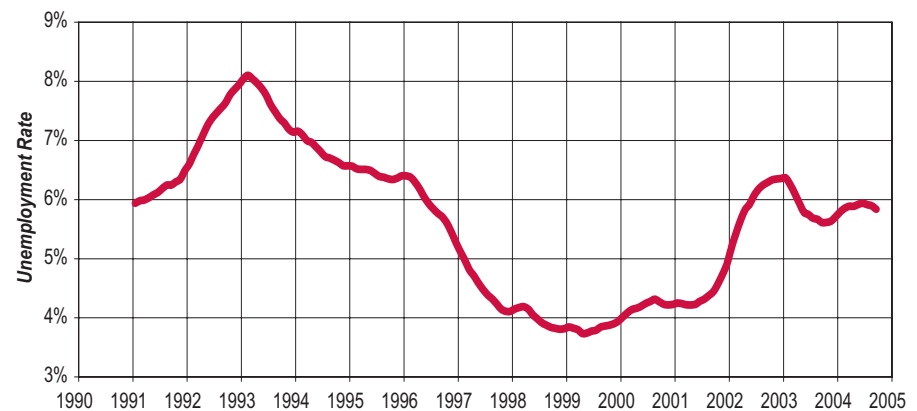
Service Industries

Total employment in the service industries has varied widely within each year over the past four years. Average employment seems to have been about 205,000, with no particular trend, although service sector employment has typically been stronger in the second half of the year. It is perhaps more useful to look at the major subsectors in services.

Wholesale Trade: Employment in wholesale trade has declined by about 10 percent over the past three years, and it appears likely to lose another 200 or so jobs in the next year. While I cannot find any specific explanations for this development, the trend is quite clear and apparently quite strong.

Retail Trade: Employment in the retail sector has declined about 3 percent over the past three years, almost entirely

Figure 2
Northwest Indiana Unemployment Rate (Twelve-Month Moving Average)



between mid-2001 and mid-2002. It has stabilized since then, with the usual seasonal fluctuations (rising in the fourth quarter). Stable employment here, of around 32,500 jobs, seems likely.

Transportation and Utilities:

Employment in this sector displays a strong within-year pattern, with employment falling dramatically from December to January, then rising slowly throughout the year. Unfortunately, employment has ended each year (2001, 2002, 2003) below the previous year's level. The decline appears to be about 400 jobs per year, so a decline to an annual average of about 11,600 jobs seems in keeping with our recent history. Part of this has been driven by productivity gains in trucking and electric power generation and distribution.

Business and Professional Services:

Another bright spot. Employment has increased from about 20,500 in mid-2001 to about 22,000 in mid-2004 (up 7.3 percent, or about 2.4 percent per year). A continuation of growth here would add about 500 jobs.

Education, Health, and Human

Services: Employment has increased by about 3 percent over three years (about 1,000 jobs). The gain appears to be about equally split between education (This is private-sector education at all levels, elementary through higher education. Public education shows up in the government sector.) and health and human services, but it's about a 10 percent employment gain in education and a less than 2 percent increase in health and human services.

Within health and human services, hospital employment rose by about 6 percent between 2001 and the end of 2003, but has since fallen back to its prior level.

Employment gains in the health sector are likely to become harder to achieve, as more attention is paid to health care costs. As a result, only continued growth in private education is likely to provide employment gains here. A net gain of about 300 jobs in this sector seems to be about the limit.

Leisure and Hospitality Services: This sector includes casinos, eating and drinking establishments, theaters, and hotels/motels. The trend over the past three years is slightly up, with a net gain of about 500 jobs (about 1.6 percent total). This industry also shows substantial within-year variation, generally peaking in the summer and bottoming out in the winter. Gains of about 150 jobs over the next year seem likely.

Other Service Employment: Additional service sectors include the information sector (publishing, telecommunications, internet services, etc.), financial services, and miscellaneous services. Employment in information services has been declining by about 200 per year. This may well continue, as some consolidation takes place and as productivity rises. Both financial services and miscellaneous services have experienced little employment change over the past three years, a pattern that is likely to continue. However, should additional locally owned banks be acquired by national banks seeking a northwest Indiana presence, some declines in banking employment may occur.

Table 1
Northwest Indiana Forecasted
Employment Gains and Losses for 2005

Industry	Gain/Loss
Construction	700
Professional and Business Services	500
Education	300
Leisure and Hospitality	150
Manufacturing	0
Retail Trade	0
Health and Human Services	0
Wholesale Trade	-200
Other Services (Information)	-200
Transportation and Utilities	-400
TOTAL	850

What may be an important change has occurred in the banking sector of the local economy and deserves mention. Mercantile National Bank, a locally owned bank with a record of commitment to northwest Indiana, has been acquired by Harris Bank (based in Chicago, a subsidiary of BOM, Ltd., a Canadian bank holding company whose largest bank is the Bank of Montreal). There is substantial research indicating that when locally owned banks are purchased by banks with a national or international presence, their focus on local depositors and local borrowers diminishes. As a result, a long-run consequence of this acquisition may be reduced access to bank credit for local small businesses.

Summary: The sectoral analyses suggest a net gain of around 150 jobs in services over the next year. Compared with the nation, or with the historical trends in northwest Indiana, this is a fairly weak performance.

Government

Little change has occurred in government employment in the past three years. Federal government employment has

remained roughly constant at about 2,000 jobs. The state of Indiana has reduced its employment in the region by about 100 jobs. Local government, including local public (elementary and secondary) education has remained at about 32,000 jobs. I foresee no change here.

Conclusions

The sector-by-sector analysis points to a gain of around 0.3 percent, or about 850 jobs (see Table 1). It seems fair to say that we can expect little employment growth during the coming year.

These projections are contingent on a national economy that continues to perform reasonably well, with output gains in the 3.5 percent to 4 percent range. Slowing of the national economy (as a result of rising interest rates or another negative shock) will, obviously, have a negative impact on northwest Indiana. The coming year does not seem likely to be one of robust growth in employment for the region. As a consequence, we should expect

very restrained income growth as well. Unemployment should hold steady at around 6 percent, and the local labor force will also probably remain unchanged (see Table 2). ◀

Notes

1. Establishment employment measures the number of jobs provided by employers in northwest Indiana (Lake and Porter counties), regardless of where the people employed live. Establishment employment data are drawn from reports of the Indiana Department of Workforce Development and the U.S. Bureau of Labor Statistics (www.bls.gov).
2. The discussion of total employment and unemployment rates uses a twelve-month moving average of monthly employment data. This smooths month-to-month variability and helps account for seasonal fluctuations.
3. Household employment is an estimate of the number of people living in northwest Indiana who hold jobs, regardless of where those jobs are located. Data on household employment and unemployment come from the Local Area Unemployment Statistics program of the U.S. Bureau of Labor Statistics (www.bls.gov).
4. At the national level, part of the discussion about these differences has focused on new business start-ups and the self-employed. In northwest Indiana, it might be more readily explained by changes in the number of people holding jobs, for example, in Illinois.

Table 2
Key Indicators for Northwest Indiana

Indicator	2003	2001	Change
Population	640,009	633,914	6,095
Labor Force (employed and unemployed)	305,880	302,130	3,750
Building Permits (residential)	4,098	3,375	723
Census of Covered Payroll Establishments*	2004:1	2001:1	Change
Total Jobs	237,401	246,088	-8,687
Total Establishments	11,963	11,643	320
Average Weekly Wage	\$655	\$607	\$48
Manufacturing Jobs	35,083	43,928	-8,845
Manufacturing Establishments	529	545	-16
Average Weekly Wage	\$1,159	\$981	\$178
Health Care and Social Services Jobs	33,160	30,615	2,545
Health Care and Social Services Establishments	1,314	1,213	101
Average Weekly Wage	\$641	\$574	\$67

* Employment figures based on establishments covered by unemployment insurance.

Indianapolis

Philip T. Powell

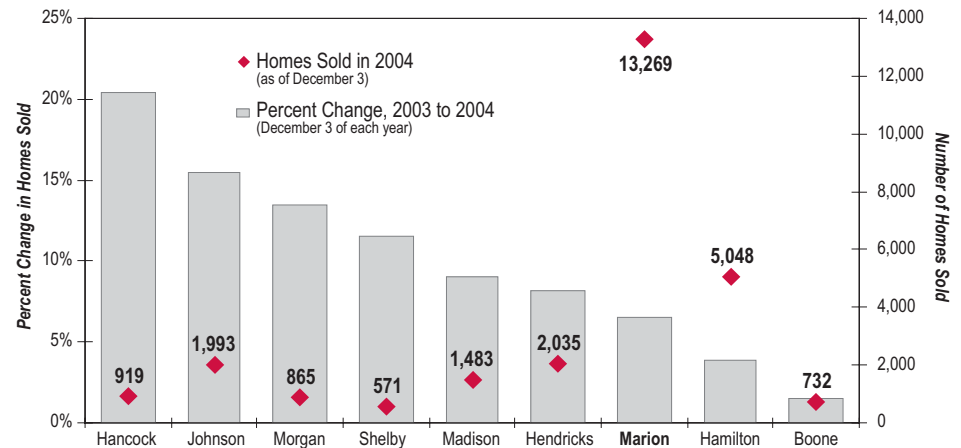
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Recent performance of the Indianapolis economy¹ fell short of expectations, especially in terms of employment. During the twelve months before September 2004, total employment shrank 2.2 percent from 868,690 to 849,830. This sharply contrasts with the U.S. employment growth of 1.4 percent during the same period. As of September 2004, the local unemployment rate was 4.7 percent, which was less than the national rate of 5.1 percent (not seasonally adjusted).

There is reason to believe, though, that measurement of the local unemployment rate understates the impact of job loss on the Indianapolis economy. The unemployment rate is the percentage of the labor force who cannot find a job. A citizen is no longer counted as part of the labor force if he or she stops looking for a job. When local jobs are scarce and acquisition of new jobs requires an unexpected wait, many discouraged individuals stop searching altogether and statistically remove themselves from the labor force. During the twelve months before September 2004, the local labor force shrank by 20,200—from 912,000 to 891,800. Nationally, the labor force grew by 0.7 percent over the same period. If the size of the local labor force had remained at 912,000 individuals, adding 20,200 back to the rolls of the unemployed, the local unemployment rate for September 2004 would be adjusted upward to 6.8 percent.

Local retrenchment in employment was not concentrated in just one or two industries. For example, between the fourth quarters of 2002 and 2003, metropolitan Indianapolis lost 3,434 jobs in manufacturing, 1,181 jobs in retail trade, 918 jobs in wholesale trade, and 746 jobs in transportation and warehousing. Growth in finance and insurance generated only 280 jobs. The most pronounced job growth occurred in educational services and health care, with gains of 1,768 and 2,215 jobs, respectively. Given the high rate of new facility construction and slower growth

Figure 1
Metro Area Home Sales as of December 3, 2004



in hiring at Eli Lilly, most job growth in health care is occurring in the services delivery area instead of bioscientific research and life science enterprise creation. Economic research has established advanced manufacturing, logistics, and life sciences as the leading sectors of long-term job growth in Indianapolis. Recent performance suggests that economic and employment takeoff has not yet occurred in these areas.

Income growth in Indianapolis has lagged national performance. Total wages earned by Indianapolis workers between the fourth quarter of 2002 and the fourth quarter of 2003 grew at an annual rate of 3.8 percent, from \$8.1 billion to \$8.4 billion. Over the same period, U.S. gross domestic product grew at a 6.1 percent annual rate. Simultaneous growth in wages and shrinkage in employment does imply an increase in productivity among individuals who had a job. This explains a weekly wage increase for the average Indianapolis worker of 3.0 percent, from \$732 per week to \$754 per week, over the same period. Weekly wages increased from \$1,060 to \$1,132 in manufacturing (6.8 percent), from \$736 to \$769 in health care (4.5 percent), and from \$1,006 to \$1,040 (3.4 percent) in finance and insurance.

Between 2002 and 2003, the number of residential building permits in Indianapolis fell 2.8 percent, but the total value of new residential construction increased 3.4 percent. Only 30.7 percent of these permits were in Marion County, and the value of new residential construction in Marion County fell 1.9 percent. This signals a disproportionately large share of new construction and commercial activity in surrounding counties.

Outlook for 2005

During 2005, job growth will be tepid at best. While continued recovery of the national economy will improve earnings for local companies and enable scattered job growth, evidence suggests that local employment bottlenecks will not break. This conclusion is reinforced by the hiring freeze at Eli Lilly, the bankruptcy of ATA Airlines, and intensified global competition in manufacturing. Incomes will grow, but probably at a rate half of that seen in the country at large.

In spite of higher interest rates, real estate will remain robust in communities surrounding Marion County as households act on their perception of better schools and lower crime farther from the city center. Recent data² show that, between December 3, 2003, and December 3, 2004, home sales increased by 7.5 percent in the MSA and broke the existing sales record set in 2003 (see Figure 1).

Residential and commercial development will continue in pockets around the downtown canal district as the local life science infrastructure expands. With housing demand centered around downtown and in suburban counties, growth in property values in Marion County townships will suffer. ◀

Notes

1. Data and forecasts refer to the entire Indianapolis Metropolitan Statistical Area (MSA), including Boone, Hamilton, Hancock, Hendricks, Johnson, Madison, Marion, Morgan, and Shelby counties. All data come from STATS Indiana at www.stats.indiana.edu, maintained by the Indiana Business Research Center at the Kelley School of Business.
2. "Central Indiana Homes Sales Break Record Today," *F.C. Tucker Newsroom*, 3 December 2004. Available online at www.fctucker.com/news/04salesrec.htm.

Kokomo

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Kokomo's economy remains heavily weighted toward manufacturing. Employment in manufacturing industries peaked statewide in June 2000, and while recent losses have been much less than before (and some months have even posted gains), employment has still not regained anywhere close to its peak. Like the rest of the state, individuals and firms in the area remain apprehensive about the economy and what it holds for them personally. While unemployment in the area peaked during 2002 and has since dropped, Kokomo had the dubious distinction of achieving the second highest unemployment rate in the country in July 2004 at 14 percent. Obviously, those numbers are way up from the pre-recession lows of about 2.5 percent, and July in Kokomo always seems to give horrible unemployment numbers. The unemployment rate did drop in August to the 5 percent to 6 percent level.

Many of the recent job losses nationally have been in transportation equipment manufacturing (vehicle parts), which is one of this area's largest industries. From 2001 to 2003, industrial production declined nationwide but is finally showing some growth (see Figure 1). This area remains heavily invested in industrial production and very subject to economic disruptions as industrial production increases and decreases. The important news is that many of these job losses will be permanent due to increasing productivity, job losses to overseas, etc. This means that manufacturing production, while increasing somewhat, is unlikely to return to the glory days of the past.

Although the state and local loss of manufacturing jobs is still troubling, we think that the worst of the economic news is behind the region and we are optimistic about 2005 for the economy in general. Given the latest productivity, gross domestic product, and labor figures, it seems that the national and state economies are going to continue growing. This will certainly also be true of the local economy. But, as noted earlier, the relatively slow growth of employment has

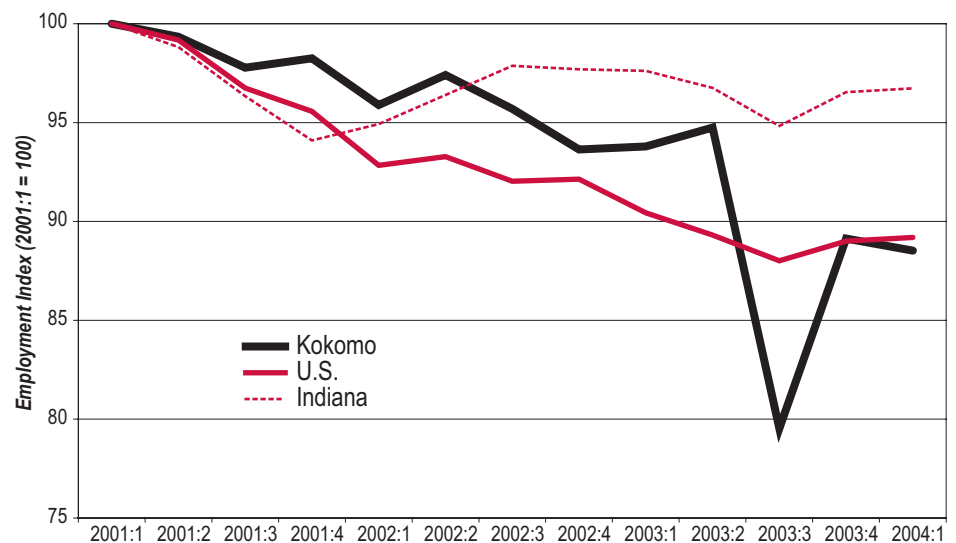
continued to be a prominent feature of this particular expansion. Recent trends show that employment is starting to pick up, giving a more favorable forecast for the area of about 3 percent to 4 percent growth—not outstanding, but not too bad either.

On the local front, past moves by the Fed to keep interest rates down and the incentives offered by the automobile manufacturers have kept auto sales fairly robust. This has protected jobs and production at the DaimlerChrysler plants, which are such an important part of this local economy. In addition, low interest rates have allowed consumers to continue buying homes, refinancing, and making home improvements. This can be seen all over the area in new home construction, building permit numbers, and new building construction. Help wanted signs are even beginning to appear in store windows. While these may not be the high-dollar manufacturing jobs that the area would like to see, it is at least encouraging to see hiring occurring and firms looking for employees. This is shown in the number of employees on nonfarm payrolls, which has increased in the Kokomo area by 5.5 percent since a year ago. But as noted in the national

outlook, the Fed is likely to raise interest rates at least once in the next few months and that will potentially put a damper on the boost in sales due to manufacturers' rebates and zero percent financing—unless the manufacturers still find it feasible to absorb the interest rate charges.

We must acknowledge that the manufacturing jobs that were so much a part of this area's economy are leaving and are not likely to return. The type of jobs we would like to attract would be high-paying jobs, but those require a stronger focus on acquiring skills and education (both K-12 and higher education) than we may have exhibited in the past. This means we must get serious about education. To attract employers to the area, we must show that we have good schools, good students, good teachers, good graduates, and so on. We must also explore and develop partnerships between schools and work, between K-12 education and higher education, between institutions of higher education such as Ivy Tech and IU Kokomo—in short, we must reinvent ourselves for the twenty-first century. We simply must change or risk being left behind in the new economy. ◀

Figure 1
Transportation Equipment Employment Index



New Albany

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During 2004, the economy of southern Indiana continues to sputter. Average employment in the Louisville Metropolitan Statistical Area (MSA), and in southern Indiana in particular, continues to decrease for the fourth year in a row. Yet, indicators of consumer activity continue to improve. In this analysis, various measures of economic activity are examined in seven counties in the Louisville MSA: Clark, Floyd, Harrison, and Scott counties in southern Indiana and Bullitt, Jefferson, and Oldham counties in northern Kentucky.¹ Four additional Indiana counties—Crawford, Jefferson, Orange, and Washington—in the southern Indiana labor market area are included when data are available.

Figure 1
September Unemployment Rates

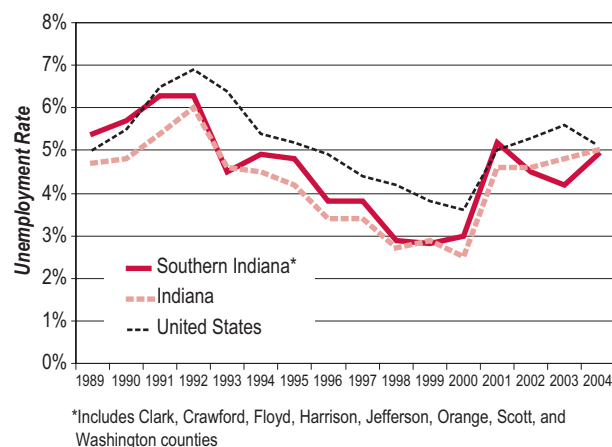


Table 1
Changes from 2003 to 2004 (January to September* Average)

Area	Total Jobs	Private	Manu- facturing	Avg. Weekly Wage	Avg. Weekly Hours
Indiana	15.2%	13.9%	-5.2%	n/a	n/a
Southern Indiana Counties ¹	-0.8%	-1.4%	-0.6%	7.8%	-1.9%
Louisville MSA ²	-0.7%	1.1%	-1.4%	18.6%	-0.3%

* September 2004 data are preliminary.

1. Clark, Floyd, Harrison, and Scott counties. The Indiana Department of Workforce Development refers to this as the New Albany area.

2. Clark, Floyd, Harrison, and Scott counties in Indiana and Bullitt, Jefferson, and Oldham counties in Kentucky.

Labor Markets

The September 2004 unemployment rates in many of the Indiana counties of the Louisville area have increased relative to the September 2003 rates. From month to month, unemployment rates in these counties are quite volatile. **Figure 1** illustrates that the unemployment rates continue to fall below that of the United States. Several counties consistently have unemployment rates that are lower than the Indiana state average, with the exceptions being Crawford, Orange, and Washington counties, which consistently have unemployment rates higher than the state.

Recent data for the Louisville MSA indicates that the average level of nonagricultural employment was 559,500 for the January–September 2004 period. This is a decrease of approximately 700 jobs from the same period last year and a decline of over 30,000 jobs since 2000. Total nonagricultural employment in the southern Indiana counties averaged 93,200, a decrease of about 800 jobs over the same period last year (see **Table 1**) and well below the May 2001 peak of 98,200 jobs.

Revised employment numbers revealed that manufacturing employment in the southern Indiana counties of the metro area has been decreasing steadily over the past several years. They averaged 17,700 jobs for the January–September 2004 period, a 600 job decline over the same period in 2003. Manufacturing employment has been steadily decreasing from the January 2001 peak of 21,100 jobs. For the MSA as a whole, manufacturing employment decreased by approximately 1,400 jobs during the first three quarters of 2004. In addition

to manufacturing, the trade, transportation and utilities sector in southern Indiana was hit hard over the past year, decreasing by an average of 600 jobs. Job growth was led by the wholesale trade, retail, and government sectors.

The average level of government employment increased steadily over the past few years in southern Indiana, adding approximately 600 jobs in 2004. The increase is attributable to state and local governments because federal government employment decreased.

Wages and Hours in Manufacturing

Manufacturing is the only sector for which wage and salary information is collected for the southern Indiana area. Average hourly manufacturing earnings in southern Indiana have increased over the past year but remain consistently below that of the MSA as a whole. While there is no standard measure of labor productivity for metropolitan areas, national averages suggest that labor productivity in manufacturing has increased substantially, which would boost wages.

Average weekly hours worked in the manufacturing sector averaged 41.4 hours per week for the first three quarters of 2004, which is below the 2003 average of 43.2 hours in the southern Indiana counties. Manufacturing hours peaked at 47.1 hours per week in November 2002.

Consumer Activity

Sales and Marketing Management magazine's 2004 survey of buying power shows a substantial increase in retail sales (see **Table 2**). Total retail sales in the Louisville MSA increased 11.6 percent from \$12.4 billion in 2003 to \$13.9 billion in 2004, surpassing the 2001 peak. Jefferson County, Kentucky, had the largest change with an increase over \$201,000 between 2003 and 2004. Floyd County had substantial positive growth in retail sales, a 16.8 percent increase, while the growth in Clark County was quite modest by comparison. The increased retail spending in Floyd may indicate a

Table 2
Total Retail Sales, 2000 to 2004 (not adjusted for inflation)

Area	2000	2001	2002	2003	2004*	2003–2004 Change	
	In Thousands of Dollars (000)					Amount (000)	Percent
Louisville MSA	13,106,414	13,535,563	12,925,845	12,439,422	13,880,949	1,441,527	11.6%
Bullitt, KY	363,515	385,269	379,800	361,338	410,765	49,377	13.7%
Jefferson, KY	9,874,800	10,186,603	9,672,799	9,267,922	9,469,346	201,424	2.2%
Oldham, KY	250,598	258,058	251,359	248,450	265,378	16,928	6.8%
Clark	1,617,183	1,659,740	1,615,787	1,505,735	1,537,458	31,723	2.1%
Floyd	484,762	507,804	471,606	492,401	575,352	82,951	16.8%
Harrison	318,975	338,155	339,518	354,175	392,135	37,960	10.7%
Scott	196,581	199,934	194,976	209,401	n/a	n/a	n/a
Washington	n/a	n/a	n/a	n/a	256,113	n/a	n/a

* Counties shown in this table do not sum to the MSA total for 2004 due to the change in metro definitions.
Source: *Sales and Marketing Management*, 2004 Survey of Buying Power and Media Markets

redistribution of spending patterns due to new retail development in the county. Harrison County is the only county in the MSA where retail sales have increased each year for the past five years.

Activity in the residential housing market continued to increase over the past year. Housing sales through October 2004 in the southern Indiana area² totaled 2,737 units (a 12.1 percent increase) compared with 2,441 for the January–October 2002 period. The average sales price was \$131,979 for January–October 2003 sales, up just over one percent from the year before. The average amount of time for a house to sell was 98 days, a decrease over the 2003 average of 113 days.

Residential construction, as measured by residential building permits for new single family residential units in the metro counties, continues to increase although at a slower rate than in the previous year. Permits for single family units increased by 3.5 percent for the January to September 2004 period.³ (The 2003 increase was 9 percent for the same period.) In contrast, the number of multi-family unit permits decreased 24 percent. Clark, Floyd, and Scott counties experienced a decrease in single family permits from the same period in 2003, while other counties increased (see Table 3). Floyd County experienced particularly strong growth in percentage terms for multi-family permits. General interest rate increases have yet to lead to substantial increases mortgage rates, which have been seesawing over the past year. As a consequence, growth in residential building permits and home sales continues.

Gaming at Caesars Casino continues to attract more customers (see Figure 2). The turnstile count for January through September 2004 was over 2.6 million, a 5.7 percent increase over the same period in 2003. Tax payments totaled \$75.35 million for the January–September 2004 period, a 10 percent increase over the same period in 2003.

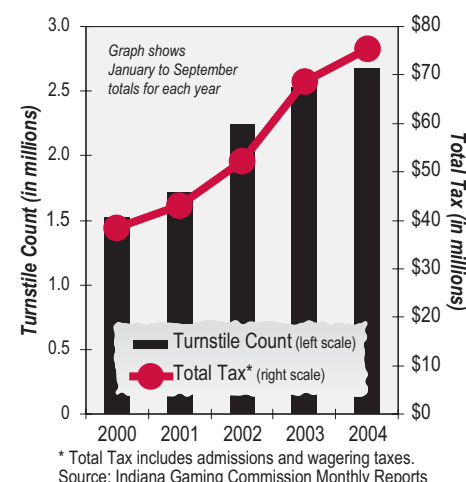
In 2004, the available labor market data for the Louisville and the southern Indiana area is not encouraging. Unemployment rates are quite volatile and definitely not displaying a downward trend. Average employment in the nonagricultural sector continues to decrease in the southern Indiana counties and the Louisville metro area as a whole. In contrast, indicators of consumer activity have strengthened. Retail spending in the MSA has surpassed the 2000 level and housing

Table 3
Residential Building Permits Issued for Privately Owned Structures*

County	Single Family Units					Multi-Family Units				
	2000	2001	2002	2003	2004	2000	2001	2002	2003	2004
Clark	547	561	689	621	611	18	189	76	122	94
Floyd	282	282	254	331	268	72	6	10	8	23
Harrison	173	144	162	146	179	26	0	4	6	0
Scott	n/a	94	90	123	78	n/a	73	72	15	4
Washington	n/a	n/a	n/a	n/a	24	n/a	n/a	n/a	n/a	10
Bullitt, KY	534	498	493	588	624	56	37	76	92	125
Jefferson, KY	2,036	2,382	2,242	2,476	2,570	531	321	540	673	510
Oldham, KY	446	469	449	491	590	46	90	61	92	0

* Data are from January to September of each year. Source: U.S. Census Bureau

Figure 2
Gaming at Caesars, 2000 to 2004



sales have increased relative to the previous year. Single family residential building permits remain strong. Over the coming year, the best we can hope for is continued strength in the consumer sector and a stabilized level of employment in the southern Indiana counties. ◀

Notes

1. In 2003, the federal government redefined the counties in the Louisville Metropolitan Statistical Area. They now are Clark, Floyd, Harrison, and Washington counties in southern Indiana and Bullitt, Henry, Jefferson, Meade, Nelson, Oldham, Shelby, Spencer, and Trimble counties in Kentucky. Most of the metro area statistics do not yet use the new definition; thus, I have continued to use the 1990 MSA configuration for this analysis.
2. Data on home sales from the Southern Indiana Realtors Association Multiple Listing Service covers Clark, Crawford, Floyd, Harrison, Jefferson, Scott, and Washington counties.
3. In January 2004, the Census Bureau began using the new metro area definitions for the building permits data.

Richmond

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The Richmond-Connersville-New Castle (RCNC) area economy is experiencing a slow recovery. A significant number of firms are operating below full capacity.

The manufacturing sector has not fully returned to normal conditions. Some firms are having increased demand for their products while others are not. This is partly due to globalization, along with its concomitant infringement of intellectual property or the lack of a level playing field. On top of this, rising prices for industrial commodities (including fuel) translate into rising product prices, which may not be competitive with foreign producer prices.

The national recovery, now in its third year, is not producing robust job growth as in the 1990s. To date, over 1.7 million jobs have been created and this is relevant to RCNC, which is interdependent with the national economy.

The September 2004 figures, released by Indiana Department of Workforce Development, showed that total employment in Wayne, Fayette, and Henry counties was 65,340 out of a labor force of 70,035. For Indiana and the United States, it was 3.0 million and 139.6 million, respectively. The non-seasonally adjusted unemployment rates in the tri-county area were 5.8 percent, 9.5 percent, and 6.9 percent respectively, up from September 2003. These rates were higher than both the state rate of 5.2 percent and

Table 2
RCNC Area Mortgage Rates, Selected Weeks

Bank	Ending October 30, 2004			Ending October 23, 2004		
	15-yr.	30-yr.	1-yr. ARM	15-yr.	30-yr.	1-yr. ARM
Capitol Mortgage, Richmond	5.00	5.5	3.00	5.00	5.5	3.13
Eaton National Bank & Trust	4.88	5.5	3.75	4.88	5.5	3.75
Edward Jones, Richmond	5.38	5.88	5.13	5.38	6.00	5.38
First National Bank & Trust, Richmond	5.25	5.88	4.00	5.25	5.88	4.00
Flagstar Bank, Richmond	5.13	5.75	4.13	5.13	5.75	4.13
Galaxy Mortgage, Richmond	5.00	5.63	4.25	4.88	5.50	4.13
Hansel Mortgage Group, Centerville	5.25	5.75	3.13	5.13	5.63	3.13
Irwin Mortgage, Richmond	5.38	6.00	3.75	5.38	5.88	3.63
MainSource Bank, Fountain City	5.25	5.75	3.75	5.25	5.88	3.75
Merrill Lynch, Richmond	5.34	5.86	n/a	5.33	5.81	n/a
Old National Bank, Richmond	5.13	5.75	4.13	5.13	5.75	4.00
State Farm, Richmond	5.64	6.08	5.26	5.47	5.96	5.13
Union County National Bank, Liberty	5.13	5.75	4.63	5.25	5.75	4.63
U.S. Bank Home Mortgage, Richmond	5.25	5.75	3.88	5.13	5.63	3.75
Wayne Bank & Trust, Cambridge City	5.13	5.75	4.25	5.13	5.88	4.25
West End Savings Bank, Richmond	5.25	5.88	4.50	5.13	5.75	4.5
Average	5.21	5.78	4.10	5.17	5.75	4.08
Source: The Palladium-Item						

the national rate of 5.4 percent (see Table 1). From the national perspective, labor markets may be closer to being in balance than they would be if employment growth were the sole criterion for normalcy.

It is also important to note that productivity, that is, output per worker hour, has been growing at an annual rate of more than 5 percent since November 2001. Such growth is far above the average productivity growth rate of 2 percent between 1996 and 2001. Rising productivity means firms hire fewer workers to produce the same output and the resultant job losses are structural. For Wayne, Fayette, and Henry counties, manufacturing employment represents 19.3 percent, 27.8

percent, and 15.6 percent, respectively, of total employment. If the high productivity growth rates continue, employment growth would be sluggish in the region.

Unlike manufacturing, the services sector accounts for most of the total employment in RCNC. Reid Hospital and Health Care Services is building a \$250 million hospital complex off of Chester Boulevard in Richmond. It is the largest capital investment in the history of Richmond and east central Indiana. This investment, combined with internal business expansions and successful business prospects by the Economic Development Corporation of Wayne County, is likely to generate job growth.

Table 1
Labor Force Statistics, September 2003 and September 2004

Area	Labor Force		Employment		Unemployment		Unemployment Rate	
	2004	2003	2004	2003	2004	2003	2004	2003
Fayette	9,725	10,010	8,800	9,050	925	960	9.5	9.5
Henry	23,750	23,770	22,110	22,590	1,640	1,180	6.9	4.9
Wayne	36,560	36,000	34,430	34,030	2,130	1,970	5.8	5.5
Indiana	3,151,600	3,189,300	3,001,100	3,035,700	150,500	153,600	5.2	5.2
United States	147,186,000	146,166,000	139,641,000	137,731,000	7,545,000	8,436,000	5.4	6.1

South Bend/Mishawaka and Elkhart/Goshen

Like services, the housing sector is holding steady. Total sales volume for houses is slightly better than last year's. This is attributable to low mortgage rates. At the end of October 2004, local financial institutions offered rates of 5.21 percent, 5.78 percent, and 4.10 percent, respectively, for fifteen-year, thirty-year, and one-year adjustable mortgages (see Table 2). These rates were somewhat lower than last year's.

Low interest rates in the past three years helped fuel a surge in the number of mortgage originations (that is, new-home purchases) and refinancing of current mortgages. Also, government-sponsored home loan programs, including those from the Veterans Administration and Federal Housing Administration, helped first-time home buyers make the leap.

The new-home buyers included transferred people and "empty nest" households wanting to downsize. The local median price of a home is \$92,000, which is substantially less than the national median of over \$180,000. It is instructive to note that the price-rent ratio for the United States and many regional markets is much higher than its historical value.

Now that the presidential election is over, it has removed an element of uncertainty confronting businesses, consumers, and investors. Consequently, I expect improved economic conditions in RCNC in the coming year. ◀

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To help understand how we came to where we are today, Table 1 and Figure 1 provide data from 1994 to the middle of 2004 that chart the longer-term progress of the Michiana region, of which South Bend/Mishawaka and Elkhart/Goshen are a major part. The index uses 1986 as the base period and employs monthly averages of seasonally adjusted index numbers.

Employment growth in the South Bend economy mirrored the sluggish growth experienced by the national and state economies. During 2003, South Bend's total nonagricultural employment decreased by 0.2 percent, with manufacturing employment contracting by 1.9 percent and nonmanufacturing employment increasing by a modest 0.1 percent.

Employment growth in Elkhart, for the second year in a row, outpaced South Bend, the nation, and the state. Elkhart's total nonagricultural employment grew by 1.9 percent, with manufacturing expanding by 2.4 percent and nonmanufacturing advancing by 1.5 percent.

The contraction of manufacturing employment in South Bend and its expansion in Elkhart derived largely from each economy's differing fortunes in the transportation equipment sector (as defined by the Standard Industrial Classification—SIC 37). In South Bend, transportation equipment remained strong throughout 2002, ending the period with an 11 percent increase (500 more jobs). This upswing likely resulted from the strong sales following the initial launch of the Hummer H2 sport utility vehicle. But in 2003, Hummer H2 sales weakened because of the natural moderation in sales that follows the successful introduction of a new vehicle. Consequently, SIC 37 employment failed to grow. Further, manufacturing employment in South Bend's other durable and nondurable manufacturing continued the downward trend of 2002 into 2003, contributing to the overall weakness in manufacturing. In Elkhart, SIC 37, primarily fueled by the robustness of the booming recreational vehicle market, increased by 5,200 jobs from December 2001 to December 2002, a 24.8 percent boost, and added another 1,600 jobs between December 2002 and December 2003, a 6.5 percent change. During 2003, nonmanufacturing employment advanced in South Bend by 0.1 percent. Employment expanded in retail trade (1.7 percent), leisure and hospitality (5.8 percent), and government (2.0 percent). Offsetting most of these gains were employment declines in natural resources and construction (-4.6 percent), wholesale trade (-1.4 percent), professional and business services (-4.8 percent), education and health services (-1.4 percent), and other services (-7.1 percent).

Elkhart's nonmanufacturing employment rose by 1.5 percent during 2003 as a result of growth in natural resources and construction (4.4 percent), wholesale trade (1.7 percent), retail trade (1.0 percent), education and health services (4.4 percent), health care and social assistance (6.0 percent), and leisure

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

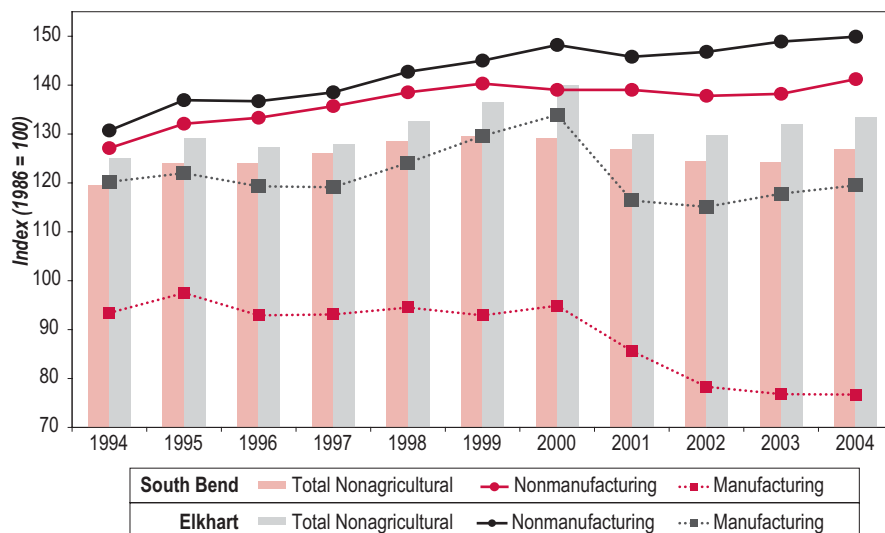


Table 1
Employment Index with Unemployment Rates, 1993 to 2004*

Indicator	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
South Bend/Mishawaka											
Total Nonagricultural	119.5	124.1	124.1	126	128.6	129.5	129.2	127	124.5	124.3	127
Manufacturing	93.4	97.5	92.9	93.1	94.5	92.9	94.9	85.6	78.3	76.8	76.7
Nonmanufacturing	127.1	132.1	133.3	135.7	138.5	140.3	139	139	137.8	138.2	141.2
Unemployment Rate	4.4%	4.3%	4.0%	3.3%	2.7%	2.9%	3.2%	4.1%	5.0%	4.8%	5.1%
Elkhart/Goshen											
Total Nonagricultural	125.1	129.2	127.4	128	132.7	136.6	140	129.9	129.7	132.1	133.4
Manufacturing	120.2	122	119.3	119.1	124.1	129.6	133.9	116.4	115.1	117.8	119.5
Nonmanufacturing	130.7	136.9	136.7	138.5	142.7	145	148.2	145.8	146.8	148.9	149.9
Unemployment Rate	3.8%	4.5%	3.8%	3.3%	2.6%	2.1%	2.7%	4.6%	4.8%	4.6%	4.3%

* All employment figures are seasonally adjusted index numbers with 1986 = 100. The underlying data are derived from a monthly survey of employing establishments and are published by the Indiana Department of Workforce Development. Figures for 2004 cover the first seven months of the year.

and hospitality (4.4 percent). Eroding part of these gains were declines in employment in transportation, warehousing, and utilities (-4.8 percent), professional and business services (-2.5 percent), other services (-2.6 percent), and government (-3.5 percent).

The most recent data from the Indiana Department of Workforce Development (through July 2004) indicate cautious signs of optimism. Although employment growth in the Elkhart economy has slowed somewhat during the first half of 2004, employment growth is expected to rebound because of the continuing strength of the recreational vehicle market. Nationally, the recreational vehicle industry remains very strong. The Recreation Vehicle Industry Association reported that wholesale shipments to the nation's retailers totaled 31,800 units in August 2004, up 16.1 percent over August 2003. August's shipment tally brought year-to-date shipments to 260,400 units, 18.7 percent ahead of 2003. The industry is on pace to ship more than 360,000 units this year, which would be its second-best in twenty-five years.¹

Outlook

Accurately forecasting economic conditions for local economies is very difficult for two reasons. First, we have much less economic information available for local economies than for larger economies, and the data we do have tends to be less accurate. Secondly, special situations affecting individual firms, which would have little impact on a regional or national forecast, can have a major impact on a local economy. The uncertainty surrounding these special situations creates uncertainty

about the forecast. At the present time we have several special situations that have the potential to impact our local economies over the next couple of years.

Accra Pac Group plans to build a \$9 million distribution center next to its existing plants in Elkhart and to hire an additional 150 employees during 2005. The 150 jobs will bring total employment at the aerosol packaging company to nearly 1,000. Since almost all of the income for these jobs comes from outside our area and no local jobs will be lost, the multiplier effect will magnify the impact.

For the last several years, the manufactured housing industry has been in a serious slump. In 1998, the industry nationwide shipped 373,000 units. In 2001, the industry nationwide shipped 193,000 units, but shipments were just 131,000 units in 2003.

The slump contributed to the large drop in jobs in 2000 and 2001. Industry production continued to fall in the first eight months of 2004 and it will likely stay at low levels during 2005.

The recreational vehicle industry has recovered strongly from the recession with more than 320,000 units produced in 2003, up from 257,000 in 2001, and the industry should produce more than 360,000 units in 2004. The strong demand should continue in 2005, although at a slightly lower level.

Indiana produces more than 50 percent of the recreational vehicles shipped nationwide and most of these vehicles are produced in northern Indiana. One example of the positive impact on our local economy is the

new Forest River expansion in Goshen which will employ approximately 600 workers. Forest River is the largest privately owned RV maker in the country and it is planning to add seven new buildings, each about 94,000 square feet. Since these vehicles are sold nationwide, the multiplier effect of increased production is strong. The RV industry has had an important positive impact on our local economy's recovery from the recession.

Like most local economies, the South Bend/Mishawaka and Elkhart/Goshen economies are greatly influenced by the national economy. The durable goods component of the national economy is important as the automobile, recreational vehicle, manufactured housing, and steel industries are major employers. The Elkhart economy, with its substantial manufacturing employment, is especially tied to the national economy. The national forecast calls for real gross domestic product growth of about 3.5 percent, relatively low interest rates, low inflation, increased consumer spending and increased employment. This outlook should lead to continued growth in both local economies. We should see reasonable growth in employment and a reduction in the unemployment rates to the 3.5 percent to 4.5 percent range during the year in Elkhart/Goshen and to the 4.0 percent to 5.0 percent range in South Bend/Mishawaka. ◀

Notes

1. Steve Bibler, "RV Shipments Strong: August Continues Yearlong Trend of Brisk Business," *Elkhart Truth*, 28 September 2004.

Terre Haute

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The economy of Terre Haute, long lagging that of the state of Indiana, may be ready for a rebound. On the strength of increased residential construction, education and health services employment, and political strength from the mayor's office, Terre Haute may be prepared to break out of its decades-long pattern of anemic economic performance.

Terre Haute's economic history, as perceived around the state, is one of decline. Manufacturing employment, once the engine for economic activity in the community, is 10 percent lower in 2004 than it was in 1995. Terre Haute has not landed a major new employer to the area since Aisin located in the Vigo County Industrial Park early in the decade. Continued high energy prices threaten the economic health of the local plastics industry. Terre Haute's unemployment rate has, for a decade, remained above that of the nation and the state. It is worth noting, however, that all have converged in recent years suggesting Terre Haute's days of seriously lagging the state and nation may be drawing to a close (see Figure 1).

Construction industry employment is the highest it has been in a decade and new residential building permits are running ahead of their 2002–2003 pace (see Figure 2). The 641-Bypass connecting I-70 to southbound U.S. 41, though proceeding slowly, offers the potential for growth on the southeast side of Vigo County. Developers continue exploratory work near the I-70 and State Road 46 interchange, leading to the possibility of a major new retail area at this relatively undeveloped site.

Elsewhere, health and education employment continues to grow as Vigo County's two major hospitals and four major institutions of higher education are once again (though to varying degrees) expanding services. Though this sector was flat from 1997 to the beginning of 2003, from March 2003 through 2004, the sector has added more than 1,000 jobs.

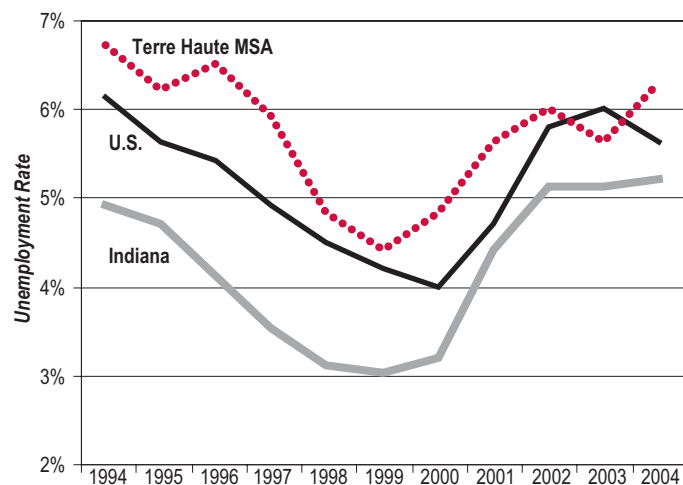
The political realm, long an arena for stagnation and complacency, has signs of new life as the people of Terre Haute and Vigo County give the new mayor, Kevin Burke, an 80 percent approval rating and

supported candidates for county council who endorse the continuation of the new CAGIT and EDIT taxes¹. Mayor Burke's approval exists despite, or perhaps because of, taking on the tough challenges of what to do with the long-abandoned Terre Haute House and the city's crumbling waste-water treatment facility, while he has endorsed the continued use of the CAGIT and EDIT taxes for economic development. Though definite plans have not been set in any of these areas, the willingness of the citizens of Vigo County and its elected leadership to look to new ideas for economic growth suggests a level of confidence in the community not seen in years. ◀

Notes

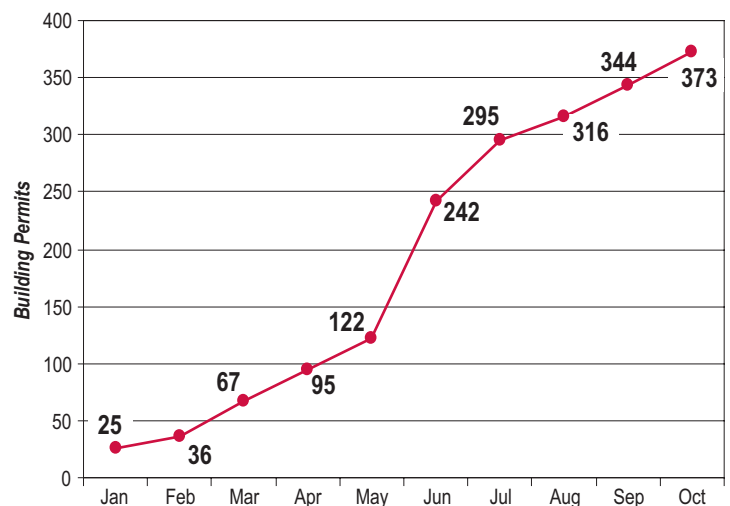
1. CAGIT, the County Adjusted Gross Income Tax, may be adopted by the county council at a rate of 0.5 percent, 0.75 percent or 1 percent. More than half of CAGIT revenue must be used for property tax relief. EDIT (also known as CEDIT) is the County Economic Development Income Tax and can be adopted at rates up to 0.5 percent (although there are caps imposed when combining types of county income taxes). Revenue is divided among the county, cities, and towns and must be used for economic development or public capital projects.

Figure 1
Unemployment Rate Annual Averages, 1994 to 2004*



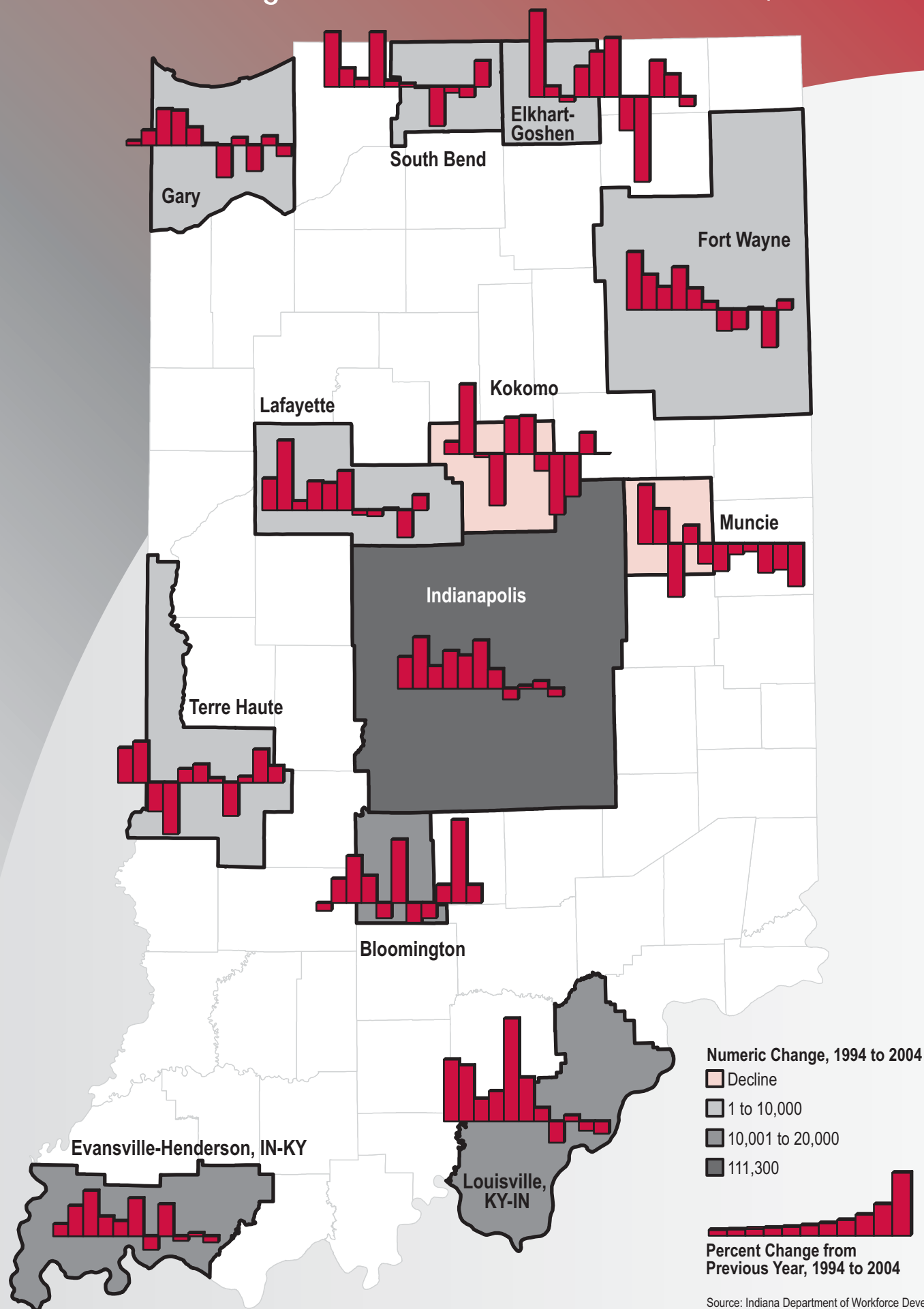
* Data collected for previous metro definition, including Clay, Vermillion, and Vigo counties. The January–October average is shown for 2004.

Figure 2
Terre Haute Metro Cumulative Year-to-Date Building Permits, 2004*



* Data collected for new metro definition, including Clay, Sullivan, Vermillion, and Vigo counties.

Jobs Watch: Change in October Job Levels Each Year, 1994 to 2004



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