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INDIANABUSINESSREVIEW



How the Economy Will Weather the Storm in 2009

Outlook 2009
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Outlook for 2009

Jerry N. Conover, Ph.D.: Director, Indiana Business Research Center, Kelley School of Business, Indiana University

December 2008

For thirty-six years, a group of Indiana University faculty has gathered at the Kelley School of Business each fall to consider the economic outlook for the coming year. In the process, they forecast the prospects in terms of global, national, state, metropolitan, and agriculture perspectives, and they also assess the outlooks for the financial and housing markets.

Suffice it to say that the economic situation did not unfold during 2008 quite as the panel predicted a year ago. The year ahead is likewise marked by risks and uncertainty, and the panel predicts 2009 will be a challenging year—but hopefully with some light at the end of the tunnel.

This year’s discussion began with a review of the latest forecast based on the econometric model of the United States developed by Indiana University’s Center for Econometric Model Research (CEMR). The researchers then made adjustments to the model’s predictions to accommodate expectations about key underlying variables. The CEMR model of Indiana’s economy similarly provided a basis for projecting the outlook for the state.

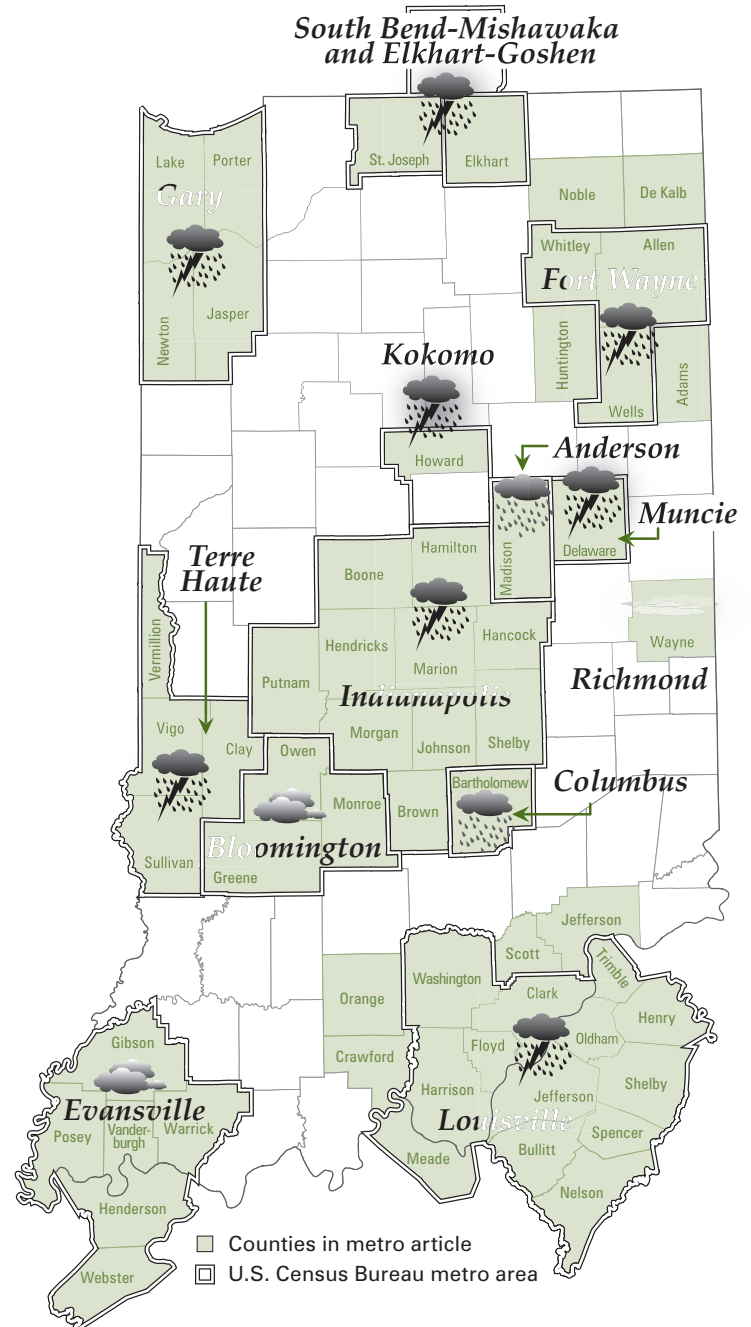
These economists and distinguished colleagues presented their predictions to audiences across Indiana through the Kelley School’s Business Outlook Panel program. In each city, an expert on the local economy joined the panel to discuss the outlook for the metro area. The 2009 predictions of all the Business Outlook panelists are presented in this issue of the *Indiana Business Review*, along with additional supporting detail.

The 2009 outlook issue of the *Indiana Business Review* begins with Ellie Mafi-Kreft’s assessment of the international outlook, predicting the weakest year for global growth since the early 1990s. Bill Witte comments on the U.S. economy, which he believes will get worse before it gets better. Gross domestic product will continue to shrink in the first half of the year, before starting to grow again. Much will depend on how long it takes the housing and financial markets to stabilize. For the financial markets, John Boquist and Rob Neal project that interest rates will remain low most of the year, corporate profits will be lower, and the stock market will be positive but below the historical average.

Jeffrey Fisher weighs the outlook for housing, anticipating that the market will begin a modest recovery late in 2009, with home prices remaining low. The forecast for Indiana’s economy, presented by Jerry Conover, calls for significant employment shrinkage before starting to grow again late in the year. Corinne Alexander looks at what is expected for the Hoosier agriculture sector, predicting net farm income in 2009 will be anywhere from \$700 million (if commodity prices remain low and

input costs remain high) to \$2 billion (if commodity prices recover somewhat and input costs fall). Finally, a group of economists and business leaders from around the state share their insights into what 2009 holds in store for most of Indiana’s metropolitan areas (see **Figure 1**).

FIGURE 1: Forecast for Indiana Metros, 2009



Source: Indiana Business Research Center

International Outlook for 2009

Elham Mafi-Kreft: Clinical Assistant Professor of Business Economics and Public Policy, Kelley School of Business, Indiana University Bloomington

November 2008

After four years of strong growth, the world economy is falling into a major downturn and is forecasted to grow at only 2.2 percent in 2009.¹ This growth rate is at its lowest level since 2002 as concerns have intensified that the rich countries will face their deepest recession since the 1930s. Any growth in the world economy in 2009 will be almost entirely driven by the emerging and developing economies, whose growth will nevertheless sharply fall to 5.1 percent from 8 percent in 2007 and 6.6 percent in 2008. At the same time, inflation has risen to its highest level since 1997—reflecting the tightness in world commodity markets. The surge in inflation rates is particularly disturbing in emerging and developing markets where the substantial increase in the price of food is leading to a surge in social unrest.

Western Europe

Economies in Western Europe face many simultaneous adverse shocks. Since the end of the summer, the European news has become more depressing with each passing month. High growth countries like the United Kingdom, Ireland, and Spain have seen investments collapse and unemployment rates soar. In Spain, unemployment is expected to jump by 3.5 percent in 2009, reaching 14.7 percent—the biggest jump over the past thirty years. Economies in Western Europe will most likely contract by an average of 0.5 percent next year.

The economic deterioration is mostly due to financial system excesses, coupled with the effect of toxic assets. In the United Kingdom, mortgage lender Northern Rock had to be nationalized and the direct effect of the bursting housing bubble on the financial system seems quite

severe. However, not all European countries have had, or will see, comparable impacts of the property bust on their financial systems. On the other hand, the slowdown in consumption and the global credit crunch will be felt throughout Europe and will most certainly hurt some banks. In Europe, when the banks experience a crisis of confidence, it is a proportionately greater problem than in the United States because the European economy is mostly funded by the banks.

Following the lead of Britain and the United States, several Western European governments have announced plans to help their national banking system. But given the size of each country's GDP and the absence of a federal budget, the response to the crisis cannot be as strong as the U.S. \$700 billion troubled assets relief program. Furthermore, in response to this crisis, several European governments will also be constrained by the state of their public finances, unless of course they breach the Maastricht limit of 3 percent of GDP deficit.²

Inflation is the other important shock hitting Western European countries this year. If this were the only shock, it would be weathered easily. In fact, many economists lately have alluded to the risk of deflation. Presently, the inflation rate is above target in every large economy except Japan. Deflation will become a problem only if the recession lasts for an extended period.

Asia

Japanese economic growth has been quite fragile in the last six years. The Japanese do not consume much relative to savings rates, and domestic consumption has stayed extremely weak. The major issue facing Japan is a deteriorating balance of trade. Weaker exports to emerging

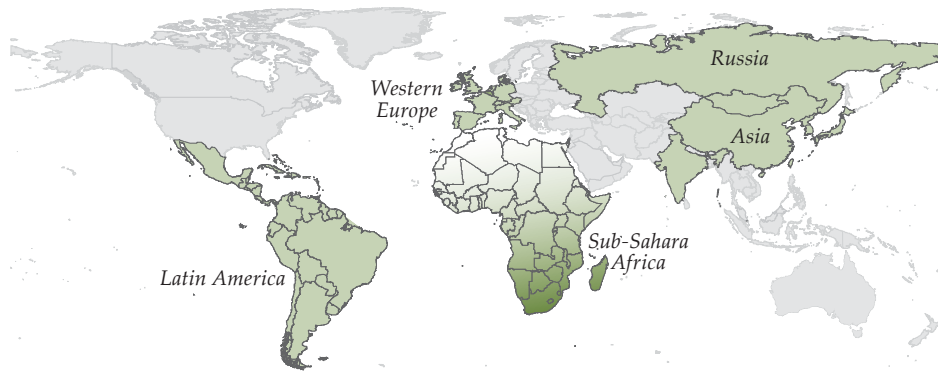
and developing economies in 2008 and 2009 will not provide enough support for growth, so the economy is forecasted to contract 0.2 percent next year.

In emerging Asia, the economies that are the most affected are those that export commodities, those facing problems of attracting foreign capital, and those experiencing liquidity problems.

The International Monetary Fund forecasts China to grow at 9.7 percent in 2008 and 8.5 percent in 2009. While this is still robust growth, it is substantially lower than 2007's 11.9 percent growth. China is a frugal nation whose industrial development has been driven by U.S. consumer demand and foreign direct investment. But U.S. consumers, producers, and investors are not in the mood for excessive consumption, and capital doesn't flow as fast as it used to in China. To reinvigorate its economy, China must rely on domestic spending and therefore has designed a "massive infrastructure and social spending program" to boost its slowing economy. This stimulus plan is estimated at about \$600 billion, or about 15 percent of China's GDP. The Chinese government can afford this plan due to a budget surplus in 2007 and a relatively modest debt-to-GDP ratio. The rest of the world should welcome this stimulus package in hopes of a richer Chinese consumer market to tap in the future.

India, Asia's third largest economy, also felt some adverse effects from the financial crisis, including a decline in foreign investors' exposure to its domestic assets and a stock market collapse. As a result, India's economy has weakened and is expected to grow at around 6.3 percent in 2009—down from 9.3 percent in 2007. The other major issue is containing inflation because of its

impact on India's hundreds of millions living in poverty. Contrary to China, India is not really in a position to launch a grand stimulus package, but the central bank has actively tried to bolster market sentiment and increase availability of money in the system despite the dollar outflows.



a staggering number of individuals to extreme levels of poverty, resulting in what the International Committee of the Red Cross has called "the tragedy of the decade." Outside economic forces are also part of the problem, such as the present drought (the worst since 1984). Additionally, high food prices (which are leading to increased social unrest) and the world's financial meltdown (which will reduce the level of remittance from African émigrés) will likely further worsen the general stability of the region and weaken its growth prospects.

Russia

While previous years have shown robust domestic spending as well as very favorable terms of trade, there have also been rising pressures on prices in an economy where food is a large component of household consumption. The strains created by the financial crisis have deteriorated the growth prospect in the region—mostly because of the large loss of confidence by investors who are pulling back their capital for equity markets. Growth is forecasted to fall to around 3.5 percent in 2009 from 6.8 percent in 2008 and 8.1 percent in 2007. The adverse effects of inflation are of particular importance in Russia, where a stronger policy stance is needed for long-term inflation control.

quite substantial in Latin American economies. This has led to a strong depreciation of local currencies, which will likely make it more expensive for domestic firms to import machines or pay bills that are denominated in dollars. Thanks to their robust external positions, the central banks of Mexico and Brazil have responded to these strong turbulences by taking extraordinary measures and flooding their markets with dollars to help fight depreciating currencies. But for those commodity-exporting countries, the further decline of prices, while moderating the risk of inflation, could put more strain on the economic prospect of the whole region.

Conclusion

Regardless of the direction we look, the prospects for the near future are not good. Some countries are facing the strong backlash of their financial industry and some are indirectly suffering from the consequences of that crisis. World growth is for the first time driven by the emerging and developing countries in what appears to be more than ever a very large global market. All recessions end and this one will not be an exception to the rule. Thus, it is probably prudent to speculate that by the beginning of the next decade we will have a more uniform, healthy, and sustainable world economy. ■

Latin America

The impact of the global financial crisis on Latin America's emerging markets is significantly weakening the value of their domestic currency vis-à-vis the dollar. The banks there had no exposure to the toxic assets, but U.S. portfolio managers are cashing out their positions and the inflow of dollars has been

Sub-Saharan Africa

For several Sub-Saharan African countries, we can talk about the mixed blessing of higher commodity prices. On one hand, high commodity prices have helped some economies take advantage of their imports and generate very favorable terms of trade. On the other hand, the high share of food in the average household's consumption basket of goods and services has driven

Notes

1. Data in the article are from the International Monetary Fund, available online at www.imf.org.
2. As discussed in the Maastricht Treaty of 1992.

U.S. Outlook for 2009

Willard E. Witte: Co-Director, Center for Econometric Model Research, Indiana University Bloomington

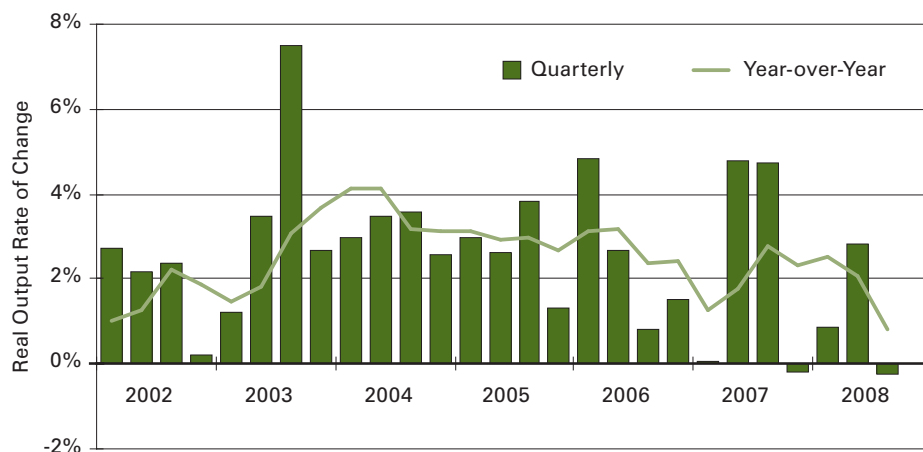
November 2008, updated December 2008

A year ago, in our expectations for 2008, we began: “During the past year, the U.S. economy has essentially been in survival mode. The good news as the year draws to a close is that we seem to have avoided intensive care. The not-so-good news is that the impediments to full recovery are not diminishing.” That last sentence has turned out to be a masterpiece of understatement. And the next sentence—“Nevertheless, we expect the economy will avoid a crisis and continue to muddle through”—was clearly an example of misplaced optimism.

Output growth in the United States decelerated for the fourth straight year during 2008. On a fourth-quarter to fourth-quarter basis, 2008 real gross domestic product (GDP) will probably show only minimal growth. (Fourth quarter data were not available at the time of this writing.) The last time the economy approximated its long-run potential (about 3 percent growth) was in early 2006 (see **Figure 1**).

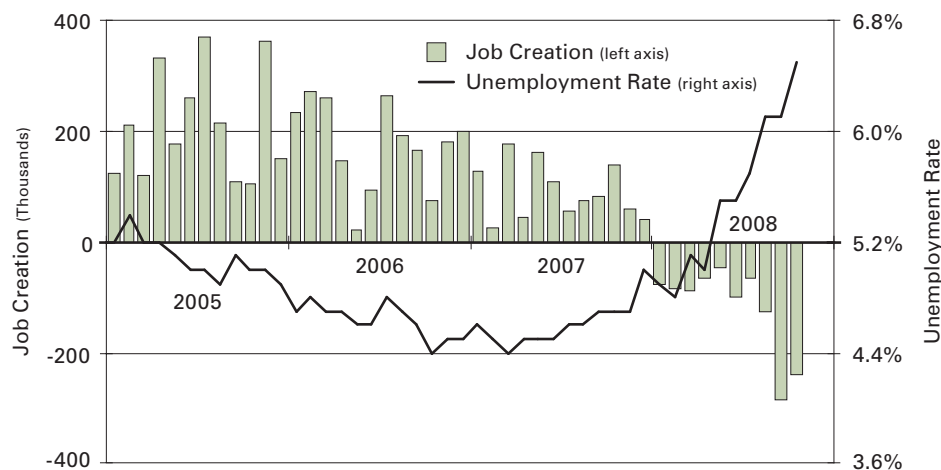
The labor market shows a similar pattern (see **Figure 2**). During 2005, the economy was adding over 210,000 jobs each month. This slowed to 175,000 per month in 2006, and to 91,000 in 2007. So far this year, the economy has been *losing* over 170,000 jobs per month, with the rate of loss increasing as the year has proceeded. In order to absorb new entrants into the labor force (for example, young people graduating from high school or college), the economy must generate about 140,000 new jobs each month. When this is not achieved, as has been the case since early 2007, unemployment rises. During this period, unemployment has gone from a low 4.4 percent to a November level of 6.7 percent, with worse yet to come.

FIGURE 1: U.S. Real Output Quarterly and Annual Rate of Change, 2002 to 2008



Note: Data are seasonally adjusted
Source: Bureau of Economic Analysis

FIGURE 2: U.S. Job Creation and Unemployment Rate, January 2005 to October 2008



Note: Data are seasonally adjusted
Source: Bureau of Economic Analysis

Three fundamental problems have contributed to this dismal performance. The starting point was the continuing implosion in the housing sector. Since peaking in late 2005, the decline has been dramatic. Housing starts, for example, have fallen by well over 50 percent, and it will probably be at least the middle of 2009 before any real improvement occurs. The weak sales environment has also become

evident in housing prices, which have been under unprecedented pressure throughout the country. As a result, record numbers of homeowners face foreclosure. Moreover, since a house is the largest asset for most households, the decline in home values has dealt a severe blow to consumer confidence in general.

The second source of negative pressure is the energy market. Two years ago, oil prices were around

\$60 per barrel. By last summer, they had reached nearly two-and-a-half times that level. With gasoline prices piercing the \$4 per gallon level, the strain on household budgets was a second and more immediate blow to consumer confidence. Even though oil prices have retraced all of this rise, and gas is below \$2 per gallon, the damage to confidence has not been repaired.

Finally, since September, the financial system has been hit by a seemingly endless series of body blows—clearly the most serious threat to that core sector of the economy since the 1930s. Major commercial and investment banks have failed or been forced into “shotgun” mergers. Fannie Mae and Freddie Mac, the primary conduits for mortgage financing, have been taken over by the government, as has the country’s largest insurance firm (AIG). The Federal Reserve and the U.S. Treasury have been concocting scheme after scheme to inject liquidity into the financial system, including direct purchases of bank equity by the government. Even so, lending has slowed to a crawl, with direct effects on both consumer and business investment. And last but not least, values in both the stock and bond markets have cratered. All of this is a third blow to consumer (and business) confidence.

With consumers and businesses cautious about their spending, there are only two potential sources of forward momentum: government and the foreign sector. The former is constrained by budget deficits, while the latter is feeling the impact of the financial crisis right along with us.

In the face of all this, it is not surprising that the economy shifted into reverse gear in the third quarter. Unfortunately, we think the worst is still ahead.

- We expect output to decline through the first half of 2009. Growth will return in the second half of the year, leaving year-end output about flat at the end of 2008. During the recession, output will decline by more than 1 percent.
- Employment will decline by well over two million from the beginning of 2008 through the end of the recession. This will drive the unemployment rate above 7.5 percent, perhaps substantially.
- Inflation will decline from elevated levels during 2008, with an assist from much lower energy prices. Weak demand for both inputs and outputs will also cause price increases to moderate.
- The Federal Reserve, which lowered its target for the federal funds rate to 1 percent in October (down from 5.25 percent in fall of 2007), will reduce rates even more in 2009.

Given the series of blows that the economy has absorbed over the past six months, this is a relatively optimistic scenario. It rests on both the housing and financial markets stabilizing as the year proceeds. Neither of these outcomes is even close to a lock, and they are interconnected. The financial situation is hampering recovery in housing, and the continuing housing implosion is a root cause of the financial crisis.

As 2008 draws to an end, our hope is that we escape 2009 with only a moderate recession (similar in severity to those in 1990 and in 2001). However, we cannot rule out something worse that would compare to the severe recession in the early 1980s. ■

Financial Outlook for 2009

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November 2008

How times have changed. Last year at this time, we saw investment storm clouds on the horizon. But like other storms, we thought they would pass through and leave us unscathed in the end. Instead, like the Indiana storms of last spring, the damage has been substantial and it will take awhile to clean up. The origin of the storm was largely financial in nature in our view. In order to understand the prospects for next year, we must first understand the causes of the financial crisis.

How We Got Here

The origins of the crisis started in 2001. In the aftermath of the tech bubble, the Federal Reserve pursued a policy of keeping interest rates very low (under 2 percent) from December 2001 to November 2004. This policy proved successful at avoiding a prolonged recession, but it had another consequence: housing prices started to climb. Investors were nervous about stocks and the low rates made real estate very attractive. From January 2002 to June 2006, housing prices climbed rapidly, more than doubling in areas like Los Angeles and Miami.

At the same time, there was a shift toward lending to riskier borrowers. In comparison with traditional loans, Alt-A loans allowed borrowers with lower down payments and lower incomes to qualify for a mortgage. The price, however, was a higher interest rate and higher fees for the mortgage. Many of the Alt-A

mortgages were for second homes (investment properties) and it was common for borrowers to overstate their ability to repay the loan. These loans were often termed “liar loans” within the mortgage industry. The shift didn’t stop there. Subprime loans were available to borrowers who didn’t even meet the criteria for Alt-A loans. Both subprime and Alt-A loans expanded rapidly between 2002 and 2007.

During this period, Wall Street became creative with subprime finance. A simple structure would look like this. A group of 1,000 subprime mortgages would be pooled together. From this pool of assets, three classes of bonds would be issued and sold to investors. The different classes of these bonds are stratified by risk. When the monthly payments are paid to the mortgage pool, the Class A bonds receive their payment first. After they are paid, then the Class B bonds get paid, and then the Class C bonds. Since the Class A bonds get paid first, they have very low risk and generally get a AAA credit rating. The Class B bonds have much greater risk. To make them more attractive to investors, supplemental insurance is added from firms like AIG so they can get a rating of BBB.

As long as housing prices were rising, everything was fine. If you borrowed \$200,000 to buy a house and the house appreciated by 10 percent, you were \$20,000 richer. No borrower would default because they could always sell the house, repay the mortgage, and keep the \$20,000 profit. While prices were rising, the mortgage bonds produced strong returns. In the summer of 2006, however, housing prices topped out and began to fall. Many of the subprime and Alt-A mortgages issued around this time became upside down—due to the decline in price, the cost of the mortgage exceeded the value of the house. Mortgage defaults

soon followed and the price of mortgage-related bonds began to fall.

To understand why this grew into a crisis, we need to consider leverage, rating agencies, and the role of Fannie Mae and Freddie Mac. By itself, leverage is not complicated. Suppose you have \$1,000 and invest it at 7 percent. In a year, you have \$1,070. Now suppose you borrow \$10,000 and pay 5 percent interest on it. If you invest it at the same 7 percent, you will get \$700. Since you have to pay out \$500 in interest, your net is \$200 and your total earnings rise from \$70 to \$270. In this example, \$1,000 represents your capital and the ratio of borrowing to capital represents the leverage ratio, 10–1 in this case. As long as nothing changes, leverage allows the 7 percent return to become a 27 percent return.

The problems start when the borrowing rate increases or the value of the investment declines. If the borrowing rate rises to 8 percent, your funding costs have risen from \$500 to \$800. Your \$270 gain now becomes a \$30 loss. The situation becomes worse if the value of your investment falls. If it declines 10 percent, your investment is worth \$9,000, but you still owe \$10,000 plus interest. Your capital can’t cover the loss, so you’re bankrupt.

The expansion of Alt-A and subprime lending required the active participation of Fannie Mae and Freddie Mac. These government agencies were willing to comply because they had evolved into gigantic hedge funds with very high leverage ratios. Their business plans were simple. Fannie and Freddie would buy loans originated by banks, pool them together, and sell them as mortgage-backed securities. After they sold the securities, Fannie and Freddie would then buy them back. This might strike you as odd, but they did this because the interest rate they received on the mortgage-backed securities was higher than their government-backed borrowing

rate. To produce greater profits, they simply increased their leverage.

The rating agencies played an important role in the crisis because they seriously underestimated the risk of mortgage-related bonds. The data used by the ratings agencies were largely limited to a period of rising prices. They didn’t capture a national decline in real estate prices or adequately reflect the high correlation of defaults. The result was a projection that was far too optimistic and disastrous for investors who relied on the agency ratings.

Now we have the pieces in place for a financial explanation of the crisis. Many of the loans issued between 2005 and 2007 are underwater. This is especially true of the subprime and Alt-A loans because of their low down payments and their low initial interest rates. Mortgage lenders continued to make these loans—even when problems were emerging—because they knew that Freddie and Fannie would buy them. Fannie and Freddie were buying because of political pressure from Congress to expand their subprime operations to help make mortgages affordable for high-credit-risk borrowers.

When it became clear that the mortgage-related bonds were much riskier than expected, everyone wanted to sell them and no one wanted to buy them. Firms with high leverage and large exposure to mortgage loans such as Bear-Sterns, Lehman, Fannie, Freddie, Indymac, and Washington Mutual are now insolvent.

However, that was just the beginning. The price collapse left its footprints everywhere. Companies with large credit operations such as General Electric and Ford have seen their valuation cut in half. As firms have scaled back their willingness to extend credit, short-term rates have jumped. Some local governments

have seen their borrowing costs double or even triple.

The crisis has taken a large toll on the equity markets. In October 2007, the Dow Industrial was at 13,900 and the S&P 500 was 1,550. Since then, these benchmarks have declined 33 percent and 37 percent, respectively, including a 14 percent decline in October. This abysmal twelve-month performance—the worst in seventy-one years—has damaged college savings and retirement plans for virtually everyone. Consumer sentiment has fallen dramatically and spending from both consumers and businesses has fallen as purchases are deferred to the future. A typical recession involves a contraction in spending from both consumer and business sectors. The combination of the spending contraction and the financial crisis has prompted many to predict that this recession will last longer, perhaps until the fourth quarter of 2009.

The Big Questions

The big questions on many investors' minds include "Is the financial crisis over?" and "What will the market look like going forward?" We see some encouraging signs that the financial crisis has largely run its course. The liquidity crisis that drove up borrowing costs and reduced the availability of funds has abated. The benchmark one-month London InterBank Offered Rate (LIBOR),¹ which jumped from 2.5 percent in September to 4.5 percent in mid-October, has now returned to its September values. The issuance of commercial paper has increased as borrowers and lenders return to the market. Housing prices have shown small increases in about one-third of the regional markets. The aggressive response from Washington has helped to stabilize the banking system and enable banks to start lending again.

Economic cycles, however, tend to be longer than financial cycles.

Our forecast is for gross domestic product growth to turn positive in mid-year 2009. Since the markets tend to anticipate economic recoveries, stock prices tend to start rising three to six months before the end of a recession. If our economic forecast is incorrect and the recession runs longer, any rebound in the market will be delayed.

The weak economic performance in 2008 and 2009 is reflected in the earnings estimates. For 2008, estimates for the S&P 500 are expected to decline 18 percent from 2007 levels. For 2009, the estimates are expected to decline an additional 9 percent. Following this declining period, we anticipate a rebound in earnings as the growth returns to the economy and the amount of credit-related charges to earnings dissipates.

A common benchmark for valuing the market is the price-earnings (P/E) ratio, which measures the price an investor needs to pay to acquire \$1 of company earnings. Firms with high P/E ratios have strong growth prospects. A decrease in the P/E ratio means that investors are less optimistic about future growth or have become more risk averse about the stock market in general. As of October 31, 2008, the P/E was 18.2, based on the reported earnings for the past twelve months. This value is substantially lower than the 23.8 average over the last fifteen years. However, it is above 15.8, the average since 1936. By comparison, the P/E fell to 7 during the high inflation, high unemployment period around 1980. The P/E is 17.1 based on estimated earnings for all of 2008. Looking forward, the P/E will rise to 19.1 using 2009 estimated earnings.

Outlook for 2009

What is the outlook for 2009? We project that the stock market will provide a positive return, although less than the historical average of about 12 percent. Several factors lead us to this projection. On the positive

side, we expect that short-term and long-term interest rates will remain low in 2009. The Fed recently cut interest rates to 1 percent. With the economic uncertainty, we expect rates to remain low for 2009. Inflationary pressures, at least over the short term, have diminished and this provides the Fed additional justification for keeping the rates low. Commodity prices, especially oil, have fallen dramatically since July and will moderate inflationary pressures.

On the earnings front, our view is that current stock prices have already incorporated the decline in 2009 earnings. If our forecast of an economic recovery in mid-year 2009 is correct, then we anticipate 2009 earnings should come in above expectations. Another positive factor is that current earnings have been reduced because of an unusually high frequency of one-time charges. Operating earnings, which exclude these charges, show a more positive outlook and the estimates for 2009 are above the 2008 levels.

Prudent investors should always diversify their investments. For 2009, many analysts are recommending an asset mix that contains slightly fewer stocks and slightly more bonds than the average recommendation. We expect the stock market performance in 2009 to be volatile, with a high likelihood of large gains and large losses. Despite the volatility, we expect stock prices to be higher a year from now. One important step investors can take to improve investment performance is to monitor the total fees paid to mutual funds and investment advisors. Fund expenses, management fees, and inefficient trading for taxable accounts can reduce total returns by 3 percent per year. Over time, this will make a surprisingly large difference in the size of your portfolio. ■

Note

1. The LIBOR rate is the most widely used benchmark rate for short-term interest rates worldwide.

Housing Market Outlook for 2009

Jeffrey D. Fisher: Director, Benecki Center for Real Estate Studies; Charles H. and Barbara F. Dunn Professor of Finance and Real Estate, Kelley School of Business, Indiana University Bloomington

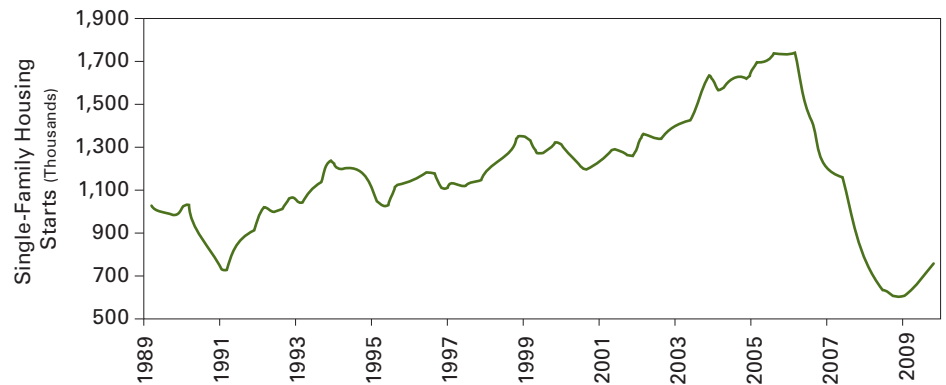
November 2008

The Blame Game

Needless to say, the housing industry has taken the blunt of the blame for the financial crisis and the current economic recession. Certainly, the unprecedented growth of subprime mortgages made to people who really couldn't afford a home was a major cause of the problems. It is questionable, at best, whether or not these mortgages were sound loans even when home prices were rising and people could refinance and take equity out of their home to help cover their future mortgage payments—especially when their “teaser” interest rates were adjusted upward to a market rate. When home prices started falling two years ago, millions of people holding these mortgages faced financial trouble. As defaults started to increase, concerns about the impact on banks and the rest of the economy swelled from a ripple to a tidal wave that swept away many financial institutions and resulted in the federal government taking over Fannie Mae and Freddie Mac.

There are certainly others to blame. Mortgage brokers encouraged homeowners to get mortgages they couldn't afford so the brokers could get fees. Lenders thought the mortgages were a good way to increase profits, and they got their service fees while selling the loans to Wall Street, who in turn created securities backed by the mortgages. The securities were rated by the rating agencies, which also received payments on fees, and then the securities were purchased by investors around the world who relied on the rating agencies. While not obvious at the time, it is now clear that the system failed us and the incentives were all wrong. Thus, we are all paying for it through the bailout and the effects the financial crisis has had on banks, retirement

■ **FIGURE 1: Single-Family Housing Starts, 1989 to 2009**



Note: Data are seasonally adjusted at an average annual rate
Source: HousingEconomics.com

accounts, Main Street, and Wall Street. Small businesses have been having problems refinancing loans to keep their businesses going as banks have severely cut back on the amount they are willing to loan and tightened lending criteria to everyone—not just mortgage holders.

Bailout and Turnaround?

The bailout may help by restoring liquidity in the banking system, removing bad mortgages from banks' balance sheets, and encouraging banks to loan again. Moves by the Federal Reserve Bank to keep interest rates down may also help. And even if inflation comes back as a result, it could ultimately help push home prices back up again.

The question is, when will the housing market turn around? There are many outstanding mortgages whose artificially low interest rates will reset in 2009, which may result in continued foreclosures that put downward pressure on home prices. On the other hand, the drop we have already experienced in home prices has started to make prices attractive again and existing home sales actually increased slightly in recent months.

Still, most economists think it will be late in 2009 or 2010 before we see much of a recovery in the housing market. According to the National Association of Home Builders (NAHB), single-family housing starts are projected to bottom out during 2009 and then begin to climb. We anticipate the bottom reached in 2009 will be slightly below the level dropped to during the recession of the early 1990s, as seen in **Figure 1**.

There is currently a ten-month supply of new homes on the market, compared to a six-month supply in 2006 before the housing crisis started. The good news is that sales of newly built single-family homes turned upward in September 2008, posting a 2.7 percent gain and marking a seasonally adjusted annual rate of 464,000 units, according to the U.S. Commerce Department. This suggests that builders are making progress in winnowing down the supply of unsold units on the market. However, the median number of months completed new homes stayed on the market moved up to 9.1 months—a new record. The level of confidence among builders surveyed in October for the monthly NAHB/Wells Fargo Housing Market Index fell to its lowest point since the series

started in 1985, indicating concern among home builders as to when the market will recover.

Existing-home sales, including single-family homes, townhomes, condominiums, and co-ops rose 5.5 percent to a seasonally adjusted annual rate of 5.18 million units in September—up from 4.91 million in August. This is 1.4 percent higher than the 5.11 million-unit pace in September 2007.

The national median existing-home price for all housing types was \$191,600 in September, down 9 percent from a year ago when the median was \$210,500. Distressed sales are currently 35 percent to 40 percent of transactions. These are pulling the median price down because many are being sold at discounted prices.

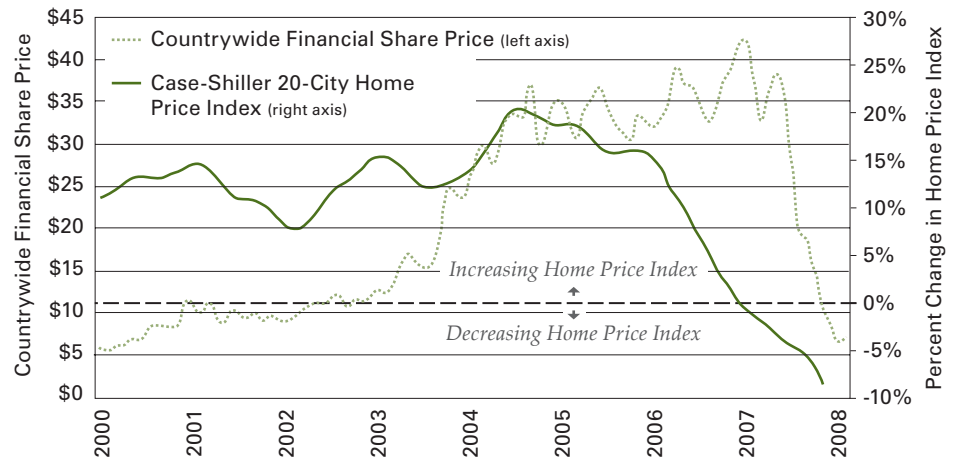
Figure 2 shows the decline in home prices based on the Case-Shiller Home Price Index. The stock price of Countrywide Financial, one of the nation's largest mortgage lenders, is also shown. Hindsight is easy, but it is clear that home prices experienced a slowdown in growth before the stock market realized the impact this would have on mortgage lenders.

Mortgage interest rates are likely to stay relatively low due to the lower demand for mortgages and the Fed lowering interest rates, although the higher risk attributed to mortgages is keeping rates from falling significantly. **Figure 3** shows a forecast of thirty-year mortgage interest rates from Forecasts.org.

Housing Affordability

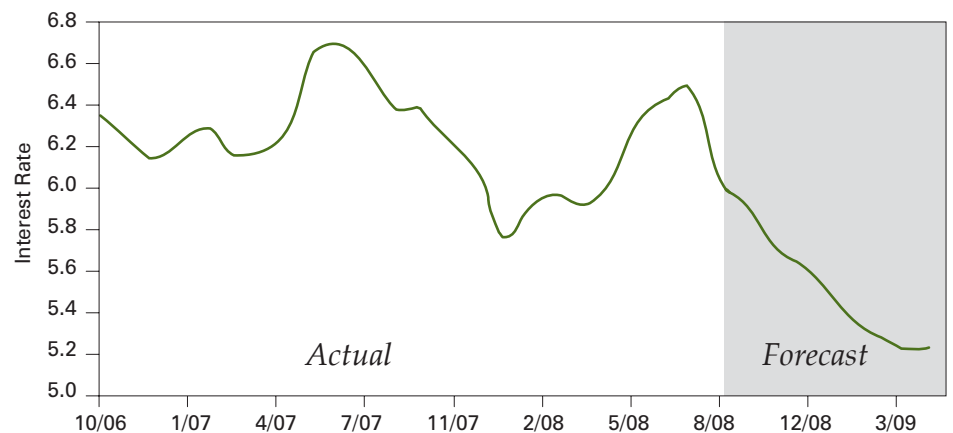
Due to the drop in home prices and continued low mortgage interest rates, housing has become more affordable. The National Association of Realtors Housing Affordability Index is now at 135, whereas it was only 106 in 2006. This indicates that the median income family now has 35 percent more income than

FIGURE 2: Countrywide Financial Share Prices and Year-Over-Year Percent Change in the Home Price Index, 2000 to 2008



Note: Year-over-year percent change data are from MacroMarkets, Yahoo!
Source: <http://seekingalpha.com>

FIGURE 3: Thirty-Year Conventional Mortgage Interest Rate—Past Trend and Projection, 2006 to 2009



Source: Forecasts.org

necessary to qualify for a loan on a median priced home, compared to 6 percent more income than necessary in 2006. That said, the blowup in the subprime mortgage market means that those without very good credit ratings are not likely to receive financing even if their income is sufficient.

Conclusion

The recovery of the housing market is going to depend partly on how the credit markets adjust. Many lenders are now more willing to renegotiate loans for those facing foreclosure. However, the credit market can only do so much. We also need to restore faith in our financial system. ■

Indiana's Outlook for 2009

Jerry N. Conover, Ph.D.: Director, Indiana Business Research Center, Kelley School of Business, Indiana University

November 2008, updated December 2008

Indiana is not immune to the forces shaping the national and global economies, so its outlook for the year ahead is similarly cloudy. At the same time, certain aspects of Indiana's economy cause the Hoosier State to perform in idiosyncratic ways. This article briefly overviews several dimensions of our state's recent performance and its outlook for 2009.

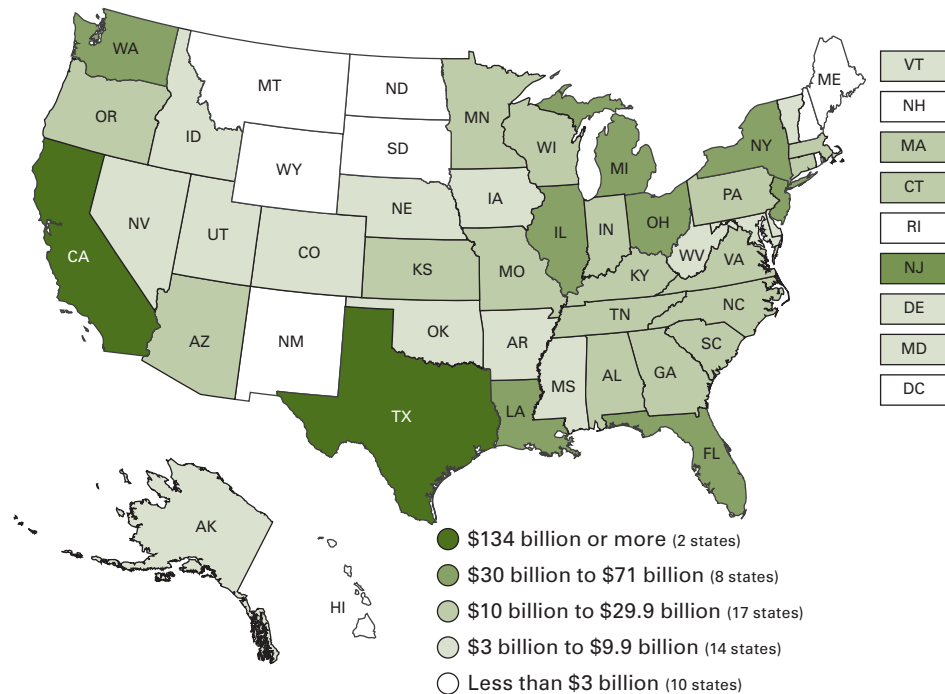
Overall Economic Output

The broadest measure of our economic activity is gross domestic product (GDP) at the state level. Indiana's GDP grew very slightly (0.3 percent) in 2007 following two years of small declines. Although these three relatively flat years followed several years of 2 percent to 4 percent annual increases, the rest of the nation has seen stronger GDP growth; since 2000, only Ohio and Michigan have had slower GDP growth than Indiana.

Indiana's manufacturing output has decreased over the past three years, but manufacturing's share (28 percent) of Indiana GDP is still the largest of any sector; only one state (Oregon) is more reliant on manufacturing. Indiana sectors with GDP that has grown in recent years include retail; transportation and warehousing; arts and entertainment; health care; technical services; and administrative and support services.

The outlook for 2009 calls for limited growth in GDP, given the weak national and global economies on which so many Indiana firms depend, coupled with weakness in the consumer sector and the automotive industry. There is some potential for further downward momentum (depending in part on the speed and effectiveness of federal stimulus actions), although late in the year we may see some GDP growth return.

■ FIGURE 1: Value of Exports by State in Current Dollars, 2007



Source: IBRC, using WISER Trade data

Exports

Indiana exports reached a record \$26 billion in 2007, up 14 percent from the previous year. Led by vehicles and parts, industrial machinery, electronics, and pharmaceuticals, this performance moved us up to twelfth place among the states (see **Figure 1**). Key factors in this growth have been booming economies overseas and a weak dollar. The dollar's recent strength, however, coupled with slower economic growth abroad presages slower export growth in 2009. This should contribute to weak GDP growth for Indiana.

Employment and Unemployment

In all but one month from December 2003 through April 2008, Indiana's payroll employment showed year-over-year gains. Starting May 2008, however, we've had five months in a row of job losses compared to a year earlier (see **Figure 2**), the first such streak since employment bottomed

out in summer 2003. By that nadir, the state's payrolls had lost more than 130,000 jobs over a two-year period; fortunately, the current recession does not portend quite so bleak an outlook.

Sectors with notable shrinkage over the past year include manufacturing (-2.8 percent year-to-date) and construction (-2.1 percent). On the other hand, employment has grown in some of the larger sectors, including education and health services (+2.3 percent), government (+1.5 percent), and leisure and hospitality (+0.8 percent).

Indiana has maintained a strong pace in announcements of business attraction and expansion, which helps us perform better on employment measures than other Midwestern states. However, some of these firms may slow their growth plans until the overall economy shows more strength and credit loosens up. There have been significant layoffs recently in the steel and automotive

sectors, finance and real estate, and other industries sensitive to weak consumer or industrial demand and tight credit. Although Indiana's unemployment rate has been a bit higher than usual in recent months, it's still not far above its average over most of this decade.

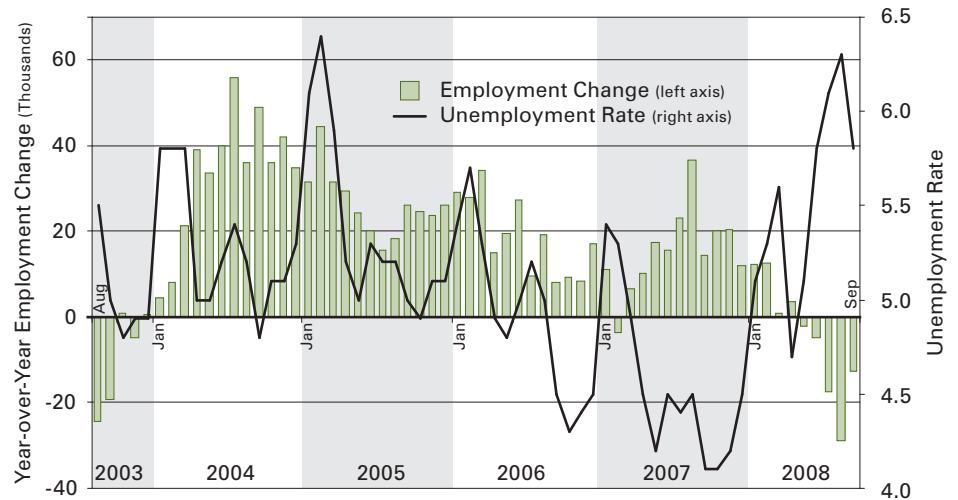
The jobs outlook for 2009 calls for shrinkage by about 50,000 jobs, and then turning back up near the end of the year. Average unemployment for the year should be in the 6.5 percent to 7.5 percent range.

Personal Income

Hoosiers' total personal income (PI) reached a record high of \$219 billion in the second quarter of 2008. As shown in **Figure 3**, Indiana's PI has grown more slowly than the nation. Indiana's PI has grown by only 32.7 percent since 2000, while U.S. PI has increased 45.2 percent. Slow population growth in Indiana accounts for part of this growing gap (as do structural shifts in the state's economy), so it's useful to look at per capita personal income (PCPI) to control for population growth.

Indiana's PCPI last year trailed the national figure by a record \$5,412. Put another way, the state's PCPI fell to 86 percent of the national value, a drop of 5 percentage points in

FIGURE 2: Indiana's Unemployment Rate and Change in Payroll Jobs, January 2003 to September 2008



Note: Data are seasonally adjusted
Source: IBRC, using Bureau of Labor Statistics data

just four years. A longer-term view reveals that PCPI has been generally declining relative to the nation for the past half century. Although many factors contribute to this trend, an important one is Indiana's reliance on manufacturing. When factories were shuttered during the Great Depression, our PCPI fell to 77 percent of the nation's, rebounding to surpass the national PCPI during World War II and the early post-war years when factories were humming. In the coming year, we

do not anticipate much rebound for Indiana's PCPI.

Housing

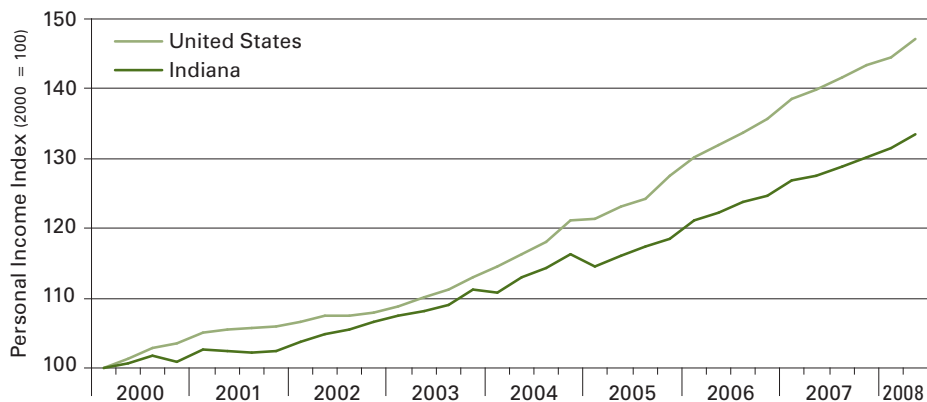
Since Indiana did not experience a big housing bubble, it has not suffered nearly as much as other parts of the country when the bubble burst. Nonetheless, single-family building permit activity so far this year is 25 percent to 30 percent below 2007 and about half its peak rate in 2005. Fortunately, we anticipate some revival of home building (perhaps as much as a 25 percent gain) in 2009, when much of the housing surplus will have been absorbed.

Sales of existing homes should end 2008 down 10 percent to 15 percent from 2007 and rise slightly in 2009. Multi-family housing construction will remain rather slow.

Conclusion

In summary, Indiana's outlook for 2009 is one of continued economic challenge echoing the national situation, though there is some light at the end of the tunnel toward the end of the year and a few bright spots along the way. ■

FIGURE 3: Growth in Quarterly Personal Income, Indiana vs. United States, 2000 to 2008



Source: IBRC, using Bureau of Economic Analysis data

Indiana's Agricultural Outlook for 2009

Corinne Alexander: Assistant Professor, Department of Agricultural Economics, Purdue University, West Lafayette

November 2008, updated December 2008

Indiana agriculture will face massive uncertainty in 2009. The excitement generated in 2008 with the rapid growth of the biofuels sector, strong export demand, and record wheat prices due to very tight worldwide wheat supplies has reversed dramatically with the financial crisis. Going forward, Indiana farm incomes are expected to be lower in 2008 and 2009 than they were in 2007, but how much lower depends on when the financial markets reach bottom, what happens to the price of crude oil, and whether input costs fall as fast as prices.

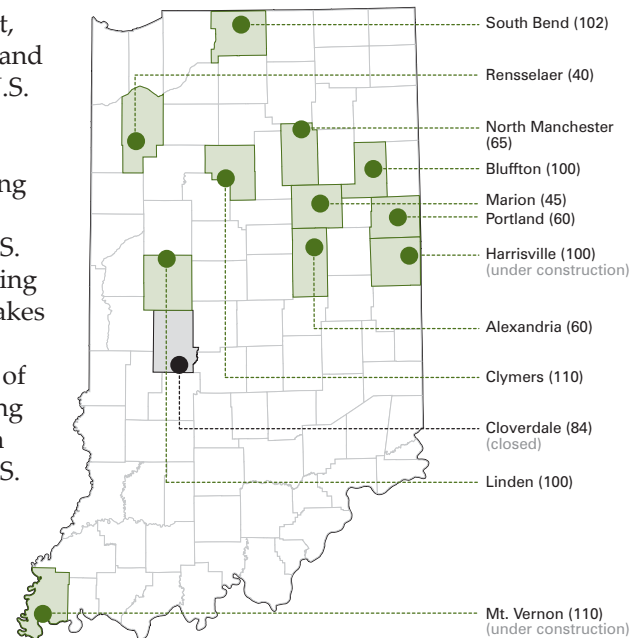
Let's discuss the developments in the biofuels sector, which now links the fortunes of many Indiana farmers to the price of crude oil. As of mid-December 2008, nine ethanol plants were operating in Indiana at South Bend, Rensselaer, Marion, Clymers, Linden, Portland, Alexandria, Bluffton, and North Manchester. Two additional plants are under construction at Harrisville and Mount Vernon (see **Figure 1**). These ethanol plants have the capacity to utilize 280 million bushels of corn—an equivalent of 30 percent of Indiana's 2008 corn production, up from just 4 percent in 2005. This new usage for Indiana corn is similar to what is happening in the rest of the Corn Belt. As a result, the price of corn is now closely linked to the price of crude oil because the ethanol industry is now a major corn user. Cash corn prices now tend to run about 5 percent of the price of crude oil per barrel. On December 10, 2008, crude oil was trading around \$45 per barrel, with cash corn prices around \$3.20 per bushel. For May 2009 delivery, crude oil futures are trading around \$52 per barrel, with cash corn prices around \$3.35 per bushel—prices much lower than what most producers were planning for and lower than the forecasted cost of production.

In addition to the crude oil price drop, agricultural commodities prices have fallen for two reasons. First, the current financial crisis and U.S. recession mean that U.S. and world income growth is slowing sharply. As a result, demand is weakening for agricultural products worldwide. Second, the U.S. dollar has been strengthening since last spring, which makes U.S. agricultural products more expensive to the rest of the world. Combine slowing world income growth with a strong U.S. dollar and U.S. agricultural exports will likely slow.

Right now, with the uncertainty about the direction of commodity prices and the uncertainty about whether input costs will fall due to slowing global demand for fertilizers, Purdue University estimates of Indiana net farm income reflect the massive uncertainty facing the global economy. Indiana net farm income in 2009 will be anywhere from \$700 million on the low end (if commodity prices remain low and input costs remain high) to \$2 billion on the high end (if commodity prices recover somewhat and input costs fall). To provide a benchmark, the 1998–2007 average net farm income in Indiana was \$1.3 billion. The next twelve months will be extremely challenging for agricultural producers and some must now “manage for survival.”

Looking to 2009, even with lower net farm income than previously expected, the value of farmland is expected to increase, though at a slower pace. Farmland value also depends on factors such as long-term interest rates, government price support payments, and real estate

■ **FIGURE 1: Ethanol Plant Locations and Plant Size in Millions of Gallons of Ethanol per Year, 2008**



Source: Professor Chris Hurt, Purdue University, November 2008

taxes. Given the current price levels for corn, soybeans, and wheat, prices continue to be well above the trigger level for government price support payments, reducing the influence of government programs. Long-term interest rates can be expected to increase, putting downward pressure on land prices. As of June 2008, the value of average quality Indiana farmland increased 15 percent over the previous twelve months according to the Purdue Land Value Survey.¹ As of October 2008, given the financial crisis, Indiana farmland values are expected to increase at a slower pace in 2009.² ■

Notes

1. For more information about Indiana farmland values, see the Purdue Land Value Survey at www.agecon.purdue.edu/extension/pubs/paer/2008/august/dobbins.asp.
2. For more information about how the financial crisis is affecting Indiana agriculture see www.agecon.purdue.edu/news/financial_crisis.asp.

Indiana's Special Sectors Outlook for 2009

November 2008

Manufacturing

Carol D'Amico: President and Chief Executive Officer, Conexus Indiana

Manufacturing has been the heart of Indiana's economy for generations, and we continue to be one of the nation's most manufacturing-intensive economies—nearly one in five Hoosiers is employed in manufacturing industries, which contribute more than \$58 billion to state gross domestic product.

Indiana's manufacturing sector cannot be immune from the downturn in the national economy. 2008 saw a decline of two million units in the light vehicle market, with a further drop of 200,000 vehicles forecast in 2009, according to the University of Michigan. The poor performance of automakers like General Motors may manifest itself in cutbacks and "temporary idlings" at Indiana plants. The outlook for U.S. exports is also pessimistic as other industrialized economies slip into negative growth, which could pull Indiana's exports down from the record levels they have enjoyed over the past several years (driven primarily by manufactured goods).

However, Indiana offers several countervailing trends that may allow us to weather the national storm better than many. The state has ranked number one in attracting new jobs through foreign investment on a per capita basis for two years running.¹ In all, since 2005, Indiana has attracted approximately \$4 billion in new manufacturing investment, accounting for nearly 30,000 new job commitments. These job gains will help offset the losses that we may suffer.

Indiana's manufacturing sector also boasts strengths in pharmaceutical and medical device production, areas that are more resistant to economic cycles. Over the last few years, companies like the

“The workforce remains a short-term strength and longer-term liability for Indiana manufacturing.”

Cook Group, Baxter Pharmaceuticals, and Zimmer have announced the creation of thousands of well-paying jobs. As pharmaceutical outsourcing trends continue, Indiana's cluster of contract manufacturers (like Cook Pharmica) should benefit accordingly.

Indiana also has the potential to capitalize on the growth of the "clean technologies" sector, areas like fuel cells, biofuels, solar, and wind power—projected to more than triple over the next decade to represent a \$255 billion industry by 2017.² With a strong cluster of innovation-minded automotive manufacturers, public-private collaborations are emerging to push development of "next generation" plug-in electric vehicles and other green manufacturing initiatives in the state. These efforts may pay dividends as early as 2009—just look toward the northside of Indianapolis, where EnerDel (a manufacturer of advanced batteries for hybrid vehicles) is growing and adding hundreds of jobs.

The workforce remains a short-term strength and longer-term liability for Indiana manufacturing. The state's existing workforce is the most productive among neighboring states (measured by output per worker). But looking further ahead, as baby boomer retirements erode the existing labor pool, the low educational attainment of Indiana's adult population will be a persistent obstacle to growth in manufacturing when the economy emerges from the recession. Strengthening both the incumbent and emerging workforce should be the primary policy goal

for continued, sustainable success in high-tech manufacturing industries. ■

Notes

1. *Inside Indiana Business*, "Indiana Leads the Nation in Attracting Foreign Jobs," October 22, 2008, www.insideindianabusiness.com/newsitem.asp?ID=32161.
2. *CleanEdge*, "Clean-Energy Trends 2008," www.cleandedge.com/reports/reports-trends2008.php.

Logistics

Carol D'Amico: President and Chief Executive Officer, Conexus Indiana

Manufacturing and logistics are rightfully treated as separate economic clusters, with many unique opportunities and challenges. However, they are also inextricably tied together as part of the broader supply chain—it's difficult to divorce production from distribution. So the fortunes of the state's logistics sector will be influenced by manufacturing output to some degree, which should remain fairly consistent as our longer-term growth opportunities are tempered by the national downturn.

However, Indiana's unique geographic advantages (our location within a day's truck drive to two-thirds of the U.S. population and businesses) should continue to bolster growth (albeit slowed somewhat by the recession) in the distribution and warehousing sectors. Indiana ranks first among states in interstate access, ninth in total rail miles, and among the top fifteen in air and maritime freight. Looking ahead, ongoing investment in the state's highway infrastructure through the Major

Moves program, plus the opening of the new Indianapolis International Airport, will continue to strengthen the state's physical infrastructure to meet the demands placed upon it.

And these demands will grow. Despite the downturn, U.S. domestic freight volume remains on pace to double by 2035¹ and Indiana is poised to leverage its position as the "Crossroads of America" into new economic opportunities within the \$1.3 trillion domestic logistics industry.

Using quarterly workforce data from the Census Bureau and estimates of future economic activity predicted by the Fair model of the U.S. economy,² continued growth in Indiana logistics employment is projected through 2010, with the necessary caveats on the uncertainty of the depth and duration of the economic recession. Regardless, given the state's geography and infrastructure, we feel confident in identifying the logistics sector as a continued source of new jobs and business opportunities for Indiana's economy, and a strength which will complement growth in manufacturing and other industries. ■

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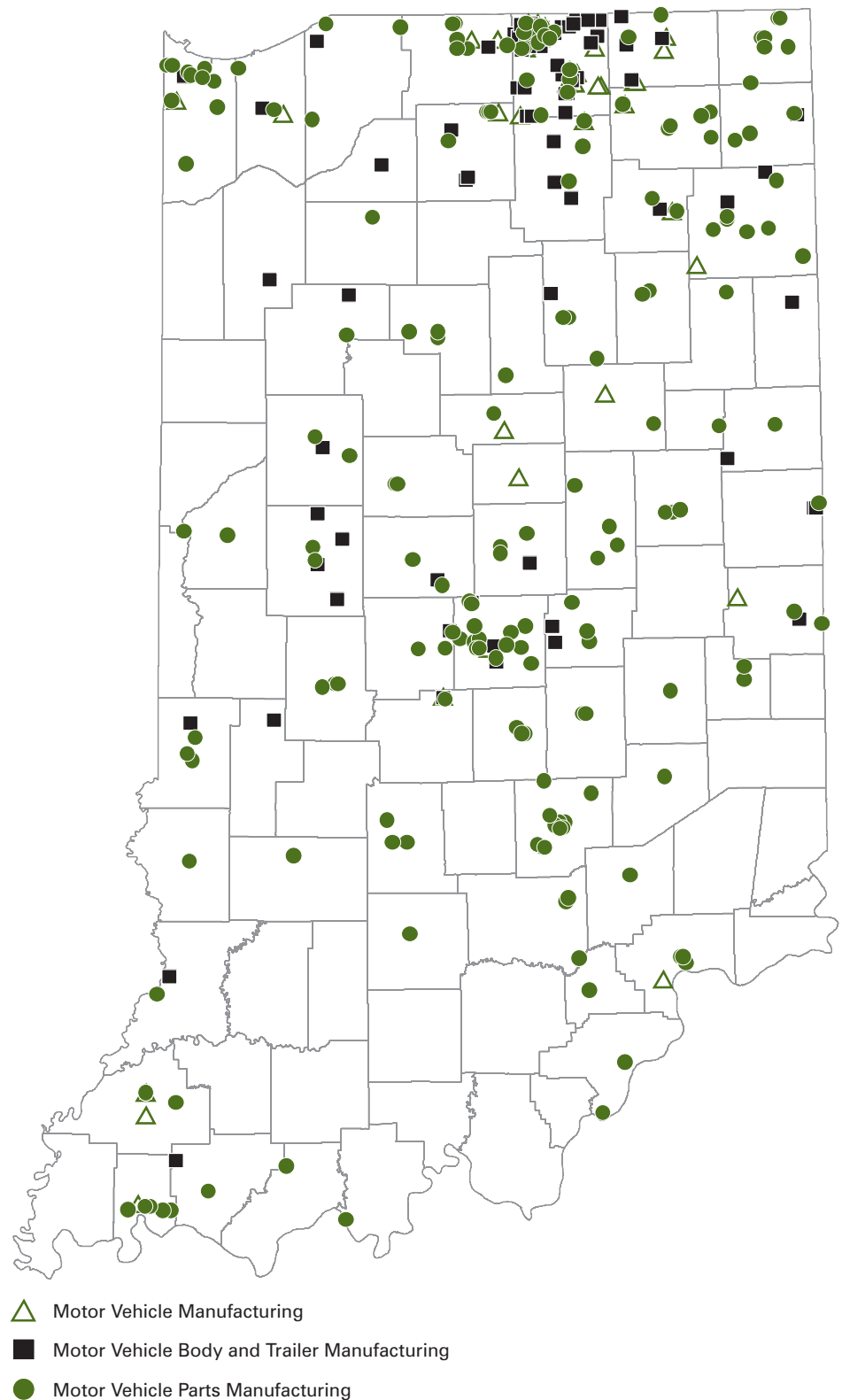
1. Federal Highway Administration
2. The Fair model is a widely used macroeconomic model of the U.S. economy developed by Ray C. Fair of Yale University.

Automotives

Jerry N. Conover, Ph.D.: Director, Indiana Business Research Center, Kelley School of Business, Indiana University

One of the most visibly stressed sectors of the economy has for some time been the automobile industry. The November auto sales drop of 36 percent was the worst year-over-year change in twenty-six years. General Motors stock traded recently at under

■ FIGURE 1: Automotive Manufacturing Locations, 2008



Source: InfoUSA

\$3 a share, a 90 percent fall from a year earlier. United Auto Workers (UAW) members are worried not about increasing pay or benefits, nor even maintaining them, but whether they will even have jobs next year.

The “Detroit Three” automakers have begged for \$34 billion in federal loans, with two of the three pleading that they may go under without immediate help. At this writing, it is unclear how Congress and the current or new administration will respond to this request. In any case, the U.S. automotive sector going forward will doubtless look quite different than it does today (see **Figure 1**).

The Detroit Three are talking about cutting marginal brands, closing dozens of assembly plants, eliminating a quarter of their dealers, and laying off tens of thousands of auto workers as part of the companies’ efforts to regain competitiveness and justify the government loans. And these predictions do not encompass the much more numerous firms and workers of the larger automotive cluster that includes automotive parts manufacturers, automobile and parts dealers, service providers specializing in the auto sector, and others. Nor do they reflect the induced impacts that such major cutbacks would have on the larger economy as the auto sector’s payrolls shrink and there’s less money to spend on consumer goods and services.

Clearly, even in an optimistic scenario, the national automotive sector over the next few years will be significantly smaller than it is today. At best, it is years away from the handsome profits it enjoyed before fuel prices started soaring and the financial markets collapsed.

The pain of the auto sector will be felt as strongly in Indiana as anywhere in the nation. In 2007, 159,603 Hoosiers were on the

“ Significant retrenchment in the auto industry will hit the state very hard, and it will probably take years before we again see a strongly profitable auto sector. ”

payrolls of the sector’s 3,504 Indiana manufacturers and dealers, earning wages totaling more than \$8 billion. The vehicle and parts manufacturers, long the keystone in Indiana’s manufacturing economy, paid wages averaging \$55,915 per worker. Significant retrenchment in the auto industry will hit the state very hard, and it will probably take years before we again see a strongly profitable auto sector. ■

Life Sciences

Lawrence S. Davidson: Founding Director, Center for the Business of Life Sciences, Kelley School of Business, Indiana University Bloomington

Indiana is fortunate to have more than its share of biotech, pharmaceutical, and medical device companies. Bloomington, Fort Wayne, Indianapolis, and Warsaw house one of the nation’s top enclaves of life sciences firms. It is no secret that these companies made record profits in 2008 and are generally less sensitive to business cycle downturns than are companies in consumer white goods or electronics. While a patient could theoretically take fewer pills than recommended, many health procedures are not so easily postponed. But that does not mean that recent trends won’t impact these companies. For example, an important national goal aims at reducing the growth of healthcare expenditures. This puts pressure on life sciences firms to increase quality while lowering the prices of their products and services. Many of these companies are laying off

workers. Many are changing their business models—replacing work done in-house with purchases from new vendors and partners. When Eli Lilly and Company announced that it is now a FIPNet instead of a FIPCo,¹ there was concern among some employees as to how that change will impact layoffs. Of course, the other side of the equation is that employment in many Lilly suppliers will increase. Lilly also exemplifies another industry trend as it evolves from traditional pharmaceutical manufacturing to a biotech firm focusing on proteins and cell structure.

Mergers, acquisitions, and other strategic alliances should strengthen Indiana pharmaceutical and medical device companies. Of course, all this takes money and credit. While many life sciences firms have cash now, the market and opportunity cost of funds is very high, and the availability is low. Venture and other forms of capital are much harder to attract these days, indicating that some promising new ventures and ideas may be postponed. Thus, while life sciences firms may be shielded somewhat from the current economic slowdown, they will not be immune to the experience of other firms. ■

Note

1. A FIPCo (Fully Integrated Pharmaceutical Company) typically keeps research and development functions in house and behaves fairly independently. A FIPNet (Fully Integrated Pharmaceutical Network) encourages partnerships with contract service providers in an effort to drive collaboration, share risk, and reduce costs. In essence, a FIPNet outsources research and development functions to contractors.

Anderson Forecast 2009

Barry C. Ritchey, Ph.D.: Professor of Economics, Falls School of Business, Anderson University

October 2008

What a difference a year makes. Profound changes occurred between the fall of 2007 and the fall of 2008 that will likely change the landscape of our economic world. Nationally, we have gone through one of the most profound economic challenges in history.

A year ago, the city of Anderson was building momentum in its attempt to redefine and rebuild its economy. The Chamber of Commerce had awarded the city its City of the Year Award, Forbes had ranked Anderson as a top 100 city for business climate, and the Rotary had also given recognition to the city. Momentum looked positive and there was room for optimism as Anderson took the first few steps of the long journey toward its economic reconstruction. Voters spoke in Anderson's last election, removing the previous mayor. Turnover in leadership is a difficult obstacle to overcome in maintaining momentum. There is some truth in the old adage that you never change horses in midstream. It may be that the new leadership will be successful; however, it takes time to establish a new administration.

A year ago, the housing market in Anderson was extremely weak by historical comparison. This year's national events in financial markets have taken a bad situation in Anderson and made it worse. Credit markets have tightened lending and the excess supply of housing in Anderson has not dwindled. The threat of falling national income has surely been another factor in local economic performance. It is not surprising that the obstacles that faced the city a year ago remain. The profound sense of local economic loss in Anderson has been matched nationally as well.

From beginning to end, the Anderson rebuilding process will

face obstacles. In our case, the most imposing obstacle is that of improving local education. Economic issues all take a back seat to rebuilding our local schools. Success at the local school builds the foundation for success with the local economy.

A recent article in the *Herald Bulletin* points out some of the symptoms of poor school performance. From 2007 to 2008, Anderson city schools lost another 378 students. Over the past twenty years, the school system has lost over 3,000 students. While part of this loss can be attributed to demographic changes, a significant portion of the loss can be attributed to families responding to the weak performance of our local schools. Tuition transfers and enrollment in alternative charter schools have increased the drain of students. Another article from the same source reports that graduation rates for the two high schools in the city are 66 percent and 53 percent, far below the national average. Any attempt to rebuild the local economy must begin and end with rebuilding local education.

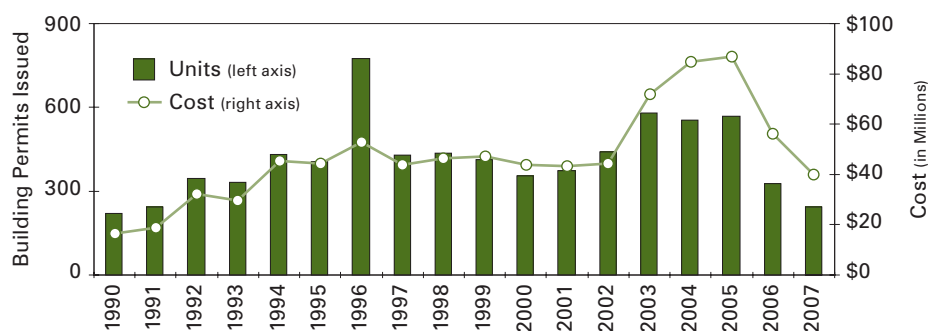
In what state do we now find the local economy? The housing market continued its decline last year. In 2007, only 243 permits were issued in the county, representing a mere \$40 million of housing construction (see **Figure 1**). In 2006, 328 permits were

issued, representing \$56 million of housing construction. In 2005, a year more comparable to historical levels, 569 permits were issued, representing \$87 million in housing construction. In the short span of two years, from 2005 to 2007, investment in new home construction in Madison County fell 54 percent.

In the labor market, unemployment has changed only slightly from last year. The county had a yearly unemployment rate of 6.3 percent in 2007; Anderson had an unemployment rate of 7.1 percent. For January through September 2008, Madison County had an unemployment rate of 6.8 percent and the city of Anderson had a rate of 7.2 percent. If national unemployment should rise significantly, unemployment in Anderson will likely be more stable than past trends might indicate. In the past, the county moved into high unemployment ahead of the nation because of the county's concentration of automotive jobs. Now that the automotive industry has moved out of the county, the Anderson metro tends to lag behind the rest of the country's unemployment trend. Hence, the nation will likely see an increase in unemployment before Madison County's rate increases.

The labor force in Madison County has been declining, falling to 60,613 for 2007. This marks an 8.8 percent

■ FIGURE 1: Total Building Permits in Madison County, 1990 to 2007



Source: IBRC, using U.S. Census Bureau data

Bloomington Forecast 2009

Jerry N. Conover, Ph.D.: Director, Indiana Business Research Center, Kelley School of Business, Indiana University

November 2008

decline over the past decade. Some of this change is likely due to the aging of the county workforce. Many older workers have retired, thus reducing the size of the workforce. The number of workers employed fell to 56,805 for 2007—an 11.4 percent decline over the past decade. The largest employment category for the county is now health care. The average wage in health care is approximately half of the average wage in manufacturing. Manufacturing has fallen to the third largest employment category behind health care and retail. Retail workers have an average annual wage that is about one-third of that for manufacturing workers. Clearly, the outcomes in the labor market have significant implications for the community's income.

From 2001 to 2006, real net earnings for residents of Madison County fell by 2.4 percent. We ranked eighty-fourth out of ninety-two counties. Even as county income has been falling, transfer payments to retirees have risen by nearly 21 percent over that same time period. If it had not been for transfer payments to retirees, our income performance would have been weaker. The weakness of the labor market, falling income, and distributional issues have affected the poverty rate in the county. By 2005, the poverty rate had increased to almost 12 percent.

Of course, the key to rebuilding the city depends upon rebuilding the economic base. Leadership has the choice of internal job creation or external job attraction. However, both of these choices will depend upon the quality of education created within the community. The jobs that we create internally will provide greater value as we improve the education levels of the workforce. The same holds true for external jobs attracted to the city. We can only attract high value-added jobs if the workforce is well educated. Our economic outlook for the future will improve as we improve our educational performance. ■

Just as 2009 promises to be a tough year for economies throughout the nation and around the world, it will challenge the Bloomington economy. The prospects for the Bloomington area, however, seem somewhat less cloudy than in many places, including much of Indiana.

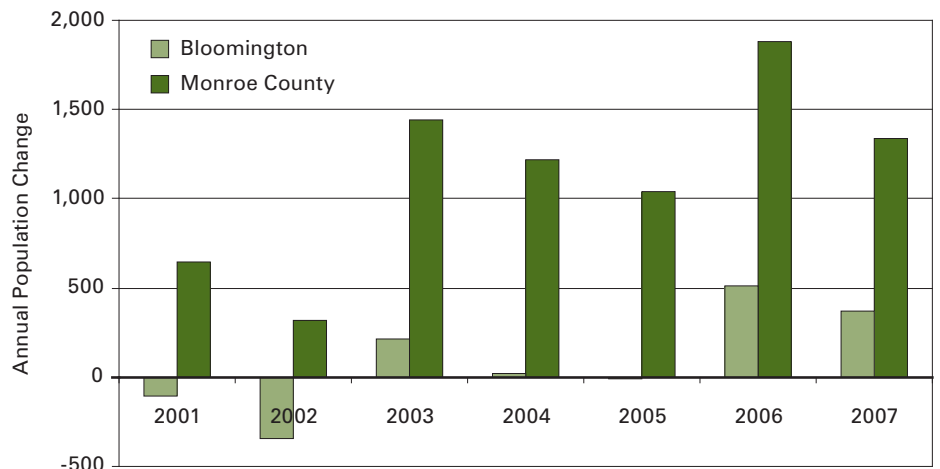
On the bright side, the population of Bloomington and Monroe County continues to grow, and this in turn fuels businesses that serve the local market. As shown in **Figure 1**, both the city and the county have grown substantially over the past two years, and the city continues to account for a minority of total county growth. Monroe County gained an estimated 1,337 residents in 2007, its largest annual jump since the turn of the century and the fastest growth rate of any county in the region. Continued gradual population growth is expected in 2009.

Growth of the overall economy of the Bloomington metropolitan statistical area (MSA) presents a mixed picture. The metro area's economic output (gross domestic product at the county level) grew

7.7 percent from 2001 through 2006 (the most recent year for detailed MSA data), but this was only half the national rate. The area's retail output grew more slowly than U.S. retail output, while its manufacturing output nearly equaled the national growth rate at 14.5 percent. Output of the professional and technical services sector gained a respectable 25.3 percent, outpacing the nation in this sector. In a preview of a general slowdown in building, output of the metro area's construction sector fell 12 percent in 2006 after five relatively steady years. The Bloomington area's output should end 2009 somewhere between flat and up very slightly (perhaps 1 percent) compared to 2008.

As this article was written, the Bloomington MSA appeared to be reaching a possible turning point in employment growth. For 2008 through September, payroll employment averaged more than 1,000 jobs above the same period in 2007. Job change in September and October, however, averaged a slight decrease. This workforce shrinkage was seen across a wide range of

■ **FIGURE 1: Annual Population Change in Bloomington and Monroe County, 2001 to 2007**



Source: IBRC, using U.S. Census Bureau data

industries, more so in services than in goods production. One month of two does not make a trend, but given other signs of economic distress, it sharpens our focus on jobs figures for upcoming months. The outlook for 2009 calls for growth of about 500 jobs overall.

Monroe County manufacturing employment in the first quarter of 2008 was up by 139 jobs compared to a year earlier; chemical manufacturing (which includes pharmaceutical products) was up 271 jobs. As shown in **Figure 2**, despite some ups and downs, the county's manufacturing employment has followed a generally upward trend for about three years—gradual growth that's very welcome after years of significant declines. Over the past year, however, factory wages have slipped by \$27 per week—a small but noticeable decline evident in **Figure 2**. For the year ahead, manufacturing should hold its own in Monroe County with regard to jobs, while wages will still be under modest downward pressure.

“The local real estate outlook may represent a ray of light toward the end of 2009 as credit markets loosen up and the remaining surplus of houses fills increasing demand.”

The Bloomington MSA's per capita personal income (PCPI) continued its long-term deficit relative to the United States, with 2007 PCPI only 74.3 percent of the national figure. The long-term loss of well-paying manufacturing jobs is a significant contributor to this slippage, a phenomenon that plagues the state as well. Though local PCPI will continue to grow in an absolute sense, our incomes are not likely to close the gap with the nation in the coming year.

Finally, the local area's housing market has been slowing down recently, but it's not nearly as weak as in many parts of the country. Residential home sales for 2008 through September were down about 11 percent compared to the same period in 2007, while home prices

were down about 2 percent. Time on the market has also risen from 105 to 130 days, and more foreclosed homes are available on the market now. Demand is pretty good for houses in the \$100,000 to \$250,000 range, but weak for higher-priced homes. As elsewhere, financing is available but limited to buyers with strong credit ratings and equity to bring to the purchase. The local real estate outlook may represent a ray of light toward the end of 2009 as credit markets loosen up and the remaining surplus of houses fills increasing demand. However, actions yet to be determined by the federal government could greatly affect prospects for a housing turnaround in the Bloomington area. ■

■ **FIGURE 2: Monroe County Manufacturing Jobs and Real Wages, 2001:1 to 2008:1**



Source: IBRC, using Bureau of Labor Statistics data

Columbus Forecast 2009

James C. Smith: Senior Lecturer in Finance and Co-Director: Center for Econometric Model Research, Kelley School of Business, Indiana University

November 2008

Columbus and Bartholomew County have always depended on manufacturing for their economic health. Given that the nation's manufacturing sector typically contracts sharply in a recession, recessions have hit hard in Indiana and Bartholomew County. This time, however, we may dodge a bullet—or at least the biggest bullets.

The worst U.S. recession in recent memory took place in 1981–1982. In December 1982, the unemployment rate in Indiana reached 12.5 percent. The national rate peaked at 10.8 percent. **Figure 1** shows the three-month moving average for unemployment rates.

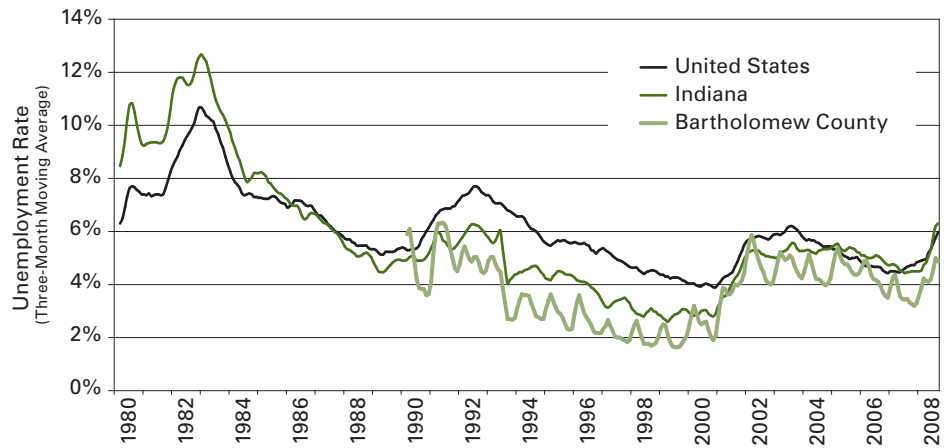
Data on unemployment rates by county are not available for that period, but we know that thousands of local people lost their jobs. During 1982, Bartholomew County lost in excess of 2,700 jobs, more than 7 percent of its total employment. In relative terms, job losses the county were far worse than the national average. When employment numbers are indexed to 1980, the damage is obvious (see **Figure 2**). Indiana and Bartholomew County suffered much more than the nation in that recession.

During the recession of 1991–1992, however, Bartholomew County did not reprise its poor 1982 performance. The unemployment rate hit 7.8 percent nationwide, but topped out at about 6.3 percent in Indiana and 6.6 percent in Bartholomew County.

When the next recession took hold in 2001, it brought a big decline in durable goods sales. Employment in Indiana and Bartholomew County once again fell more steeply than in the nation as a whole. The actual rate of unemployment, however, was never much worse than the national average.

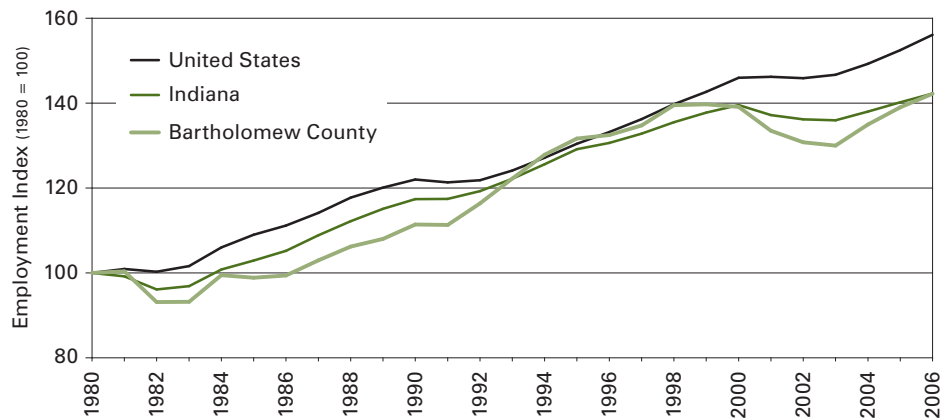
Our forecast for Columbus and Bartholomew County in the recession

FIGURE 1: Unemployment Rates, Three-Month Moving Average, 1980 to 2008



Source: Bureau of Labor Statistics

FIGURE 2: Employment Index, 1980 to 2006



Source: Bureau of Economic Analysis

of 2008–2009 is not as gloomy as the forecast for the nation. Bartholomew County is better prepared than most areas to defend itself against the coming slowdown. There are at least three reasons for this.

1. Indiana in general did not experience the bubble in housing prices that occurred in other parts of the country. Now that the bubble has burst, we don't have as far to fall.
2. The economic activity in Columbus and Bartholomew County has become more

diversified. In 1980, heading into that awful recession, 43 percent of the county's jobs were in manufacturing. Today that figure is about 28 percent. Over a period of many years, economic development leaders here have made wise and productive decisions.

Indeed, during the 2001 recession, employment actually expanded in the sectors of health care, finance, and professional services. Those three sectors together now account for nearly

Evansville Forecast 2009

Mohammed Khayum: Professor of Economics and Dean of Business,
College of Business, University of
Southern Indiana

November 2008

“*In important respects, the Columbus and Bartholomew County area has armored itself well against a recession.*”

15 percent of jobs in the county. The Center for Econometric Model Research at Indiana University predicts that the Columbus metro area will be one of the best performers among all Indiana metro areas in 2009.

3. Several major employers in the Columbus area are well-positioned to face the pressures of a recession. Three big organizations appear to be particularly well-managed.
- The hospital has just re-opened after the June flood. Though it laid off a few workers while it was closed, this major regional medical facility will certainly give rise to more jobs and more payroll dollars as it regains its momentum.
 - Cummins' headquarters and central design functions remain here, but the company has built up businesses in dozens of other countries and in a wide array of new product lines. At the end of October, a Standard & Poor's stock research report on Cummins predicted profit growth from margin improvement, technology leadership, and strong (though perhaps slowing) new markets. Caterpillar's decision to withdraw from the on-highway truck engine business also helps by removing a source of competition. Cummins' presence in Columbus is likely to be much more stable during 2009 than in past recessions.

- Irwin Financial has been bloodied by the general epidemic of losses afflicting the financial services industry, but there are signs that the worst is behind it. As long as the global banking industry produces no more big calamities, this company has a good chance of squeaking through the recession in 2009 without major layoffs.

While these factors are encouraging, recessions are still nasty things. And this one looks like it will last awhile. Certain sectors of the Columbus area economy will get hurt, and our workforce will suffer further layoffs. The local unemployment rate, currently near 5 percent, is forecast to inch up past 6 percent this winter. But the unemployment rate already is nearly 8 percent in California and more than 8 percent in Michigan. The overall U.S. rate is predicted to be more than 7 percent by early 2009. Bartholomew County should stop well short of that figure.

Retail businesses, however, are likely to see further declines in revenue. New car sales have already dropped precipitously and will probably not recover much until the second half of 2009. Residential construction will continue to be depressed through most of 2009 by an inventory of unsold and foreclosed homes throughout the region.

But in important respects, the Columbus and Bartholomew County area has armored itself well against a recession. The county should be able to dodge most of the bullets hitting places like Michigan and California. ■

In 2008, the Evansville economy was not immune to the volatility of financial markets and the slowdown in the national economy that arose after the emergence of the subprime mortgage crisis in early 2007. In 2008, nominal personal income is estimated to increase by 2.2 percent compared to an average annual growth rate of 4.5 percent between 2002 and 2007. Economic performance in 2008 was driven by job losses in key sectors, particularly in manufacturing, construction, and financial services. As a result, real gross metro product is estimated to increase by only 0.9 percent in 2008.

Housing

As the Evansville economy tracked the U.S. economy in 2008, there were indications of a rise in employment volatility, a slowing housing market, deteriorating credit quality, and higher delinquency rates. Single-family housing permits are estimated to have dropped 50 percent between 2007 and 2008, and existing home prices declined from an average of \$98,000 in 2007 to \$94,000 in 2008. Mortgage originations also dropped from \$1.49 billion in 2007 to \$769 million in 2008, while personal bankruptcies per 1,000 persons increased from 4.2 to 5.6.

Manufacturing

The Evansville economy is one of the most manufacturing-dependent metro areas in the nation, but has become less dependent in recent years (see **Figure 1**). However, even as the economy diversifies away from manufacturing-industry dependence, the sector continues to be important

to metro area household incomes and consumer spending activity.

Since 2000, Evansville's manufacturing workforce has fallen by 15.4 percent or about 5,700 workers, compared to the 20.4 percent reduction in Indiana's manufacturing workforce over the same period. At the same time, manufacturing earnings as a share of total earnings has remained stable at about 28 percent between 2001 and 2007 in the Evansville metro economy. The national economic slowdown and its impact on the automotive sector partly explains the trajectory of Evansville's manufacturing sector in 2008.

During the summer, the largest Evansville area employer—Toyota—implemented several non-production days for half of its employees as sales for cars and trucks dipped. Workforce reductions were also announced by a plastics firm, automotive parts manufacturers, and Whirlpool Corporation.

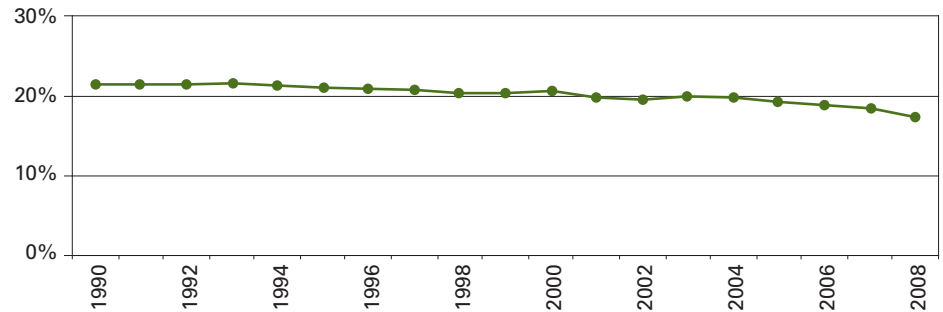
Outlook

In 2009, we forecast output to increase by 0.4 percent, the number of jobs to decrease by 1,000 and nominal personal income to grow 2 percent.

Figures 2 and 3 provide a comparison of forecasts for the Evansville economy and the state of Indiana for the 2006–2010 period.

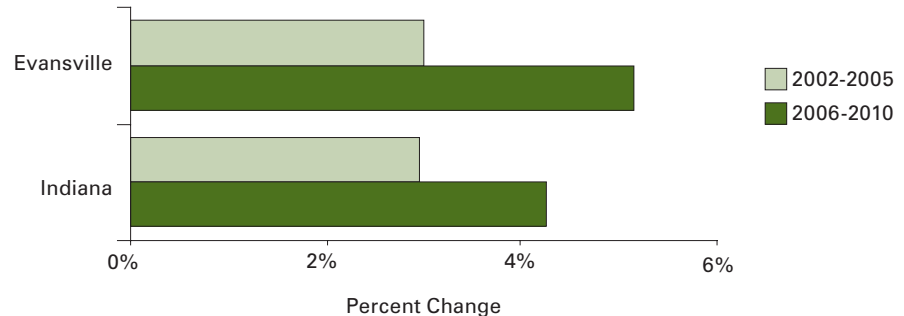
Ongoing challenges for the Evansville economy include adjustment away from manufacturing-industry dependence, particularly in nondurable manufacturing (see **Table 1**), an elderly age cohort as a proportion of the population that is higher than the state average, and a youth cohort as a proportion of the population that is lower than the national average. ■

FIGURE 1: Evansville MSA Manufacturing Employment as a Percent of Total Nonfarm Employment



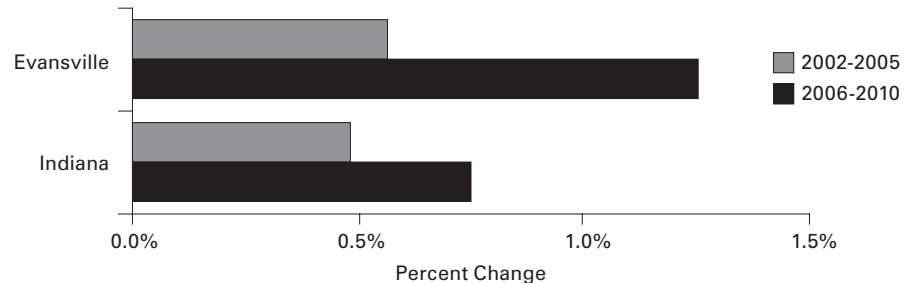
Source: IBRC, using Bureau of Labor Statistics data

FIGURE 2: Average Growth for Personal Income



Source: Center for Econometric Model Research, Indiana University

FIGURE 3: Average Growth for Total Employment



Source: Center for Econometric Model Research, Indiana University

TABLE 1: Manufacturing as a Percent of Total Employment, September 2008*

	Evansville Metro	Indiana	United States
Manufacturing	18%	18%	10%
Durables	54%	73%	63%
Nondurables	46%	27%	37%

*Preliminary data

Source: IBRC, using Bureau of Labor Statistics and the Indiana Department of Workforce Development data

Fort Wayne Forecast 2009

John Stafford: Director, Community Research Institute, Indiana University-Purdue University Fort Wayne

November 2008, updated December 2008

What a difference a year makes. The outlook prepared last year for the Fort Wayne area referenced concern over the “ongoing turmoil in the domestic automotive industry impacting the supply network” and the “slump in housing construction caused in large measure by the crisis in single-family housing finance issues.”

There was no reference, however, to “the worst financial market crisis in decades.”

Clearly, the severity of the national and international economic downturn will dominate what happens in the local economy. Just how severe that impact will be is the difficult question to answer.

We will use the seven-county Fort Wayne Combined Statistical Area as the geographic definition of the Fort Wayne area. This includes Adams, Allen, DeKalb, Huntington, Noble, Wells, and Whitley counties.

We have had five previous national business cycle contractions since the early 1970s.¹ Each one has been somewhat unique in its impact on employment in this area—both in the length of its duration and the extent of employment loss in the Fort Wayne area.

- **1973–1975:** The contraction beginning in November 1973 lasted sixteen months nationally. The seven-county Fort Wayne area experienced a 6.1 percent decline in total employment between 1974 and 1975, a loss of nearly 12,500 jobs.
- **1980:** The national contraction beginning in January 1980 lasted six months and we experienced a loss of nearly 14,700 jobs in the area between September 1979 and April 1980.
- **1981–1982:** The second component of that double-dip recession began nationally in July 1981 and lasted for sixteen

“Much like the entire state of Indiana, the economy of the Fort Wayne region continues to be dominated by the manufacturing sector.”

months. Employment in the region began to drop in October 1981 and declined thirteen of the next fifteen months, dropping by more than 16,000 jobs. If these two nearly back-to-back events are combined, the Fort Wayne area experienced an 11.6 percent decline in employment between 1979 and 1982 with a total loss of nearly 26,000 jobs.

- **1990–1991:** A national contraction began in July 1990 and lasted eight months. Its effect on the Fort Wayne area was relatively modest with a 2.7 percent decline in employment between October 1990 and March 1991. The drop in area employment during that period was approximately 6,600 jobs.
- **2001:** A national contraction that began in March 2001 also lasted eight months. However, the Fort Wayne area was hurt more substantially with a loss of nearly 18,000 jobs between 2000 and 2003, a decline of 5.8 percent. It is difficult to determine exactly when this downturn ended in the Fort Wayne area: there was no distinct rebound following a distinct low point. Employment declined for twenty-seven of the thirty-eight months beginning in April 2000.

What Lies Ahead

Much like the entire state of Indiana, the Fort Wayne regional economy continues to be dominated by the manufacturing sector. Even though manufacturing experienced

substantial job losses this decade, average annual employment data from the Quarterly Census of Employment and Wages for 2007 still indicates that 23.7 percent of all jobs reported (covered employment) are directly tied to manufacturing. That compares with only 10.2 percent nationally for the same period. Past national economic downturns have heavily affected northeast Indiana as the declines in tangible goods purchases hit hard at the core of our manufacturing-based economy.

Given the influence of manufacturing on the area’s economic base, the Federal Reserve Bank of Chicago’s Midwest Manufacturing Index² is one strong indicator of what may be ahead for the Fort Wayne area in 2009. The index is a monthly estimate of manufacturing output using a composite of fifteen manufacturing industries’ hours-worked data to measure monthly changes in regional activity for the Seventh Federal Reserve District (Iowa and parts of Illinois, Indiana, Michigan, and Wisconsin).

The Midwest Manufacturing Index declined for seven of the first ten months of 2008. The longest declining trend in the index was the twenty-three months beginning in December 2000. There have been prior declines in the index and, as one would expect, each corresponds with a national economic contraction. Nothing we have seen from the index begins to compare with the dramatic downturns experienced between late 1979 and 1982 or in the early portion of the current decade

(see **Figure 1**). The composition of the regional economy is also less dependent on manufacturing than it was in the early 1980s. Other sectors such as health care, defense/aerospace engineering, and financial services all play an important role in the Fort Wayne area economy. Nationally, the current financial situation involves a more complex set of economic variables than some of our past downturns and therefore may influence local economic events in different ways than we have previously experienced.

If one accepts the national forecast that we will see an economic upturn by the third or fourth quarter of 2009, then perhaps this contraction will most resemble the events of the early 1970s. Under that scenario, the Fort Wayne area could expect a downturn in manufacturing to last fourteen to eighteen months. Employment totals for the seven-county region could

“ Sectors such as health care, defense/aerospace engineering, and financial services all play an important role in the Fort Wayne area economy. ”

drop by approximately 6 percent from a peak of 276,000 in early 2007. That would be a two-year decline of approximately 17,000 jobs—comparable to the loss between 2000 and 2003.

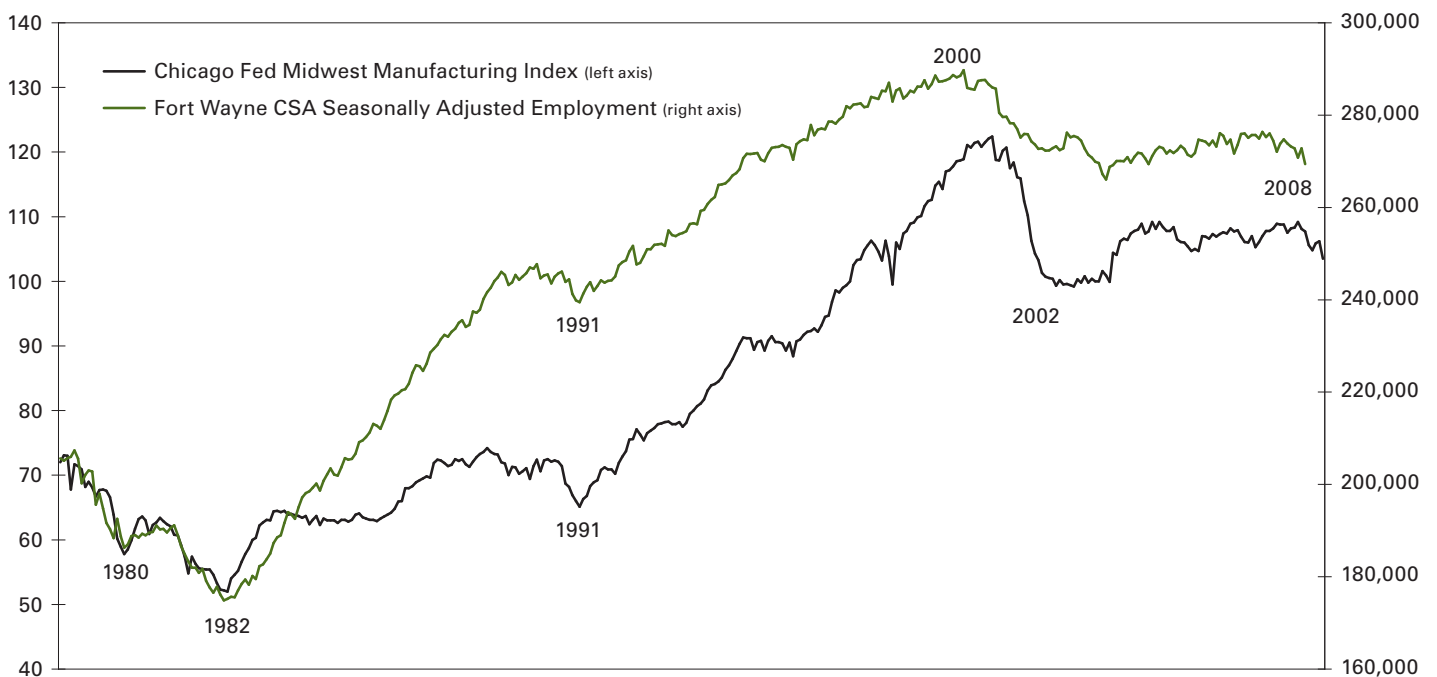
Indications are that the area has already lost approximately 10,000 jobs since early 2007. September 2008 represented the nineteenth straight month in which area employment has declined (based on Local Area Unemployment Statistics comparing a given month with the same month of the prior year). We may be much further into the current decline than we realize. We should expect some

turnaround in this trend by late 2009. How strong that rebound will be for the Fort Wayne area continues to depend both on the strength of the national economy recovery and on our ability to diversify the core of our regional economy beyond manufacturing jobs (not necessarily output, but certainly employment). ■

Notes

1. National Bureau of Economic Research, Business Cycle Expansions and Contractions, www.nber.org/cycles.html.
2. Federal Reserve Bank of Chicago Midwest Manufacturing Index, www.chicagofed.org/economic_research_and_data/cfmmi.cfm.

■ **FIGURE 1: Total Employment in the Fort Wayne-Huntington-Auburn Combined Statistical Area Compared to the Chicago Fed Midwest Manufacturing Index, 1979 to 2008**



Note: Employment data are seasonally adjusted
Sources: Federal Reserve Bank of Chicago Midwest Manufacturing Index and Bureau of Labor Statistics

Gary Forecast 2009

Donald A. Coffin, Ph.D.: Associate Professor of Economics, Indiana University Northwest

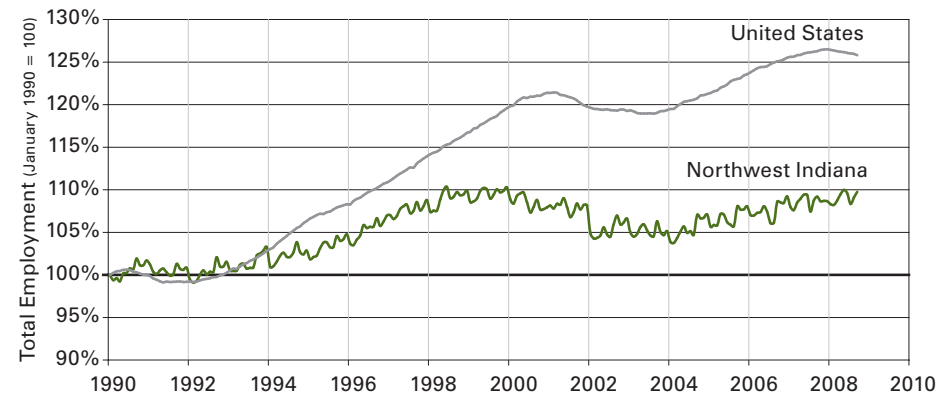
November 2008, updated December 2008

The performance of the northwest Indiana economy in 2008 has been, in a number of ways, a surprise. Historically, northwest Indiana has lagged the nation in employment growth (see **Figure 1**), but that has not been the case in the last year.¹ Our expectation a year ago was for total employment to grow by 0.3 percent,² in the context of a national economy experiencing moderate employment growth. Indeed, employment in northwest Indiana did grow by 0.5 percent, but, nationally, instead of 1.5 percent to 2 percent employment growth,³ the U.S. economy lost jobs—falling 0.3 percent during 2007 and decreasing employment each month during 2008. That rate of national employment growth would almost always be associated with declining employment in northwest Indiana.

Furthermore, national data from the Current Population Survey show employment declining slightly between September 2007 and September 2008, down a little more than 1 million (a 0.8 percent decline), while data for northwest Indiana show an increase of about 2,500 people with jobs (a 0.8 percent increase). And while northwest Indiana's unemployment rate increased (from 4.5 percent in September 2007 to 5.5 percent in September 2008),⁴ that increase was substantially smaller than the national unemployment rate increase (up from 4.5 percent to 6.0 percent).⁵

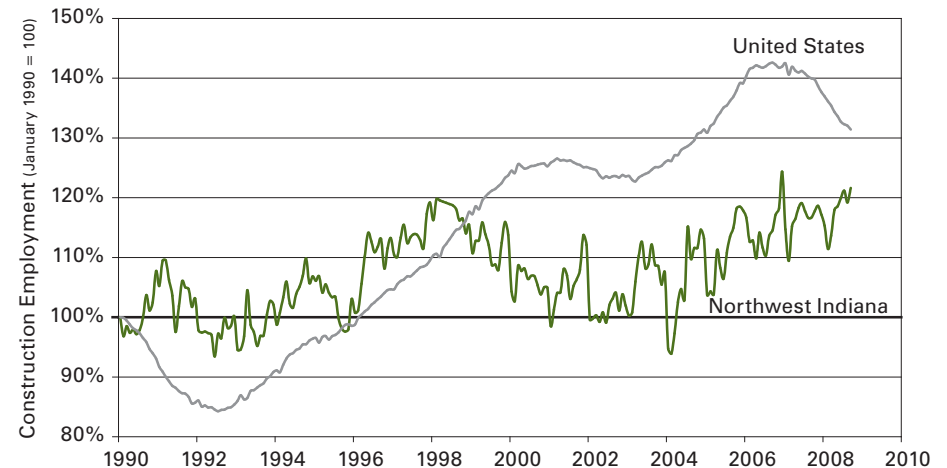
Specific industries also provided some major surprises. For the past decade, the local construction sector has lagged behind the nation in terms of employment growth (see **Figure 2**). As is generally well-known, the construction industry has experienced a severe decline nationally—down 6 percent from September 2007 to September 2008.⁶ In northwest Indiana, however, construction employment has

■ **FIGURE 1: Total Employment in Northwest Indiana and the United States**



Source: Bureau of Labor Statistics

■ **FIGURE 2: Construction Employment in Northwest Indiana and the United States**



Source: Bureau of Labor Statistics

increased 4.2 percent over the last year. Meanwhile, residential building permits in Lake and Porter counties fell from 1,782 (January to September 2007) to 869 (January to September 2008)—a decline of 51 percent.⁷ Nationally, employment in iron and steel mills fell by 2.6 percent from September 2007 to September 2008⁸ but rose nearly 2 percent (300 jobs) in northwest Indiana.

The northwest Indiana economy has not outperformed the national economy in a long, long time. That it has done so in the past year is surprising; that it will do so in the coming year is unlikely. And the

coming year looks like a difficult one nationally. The Indiana Center for Econometric Model Research forecast for the 2009–2010 period shows slower than normal output and employment growth for the United States; and, if historical patterns persist, slower than normal growth for the U.S. economy means extremely slow growth, perhaps even declines, for the northwest Indiana economy.

Total establishment employment in northwest Indiana will likely fall about 1.5 percent over the next year,⁹ with the largest percentage declines in the construction, manufacturing,

and finance industries. Growth in health care (including hospitals) will likely continue, albeit more slowly. For the October 2008 to September 2009 period, this would yield average establishment employment of about 279,000—down from about 283,000 (see **Table 1**). We project labor force growth will slow to its long-term average of about 0.5 percent per year, but household employment¹⁰ will decline about 1.5 percent. The unemployment rate should average about 7.1 percent over the coming year.

Difficult Times in Construction and Manufacturing

As noted above, northwest Indiana's construction sector has held up remarkably well. However, the (apparent) collapse in residential construction is not a positive sign.¹¹ Given the tighter lending practices in the home mortgage industry, it seems unlikely that residential construction will recover quickly. Furthermore, during the recession, we can expect cutbacks in nonresidential construction as well.¹² Construction employment in northwest Indiana is projected to decline by about 5 percent on average during 2009, down from roughly 20,000 jobs to a little less than 19,000.

Manufacturing employment in northwest Indiana, especially in steel, appears to have stabilized beginning in late 2003, with around 38,000 jobs in manufacturing and 18,000 in steel. This is not likely to continue. Two of the major users of steel in the United States are nonresidential construction (which we project to decline) and motor vehicles. National motor vehicle sales in September and October were down about 30 percent from the same months in 2007.¹³ Virtually no one expects a substantial rebound in automobile sales or production. These developments will put significant downward

TABLE 1: Employment and Forecasted Change in Employment by Industry in Northwest Indiana, 2008 to 2009

Industry	Employment, 2008*	Employment, 2009**	Percent Change, 2008-2009	Average Annual Percent Change (1991-2008)
Total Establishment Employment	283,029	278,830	-1.5%	+0.5%
Construction	19,889	18,985	-5.0%	+0.7%
Manufacturing	37,745	36,235	-4.0%	-2.6%
Durable Goods	29,599	28,119	-5.0%	-2.4%
Iron and Steel Mills	17,013	15,992	-6.0%	-3.5%
Wholesale Trade	10,369	10,162	-2.0%	+0.6%
Retail Trade	35,687	34,983	-2.0%	+0.6%
Financial Activities	9,735	9,248	-5.0%	-0.8%
Health Care and Social Assistance	38,551	39,798	+3.0%	+3.0%
Hospitals	13,432	13,768	+2.5%	+1.5%
Arts and Entertainment	7,847	7,533	-4.0%	+3.9%
Accommodation and Food Service	22,314	21,867	-2.0%	+1.8%
Government	38,808	38,774	-0.1%	—
Federal	2,058	2,024	-1.7%	-1.7%
State	4,221	4,221	—	+0.2%
Local	32,528	32,259	—	+0.7%
Local Public Education	18,305	18,305	—	+0.8%

*Average of October 2007–September 2008 monthly data

**Forecast for the average monthly data for October 2008–September 2009

Source: Bureau of Labor Statistics

pressure on output in the steel industry. Coupled with the apparent slowdown in growth in China, for example,¹⁴ this strongly suggests cutbacks in domestic steel production and employment. Steel mill employment in northwest Indiana will likely fall from around 17,000 for the October 2007–September 2008 period, to a little less than 16,000, a loss of about 1,000 jobs. That will account for about two-thirds of the expected decline in employment in manufacturing.

In addition, the reduction in manufacturing activity will directly affect wholesale/warehousing employment. While this sector has contributed modestly to employment growth over the past eighteen years, the declines in manufacturing activity will almost certainly lead to

a small (2 percent or so) reduction in employment over the coming year.

Financial Services

In northwest Indiana, the financial services sector has experienced a slow decline in employment (-0.7 percent per year since 1991), although financial services output has certainly grown. In the last few months, however, the national financial services sector has suffered some severe strains. National employment has declined by about 1.3 percent over the past year,¹⁵ and a number of banks, investment banks, securities trading firms, and at least one major insurance company have been absorbed into other firms or become bankrupt. It will take some time before stability returns to this sector, and continued retrenchment

seems likely. Locally, employment has declined about 1 percent over the past year, generally in keeping with the longer-term trends. A combination of a national recession and some restructuring of this sector suggest a sharper decline in the coming year of roughly 5 percent.

Spillovers

As noted earlier, the decline in manufacturing will likely result in modest employment losses in wholesale and warehousing activities. As overall employment declines, reductions in household incomes will result in other cutbacks as well. One quite well-known response to a recession is a reduction in eating out, and we project a 2 percent decline in food services sector employment. Other discretionary spending is also likely to decrease, and the amount of travel for entertainment purposes is also likely to decline. Taken together, this suggests a decline in employment of around 4 percent in the entertainment sector.

Good News?

Over the past two decades, the health care sector has shown the most consistent growth. While it is not recession-proof, it should continue to provide a source of increased employment for the region. In the next year, we expect an addition of about 1,150 jobs (up 3 percent), of which about 340 will be in local hospitals (up 2.5 percent).

Government—particularly the federal government—frequently adds jobs in recessions. However, we do not expect employment growth in the government sector. Indeed, federal government employment has shrunk for two decades, and we see no reason for that to change. State and local governments will do well to maintain employment in the face of what is likely to be a period of reduced tax revenues.

“As overall employment declines, reductions in household incomes will result in other cutbacks as well.”

Summing Up

As usual, we project northwest Indiana will underperform both the state economy and the national economy. The coming year should see a decline (of about 1.5 percent) in total employment, with a resumption of larger percentage declines in manufacturing. Whether the declines in manufacturing are only cyclical, with jobs returning as we recover from the recession, remains to be seen. Construction seems poised for a significant contraction, with residential construction almost certain to fall and nonresidential construction suffering from business cutbacks during the recession. This will almost certainly be temporary, as will the expected declines in entertainment and food services. The decline in financial services is likely to be permanent, however, as the long-term employment decline continues. Only health care provides much hope for employment growth in the coming year.

More recent data on the state of the national economy, in particular the employment declines in October and November, suggest that the prospects for the northwest Indiana economy are worse than they appeared two months ago. The forecast presented here, therefore, is a best-case scenario. ■

Notes

1. Unless otherwise indicated, all data for northwest Indiana come from the Indiana Business Research Center's STATS Indiana website at www.stats.indiana.edu. All employment change data for northwest Indiana and the United States refer to changes from September 2007 to September 2008.

2. Donald A. Coffin, "Gary," *Indiana Business Review*, Winter 2007, www.ibrc.indiana.edu/ibr/2007/outlook/gary.html.
3. Willard E. Witte, "The U.S. Economy," *Indiana Business Review*, Winter 2007, www.ibrc.indiana.edu/ibr/2007/outlook/national.html.
4. An interesting development is that the labor force (those people either employed or looking for work), which usually declines in September from its summer levels (a typical decline is around 2 percent), has decreased only half as much as usual this year.
5. Information on the national employment situation may be found at www.bls.gov/news.release/empsit.t01.htm.
6. Current Employment Statistics are available at www.bls.gov/ces/data.htm.
7. Building permit data are available at <http://censtats.census.gov/bldg/bldgprmt.shtml>.
8. *Ibid.*
9. Technically, this is a decline from the average employment level for the October 2008 to September 2009 "year," compared to the October 2007 to October 2008 period.
10. Household employment typically exceeds establishment employment, because more people commute out of northwest Indiana to jobs (to Chicago for example) than commute into northwest Indiana for jobs.
11. Residential building permits fell 50 percent in Lake and Porter counties in the first nine months of 2008, compared with the same period in 2007. Nationally, investment in residential structures has declined 22 percent between the third quarter of 2007 and the third quarter of 2008, and by an even larger 43 percent since the third quarter of 2005. See the Federal Reserve Bank of St. Louis website at <http://research.stlouisfed.org/fred2/series/PRFIC1/downloaddata?cid=112>.
12. These are apparently only beginning, with spending down 1 percentage point in the third quarter of 2008, compared with the second quarter of 2008. See the Federal Reserve Bank of St. Louis website at <http://research.stlouisfed.org/fred2/series/PNFIC1/downloaddata?cid=112>.
13. See Econbrowser online at www.econbrowser.com/archives/2008/11/another_bad_mon.html for details.
14. David Marcellis blog, "Economists React: China's Growth is Slowing, Not Slumping," October 20, 2008, <http://blogs.wsj.com/economics/2008/10/20/economists-react-chinas-growth-is-slowing-not-slumping>.
15. Current Employment Statistics are available at www.bls.gov/ces/data.htm.

Indianapolis-Carmel Forecast 2009

Philip T. Powell, Ph.D.: Associate Clinical Professor of Business Economics; Faculty Chair, Evening MBA Program, Kelley School of Business, Indiana University

November 2008

The following data and forecasts refer to the entire Indianapolis-Carmel metropolitan statistical area, which includes Boone, Brown, Hamilton, Hancock, Hendricks, Johnson, Marion, Morgan, Putnam, and Shelby counties. Unless otherwise noted, data comes from STATS Indiana at www.stats.indiana.edu.¹

Income²

The Indianapolis economy entered into recession during the first quarter of 2008. Between the first quarters of 2007 and 2008, total wage income in the Indianapolis metro fell 0.3 percent in real terms. Real weekly wages for the average worker fell 1.3 percent. This compares with growth of 2.2 percent in total real wage income and 0.7 percent in the real weekly wage per worker between the first quarters of 2006 and 2007.

Matching a fall in real income was the fall from 39,037 to 38,957 Indianapolis business establishments from the first quarter of 2007 to the same quarter in 2008. Even during the last Indianapolis recession between 2001 and 2003, the number of establishments grew by 1,000. Many small businesses in Indianapolis face financial and market challenges that are historic in nature.

The curtailed spending of financially-stressed households was a major source of economic contraction between the first quarters of 2007 and 2008. Shrinkage in real wage income equal to 6.7 percent in retail, 5.9 percent in arts and entertainment, and 5.6 percent in real estate signaled dramatic retrenchment in expenditures by Indianapolis residents. Real wage income within organizations offering business management services declined 11.6 percent, suggesting no recessionary immunity for highly skilled workers.

Steady performance in three industries that offer Indianapolis a competitive advantage insulated the economy from further decline. Real income from manufacturing grew by 0.3 percent as local factories took advantage of a weak dollar to increase sales to foreign markets. Health care grew 3.9 percent as Indianapolis strengthened its position as a regional hub of medical services. Real income from transportation and warehousing remained level as higher oil prices motivated companies to outsource logistic and supply chain services to local providers.

Employment³

A rise in the unemployment rate from 3.7 percent to 5.1 percent between September 2007 and September 2008 is more evidence of a local recession. Over the same period, the number of unemployed residents in the metropolitan area increased 39.5 percent. A September 2008 unemployment rate of 5.8 percent statewide and 6 percent nationwide, though, suggests better-than-average local employment conditions.

An equal jump in the unemployment rate in the Indianapolis-Carmel metro occurred between September 2000 and September 2001 before the last economic slowdown. Unemployment continued to rise for seventeen months before finally falling from its high of 5.1 percent in February 2003. This fact suggests continued increases in the unemployment rate to a peak higher than earlier in the decade.

Real Estate⁴

Indianapolis real estate may be on the verge of a slow recovery. Over the last twelve months (October 2007 to October 2008), median prices increased 3.6 percent and the inventory of unsold homes fell 9.3

percent. Long-term affordability of houses in the metropolitan area is helping Indianapolis real estate reverse such declines earlier than other cities in the country.

Forecast

The Indianapolis economy will shrink between 0.5 percent and 1 percent in real terms during 2009. A stronger dollar will reverse growth in manufacturing and leave the local economy more vulnerable to recessionary forces. Logistics and health care will remain relatively strong and provide sources of growth. The local unemployment rate will increase throughout the year to between 6 percent and 6.5 percent and will not peak until 2010. Small businesses will face a challenging year both in maintaining revenue and accessing credit. Until bankruptcies, foreclosures, and job losses slow in Indianapolis, households will refrain from spending—keeping the local economy stagnant. Across business sectors, retail, restaurant, and entertainment establishments will feel the biggest hit. The real estate sector will improve, but modest recovery will not be enough to ignite general economic recovery. ■

Notes

1. STATS Indiana is maintained by the Indiana Business Research Center at Indiana University's Kelley School of Business.
2. Wage statistics come from the Bureau of Labor Statistics' Quarterly Census of Employment and Wages database supplied by STATS Indiana. Nominal wages are converted to real wages using Consumer Price Index values supplied by the Bureau of Labor Statistics.
3. Aggregate Indianapolis employment data are derived from labor force statistics supplied by STATS Indiana.
4. Indianapolis housing market data are from www.housingtracker.net.

Kokomo Forecast 2009

Jason VanAlstine: Acting Assistant Professor of Economics, Indiana University Kokomo

November 2008

Recent news from the Kokomo manufacturing sector has not left much room for optimism. Two of the area's largest employers have recently announced large layoffs that could have a significant impact on the area. In addition, a GM/Chrysler merger could lead to substantial job losses in Kokomo. Recent employment increases in the education and health services sector will not be large enough to make up for the local impact of manufacturing cutbacks.

Jobs and Unemployment

In recent months, Kokomo's unemployment has increased substantially. Since January, the lowest reported unemployment rate was 6.7 percent (February and April). In July, the unemployment rate peaked at 9.2 percent. Last year's annual unemployment rate was 5.4 percent. Kokomo has also had a higher unemployment rate than the state of Indiana in all years since 2000 (see **Figure 1**). For January through September, Kokomo's average monthly unemployment rate has been 2 percentage points higher than the state average. Area employment figures have also been declining the last ten years, indicating a decreasing

number of job opportunities in the Kokomo area (see **Figure 2**).

Average annual wages have been on the rise, increasing by 3.4 percent from 2006 to 2007 to total \$48,844. This is outpacing the inflation rate, which over that time period was 2.5 percent nationally. However, this information conflicts with more recent data on average weekly wages. In the first quarter of 2008, average weekly wages were \$852, decreasing in three consecutive quarters from the \$988 per week record for the second quarter of 2007.

Howard County's economy is still very dependent upon the manufacturing sector, particularly the automotive manufacturing industry. The manufacturing sector makes up approximately 30 percent of Howard County's overall employment figures. Other important sectors in the Kokomo economy include health and educational services (15 percent of total employment) and retail (13 percent of total employment). This past year's decrease in employment has been particularly difficult for the manufacturing sector with losses of almost 2,000 jobs (a 14 percent decrease). One bright spot was the growth in the health and educational services sector, which saw a 5 percent

increase in overall employment from 2006 to 2007.

The Automotive Industry

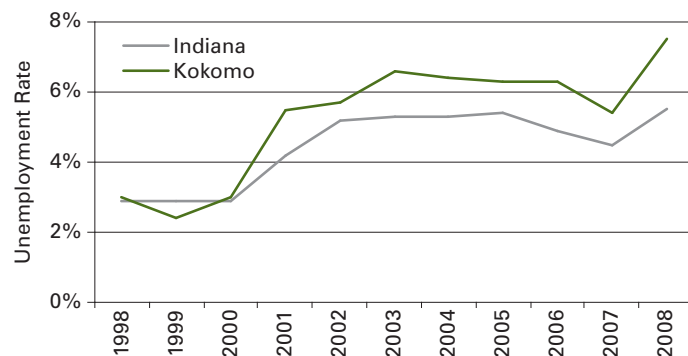
Two of Kokomo's largest employers, Delphi and Chrysler, belong to the automotive manufacturing sector. These two companies make up more than 20 percent of Kokomo's total employment. Recent Delphi and Chrysler news has not been optimistic. In August, Delphi announced that it would cut 10 percent of its salaried jobs at the Kokomo plant.¹ This news came after years of losses and job cuts from the large automotive parts supplier. Chrysler also announced that it would cut back its salaried workforce by 25 percent nationally starting in November.² The impact that this will have on the Kokomo plant is not entirely clear.

Additionally, GM and Chrysler are currently discussing a merger that could mean large job cuts at the Kokomo plants. This may also impact the pensions that the retired union workers living in Kokomo depend on for their well-being.³

Outlook

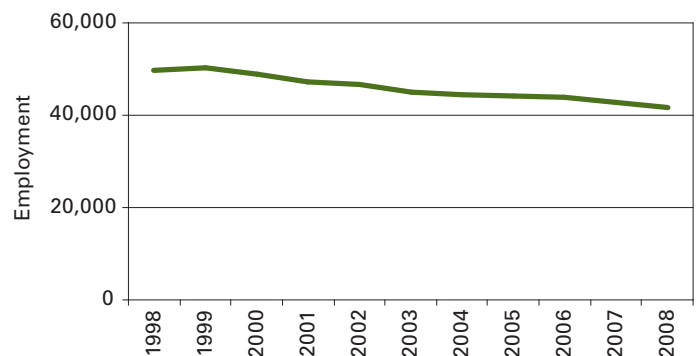
The short-term economic outlook for Kokomo is uncertain. With the automotive sector faltering

■ **FIGURE 1: Unemployment Rate in Kokomo and Indiana, 1998 to 2008**



Note: 2008 data are estimated using the average of the first nine months
Source: Bureau of Labor Statistics

■ **FIGURE 2: Kokomo Employment, 1998 to 2008**



Note: 2008 data are estimated using the average of the first nine months
Source: Bureau of Labor Statistics

Louisville Forecast 2009

Uric Dufrene: Sanders Chair in Business, Indiana University Southeast, New Albany

October 2008, updated December 2008

throughout most of the United States, Kokomo should expect continued job losses in this industry. Many of these workers may have to shift to lower-paying industries. The recent decrease in gas prices may give the national automotive industry a short reprieve; however, the uncertainty surrounding the financial and housing sectors is making consumers hesitant to purchase big ticket items such as new cars.

To improve the long-term state of the Kokomo economy, the area will need to attract producers of “new” manufacturing technologies, such as hybrid electric systems or wind turbines. Such producers will find a large pool of skilled laborers who will need little training.

Kokomo’s primary and secondary schools must also emphasize the importance of obtaining a college education. The trend throughout the entire United States has been increased wages and job opportunities for individuals possessing a college degree. Encouragingly, Kokomo’s high schools are performing well compared to the state averages for both graduation rates and the percent of students seeking a college education.⁴ ■

Notes

1. Ted Evanoff, “Kokomo takes another hit with 300 Delphi layoffs,” *The Indianapolis Star*, August 19, 2008.
2. Inside Indiana Business, “Chrysler Announces More Cuts, Indiana Impact Not Known,” October 24, 2008, www.insideindianabusiness.com/newsitem.asp?ID=32221 (accessed October 30, 2008).
3. Ted Evanoff, “Fading Future,” *IndyStar.com*, October 25, 2008, www.indystar.com/apps/pbcs.dll/article?AID=/20081026/BUSINESS/810260321/1003/BUSINESS (accessed October 30, 2008).
4. Indiana Department of Education, www.doe.in.gov/ (accessed November 2, 2008).

How will Louisville weather the current financial crisis? Based on current readings of data in the Louisville metro, trends over the past year, and the historical relationship between Louisville and the U.S. economy, the outlook for Greater Louisville is an overall decrease in nonfarm payroll jobs. Unemployment could reach 8 percent, and the region will see decreases in manufacturing, construction, retail, leisure and hospitality, financial services, and professional and business services.

Labor Markets

The Louisville metro, including its four southern Indiana counties (Clark, Floyd, Harrison, and Washington), is showing significant increases in the number of people unemployed. An increasing labor force and a decrease in the number employed are interacting to produce a significant spike in the unemployment rate (see **Figure 1**). As of August, the Louisville metro’s 6.6 percent unemployment rate was at its highest in the past 18 years.¹ Southern Indiana’s portion of the metro had a 6.1 percent unemployment rate—lower than the metro area, but

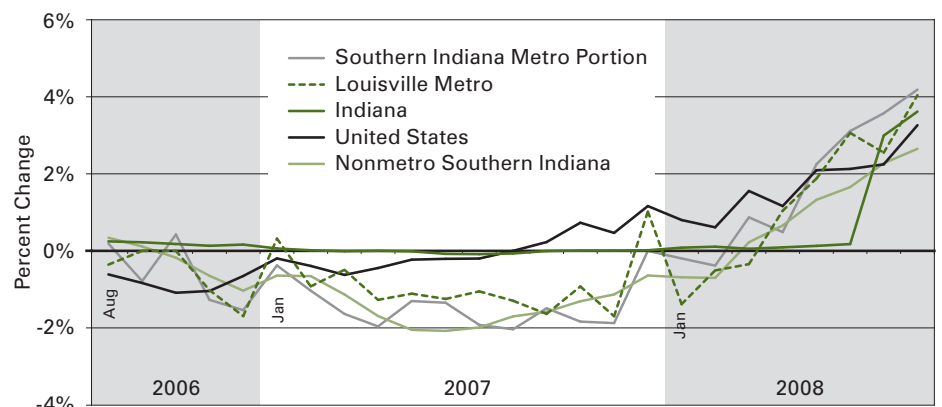
considerably higher than the rate of 4.3 percent observed in 2007.

Unemployment claims for the southern Indiana portion of the metro increased significantly compared to last year.² The August year-over-year increase represents the largest percentage increase in unemployment claims since the recession of 2001, and the percentage change in claims exceeds the change for Indiana (see **Figure 2**). Does this increase represent a peak or the beginning of slower growth in the near- to intermediate-term?

Nonfarm Payrolls

As of September, the Louisville metro lost approximately 5,000 jobs compared to the previous September.³ Recently released October data indicate job losses have accelerated with an overall decline of 8,200 nonfarm payroll employment. No doubt, slower national economic activity is beginning to affect the Louisville metro. The largest losses were registered in manufacturing and in professional and business services. Health and educational services showed a smaller increase than previous years, while the government sector registered strong gains (see **Figure 3**).

■ **FIGURE 1: Change in Unemployment Rate from Previous Year, August 2006 to August 2008**



Source: Bureau of Labor Statistics

Manufacturing

The Louisville metro lost approximately 4,600 manufacturing jobs from September 2007 to September 2008. The majority of these losses were in durable goods, symptomatic of consumer issues nationally. Weaker domestic consumer activity, slower global growth, declining business investment nationwide, and a resurgence of the dollar will all present challenges to local manufacturers.

Financial, Professional, and Business Services

A slower economy for 2009 is now evident for both the financial activities and professional and business services sectors. As of September 2008, financial activities lost 800 jobs. This directly relates to the ongoing struggles in the financial sector and is a sign of overall economic weakness to come. Meanwhile, the professional and business services sector recorded the first September decline (down 2,100 jobs) since the mild recession of 2001.

Consumer-Related Sectors

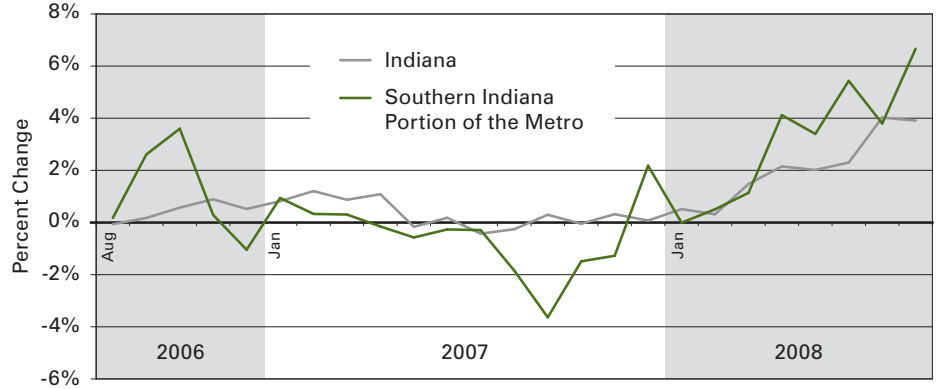
The developing stresses in the labor market and the recent decrease in consumer wealth resulting from financial market volatility will exert significant pressures on certain retail sectors. Retail establishments that rely on discretionary income, do not have a loyal customer base, or contain weak balance sheets will find 2009 to be a very challenging year.

While the retail sector thus far has shown some resilience, other consumer-related sectors are beginning to exhibit slower growth. The leisure and hospitality sector has shed approximately 900 jobs, the first decline since the last recession. This sector relies heavily on discretionary spending and could see some additional job losses.

Real Estate and Housing

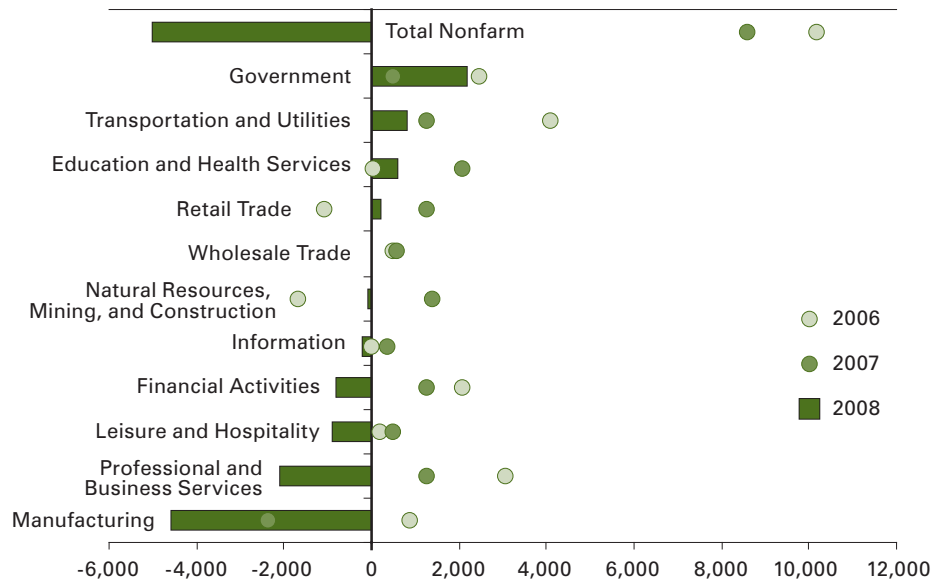
Building permits have continued to decline. While this will present some challenges to the construction

FIGURE 2: Change in Unemployment Claims from Previous Year, August 2006 to August 2008



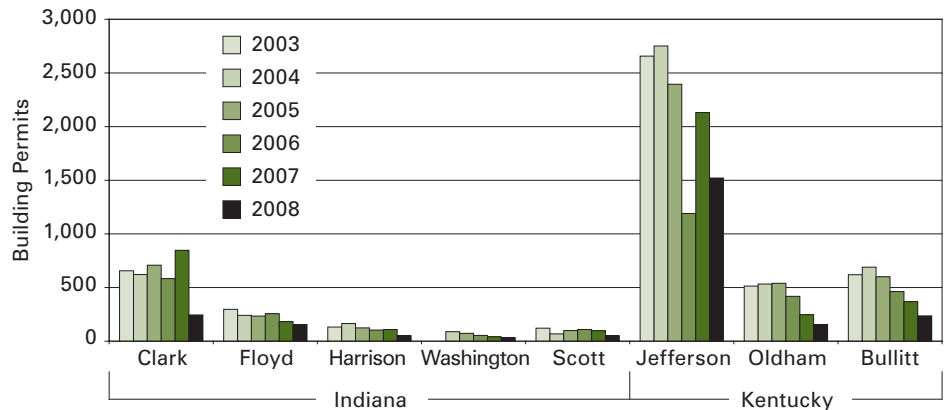
Source: Indiana Department of Workforce Development, using Bureau of Labor Statistics data

FIGURE 3: Change in Employment from Previous Year in the Louisville Metro, September of Each Year



Source: Bureau of Labor Statistics

FIGURE 4: Total Building Permits in the Louisville Metro by County, 2003 to 2008



Note: Data are from January to August of each year
Source: U.S. Census Bureau

industry, we view this as an overall favorable development in the near term. A considerable decline in residential permits will allow existing homes to clear the market and help minimize downward pressures on real estate prices. As we move past problems in residential real estate, the next potential cause of concern is the commercial real estate sector. Retrenchment by consumers will apply pressure to commercial retail development.

Figure 4 shows single-family building permit activity for August year-to-date from 2003 to 2008.

Outlook for 2009

The Louisville metro, including southern Indiana, will see an overall loss of jobs in the coming year. A decline in national consumer spending will continue to adversely impact the manufacturing sector. Recent efficiencies gained in manufacturing will help minimize sector job losses; however, the combination of both slower global and domestic growth will present challenges to manufacturing. We will likely see further declines in financial activities and professional and business services—the result of overall economic slowness. Businesses that cater to consumer discretionary spending will see some challenges throughout the year. The loss of wealth, both in real estate and equity values, will present significant challenges to these establishments.

The unemployment rate for the Louisville metro will likely surpass 7 percent and could potentially exceed 8 percent. This will cause added pressure on the real estate sector, both commercial and residential, and on sectors that rely on consumer spending. ■

Notes

1. Bureau of Labor Statistics local area unemployment statistics, available online at www.bls.gov/lau.
2. Hoosiers by the Numbers, available online at www.hoosierdata.in.gov.
3. Bureau of Labor Statistics state and metro area employment, hours, and earnings. Data are available online at www.bls.gov/sae.

Muncie Forecast 2009

Dagney Faulk, Ph.D.: Director of Research, Center for Business and Economic Research, Ball State University

November 2008

Like many small Midwestern cities, the Muncie metro area (Delaware County) struggles to reinvent itself in the face of daunting demographics, the loss of traditional manufacturing jobs, and all the attendant woes of the current recession. Borg Warner’s Muncie plant, maker of transfer cases for transmission systems and the last of the giant auto-related manufacturing facilities in Muncie, is scheduled to close in April 2009. Local government has begun to decrease jobs due to tighter budgets. However, as the regional economy braces for movement from traditional manufacturing jobs, there are reasons for optimism. Brevini, the Italian-maker of gear boxes for wind turbine energy generation and other applications, has committed to building a facility by mid-2010 that is projected to create 450 jobs. Ball State University continues to expand its programs and is building a reputation as a high technology university.

Various measures of economic activity are examined for Muncie-

Delaware County in this analysis. The data used are from 2001 (the last recession) through the most recent data available at the time of writing. As we face this recession, our goal is to identify and analyze trends since the last recession and changes over the past year. We conclude with a summary of the labor market forecast for the Muncie area.

Labor Markets

The unemployment rate in Delaware County has steadily increased over the past year (see **Table 1**) although there has been some relief, likely related to the school year, over the past few months. The unemployment rate remains consistently higher (6.6 percent in September) than that of Indiana (5.8 percent) and the nation (6 percent). **Figure 1** shows the trend in unemployment for Delaware County, Indiana, and the United States since 2001.

Table 2 shows average employment 2007 through 2008 for the Muncie metropolitan area.¹ Total nonfarm employment was 53,211 jobs, a decrease of 689 jobs (1.3

■ **TABLE 1: Labor Force and Unemployment for Delaware County**

Year	Month	Labor Force	Unemployed	Unemployment Rate
2007	September	55,803	2,584	4.6
	October	55,765	2,532	4.5
	November	56,006	2,573	4.6
	December	55,871	2,768	5.0
	Annual Average	55,746	2,908	5.2
2008	January	55,679	3,335	6.0
	February	55,465	3,263	5.9
	March	56,099	3,812	6.8
	April	55,907	3,103	5.6
	May	56,384	3,302	5.9
	June	54,959	3,781	6.9
	July	55,125	4,171	7.6
	August	55,505	3,984	7.2
	September*	56,441	3,732	6.6

*Preliminary data
Source: Bureau of Labor Statistics

percent) over the 2007 average. This decline in jobs is substantially smaller than job losses earlier in the decade, but current economic conditions suggest that job losses will continue to increase for the remainder of 2008. The 2008 data through September suggest that trade, transportation, and utilities (TT&U); manufacturing; construction; and government will be the hardest hit sectors. Over the same period, small employment gains occurred in financial activities and private education and health services. The losses in TT&U and manufacturing are smaller than those earlier in the decade, suggesting that Muncie has weathered the worst of the downturn in traditional manufacturing.

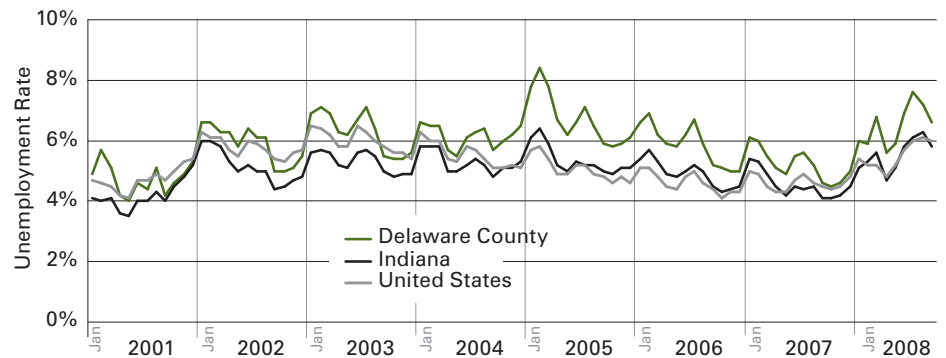
Despite the continuing decline in employment, wages in some sectors in the Muncie area have grown over the past year—perhaps signaling increased productivity. **Table 3** shows changes in average weekly wages (not adjusted for inflation) from the first quarter of 2007 to the first quarter of 2008 in Delaware County. The inflation rate was 4.1 percent for this same period, so average weekly wages growing by more than 4.1 percent are growing faster than inflation. Wages in several sectors—including wholesale trade, information, professional, scientific, and technical services—meet this criteria and are also growing faster than the state.

Housing

Residential construction, as measured by residential building permits for new single- and multi-family residential units, peaked in 2003 with 563 permits issues. In contrast, only 30 permits have been issued from January to September 2008 (see **Table 4**).

Activity in the Delaware County residential real estate market has slowed over the past year (see **Table**

FIGURE 1: Comparison of Unemployment Rates, 2001 to 2008



Source: IBRC, using Bureau of Labor Statistics data

TABLE 2: Delaware County Annual Average Employment, 2007 to 2008

Industry	2008*	Change Since 2007	Percent Change 2007–2008
Total Nonfarm	53,211	-689	-1.3%
Total Private	40,644	-656	-1.6%
Goods Producing	7,544	-256	-3.3%
Manufacturing	5,378	-222	-4.0%
Natural Resources, Mining, and Construction	2,167	-33	-1.5%
Service-Providing	45,667	-433	-0.9%
Private Educational and Health Services	9,756	56	0.6%
Trade, Transportation, and Utilities	8,533	-367	-4.1%
Leisure and Hospitality	5,222	-78	-1.5%
Professional and Business Services	4,978	-22	-0.4%
Financial Activities	2,378	78	3.4%
Other Services	1,767	-33	-1.9%
Information	467	-33	-6.7%
Government (Includes Public Schools and Hospitals)	12,567	-133	-1.1%

*January through September average for 2008. September 2008 data are preliminary. Annual data used for 2007.
Source: Bureau of Labor Statistics

5). The number of units sold through the end of October is a couple of hundred units lower than it was last year, and the average number of days on the market has increased to 142 days from 127 in 2007. The average sale price has been trending downward since its 2005 peak. Higher mortgage interest rates, increasing property tax payments, and a slowing economy have all contributed. As shown in **Table 5**, the

property tax/sales ratio has increased over the past couple of years, although some relief for property taxpayers is expected over the next few years due to the 2008 property tax reform measures.

Outlook

In 2008, the available labor market data for Delaware County are fairly pessimistic. Overall employment has decreased (although job losses are

smaller than earlier in the decade) and the rate of decline is larger than that of the state as a whole. The housing market has slowed—fewer building permits were issued in 2008 and it is taking longer for existing houses to sell.

Positive economic indicators also exist. There have been wage gains in some sectors, possibly indicating increases in productivity, and Brevini—a company manufacturing parts for the wind energy industry—has committed to opening a plant. This signals that the Muncie area is attractive to companies related to “green energy.” In addition, there is a supply of workers with the necessary skills ready for both manufacturing jobs in this industry and research and development positions.

Nevertheless, we expect a decrease in employment (1.4 percent—about 900 jobs) for 2008 and a smaller decrease (0.7 percent—about 425 jobs) in 2009 as the economy begins to recover from the current recession.² Personal income in the durable goods sector will decline about 2 percent through 2008 and then experience a dramatic decline (16 percent) in 2009 related to the closing of Borg Warner and related businesses. We expect smaller losses in income in the health care sector (0.8 percent for 2008 and 0.5 percent in 2009) and growth in the nondurable goods sector. A decline in income does not necessarily translate to corresponding losses in jobs. Businesses may cut overtime or move some workers from full-time to part-time status. Finally, we expect retail income to decline in 2008 (2.1 percent) and then recover (1.4 percent) in 2009. ■

Notes

1. The 2008 data are average employment for January through September.
2. For the detailed Muncie labor market forecast, see <http://cms.bsu.edu/Academics/CentersandInstitutes/BBR.aspx>

■ TABLE 3: Average Weekly Wages in Delaware County, 2007 to 2008

Industry	2008:1	Change Since 2007:1	Percent Change 2007–2008
Total	\$601	\$12	2.0
Management of Companies and Enterprises	\$1,750	\$773	79.1
Professional, Scientific, and Technical Services	\$748	\$56	8.1
Administrative, Support, and Waste Management	\$323	\$23	7.7
Information	\$648	\$29	4.7
Arts, Entertainment, and Recreation	\$249	\$11	4.6
Wholesale Trade	\$838	\$35	4.4
Accommodation and Food Services	\$209	\$7	3.5
Educational Services	\$719	\$22	3.2
Retail Trade	\$383	\$8	2.1
Transportation and Warehousing	\$713	-\$2	-0.3
Other Services (Except Public Administration)	\$415	-\$2	-0.5
Construction	\$663	-\$4	-0.6
Public Administration	\$643	-\$6	-0.9
Health Care and Social Services	\$601	-\$8	-1.3
Real Estate, Rental, and Leasing	\$587	-\$10	-1.7
Finance and Insurance	\$729	-\$15	-2.0
Utilities	\$1,513	-\$58	-3.7
Manufacturing	\$827	-\$93	-10.1

Source: Bureau of Labor Statistics

■ TABLE 4: Delaware County Residential Building Permits, 2001 to 2008

Annual	2001	2002	2003	2004	2005	2006	2007	January–September 2008
Total Permits	336	313	563	359	267	208	134	30
Single-Family	302	293	290	289	256	153	120	26
Multi-Family	34	20	273	70	11	55	14	4

Source: U.S. Census Bureau

■ TABLE 5: Delaware County Residential Real Estate Sales, 2003 to 2008

	2003	2004	2005	2006	2007	2008*
Units Sold	1,170	1,347	1,253	1,374	1,210	785
Average Days on Market	110	112	121	129	127	142
Median Days on Market	83	84	92	105	98	120
Average Sale Price	\$95,485	\$97,162	\$100,898	\$96,320	\$90,433	\$92,704
Median Sale Price	\$80,000	\$80,000	\$82,500	\$79,000	\$78,000	\$78,000
Average Property Tax / Average Sales Price	1.08%	1.19%	1.21%	1.19%	1.35%	1.68%

*Data through October 2008

Note: Dollar values are not adjusted for inflation

Source: Mideastern Indiana Association of REALTORS Multiple Listing Service

Richmond Forecast 2009

Paul W. Lingle: President, Lingle Real Estate

November 2008

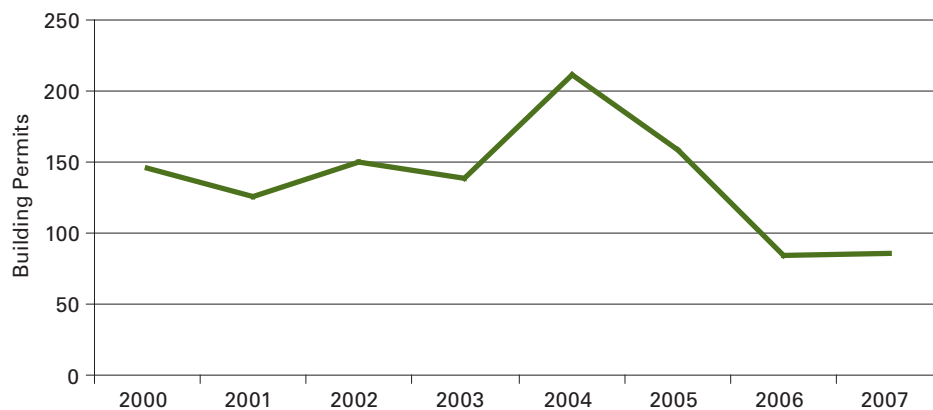
Although not as active as in the past, the Wayne County housing market has not had the dramatic drop in values that has occurred in other parts of the country, such as California, Florida, and Nevada.

The average sale price for single-family homes in Wayne County reported by the Richmond Management Listing Service peaked at \$103,000 in 2005 and has dropped in 2008 by a little over 10 percent from that 2005 high. This compares with 20 percent to 40 percent decreases in other areas of the country. Of course, we didn't have the tremendous appreciation that occurred, so there was not as far to fall. When you compare today's average sale price with 2003, Wayne County's price is down approximately 5 percent.

The annual 20 percent appreciation (and sometimes more) of homes was greatly responsible for the collapse of the real estate market nationally and internationally. People would buy more expensive homes or refinance their current home and spend the money. When the market turned, due to overbuilding and a softer economy, some homes were worth less than the loan balance. Because Wayne County did not have that kind of run-up in prices (3 percent in a year was a big increase for us), we have had a much softer landing. Moreover, Wayne County did not experience the overbuilding of new single-family homes that occurred in many areas, so there were fewer new homes to be absorbed.

The number of single-family Wayne County homes that were listed by the Richmond Management Listing Service peaked in 2005 at 1,800. As of October 1, 2008, the number of homes placed on the market stood at 1,354. Because the average number of days on the

■ FIGURE 1: Wayne County Building Permits, 2000 to 2007



Source: IBRC, using U.S. Census Bureau data

market is higher and people are more tuned into housing, the perception is that a lot more homes are on the market than normal.

Although foreclosures are higher than in past years, they are a fraction of what they are in other areas of the country. It is impossible to get an accurate number due to the process. Troubled mortgage loans are often negotiated with lenders who will adjust the loan balance owed—resulting in a short sale—or take title to the homes rather than actually foreclosing.

As of November 7, 2008, 734 single-family homes were sold in the past twelve months in Wayne County according to the Richmond Listing Service. This figure only includes homes sold by the real estate community and not those homes transferred without the services of a real estate agent.

Meanwhile, the number of building permits in Wayne County has decreased, down 41 percent since the turn of the century (see **Figure 1**).

With the recent troubles in the stock market, a lot of investors like the tangible control that they enjoy with real estate. Typically, these are properties that have loan delinquency and are in need of

some minor reconditioning. The net income generated by the property can often produce a 15 percent or higher return. And, of course, there is the opportunity for rather substantial price appreciation in the future.

Outlook for 2009

What about the future? As is often the case, the future can be seen by looking into the past. In 1981, when mortgage rates were 16.5 percent, short-term interest rates were 21 percent, and inflation was 12 percent, housing was at a much bigger standstill in Wayne County than it is today. There was little, if any, financing available and a 16.5 percent borrowing rate was not very desirable. Today, although the credit markets are much more selective than in the recent past, money is available to qualified buyers at very reasonable interest rates. Thirty-year fixed-rate loans have been consistently available in the 6 percent interest rate range.

Wayne County housing is and will be affected a lot more by the local economic issues. Employment and new job creation has and will continue to be vital for a healthy housing market, but also for healthy retail, service, and government sectors. ■

South Bend and Elkhart Area Forecast 2009

Grant C. Black: Director, Bureau of Business and Economic Research, Assistant Professor of Economics, School of Business and Economics, Indiana University South Bend

November 2008

The Michiana region, comprised of the South Bend–Mishawaka (St. Joseph County) and Elkhart–Goshen (Elkhart County) areas, will rebound slowly in 2009 after facing a weakened economy in 2008. Recovery will depend on manufacturing conditions and the overall national economy.

Output

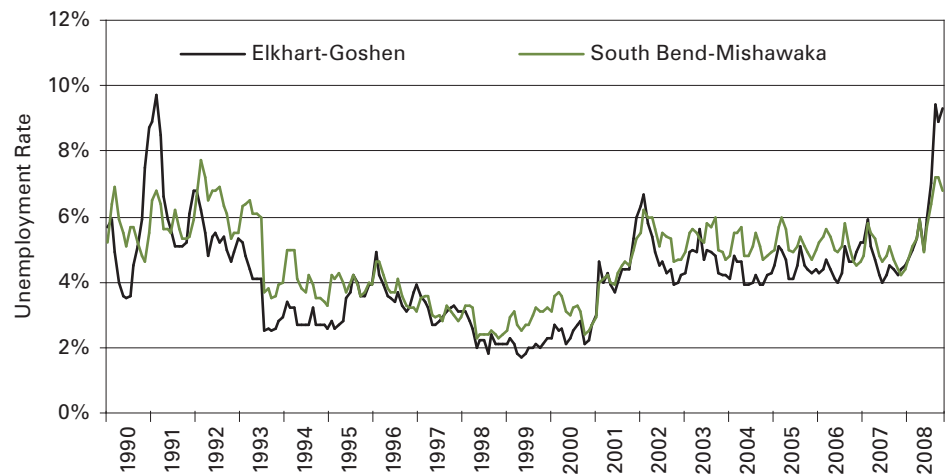
Real gross domestic product (GDP) for the region has increased.¹ Real GDP grew 0.1 percent in 2005–2006 in South Bend and 3 percent in Elkhart. In 2004–2005, South Bend’s real GDP declined 2.3 percent, while Elkhart’s expanded 2.7 percent. The size of the local economies in 2006 was \$10.1 billion (chained 2001 dollars) in South Bend and \$9.5 billion in Elkhart.

Employment

The region has faced weakening labor markets overall. **Figure 1** shows metropolitan unemployment rates from 1990 to 2008.² Unemployment rates escalated rapidly in 2008, reaching their highest levels since the early 1990s. Due to substantial declines in employment in transportation equipment and related industries, Elkhart’s unemployment rate surpassed South Bend’s—reversing a long-time trend. Regional unemployment rates also grew worse relative to state and national averages.

Table 1 reports employment data by industry for the region’s metropolitan areas. Approximately 268,100 people are employed in nonfarm sectors across the region, with employment being about 17,900 higher in South Bend compared to Elkhart. From September 2007 to September 2008, total nonfarm employment in South Bend and Elkhart decreased 3.2 percent with a loss of 3,500 jobs in South Bend and 5,300 jobs in Elkhart.

FIGURE 1: Unemployment Rate, 1990 to 2008



Source: IBRC, using Bureau of Labor Statistics data

TABLE 1: Employment in South Bend–Mishawaka, Elkhart–Goshen, and the Combined Area, September 2008

Industry	South Bend–Mishawaka		Elkhart–Goshen		Combined	
	Employment	Change Since September 2007	Employment	Change Since September 2007	Employment	Change Since September 2007
Total Nonfarm	143,000	-3,500	125,100	-5,300	268,100	-8,800
Manufacturing	19,000	-900	58,500	-3,800	77,500	-4,700
Trade, Transportation, and Utilities	27,800	-700	17,900	-700	45,700	-1,400
Educational and Health Services	32,500	-200	11,300	0	43,800	-200
Government	16,600	-600	8,900	-100	25,500	-700
Professional and Business Services	13,700	-500	8,700	-200	22,400	-700
Leisure and Hospitality	12,200	-300	7,400	-300	19,600	-600
Natural Resources, Mining, and Construction	6,600	0	4,500	0	11,100	0
Financial Services	6,900	-100	3,100	-100	10,000	-200
Other Services	5,700	0	4,100	0	9,800	0
Information	2,000	-200	700	-100	2,700	-300

Source: Bureau of Labor Statistics

That is substantially more than the approximately 0.1 percent decline the previous year—a condition then not seen since 2003 when employment fell from the year before.

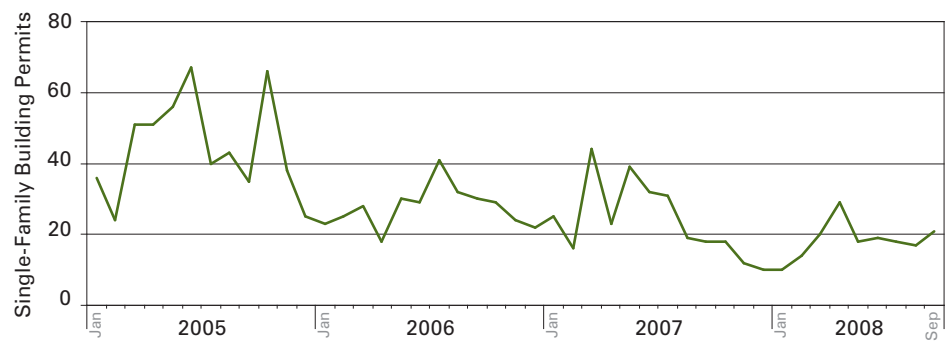
Manufacturing employment fell by 4,700 jobs due to heavy layoffs and closings in transportation and related sectors. Heavily affected by plummeting RV production, Elkhart lost 3,800 manufacturing jobs. Manufacturing employment will likely remain uncertain in the year ahead as the RV and automotive markets remain sluggish and exports decline due to softening global demand.

Unlike the previous year, nonmanufacturing employment also saw sizeable employment losses from September 2007 to September 2008. No sectors experienced employment gains. Some sectors—including natural resources, mining, and construction and other services—remained stagnant, likely due to the sluggish national economy. The largest nonmanufacturing losses were in trade, transportation, and utilities, with a combined loss of 1,400 jobs in the region. Other sectors suffering sizeable losses included government, professional and business services, and leisure and hospitality. Losses in these sectors were particularly strong in South Bend. Educational and health services saw no change in Elkhart but declined by 200 jobs in South Bend. Employment in services and trades will likely remain poor as demand weakens due to continued low spending and unstable financial markets.

Wages

Over the past year, wages changed quite differently across the region.³ The average weekly wage rose 6 percent from the first quarter of 2007 to the first quarter of 2008 in South Bend but remained unchanged in Elkhart. Wages had grown 1.7

■ FIGURE 2: Single-Family Residential Building Permits in St. Joseph County, 2005 to 2008



Source: St. Joseph County Building Department

percent the previous year across the region. The increase in wages in South Bend coincides with more rapid inflationary pressures in late 2007 and early 2008, while the decline in Elkhart's average wage likely stems from lower labor demand in manufacturing sectors. Manufacturing wages fell 0.6 percent in Elkhart but rose 8 percent in South Bend. Average wages in retail fell 7.1 percent in South Bend but rose 4.1 percent in Elkhart. In health care and social services, wages rose 2.4 percent in Elkhart but only 0.1 percent in South Bend. Expected slower inflation in 2009 and continued weak labor demand in many sectors will contribute to slower growth in wages over the coming year.

Housing

Residential construction, measured by the number of new single-family housing permits issued in St. Joseph County, remained soft in 2008 (see **Figure 2**). From January 2008 to September 2008, 166 new housing permits were issued, compared to 247 during the same period in 2007, 256 in 2006, and 403 in 2005. Early 2008 reversed the decline experienced in much of 2007, but the turnaround was short lived, with a drop in new housing permits in mid-2008. A slight positive gain emerged in September 2008. The continuance of this development is uncertain as

real estate markets stay sluggish and outcomes in financial markets remain unclear. Michiana will likely continue to face weak housing markets because of weak demand, growing inventories of existing homes, and tougher credit markets.

Summary

In 2007 and 2008, the Michiana region experienced a sluggish economy: declining employment, accelerating unemployment rates, mixed changes in wages, and continued slow real estate markets. The outlook for 2009 is far from optimistic and faces considerable uncertainty. Much of what was seen in the past year will likely continue, with hope for some recovery as the nation's economy gradually recovers and financial markets stabilize. Deterrents, such as weakening global demand, ongoing cautious spending, and fragile transportation-related manufacturing, will hamper the growth that does occur. ■

Notes

1. GDP data for the South Bend–Mishawaka metro include Cass County, Michigan. GDP data are from the Bureau of Economic Analysis, 2008, www.bea.gov/newsreleases/regional/gdp_metro/gdp_metro_newsrelease.htm.
2. STATS Indiana, Labor Force Estimates Timeseries View, 2008, www.stats.indiana.edu/laus/laus_view3.html.
3. STATS Indiana, Quarterly Census of Employment and Wages, 2008, www.stats.indiana.edu/cew/.

Terre Haute Forecast 2009

Robert Guell: Professor of Economics, Indiana State University

November 2008

Just when it looked like Terre Haute had turned the corner on a decades-long economic malaise, the fortunes have once again turned against the city. Little more than two years ago, it looked as if Terre Haute would gain traction and begin a welcome rebound. The news in 2005 and 2006 was almost entirely good. Pfizer began construction on a facility to produce the inhaled insulin drug Exubera. Boral Brick and Certainteed began construction on facilities to feed the ravenous appetite for building supplies. Sony-DADC had decided to locate its entire North American Blu-ray production facility at its Terre Haute location, stemming the CD market losses that were being felt as a result of iTunes and the closure of the Columbia House facility. When combined with a string of public works projects and a resurgence of the downtown business district, Terre Haute stood ready to grow at a rate not seen in two generations.

Beginning in October 2007 and extending into all of 2008, the string of good news turned mostly bad.

First, Pfizer stopped production of Exubera for lack of sales. Shortly thereafter, the national housing market began to unravel, leaving Boral Brick and Certainteed to begin their Terre Haute operations facing strong headwinds. Though anticipated by many, the biggest blow came in early 2008, as Pfizer announced it was departing Terre Haute entirely. At its peak, Pfizer employed 810 people, and though 165 remain, those jobs will end when the plant closes completely in 2009. **Figure 1** shows monthly employment in the Terre Haute metro since 2000.

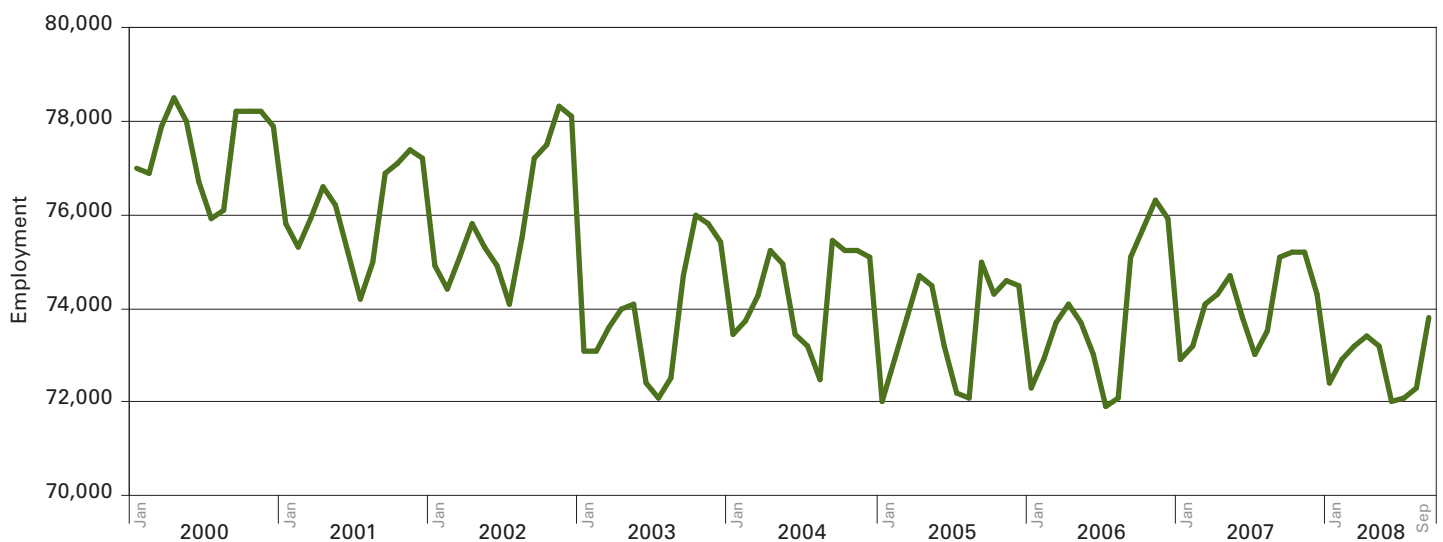
One consequence of these economic events is the devastation to the real estate market for homes valued over \$200,000. The credit crisis in the fall of 2008 was also blamed for the loss of an additional 250 jobs at Great Dane's Terre Haute and Brazil facilities, as trucking companies could not garner funds and were forced to cancel existing orders.

Though the clouds are dark, silver linings can be found. Alorica, an international call-servicing company locating to Terre Haute's

northside, will provide a promised 600 jobs. Certainteed and Boral Brick began their 2008 operations with a combined 125 workers, with another 75 to be added as demand increases. Applied Extrusion Technologies closed a West Virginia facility and moved production to its Terre Haute site, thereby adding 60 jobs. The victory of Sony over Toshiba in the high-definition DVD market continues to add employment to a location that already employs 1,200. In 2009 and beyond, ChemGen, Kellogg, Marion Tool & Die, and N.E.W. Customer Service Companies have announced plans to hire a combined 650 workers.

The national economic outlook suggests that 2009 is likely to be difficult and there is little reason to believe that Terre Haute will escape that fate. Beyond 2009, replacing Pfizer's 810 jobs with ones that pay as well will be a challenge. Of the new jobs slated to be created, only a few offer similar salaries to those lost through Pfizer's departure. ■















■ FIGURE 1: Monthly Employment in the Terre Haute Metro, January 2000 to September 2008



Note: Data are not seasonally adjusted
Source: IBRC, using Bureau of Labor Statistics data

INDIANA BUSINESS REVIEW

Outlook 2009

Indiana	Anderson	Bloomington	Columbus	Evansville	Fort Wayne	Gary
 <p>Stormy, with slow economic growth. A significant number of jobs will be lost and per capita income will be fairly stagnant. Possibly sunny toward the end of the year with a slight increase in existing home sales.</p>	 <p>Rainy, with much of the forecast relying on rebuilding the economic base. Leadership and education are key factors in how the metro weathers the upcoming year.</p>	 <p>Cloudy, with little to no increase in output. Jobs will increase, but wages will remain under modest downward pressure. Income will increase, albeit slowly. Somewhat sunny toward the end of the year with more homes in demand.</p>	 <p>Rain, with continued cuts into the labor force. Unemployment is expected to inch up. Retail businesses should prepare for further declines in revenue, and construction will remain down.</p>	 <p>Partly cloudy. Output will increase slightly, but the number of jobs will decline. Overcast skies make it difficult to see how the metro will react to the continual shift away from manufacturing dependence.</p>	 <p>Thunderstorms throughout the area, with continued decreases in employment. The skies could possibly clear toward the end of the year, but recent measurements suggest storms through at least the third quarter.</p>	 <p>Severe thunderstorms as northwest Indiana is projected to underperform both the state and nation. Employment will decline, especially in manufacturing and construction. Health care could help the area weather the storm.</p>
Indianapolis-Carmel	Kokomo	Louisville	Muncie	Richmond	South Bend-Mishawaka	Terre Haute
 <p>Stormy, with a shrinking economy. A stronger dollar will cause declines in manufacturing, and unemployment will increase. Small businesses, retail, restaurant, and entertainment establishments will be hit hardest.</p>	 <p>Thunderstorms likely. Automotive industry will continue to lose jobs, and alternative job options will not pay as well. Education will be a key determinant for the metro's future, as higher education usually means higher paying jobs.</p>	 <p>Storms, with a loss in jobs. Lower consumer spending will pressure the manufacturing sector. Overall economic slowness will cause declines in financial and professional and business services. Higher unemployment likely.</p>	 <p>Storms, with a decrease in employment. Personal income in durable goods will decline due to the closing of at least one large employer. Smaller losses will occur in the health care sector.</p>	 <p>Foggy, with employment and new job creation being vital for healthy housing, retail, service, and the government sector.</p>	 <p>Showers and storms likely, with continued losses in employment and slow real estate markets. Weakening global demand, cautious spending, and fragile automotive manufacturing will hamper growth.</p>	 <p>Severe thunderstorms as the Terre Haute area struggles to replace the high paying jobs Pfizer provided. However, the silver lining is that there have been jobs promised in the area as new companies locate to the area and current ones expand.</p>

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