12-2006

A Soft Landing, Steady Growth, and Accelerating Farm Income

John Austin
University of Nebraska-Lincoln

Chris Decker
University of Nebraska at Omaha, christopherdecker@unomaha.edu

Tom Doering
Nebraska Department of Economic Development

Ernie Goss
Creighton University

Nick Hernandez
Nebraska Department of Labor

See next page for additional authors

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See next page for additional authors

Authors
John Austin, Chris Decker, Tom Doering, Ernie Goss, Nick Hernandez, Bruce Johnson, Ken Lemke, Franz Schwarz, Scott Strain, Eric Thompson, and Keith Turner

Business in Nebraska

VOLUME 61 NO. 685 PRESENTED BY THE UNL BUREAU OF BUSINESS RESEARCH (BBR) DECEMBER 2006

A Soft Landing, Steady Growth, and Accelerating Farm Income

*By the Nebraska Business Forecast Council**

U.S. Macroeconomic Outlook

After years of accelerating growth, the U.S. economy achieved a soft landing in 2006. The rate of economic growth remained positive but slowed sufficiently to reduce inflation pressures and the need for further interest rate increases. At the same time the economy remained strong enough to continue the current expansion which has been in place since late 2001. Such a soft landing is vital because it should allow the economy to continue to expand for years to come, but with moderate inflation.

The housing sector played an important role in the U.S. economy's recent slowdown. Housing prices and construction activity have fallen significantly in 2006. The decline is expected to continue into early 2007 before housing prices stabilize and construction activity and employment begin to grow again. Other sectors of the economy (manufacturing, retail, and services) should continue to grow throughout the period.

A recovering housing sector in 2007 should lead to a reacceleration of the economy in the second half of the year. Overall, the slow growth seen in late 2006 is expected to continue through early 2007. As a result, growth in real GDP will reach only 2.5% in 2006 and 2007. Real GDP growth will reach 3.0% in 2008 and 3.5% in 2009.

The rate of inflation also began to slow in late 2006 due to falling energy prices. Gasoline prices have stabilized at historically higher levels. Stable prices, however, will not fuel inflation in the years to come. Less risk to inflation has allowed the Federal Reserve Bank to end its string of interest rate increases.

Employment is expected to expand in all major industry groupings throughout the 2007 to 2009 period. The fastest rate of growth is anticipated in the services sector. Manufacturing employment also is expected to grow. Solid job growth will keep national unemployment rates well below 5 % throughout the period.

Nebraska Outlook

The panel remains optimistic about the outlook for the Nebraska economy. Employment will continue to expand in Nebraska. Aggregate farm income is expected to grow rapidly in 2007 and it will remain high in 2008 and 2009.

Table 1— Key Economic Growth Rates

	Nonfarm Employment	Nonfarm Personal Income	Net Taxable Sales
2005	1.5%	4.5%	3.5%
2006	1.5%	6.2%	1.8%
2007	1.8%	5.9%	3.2%
2008	1.9%	5.9%	4.3%
2009	1.9%	5.9%	5.1%

Manufacturing employment also is expected to grow robustly. Employment growth will help generate growth in both income and taxable sales in Nebraska. Total nominal income growth, including farm income,

* The Nebraska Business Forecast Council thanks Barbara Keating for her help in writing sections of this report.

is expected to average 5.9% per year over the outlook period. Adjusting for an average inflation rate of 2.5%, income growth will average 3.4% in real terms. Growth in net taxable sales will average just over 4% per year from 2007 through 2009. A summary of the Nebraska outlook is reported in Table 1.

Employment

Nebraska will experience broad-based employment growth over the next three years, with consistent growth in all sectors. Even construction employment is expected to expand beginning in 2007 as the sector begins to recover, after declining in both 2005 and 2006. Manufacturing employment also will grow during the outlook period, but the faster rates of growth are expected in the services, financial, and transportation industries. Job growth is expected to be tepid in the wholesale and retail trade industry, reflecting a pattern exhibited since 2000. With solid growth in sales over the period, these results suggest that strong labor productivity growth has taken place in these industries.

Construction and Mining

Construction employment decreased in Nebraska in 2005 and 2006, as decades of rapid growth in residential construction came to an end. Looking forward, employment in both segments of the construction industry is expected to stabilize and begin to expand in 2007, with solid growth in 2008 and 2009.

Commercial construction opportunities in Omaha have slowed from their previous blistering pace. Growth will slow in 2007, with a gradual improvement envisioned for the next several years. Throughout the forecast period, demands for new ethanol plants, expanded hospital and nursing home facilities, and schools continue to provide a firm floor for commercial construction activity across the state.

Residential construction is expected to reach bottom in the winter months of 2006/2007. While the market is affected somewhat by past overbuilding, income growth and mortgage interest rates continue to be favorable. Housing activity will rebound in the outyears of the forecast.

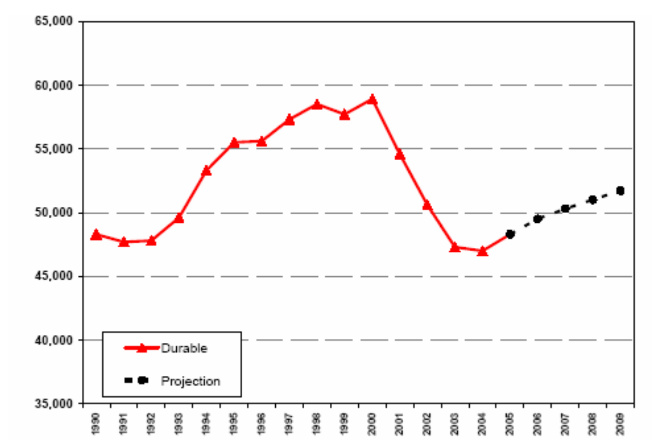
Spending on road construction will continue to expand during the outlook period and will continue to generate employment in heavy construction.

As seen in Table 2, overall construction employment will decline 4% in 2006. Construction employment will rise 1% in 2007, followed by moderate increases of 2.0% and 2.3% in 2008 and 2009.

Manufacturing

Recent data indicate an upturn in employment in both the durable and nondurable goods manufacturing sectors. Employment in the durable goods sector is forecast to increase 2.5% in 2006 with the growth rate slowing in subsequent years to 1.6% in 2007 and 1.4% in 2008 and 2009. Nebraska's durable goods manufacturers have benefited from an improved national economy with employment showing signs of growth in metals manufacturing, motor vehicle parts, and miscellaneous manufacturing, which includes surgical and medical instruments manufacturing. The strong agricultural economy is supporting employment growth in the farm machinery and equipment sector.

Nebraska Durable Goods Manufacturing Employment 1990–2005 with Forecast to 2009



Nebraska Non-Durable Goods Manufacturing Employment 1990–2005 with Forecast to 2009

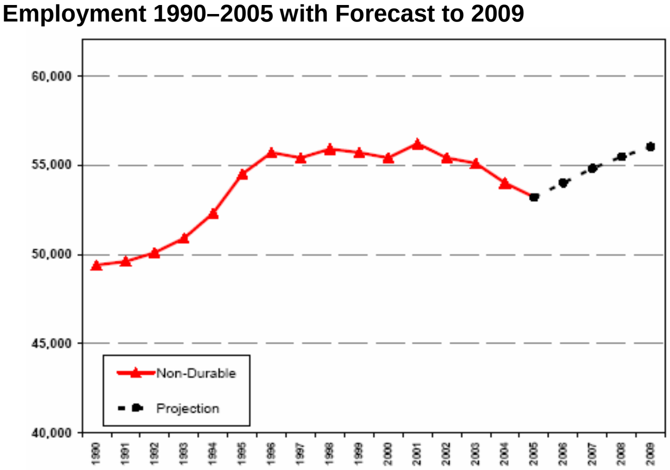


Table 2—Number of Nonfarm Jobs and Percent Changes by Industry Annual Averages (in thousands of jobs)

	Nonfarm Total	Construction, Mining & Natural Resources	Durables	Non-durables	Wholesale Trade	Retail Trade	Trans-portation and Utilities	Info	Financial	All Services	Federal Gov't	Local Gov't
1996	836.8	38.2	55.6	55.7	40.4	104.6	38.6	23.5	54	275	16	135.4
1997	857.1	40	57.3	55.4	41.2	105.3	41.6	25.1	55.7	283.5	16.1	136.1
1998	879.9	42.4	58.5	55.9	42.2	107.5	43.3	26.3	58.8	294.2	16	134.9
1999	897.4	44.3	57.7	55.7	42.5	110.2	44.5	27.1	60.9	303.1	15.9	135.6
2000	914	45.2	58.9	55.4	41.9	111.3	45.1	26.9	60.5	314.3	16.6	137.9
2001	919.7	45.3	54.6	56.2	42.5	110	45.2	25.8	60.2	323	16	140.8
2002	911.5	46.1	50.6	55.4	41.5	108.5	44.9	23.2	61.4	321.2	16.3	142.6
2003	914.2	47.4	47.3	55.1	41	106.7	46.4	21.5	62.4	327.3	16.7	143.1
2004	922.3	48.4	47	54	40.8	106.5	48.9	21.1	63.2	332.2	16.5	143.6
2005	935.8	47.5	48.3	53.2	40.6	107.1	52.3	20.4	64.5	340.7	16.3	145
Forecast Number												
2006	949.9	45.6	49.5	54.0	40.6	107.1	54.1	20.0	65.9	349.6	16.3	147.2
2007	966.8	46.1	50.3	54.8	40.7	107.6	55.9	20.1	67.5	359.0	16.3	148.5
2008	984.8	47.0	51.0	55.5	40.8	108.3	57.6	20.2	69.3	369.0	16.3	149.8
2009	1003.6	48.1	51.7	56.0	40.9	108.9	59.3	20.4	71.1	379.8	16.3	151.2
Forecast Percent												
2006	1.5%	-4.0%	2.5%	1.5%	0.0%	0.0%	3.5%	-1.8%	2.1%	2.6%	0.0%	1.5%
2007	1.8%	1.0%	1.6%	1.5%	0.2%	0.5%	3.3%	0.5%	2.5%	2.7%	0.0%	0.9%
2008	1.9%	2.0%	1.4%	1.2%	0.3%	0.6%	3.0%	0.5%	2.6%	2.8%	0.0%	0.9%
2009	1.9%	2.3%	1.4%	1.0%	0.3%	0.6%	3.0%	0.6%	2.6%	2.9%	0.0%	0.9%

Source: http://data.bls.gov/cgi-bin/dsrv, 2006

Employment in the nondurable goods sector is expected to grow 1.5% in 2006 and 2007 before slowing slightly to 1.2% and 1.0% in 2008 and 2009. Employment growth in Nebraska's food processing manufacturing sector will be the major contributor to the employment turnaround in nondurable goods manufacturing employment.

Transportation and Warehousing

A growing national economy and goods-producing sector provide a favorable setting for increasing employment and business activity in the transportation sector. In Nebraska, favorable demographics and infra-structure, low entry cost, and state government's interest in promoting trucking and warehousing suggest continued employment growth. The construction of ethanol plants in the state may stimulate additional freighting demand in shipping corn to new plants. The rail industry, with its significant presence in Nebraska, also will generate new employment in response to growing national demand. There are even concerns now that the increased freight demand could stress the existing rail network.

Strong growth in trucking and rail and moderate growth in warehousing implies that the transportation and warehousing industry will continue to be an engine of job growth in Nebraska during the forecast period. Employment growth will reach 3.5% for 2006. The rate of growth will decelerate slightly in 2007 through 2009. The outlook is for 3.3% job growth in 2007 and 3.0% growth in both 2008 and 2009.

Wholesale Trade

Wholesale trade employment in Nebraska has grown little over the last decade, despite a growing economy in the state. Such a pattern is characteristic of industries with rising labor productivity, where rising productivity causes employment to remain steady even as total industry activity increases. Our forecast expects this trend to continue and calls for wholesale trade employment to rise only modestly even as the Nebraska economy expands. Employment is expected to be flat in 2006 and grow between 0.2% and 0.3% in 2007 through 2009.

Retail Trade

Solid growth is anticipated for Nebraska retail sales over the next three years. This will support job growth in the retail trade industry over the period. Retail job growth is expected to average around 0.5% to 0.6% per year from 2007 through 2009, as seen in Table 2. This is roughly in line with anticipated population growth in the state. This rate of growth contrasts with the rapid 1.5% annual growth the retail industry experienced during the 1990s. The difference may be rising productivity growth in the retail industry.

There are several reasons to expect rising productivity in the retail industry. Growth in the number of big box retailers in Nebraska will allow sales per employee to rise. Growth of internet-based sales also will curb employment growth at store sites.

Information

There was substantial job loss in the information sector during and after the last recession. Industry employment declined 5,600 jobs, or 20%, between 2000 and 2003. The rate of job loss steadied to just 400 to 600 jobs per year from 2004 through 2006. Such losses have been possible because the information sector includes many business in areas such as telecommunications, data processing, web site development, and web publishing, which have gone through substantial consolidation and downsizing since the late 1990s. Industry employment is expected to stabilize and grow modestly over the next three years.

Financial

The finance industry comprises finance, insurance, and real estate. Like the services sector, this industry has expanded at more than 2% per year since 1990 with all areas of the industry contributing to growth. Conditions are favorable for continued growth throughout the industry. We anticipate job growth at around 2.5% per year through the outlook period with employment reaching 71,000 by 2009, as seen in Table 2. Growth is expected to be broad-based, with employment expanding in the state's banks and insurers. Real estate employment growth depends on continued low mortgage rates and steady improvement in total employment.

Services

The rapidly growing services sector now accounts for more than one-third of employment in the economy. This share will grow over time, as services sector employment typically grows faster than total employment. Overall services employment is forecast to grow 2.6% in 2006, 2.7% in 2007, 2.8% in 2008, and 2.9% in 2009. Below, we consider job growth in several key sub-sectors of the services industry.

Professional, scientific, and technical services is the most pro-cyclical portion of the services sector and grows most quickly when the economy is expanding. Employment is expected to grow 4.6% in 2006 and at a similar strong pace in 2007 through 2009, as the economy expands solidly. The sector will add approximately 2,000 jobs per year and will employ 44,000 Nebraskans by 2009. Professional, scientific, and technical services includes many high wage occupations in areas such as legal, accounting, and bookkeeping, architectural and engineering, computer, consulting, and research services as well as advertising, veterinary services, and photographic services. This sector will bring high wage job growth during the forecast period.

Health care and social assistance is the largest part of the services sector and grows steadily as Nebraska's population grows and ages. Ambulatory health care services such as home health care services, ambulance services, blood donor stations, and health screening services are the fast growing portion of health care. Health care and social assistance employment will grow roughly 3.5% throughout the 2007 to 2009 period. By 2009, the health services and social assistance subsector will employ nearly 125,000 Nebraskans.

Growth will be solid to strong in the leisure sector of the services industry (areas such as food services, lodging, and recreation). Lodging employment is expected to grow more than 3.5% per year through 2009 and return to pre-recession levels of around 9,000 employees. Arts, entertainment, and recreation also will add employment at 4.0% per year, reaching employment of nearly 14,000 by 2009. Growth in food services and drinking places will be steady at just over 1.5% or roughly 1,000 jobs per year. By 2009, there will be nearly 65,000 Nebraska jobs in food services and drinking places.

Government

Despite growing federal programs and expenditure, federal employment has been stagnant or in decline in Nebraska for the last decade. As seen in Table 2, our outlook calls for no change in federal government employment through 2009. Growth, however, is anticipated for state and local government. Growth in state and local government employment has tended to exceed, though only slightly, the rate of population growth in Nebraska. State and local government employment historically has grown 1% per year on average. This makes sense, as the need for teachers, police, fire, and other state and local employees who work directly with the public rises with population. As the economy expands, the state tax revenue base should be growing strongly over the next few years, which also will encourage new employment. Our expectation is that state and local government employment will grow 0.9% per year from 2007 through 2009, which is just below historical averages. Government employment will be somewhat lower because the rate of population growth has declined in Nebraska in the current decade relative to the 1990s.

Non-Farm Personal Income

As the current economic expansion continues and unemployment rates decrease, strong job growth is expected to create growing pressures on growth in wage and salary income. Even with expected moderate inflation, we expect non-farm wages and salaries to grow at about 5.4% per year from 2007 through 2009, as seen in Table 3. Employee benefits (other labor income) are expected to grow nearly 7% per year, driven by increasing health care costs.

Non-farm proprietor income is another income component that gains strength as the economic expansion continues. Non-farm proprietor income is expected to increase nearly 8% per year during the outlook period.

Dividend, interest, and rent income will grow at a moderate 5.5% rate during the expansion period. Interest rates are expected to stabilize over the next three years. Dividend income also is expected to grow at a moderate rate. Healthy growth in corporate profits should allow firms to continue to grow dividends.

Transfer income growth is expected to be steady, as no major change in transfer policy is anticipated during the forecast period. Any tinkering with the Social Security system, for example, would not be expected to take effect for several years. With no major changes transfer payments should grow at around the 6% rate, Nebraska's historical average since 1990.

Farm Income

The net income forecast for the state's agricultural economy has taken a strong upward turn in a relatively short period of time. Fueled by rapidly rising grain prices over the last part of the year and good crop yield levels, the Nebraska net farm income is forecast to be $2.8 billion in 2006. The 2006 forecast is about 4% above the 2005 level and well above the 1996-2005 annual average. As seen in Table 3, farm incomes are expected to rise even faster in 2007 and stay high in 2008 and 2009.

The main contributing factor has been sharply higher corn prices due to growth in the state's ethanol industry. Given projections of new plants and expansion of present plants over the next three years, a vibrant cattle industry which utilizes the distillers' grain by-products; and ideal transportation location for West Coast exports, it is possible Nebraska is likely to become a dominant state in ethanol production.

During 2006 the livestock industry has been a relatively strong market as prices remained in the profitable range. Stronger corn prices in the last part of the year however, have cut into producer profits; though the upward price effect on corn for cattle feeders has been buffered due to the availability of the high quality distillers' grains from ethanol plants.

Higher grain prices have been more of a burden for other parts of the agricultural production sector such as hog and poultry producers, who currently do not benefit from the use of distillers' grain. This may create new challenges for many in the industry, unless higher feedgrain prices can be passed to end-consumers. The drought also played a role. In some state regions, 2006

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

	Nonfarm Personal Income	Dividends, Interest, & Rent	Total Personal Current Transfer Receipts	Nonfarm Wages & Salaries (Wages & Salaries—Farm Wages)	Other Labor Income	Contributions to Social Insurance	Residential Adjustment	Non-Farm Proprietor Income	Net Farm Income (USDA)
Millions of Dollars									
1996	$36,828	$7,823	$4,961	$20,523	$4,343	$3,264	-$579	$3,022	$3,466
1997	$38,754	$8,272	$5,132	$21,936	$4,456	$3,462	-$653	$3,073	$2,023
1998	$41,591	$9,096	$5,477	$23,343	$4,744	$3,686	-$684	$3,300	$1,816
1999	$43,644	$9,148	$5,822	$24,796	$4,999	$3,874	-$762	$3,517	$1,707
2000	$46,366	$9,991	$6,075	$26,186	$5,317	$4,032	-$825	$3,654	$1,440
2001	$48,103	$9,998	$6,667	$26,908	$5,612	$4,200	-$833	$3,952	$1,893
2002	$49,731	$10,023	$7,069	$27,713	$6,363	$4,350	-$869	$3,782	$857
2003	$51,409	$10,002	$7,424	$28,689	$6,753	$4,541	-$920	$4,003	$2,787
2004	$53,896	$10,188	$7,724	$30,052	$7,173	$4,704	-$952	$4,415	$3,568
2005	$56,325	$10,603	$8,111	$31,214	$7,664	$5,025	-$986	$4,744	$2,700
Forecast Number									
2006	$59,817	$11,292	$8,598	$32,931	$8,201	$5,301	-$1,050	$5,147	$2,800
2007	$63,371	$11,969	$9,122	$34,672	$8,757	$5,581	-$1,116	$5,548	$3,500
2008	$67,111	$12,628	$9,679	$36,530	$9,358	$5,881	-$1,187	$5,984	$3,600
2009	$71,068	$13,322	$10,269	$38,507	$10,005	$6,199	-$1,263	$6,427	$3,700
Forecast %									
2006	6.2%	6.5%	6.0%	5.5%	7.0%	5.5%	6.5%	8.5%	3.7%
2007	5.9%	6.0%	6.1%	5.3%	6.8%	5.3%	6.3%	7.8%	25.0%
2008	5.9%	5.5%	6.1%	5.4%	6.9%	5.4%	6.4%	7.9%	2.9%
2009	5.9%	5.5%	6.1%	5.4%	6.9%	5.4%	6.4%	7.4%	2.8%

Source: http://www.bea.gov, 2006

production levels were significantly below normal and are not likely to rebound in the next year. The state's agricultural sector will experience for 2006 and the near future a wide range of economic conditions from one region to the next.

Looking forward, risks facing the industry include continuing dynamic patterns in the ethanol industry, the uncertainty of a new farm program in 2008, and the ongoing drought. In the next, two-to-three year window of time, however, we expect relatively favorable earnings for the state's agricultural production sector as a whole, with particularly strong expectations for feed/fuel grain producers. For 2007, farm income is expected to rise to a near record $3.5 billion and then increase slightly to $3.6 billion in 2008 and $3.7 billion in 2009. These strong income forecasts are being made despite an expected decline in farm program payments.

Net Taxable Retail Sales

In Table 4, data on net taxable retail sales are divided into motor vehicle sales and non-motor vehicle net taxable retail sales. The distinction is important. Motor vehicle net taxable sales are growing over time, but from year to year are affected by cyclical sales. Non-motor vehicle taxable sales rise steadily, but are affected by periodic changes to Nebraska's sales tax base.

Table 4 shows a steady increase in non-motor vehicle taxable sales over the 2007 to 2009 period. Growth is muted in 2007 because in late 2006 Nebraska exempted from taxation sales of contract labor. As a result, comparisons between the year 2007 and 2006 reflect a smaller tax base in 2007 relative to the first half of 2006. This reduction in the sales tax base does not affect growth rates for 2008 and 2009. Non-motor vehicle taxable sales are expected to rise 4% to 5% during those two years.

Growth in motor vehicle net taxable sales is much more variable. Sales grew rapidly in 2002, but have fallen since then. This pattern is familiar in Nebraska: motor vehicle sales periodically grow rapidly one year and then growth slows or sales decline in the years that follow. Vehicles purchased during the sales peak years of 2001 and 2002 will have reached six years of age by 2008, and we anticipate strong sales growth in 2008 due to replacement of older vehicles. The increasing importance of automobile leasing, not included in taxable purchases, will limit motor vehicle taxable sales throughout.

Overall growth in net taxable sales is expected to reach 3.2% in 2007. Growth is expected to increase to 4.3% in 2008, as the rate of growth in non-motor vehicle taxable sales increases. By 2009, growth in overall net taxable sales is expected to reach nearly 5.1%.

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

Year	Total Sales	Motor Vehicle Net Taxable Sales	Non Motor Vehicle Net Taxable Retail Sales
1996	$16,853,403,165	2,068,252,474	14,785,150,691
1997	$17,815,213,048	2,204,779,981	15,610,433,067
1998	$19,005,203,351	2,416,875,627	16,588,327,724
1999	$19,806,203,447	2,519,969,289	17,286,234,158
2000	$20,443,147,008	2,605,040,740	17,838,106,268
2001	$21,056,748,756	2,896,708,697	18,160,040,059
2002	$21,426,001,233	2,926,105,837	18,499,895,396
2003	$22,092,175,638	2,893,503,697	19,198,671,941
2004	$23,618,358,536	2,885,018,183	20,733,340,353
2005	$24,442,519,011	2,751,314,526	21,691,204,485
Forecast Numbers			
2006	$24,887,786,590	$2,628,055,635	$22,259,730,955
2007	$25,689,136,904	$2,628,055,635	$23,061,081,269
2008	$26,794,361,210	$2,764,714,528	$24,029,646,682
2009	$28,168,314,992	$2,889,126,682	$25,279,188,310
Forecast Percent			
2006	1.8%	-4.5%	2.6%
2007	3.2%	0.0%	3.6%
2008	4.3%	5.2%	4.2%
2009	5.1%	4.5%	5.2%

Source: Nebraska Department of Revenue

Our Thanks …

The Bureau of Business Research is grateful for the help of the Nebraska Business Forecast Council. Serving this session were

- John Austin, Department of Economics, UNL;
- Chris Decker, Department of Economics, UNO;
- Tom Doering, Nebraska Department of Economic Development;
- Ernie Goss, Department of Economics Creighton University;
- Nick Hernandez, Nebraska Department of Labor;
- Bruce Johnson, Department of Agricultural Economics, UNL;
- Ken Lemke, Nebraska Public Power District;
- Franz Schwarz, Nebraska Department of Revenue;
- Scott Strain, Greater Omaha Chamber of Commerce
- Eric Thompson, Bureau of Business Research UNL;
- Keith Turner, Department of Economics, UNO (emeritus)

University of Nebraska Lincoln
BUREAU OF BUSINESS RESEARCH
347 CBA
LINCOLN NE 68588-0406
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