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Georgia's economic outlook for 2007

Jeffrey M. Humphreys
P. George Benson

The 2007 forecast calls for Georgia's inflation-adjusted GSP to increase by 3.3 percent, which is a full percentage point lower than the 4.3 percent advance in GSP estimated for 2006. It will be higher than the 2.3 percent growth expected for the nation, however. Georgia's nonagricultural employment will follow a similar path, expanding by 1.5 percent in 2007, down from the 2 percent gain posted in 2006, but again markedly higher than the 1.1 percent gain expected in nationwide employment. Of the four business clusters that took direct hits in the last recession, only air transportation and manufacturing are still in trouble. In contrast, hospitality will be a major driver of overall employment growth and the information industry is poised for growth in 2007.

In contrast, personal income growth will not slow significantly. Georgia's nominal personal income will expand by 6.1 percent, which will essentially match the 6.2 percent gain expected for 2006. A higher proportion of jobs in relatively high paying industries/occupations will help to maintain the pace of personal income growth. Moreover, virtually all of the job growth will occur in areas of the state where prevailing salary levels are relatively high. For example, as a group, the state's metropolitan counties will see the number of jobs rise by 1.8 percent even as the number of jobs drops by 0.4 percent the state's non-metropolitan counties. Finally, increases in compensation per hour worked, and solid prospects for income derived from dividends, interest, and rent are among the factors that will help to sustain the pace of income growth.

Many of the positive forces underlying the forecast for Georgia and the U.S. are the same. Businesses will continue to hire and to make capital investments. Nonresidential construction will be on the increase. The global economy will continue to expand, albeit more slowly than in 2006. The dollar will weaken, boosting prospects both for export-oriented businesses as well as those producing primarily for the domestic market. Energy prices will be lower than they were in the first eight months of 2006. Core inflation will diminish, which will give the Federal Reserve the leeway to stop hiking interest rates.

As always, there are several negative forces, too. The housing recession will intensify. Consumer spending will slow as households become aware that they are significantly overextended. The federal fiscal stimulus will wind down. Moreover, many of the positive stimuli stemming from rebuilding after Hurricane Katrina gradually will fade.

In general, the economic implications are the same for Georgia as they are for the nation, but this is not uniformly the case. For example, existing home prices nationwide are expected to decline by several percentage points, but because home price bubbles did not develop in any of Georgia's MSAs, existing home prices will not drop here. Nonetheless, Atlanta's economic growth is more dependent on new home construction than is true for the U.S. economy. More home building permits are issued each year in the Atlanta that in any of the nation's other major metropolitan areas, therefore the deepening housing recession has the potential to damage the Atlanta metro area's economy, but its impacts will be more focused on the housing industry itself. Thus, even though the decline in home construction jobs is likely to be steep, the state's overall rate of job growth will exceed the nation's.

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The economic repercussions of oil and fuel price movements also demonstrate how national trends can play out differently in Georgia. The steep climb in oil and fuel prices over the last several years did much more damage here than it did in many other states, so the recent moderation in fuel prices should bring considerable relief. Our vulnerability to high fuel prices stems from the very structure of the state's economy. Georgia is a major regional transportation, distribution, and logistics center, and these activities are fuel intensive. Georgians also are more dependent on their personal cars than are people in many other states. Also since Georgia's per capita personal income is only 90 percent of the national average, high fuel prices probably hit consumer spending a little harder here than they did in the nation as a whole. Finally, since Georgia produces no oil and has no major oil refineries, there was no upside to high oil prices.

There also are many strictly state and regional developments that create economic challenges. Several of the state's largest employers are not doing very well, so smaller companies not only must grow fast enough to compensate for sluggish or declining activity at Delta Air Lines, Coca-Cola, and Bell South, but also to offset jobs that will be lost when the GM plant in Doraville and the Ford plant in Hapeville close.

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On a more optimistic note, Georgia stands to realize a major economic boost from the recent round of base closing and realignments. The net gain to the state will be approximately 4,000 military and civilian jobs. In addition to these direct jobs, there is the induced impact that will add another 2,000 to 4,000 jobs to the off-base economies of the communities that host these bases. Fort Benning in Columbus emerged as the largest winner, with a proposed gain of nearly 10,000 civilian and military jobs at the base itself and $1.1 billion in annual payroll. Robins Air Force Base in Warner Robins, Moody Air Force Base in Valdosta, the Marine Corps Logistics Base in Albany, and Dobbins Air Reserve Base in Marietta also stand to gain significant numbers of jobs. Although Georgia was a net overall beneficiary of the latest BRAC, the closing of the Naval Air Station, Fort McPherson, Fort Gillem, and the Navy Supply Corps School will cost the Atlanta-Athens region thousands of military and civilian jobs. Of course, it will take years to fully implement these decisions.

The deepwater ports are another big plus. Savannah's port is poised to set another in a long series of new records. The Port of Savannah announced in 2004 that it anticipated a 150 percent increase in TEUs (Twenty-Foot Equivalent Units) in less than 15 years. Although this forecast may seem sanguine, the latest cargo statistics indicate that in fiscal year 2006, the port experienced a 15.9 percent increase in the number of TEUs, and a record 2.04 million TEUs shipped. In fiscal year 2005, the port experienced a 12 percent increase in the number of TEUs, and a record 1.76 million TEUs shipped. Thus, over the last two years, the Port of Savannah has substantially exceeded expectations.

The announcement of several new shipping services at the Port of Savannah, including a 20-year agreement with Maersk Line and a 15-year agreement with CMA CGM, enhance the prospects for future growth. Also, Target and IKEA plan to build four million additional square feet of distribution space at the Savannah International Trade Park. Meanwhile, the Port of Brunswick has carved a lucrative niche for itself in agricultural cargo and car shipments. The massive expansion project that was recently approved for the Port of Brunswick will double its rail capacity.

Employment

On an annual average basis, the state's nonagricultural employment will increase by 1.5 percent in 2007, which falls short of the 2 percent increase estimated for 2005. Total employment will rise by 59,600 jobs, from 4,080,800 jobs in 2006 to 4,140,400 jobs in 2007. All of the new jobs will be in services-producing industries. Indeed, heavy job losses in residential construction and manufacturing will be the two main headwinds restraining overall employment growth. If not for job losses in these two industries, the overall rate of job growth would not slow in 2007. One consequence of the slowdown in employment growth will be a slight rise in the unemployment rate from 4.8 percent in 2006 to 4.9 percent in 2007.

Services-Producing Industries

The broadly based gains will be centered in the higher wage industries. For example, the state's information industry will be hiring again. Since information accounts for a relatively high share of Atlanta's overall employment, this is an important development. As has been true for the last several years, professional and business services will se the highest rate of growth—3.4 percent—and will create 18,800 jobs. The high level of corporate profits, rising markets for most goods, high cost of maintaining in-house experts, and the ever increasing complexity of business operations are the primary forces behind the projected gains in employment.

Lawyers and law firms operating in Georgia will benefit from advances in GSP, more business startups, more mergers and acquisitions, the sustained growth of households' personal income, and the state's above-average pace of overall employment growth. Large firms will find the best opportunities in Atlanta, but independent lawyers probably will fare best in either the rapidly expanding suburbs or in smaller towns. Staffing and temp agencies also should do very well, benefiting from sustained economic growth as well as their increased focus on professional and technical workers. The fastest growing niche markets include medical and technical staffing. Firms specializing in clerical and light industrial staffing will see only modest gains. One factor that will challenge staffing agencies is that many of Georgia's largest companies have not been doing well, and historically they tend to rely the most on staffing agencies.

Private firms that provide education and health care will see a 2.8 percent employment growth and will add 12,200 jobs. Above-average population growth and favorable demographics are spurring demand for these basic and increasingly essential services. Hospitals' out-patient care facilities and specialty care centers will experience exceptionally strong growth in demand, and in-patient care facilities will see moderately higher demand. As the state's labor market improves, more Georgians will be eligible for employer-provided health insurance plans, which will lower bad debt expenses.

The transportation, retail trade, and utilities business grouping will see the third fastest rate of employment growth—1.9 percent—and will add 16,500 jobs. Within transportation, the prospects are superb for the trucking, rail, and port industries, but the airlines will continue to struggle. Indeed, the 2007 forecast assumes that Delta Air Lines ultimately emerges from bankruptcy as a company that is still headquartered in Atlanta. Although Delta's salary structure and headcount will be markedly lower, the company will be much more efficient and will have better long-run survival prospects. At this point, Delta's troubles probably will not lower the growth trajectory for Atlanta any further. Most of the direct and indirect job losses have already been absorbed, and other airlines, especially AirTran, are rushing into the Atlanta market to take advantage of the scarce airport infrastructure and the huge base of customers.

The outlook for trucking companies is excellent. Increases in industrial production, growth in consumer spending, more domestic outsourcing, and more international trade will cause total cargo volumes to grow faster than GSP. Shipments of containerized cargo will grow much faster than GSP, which will benefit intermodal carriers. Due to strong demand growth and several very profitable years, carriers will be eager to add trucks in 2007, but a severe shortage of drivers will prevent carriers from expanding too fast. Higher demand should give trucking firms the pricing power needed to continue to raise rates, however.

TABLE 1

GEORGIA'S GROSS STATE PRODUCT, 1998-2007
(billions of dollars)

			Percent Change from Previous Year	
Year	Current $	Constant (2000) $	Current $	Constant (2000) $
1998	255.5	266.0	7.6	6.1
1999	277.1	282.8	8.5	6.3
2000	290.9	290.9	5.0	2.8
2001	299.4	292.8	2.9	0.7
2002	306.7	294.1	2.4	0.4
2003	317.5	299.5	3.5	1.8
2004	339.7	313.1	7.0	4.6
2005	364.3	327.5	7.2	4.6
2006	391.3	341.5	7.4	4.3
2007	413.2	352.8	5.6	3.3

Source: Data for 1998 through 2005 were obtained from the U.S. Department of Commerce. Data for 2006-2007 were obtained from the Selig Center for Economic Growth, Terry College of Business, University of Georgia (September 26, 2006).

Although the ongoing restructuring of retailing is far from complete and a slowdown in retail sales growth is anticipated, retailers will contribute to job growth in 2007. The recent downshift in housing markets, especially less housing turnover and slower appreciation, will slow household spending, but the effects of the less robust housing markets will not immediately challenge Georgia's retailers too much. In fact, unless the slowdown in the housing market is very sharp, the lagged effects of recent home price appreciation and new housing development probably will continue to help retailers through the first half of 2007.

Due to competitive restructuring and technological advances, employment in the utilities sector probably will be stable. In 2007, utilities should expect growth in the commercial markets to outpace growth in residential markets. In Georgia's deregulated natural gas retail market, competition among the marketing companies will be no less intense. One risk is that high and volatile gas prices in combination with an unusually cold winter could prompt more people to default on their bills, and thus create significant bad debt problems for natural gas marketers.

The hospitality industry will grow by 2.2 percent and add 6,100 jobs. Generally, luxury and resort properties are expected to outperform moderate and economy properties. An enduring reason for why the industry's prospects are excellent is that Atlanta has, or soon will have, the Georgia Aquarium and an expanded World of Coca-Cola. But there are some special challenges in 2007, however. Spending associated with the displacement of travel to Georgia from New Orleans and the Gulf Coast will provide a smaller boost to the industry than it did in 2006. Also, Atlanta will be contending with the loss of the National Association of Home Builders convention.

Providers of financial services will hire 3,700 additional workers in 2007. In the short term, banks and others that cater to business customers probably will hire more aggressively than those that cater to households, reflecting faster growth in demand for commercial and industrial loans, improved credit for commercial customers, more active capital markets, stronger export markets, slightly better performance of equity markets, and stronger non-residential real estate markets. In contrast, the recession in the housing market, less mortgage refinancing, and slower growth in consumer spending for durables will restrain hiring at community banks.

For the first time since 2000, Georgia's information industry will post year-over-year employment growth. Although the gains will be relatively small, this is welcome news. Even though the Selig Center expects the demand for information services to grow very briskly, it may take a decade or more for Georgia to recover the 30,000 information jobs lost in the first half of this decade.

Goods-Producing Industries

The downward trend continues, even though Georgia's manufacturers will see higher demand for their products. Manufacturing employment will decline by 2 percent in 2007, which is more than double the percentage decline estimated for 2006.

After three-straight years of substantially above-average growth, construction employment will decrease by 1.4 percent in 2007. Higher mortgage rates and the specter of home price declines elsewhere in

TABLE 2

GEORGIA'S ECONOMIC FORECAST, 2006-2007

Georgia	2002	2003	2004	2005	2006	2007
Real Gross State Product, Bil of 2000$	294.1	299.5	313.1	327.5	341.5	352.8
Percent change	0.4	1.8	4.6	4.6	4.3	3.3
Nonfarm Employment (thousands)	3869.5	3844.9	3900.5	4000.1	4080.8	4140.4
Percent change	-1.9	-0.6	1.4	2.6	2.0	1.5
Personal Income, Bil of $	245.0	251.6	265.2	283.0	300.5	318.9
Percent change	1.8	2.7	5.4	6.7	6.2	6.1
Housing Permits, Total	97,523	96,704	108,356	109,336	107,400	98,800
Percent change	4.8	-0.8	12.0	0.9	-1.8	-8.0
Unemployment Rate (percent)	4.9	4.8	4.8	5.3	4.8	4.9

Source: Selig Center for Economic Growth, Terry College of Business, The University of Georgia, September 26, 2006.

TABLE 3

GEORGIA'S EMPLOYMENT FORECAST, 2006-2007

Georgia	2002	2003	2004	2005	2006	2007
Nonfarm Employment[1]	3869.5	3844.9	3900.5	4000.1	4080.8	4140.4
Goods Producing	674.8	659.3	660.3	669.8	672.3	660.4
Natural Resources and Mining	12.3	12.3	12.2	12.1	12.2	12.2
Construction	195.9	195.0	199.8	208.9	215.4	212.4
Manufacturing	466.7	452.0	448.3	448.8	444.8	435.9
Services Providing	3194.7	3185.7	3240.2	3330.3	3408.4	3479.9
Trade, Trans., Utilities	832.3	824.6	830.2	851.9	870.6	887.2
Information	131.8	123.4	118.2	116.2	116.2	118.1
Financial Activities	212.8	216.4	218.8	225.4	230.4	234.0
Professional and Business Services	515.8	490.3	510.4	534.5	552.7	571.5
Education and Health Services	372.0	395.0	409.3	423.1	435.8	448.0
Leisure and Hospitality	337.3	348.1	360.1	371.3	379.5	385.5
Other Services	167.9	155.5	156.2	158.0	159.7	161.5
Government	624.8	632.4	637.2	649.9	663.5	674.2
Percent Change						
Nonfarm Employment	-1.9	-0.6	1.4	2.6	2.0	1.5
Goods Producing	-5.7	-2.3	0.2	1.4	0.4	-1.8
Natural Resources and Mining	-4.7	0.0	-0.8	-0.8	0.8	0.0
Construction	-4.1	-0.5	2.5	4.6	3.1	-1.4
Manufacturing	-6.3	-3.1	-0.8	0.1	-0.9	-2.0
Services Providing	-1.0	-0.3	1.7	2.8	2.3	2.1
Trade, Trans., Utilities	-2.3	-0.9	0.7	2.6	2.2	1.9
Information	-8.3	-6.4	-4.2	-1.7	0.0	1.6
Financial Activities	0.7	1.7	1.1	3.0	2.2	1.6
Professional and Business Services	-2.2	-4.9	4.1	4.7	3.4	3.4
Education and Health Services	3.5	6.2	3.6	3.4	3.0	2.8
Leisure and Hospitality	0.8	3.2	3.4	3.1	2.2	1.6
Other Services	-11.0	-7.4	0.5	1.2	1.1	1.1
Government	2.4	1.2	0.8	2.0	2.1	1.6.

[1]Indicates thousands of workers.

Source: Selig Center for Economic Growth, Terry College of Business, The University of Georgia, September 26, 2006.

the nation will be the main culprits behind the housing downturn. Nevertheless, builders and developers may find some relief in the form of less pressure on wages and salaries.

The outlook for Atlanta's office market calls for positive growth in new construction and lease volume, but the pace of absorption will slow. While two-straight years of solid growth in office-based employment has brought the office vacancy rate in the metro area down to 20 percent from its peak level of 23 percent, Atlanta's office vacancy rate is still one of the highest in the nation. The Atlanta office market is clearly in an expansion phase, and despite the fact that one in five offices sits empty, the Selig Center expects the current expansion to continue. In 2007, office property valuations are likely to rise only very slightly or to simply flatten, but a price decline cannot be ruled out.

The situation in the industrial property market is similar. Vacancy rates are high (14 percent in the Atlanta area) and rents are stable at depressed levels. An abundance of speculative construction is still taking place, however. Since more companies will relocate or expand in 2007, demand for new industrial space will increase, but not nearly quickly enough to absorb all of the newly available facilities.

Prospects for Selected MSAs

Atlanta On an annual average basis, the 28-county Atlanta MSA will add 45,600 jobs, a year-over-year increase of 1.9 percent that exceeds the 1.5 percent gain predicted for the state as a whole. Atlanta's high concentration of services-producing industries, distribution companies, and very low concentration of goods-producing jobs (the lowest in the state) partially explains the above-average growth. Emory University and Georgia Tech in particular also will power the region's economic development. The huge information industry should gather momentum in 2007, providing some long absent economic stimulus.

Factors that will hinder Atlanta's growth include the restructuring of its large air transportation industry, limited prospects for employment gains at several major companies, and the early effects of the announced closing of three military bases. Although the bases have considerable potential for conversion to productive non-military uses, the re-alignment and reuse process will take a long time.

Albany The 2007 forecast indicates that the area will see it third-straight year of solid job growth. Nonagricultural employment will rise by 1.2 percent. Because Albany is a small MSA, the actions for the better or for the worse by one major company probably will determine the area's actual economic performance, and so its long-term outlook will be positively the impacted by the BRAC.

In 2007, Albany will capitalize on its many assets, including a low cost of doing business, an excellent telecommunications infrastructure, and a low crime rate. The area has potential as a center for back office operations and telemarketing, but more intense foreign competition for these jobs probably will limit actual gains. Albany also will benefit from its role as a regional distribution center and from powerful spillover from Florida's vibrant economy. Redevelopment efforts along the Flint River should add to the area's charm, and add to the area's potential to benefit from tourism and retiree-based development. Its increasing role as a regional center for health care also is a big plus.

Athens This MSA will enjoy solid economic expansion, with an overall rate of employment growth of 1.5 percent or 1,200 jobs. If the forecast is correct, then 2007 will be the third-straight year that the pace of job growth in Athens is either above or equal to that of the state. The area's expansion owes much of its impetus to three primary drivers, all of which will continue to be important sources of growth in 2007. They are: state and local government--especially the University of Georgia; the area's expanding role as a regional center for health and educational services; and the growth of the convention and tourism industry.

The Athens MSA is characterized by the massive presence of the government sector, and since a large proportion of spending and employment is tied to government appropriations, the local economy is very recession resilient. The Athens area did not escape the recession, but it was hit relatively lightly and recovered rapidly. Meanwhile, higher enrollment at the University of Georgia will continue to boost spending by the large student population, which provides critical support to the area's retail and services sectors.

The two biggest problems, however, are the announced closing of the Navy Supply Corps School and the area's significant exposure to additional job losses in manufacturing. Because the University is here, Athens usually is not considered to be a factory town, but statistically it continues to be relatively dependent on manufacturing jobs. Those jobs have been and will continue to be vulnerable to foreign competition. The closing of the Navy School diminishes the prospects for growth, too. The Department of Defense estimates that the closing will cost the area about 500 jobs, and this estimate does not include the multiplier effect. Assuming that the multiplier is relatively high, the overall job losses could total 1,000, which amounts to about 1.3 percent of the jobs that currently exist in the Athens MSA.

Augusta Employment will climb by 1 percent in 2007 (or by 2,100 jobs), thanks to the very solid growth in the health care, private education, hospitality, and financial services sectors. The area's information industry, which largely avoided the recession, also will contribute to job growth. Jobs losses are expected in both manufacturing and construction, however.

Augusta's hospitality industry should continue to benefit from many recent downtown developments. The adaptive reuse of historic structures makes the city more appealing as a site for regional meetings and conventions. Moreover, the presence of the Medical College of Georgia is a major advantage in the plans to establish Augusta as a center for the booming biotechnology sector.

Columbus The excellent outlook for this MSA is due to fast-paced growth. AFLAC plans to expand its employment in Columbus by 2,000 jobs over the next five to seven years, and these jobs should pay well. Also, Kia Motors has just broken ground for an assembly plant north of the city. When completed, the plant will employ about 2,500 workers.

Another primary reason why Columbus is poised for above-trend growth is that base realignment at Fort Benning—as well as other military transfers—will provide an economic windfall. The number of military personnel, contractors, and civilian employees

TABLE 4

GEORGIA'S EMPLOYMENT FORECAST FOR METROPOLITAN AREAS, 2006-2007

Metro Area	2002	2003	2004	2005	2006	2007
Nonfarm Employment[1]						
Albany	62.5	63.8	63.7	64.6	65.9	66.7
Athens	75.4	76.6	76.9	79.0	80.8	82.0
Atlanta	2,258.7	2,236.9	2,268.5	2,337.6	2,400.7	2,446.3
Augusta	207.0	208.8	213.6	214.5	217.1	219.2
Brunswick	41.2	41.4	42.8	44.5	45.9	47.1
Columbus	119.9	120.2	120.1	122.1	124.2	126.5
Dalton	77.3	76.1	76.8	78.2	79.6	79.6
Gainesville	65.2	68.0	68.5	70.0	71.3	72.3
Hinesville	15.5	15.8	16.8	17.6	17.8	18.0
Macon	99.1	100.3	101.3	101.3	101.4	102.1
Rome	41.1	42.8	42.7	43.3	43.7	44.1
Savannah	138.4	138.4	145.8	151.5	156.2	160.4
Valdosta	50.4	51.7	52.8	54.4	55.5	56.3
Warner Robins	49.1	50.2	51.4	53.0	54.2	55.1
Percent Change						
Albany	-1.0	2.1	-0.2	1.4	2.0	1.2
Athens	1.1	1.6	0.4	2.7	2.3	1.5
Atlanta	-1.9	-1.0	1.4	3.0	2.7	1.9
Augusta	0.5	0.9	2.3	0.4	1.2	1.0
Brunswick	-0.2	0.5	3.4	4.0	3.2	2.6
Columbus	-1.4	0.3	-0.1	1.7	1.7	1.9
Dalton	0.8	-1.6	0.9	1.8	1.8	0.0
Gainesville	-0.6	4.3	0.7	2.2	1.8	1.5
Hinesville	0.6	1.9	6.3	4.8	1.1	1.0
Macon	-0.2	1.2	1.0	0.0	0.1	0.7
Rome	1.5	4.1	-0.2	1.4	0.9	1.0
Savannah	1.2	0.0	5.3	3.9	3.1	2.7
Valdosta	4.1	2.6	2.1	3.0	2.0	1.5
Warner Robins	2.1	2.2	2.4	3.1	2.3	1.6

[1] Indicates thousands of workers.

Source: Selig Center for Economic Growth, Terry College of Business, The University of Georgia, September 26, 2006.

associated with the fort is expected to grow by at least 10,000 over the next four years.

In addition, the hospitality industry has become both a powerful and dependable driver of growth. Extensive redevelopment of downtown Columbus has made the city attractive to tourists and conventioneers. Also, since 9/11, people's travel preferences have changed in ways that favored Columbus: a smaller, appealing metro area that is within driving distance.

Macon Despite some recent setbacks in manufacturing, Macon's total employment will rise by 0.7 percent in 2007. Two clusters will account for much of the area's growth: transportation, logistics, and warehousing; and financial, business, and professional services. Also, the area's role as a remote bedroom community for the southern portion of the Atlanta MSA helps, too.

Macon's extensive surface transportation system and its proximity to Atlanta are pluses for the area, and will continue to power the growth of Macon and Middle Georgia. Macon is located strategically at the intersection of I-75 and I-16, has two railroad lines, and a good airport that is used by local residents as well as others from throughout much of South Georgia. Moreover, as Atlanta becomes more congested, sites in Macon will become very attractive to both private businesses and state government operations.

Savannah Virtually all sectors of Savannah's economy are expanding, and the number of jobs will climb faster here than in any of the state's other MSAs. Employment is projected to rise by 2.7 percent in 2007, or by 4,200 jobs.

Historic charm and a thriving deepwater port account for much of Savannah's success. In fact, the metro area's short- and long-term growth prospects are among the best in the nation. For example, the presence of the Port of Savannah was crucial to Bass Pro Shops' recent decision to develop its Southeastern regional distribution center in Macon. The city also is a premier destination for national conventions and trade shows, thus convention business will be one of the area's brightest economic sectors. ■

The National Outlook 2007

Jeffrey M. Humphreys
P. George Benson

Although the U.S. economic expansion is in no immediate danger of faltering, the housing recession as well as other factors means there will be a sharp showdown in the pace of GDP growth. The GDP will rise by 2.3 percent in 2007, which will be lower than both the 3.3 percent increase expected for 2006 and the long-term trend rate of growth of 3.1 percent. It also is worth noting that GDP growth of 2.3 percent will be a respectable achievement for an expansion that is already five years old.

Aside from the housing recession, the primary factor that will contribute to below-average GDP growth in 2007 is consumer caution. The Selig Center is convinced that slower growth in consumer spending lies immediately ahead. Households' inflation-adjusted spending will grow by only 2.2 percent, compared to 3.2 percent in 2006. This will be the smallest gain since 2001. This slowdown reflects the lagged effects of the Federal Reserve's interest rate hikes, an expectation of no significant appreciation in asset values, and high levels of consumer debt coupled with the need to save more out of current income.

The Selig Center's expectation of a mid-cycle correction rather than an outright recession hinges on several developments. First, U.S. export growth will accelerate and import growth will decelerate. Net exports therefore are expected to make a significant contribution to GDP growth. Second, businesses' spending for new equipment will continue to grow quickly, albeit not as fast as it has over the last few years. Third, spending on nonresidential construction will increase. Fourth, the proportion of high-wage jobs created will rise even as total employment growth slows. Fifth, crude oil and gasoline prices should remain at levels that are well below 2006's peaks. Finally, significant deceleration in inflation should reassure the bond markets and the Federal Reserve, making additional rate hikes highly unlikely. Indeed, the Fed is likely to keep rates where they are for some time. If most of these expectations are realized, then the country will experience continuing, but moderating economic growth, with a very low risk of high inflation and a low (25 percent) risk of recession.

The upside and downside risks to the baseline forecast appear to be well balanced. On the positive side, productivity gains could be stronger than expected, which would spur GDP growth while containing both inflation and interest rates. Also, bearish bond investors might push down long-term interest rates, which could revive the housing market. Other potential positive developments include lower than expected oil prices, acceleration rather than deceleration in businesses' spending for investment, and stronger than expected growth in foreign GDP.

The major downside risk is that there is less spare capacity than expected, which would tend to push up both commodity prices—including oil—and labor costs, thereby generating widespread and accelerating inflation. The Federal Reserve probably would respond by hiking interest rates sharply, which would punch debt-heavy consumers. As a result, the ongoing housing recession would intensify, confidence would falter, and a deeper and more broadly-based downturn in spending by both consumers and businesses then would push the U.S. economy into a recession.

The oil and/or refined petroleum products markets pose another risk to the forecast. Due to tight market conditions, a significant interruption in the supply of crude oil and/or refinery products could make prices climb dramatically. A second energy crunch—one stemming from major supply interruptions rather than robust demand growth—might cause the U.S. and global economies to plummet. The 2007 economic outlook assumes that the baseline forecast prevails, however, and that the extreme outcomes on both sides of the scale are avoided.

Consumer Spending

Consumer spending will grow much more slowly than in 2007, but people will continue to spend more. Job creation and wage and salary growth will help to keep things steady, however, despite the fact that consumers are heavily indebted and very short on savings. It is simply unrealistic to expect that the extremely depressed 2006 household savings rate of -1.4 percent (the lowest since the Depression) will be sustained through 2007. So, in the face of relatively slow gains in wages and salaries, households opted to boost current spending by extracting wealth from their appreciated homes, which was facilitated by low mortgage rates. Now homes are no longer appreciating in value, and mortgage rates are well above their recent historic lows. Consequently, we expect households to gradually curb their discretionary spending.

As households gradually shift their priorities from spending to savings, the savings rate will rise, but it probably will not move firmly into positive territory until 2008. Furthermore, it will be several years before the household savings rate comes anywhere close to the 5 percent savings average of the 1990s or the 9 percent average from 1961-1990. In short, the Selig Center expects the savings rate to shift from a tailwind for consumer spending to a headwind, which will be the most important factor behind the slowdown in the rate of growth of consumer spending.

At this juncture, job creation and its accompanying income growth is vital to the outlook for both consumer spending and the overall economy. The 2007 forecast anticipates that job growth should be adequate to ensure continued economic expansion, but not sufficient enough to maintain its current rate of growth. With asset appreciation on hold, increases in inflation-adjusted disposable personal income will account for virtually the entire projected rise in consumers' spending. The number of jobs, which is forecast to expand by 1.1 percent, will support this income growth.

In the coming year, consumers' spending for services will increase much faster than their spending for goods. Among services, spending on vehicle leasing, medical care, and personal business services will increase the fastest. Among goods, spending for durables will decline, but spending on non-durables will increase. Outlays for drugs, pharmaceuticals, purchased meals, and computers will increase briskly. In contrast, spending on cars and household appliances will decline sharply.

Labor Markets

With business and state government spending headed up, the overall outlook for jobs is fairly good. As noted previously, total nonfarm employment will expand by 1.1 percent, which is significantly lower than the 1.4 percent gain estimated for 2006. There are several reasons for the slowdown. The slowdown in GDP growth will restrain hiring; and productivity will continue to rise. The outsourcing of U.S. jobs to developing countries will continue to spread from blue-collar occupations in manufacturing to white-collar occupations in high tech and services industries, which historically have been relatively immune to such practices. Even devaluation of China's currency relative to the dollar will not help to preserve U.S. jobs to any great extent.

In the coming year, employment will rise fastest in the natural resources and mining industries. The nation's professional and business services companies will post the second fastest rate of employment growth. Leisure and hospitality, transportation and warehousing, and health services will see above-average employment gains. Below-average growth is expected in wholesale trade, retail trade, and government. Due to the housing recession, construction jobs will be on the decline. Meanwhile, U.S. manufacturing will continue to bleed jobs at a relatively steady rate. Manufacturing subsectors that will continue to shed large numbers of jobs include apparel, textiles, wood products, computer and electronic products, transportation equipment, chemicals, and plastics. Subsectors with the best immediate prospects for job growth (or at least job stability) include machinery, fabricated metal products, nonmetallic mineral products, and petroleum and coal products.

Corporate Profits

Since corporate profits are already exceedingly high, the year-over-year comparisons will be very difficult in 2007. Corporate profits are 160 percent higher than they were only five years ago, which dwarfs the 30 percent increase in nominal GDP during that period. Indeed, after-tax corporate profits are expected to decline slightly in the coming year. Many companies will continue to be flooded with cash, however, so spending for everything from salaries, to equipment, to structures, and to travel budgets therefore will outpace GDP growth.

UNITED STATES ECONOMIC FORECAST 2006-2007

United States	2002	2003	2004	2005	2006	2007
Gross Domestic Product, Bil. of 2000$	10,048.8	10,301.0	10,703.5	11,048.6	11,413.2	11,675.7
Percent change	1.6	2.5	3.9	3.2	3.3	2.3
Nonfarm Employment (milions)	130.3	130.0	131.4	133.5	135.3	136.8
Percent change	-1.1	-0.3	1.1	1.5	1.4	1.1
Personal Income, Bil. of 2000$	8,578.1	8,667.9	8,979.5	9,183.7	9,478.0	9,793.3
Percent change	0.4	1.2	3.5	2.3	3.2	3.3
Personal Income, Bil. of $	8,881.9	9,163,6	9,731.4	10,239.2	10,884.3	11,493.8
Percent change	1.8	3.2	6.2	5.2	6.3	5.6
Civilian Unemployment Rate (percent)	5.8	6.0	5.5	5.1	4.7	5.0
CPI-U, Annual Percent Change	1.6	2.3	2.7	3.4	3.6	2.6

Source: Selig Center for Economic Growth, Terry College of Business, University of Georgia, September 12, 2006.

The main challenge to the bottom line will be margin compression due to higher costs, but slower growth in demand also will hold back bottom- and top-line growth. Unit-labor costs are expected to rise faster in 2007 than in 2006. Productivity growth is expected to slow somewhat. The prices of many commodities and raw materials also will climb. On the plus side, improving conditions of supply and demand will help to maintain current high levels of profitability. Capacity utilization in many industries will rise. As market conditions for many goods and services improve, companies will be able to raise the prices of their products. Finally, the lower value of the dollar will help bolster sales of many export-oriented companies and will help companies producing for the domestic market to compete with foreign rivals.

Business Spending

The Selig Center is still bullish on capital spending, but the percentage gain in overall spending on non-defense capital equipment and software will be smaller than it was in 2006. The increase in business spending will be broadly based. Spending for computers, software, communications equipment, and other information-processing equipment will increase the fastest. Strong growth in spending for industrial equipment also is expected. Spending for transportation equipment will increase modestly. One headwind for capital spending is that the after-tax cost of corporate debt will rise very slightly in 2007, but not enough to affect investment in equipment and software.

We expect businesses' inflation-adjusted spending on buildings to rise by about 8 percent in 2007. The gains would be even larger if not for the high vacancy rates prevailing in many of the nation's major office and industrial property markets. But vacancy rates are declining, which is gradually ending the days when tenants had the upper hand in lease negotiations.

One important determinant of demand for new office space is employment growth. Since the U.S. has fully recovered the jobs that were lost to the recession, the Selig Center expects the demand for new office space to increase. The strongest source of demand for new industrial space will be the global logistics industry. With imports and exports booming, demand for distribution/logistics space near ports, airports, and interstates will skyrocket.

Housing Recession

High prices, higher mortgage rates, and investor pullbacks have cooled the nation's overheated housing market, and we predict that the market will drop even more in 2007. Sales of existing homes will decline by 11 percent, sales of new single-family homes will decline by 10 percent, and housing starts for single-family homes will decline by 9 percent. Given the setbacks already reported for 2006, these may seem like dramatic percentage declines, but only because the market was extremely overheated in 2004 and 2005.The Selig Center is not alone in this prediction. The National Association of Realtors expects sales of existing homes to drop by 2 percent, sales of new single-family homes to drop by 7 percent, and housing starts for single-family homes to drop by 12 percent. Fannie Mae expects existing home sales to drop by 4 percent, new home sales to drop by 5 percent, and single-family housing starts to drop by 8 percent. Even with these declines, 2007 will be the industry's fourth strongest year ever, just not quite as strong as the last three years.

Affordability is the most serious issue facing the housing industry. Recent home prices gains have far outpaced income growth. According to the Office of Federal Housing Enterprise Oversight, over the last five years, home prices are up 56 percent, which is more than double the 25 percent rise in total personal income.

The Selig Center fully expects the average sales price of existing homes to decline slightly in 2007, and home price declines could be substantial in the nation's frothiest markets. The overvalued markets that are most vulnerable to major price corrections are the ones where investors, speculators, or people buying second homes were the ones setting prices. When people chase prices rather than a place to live, bubbles develop.

Although the U.S. housing market's landing will not be soft, the Selig Center does not foresee a crash. After all, many of the fundamental determinants of demand for homes—growth in employment, population, personal income, relocation activity, and consumers' confidence—are still very positive, and should prevent the housing recession from becoming a housing depression. Also, from a long-term perspective, mortgage rates are not too high.

International Trade

In 2007, real exports will increase more than twice as fast as imports, and net exports therefore will contribute to GDP growth. A weaker U.S. dollar will help exports and deter imports. Also, the foreign GDP growth is expected to outpace U.S. GDP growth. Lower oil prices and increases in domestic production also significantly improve the outlook for trade.

The massive size of the current account deficit—$900 billion or about 7 percent of GDP—will continue to erode the value of the U.S. dollar, but its landing is likely to be soft. This gradual descent reflects both the dollar's role as a de facto reserve currency as well as the assumption that the U.S. economy avoids a recession in 2007. Nonetheless, the deficit increases the risks that a serious problem for the dollar and financial markets in general could develop and spill over into the overall economy.

Inflation

If oil prices steady or decline slightly, consumer price inflation will increase by 2.6 percent in 2007, compared to 3.6 percent in 2006. Of course, the news will be even better should energy prices tumble. There are no signs of runaway inflation. The Federal Reserve's short-term interest rates are slightly restrictive and there is still some excess capacity in a number of economic sectors. Heightened competition for jobs from foreign workers also helps to keep the lid on U.S. wages and benefits. Finally, it is worth noting that the two areas of the domestic and global economies that were exhibiting signs of excess demand, excess liquidity, and substantial price pressure, were the property and energy markets. At the time of this writing, both housing prices and energy prices were either softening or retreating, suggesting that the two biggest risks to higher inflation are much diminished.

On the other hand, the trade-weighted value of the dollar is forecast to decline in 2007, and it will continue to deteriorate for the next several years, which does provides a tailwind to prices. The anticipated slowdown in productivity growth also will lead to higher inflation, but due to current slack capacity and a high initial starting point, this will not give a big push to inflation.

Crude Oil Markets

If there are no significant supply interruptions, oil prices are unlikely to climb higher in 2007. Prices will range between $60 and $70 per barrel, but because prices are so volatile, it would not be too surprising if oil were to trade outside of this boundary. Also, this forecast is predicated upon a moderate slowdown in the pace of global economic growth, no major disruptions in the supply of crude, and bringing new energy infrastructure online. High prices also will gradually lead to improvements in energy efficiency, especially in the developing world.

Nonetheless, further oil price shocks remain as one of the major threats to economic growth in 2007. Energy markets are likely to remain tight for the foreseeable future, which means that the steep upward trend in oil prices may be replaced by volatility. Production by most OPEC members is already at or near full capacity, while the growing global economy continues to stimulate demand. New exploration and drilling activity is increasing rapidly, however. The bottom line is that any unanticipated supply interruption or even a surge in speculative buying will likely produce additional, sizable spikes in oil prices, and could establish a new, higher, floor for oil prices. A major crude oil supply disruption—such as the withdrawal of Iranian crude from the global market—could send crude oil prices to $100 per barrel or higher, which, if sustained, would precipitate an oil-shock recession. ■

Although a relatively small part of the state's economy, Georgia's life sciences industry as a whole grew more quickly than the rest of the state's economy.

Life Sciences Outlook

Beata D. Kochut

The life sciences industry uses modern biological techniques and supporting technologies with a goal to improve human and animal health, address threats to the environment, improve crop production, contain emerging and existing diseases, and improve currently used manufacturing technologies. These industries also utilize a specialized workforce, manufacturing procedures and facilities, and often require targeted funding.

The broad definition of the life sciences industry includes life sciences research and development, pharmaceutical and medicine manufacturing, electro-medical apparatus manufacturing, surgical and medical instrument manufacturing, surgical appliance and supplies manufacturing, medical and diagnostic laboratories, and blood and organ banks. This broad definition encompasses biotechnology as well as the pharmaceutical, diagnostics and medical device branches, as they all are a part of the state's life sciences base that reaches from the high-tech labs at the leading universities to manufacturing facilities scattered around the state.

Although a relatively small part of the state's economy, Georgia's life sciences industry as a whole expanded at a much faster pace than the rest of the state's economic sectors between 2001 and 2005. The number of life sciences establishments increased by an impressive 38.4 percent (compared to the10.5 percent average for all industries), employment jumped by 11.2 percent (compared to the1.6 percent all industry average), and total wages jumped by almost 30 percent, compared to the13 percent increase in the state economy as a whole.

While the largest life sciences manufacturing sectors (pharmaceuticals and surgical appliances and supplies) were spared much of the perils faced by Georgia's manufacturers since 2001, and expanded by 1.9 and 17 percent, respectively, between 2001 and 2005, other manufacturing sectors of this industry suffered losses. Medical and diagnostic laboratories, and life sciences R&D, on the other hand, expanded their employment by 27.8 percent and 46.5 percent, respectively, during the same period. The fastest growth took place in the life sciences R&D subsector, driven primarily by biotechnology.

The life sciences sector continued to expand in 2005, but at a slower rate than the 2001-2005 average annual rate of growth. The number of jobs fell in pharmaceutical manufacturing, electro-medical apparatus manufacturing, and surgical and medical instrument manufacturing. Blood and organ banks also saw a drop in employment. Employment in surgical appliance and supplies manufacturing, life sciences R&D, and medical and diagnostic labs expanded at rates surpassing the 2001-2005 annual averages, however.

The long-term growth of the life sciences industry is fueled by several factors. For instance, the aging population creates the demand for new and improved medical treatments. Rising fuel prices generate an unprecedented interest in bio fuels. The challenges posed by climactic changes, and by natural and man-made disasters call for new ways to raise crops and clean up the environment. Emerging diseases and the continued threat of epidemics and bio-terrorism call for more research and manufacturing of remedies and vaccines. Thus, although the manufacturing portion of the life sciences sector seems to softening, R&D and testing will continue to expand, albeit at a slower rate, characteristic of a more mature industry.

Employment in Georgia's life science sector reached a total of 15,237 employees in 2005: 1,947 in life science research and development, 3,232 in pharmaceutical manufacturing, 3,518 in surgical, electro-medical and electrotherapeutic instruments manufacturing, and 6,540 in medical and diagnostic laboratories and blood and organ banks. Based on the average annual rate of employment growth, the 2006 private life sciences employment in Georgia is estimated at 15,648, with the strongest job growth in life sciences R&D and medical and diagnostic laboratories, and weak gains and even losses in some of the medical devices manufacturing sectors.

Since the Bureau of Labor Statistics data reports only private employment covered by unemployment insurance, the size of the life sciences industry workforce is actually much larger, and includes, for example, 6,500 employees of the Centers for Disease Control and Prevention, and close to 1,000 biological sciences faculty at state universities. If speculation about a national bio and agro-defense facility locating in Athens comes true, the state's life sciences workforce will see another major employment boost, and Georgia will make a larger footprint on the nation's biosciences map.

Georgia's life sciences industry's sales increased by 32.2 percent between the 1997 and 2002 Economic Census, and reached $4.5 billion in 2002. If these rates of growth continue, sales should reach $6.2 billion in 2006.

The fast growing industry not only surpasses the state's average rates of growth in the number of establishments and employment size, but it also pays higher wages than the state average. While the 2005 private industry wage in Georgia averaged $39,506, the life science wages averaged $57,683, with the highest salaries paid in biotechnology.

High wages benefit not only life sciences professionals, however. The annual pharmaceutical manufacturing salary reached $77,104 in 2005. Pay in the medical devices manufacturing sectors ranged from $75,281 to $49,254, while life science research and development averaged $67,698.

Medical and diagnostic laboratories, pharmaceutical manufacturing, and surgical appliance and supplies manufacturing are the largest sectors of the bioscience industry in Georgia. Medical and diagnostic laboratories constitute 58 percent of these establishments and provide 34 percent of the industry's employment, and 26 percent of total annual wages. The group of 43 pharmaceutical manufacturers provides jobs for 21 percent of the industry's workforce, and 28.4 percent of the wages. Surgical appliances manufactures provide 16.3 percent of life sciences industry jobs, and 13.9 percent of wages. Life sciences research and development firms, on the other hand, employ only 12.8 percent of the industry's workforce, but provide 15 percent of its wages.

In terms of the number of life science professionals employed in both private and government-run institutions, Georgia ranks fifteenth in the country. While the average professional life sciences salary of $56,948 ranks eighth among the states, medical scientists' average salary in Georgia ranks third and microbiologists' earnings ranks fourth in the country.

Biotechnology

Among the life science R&D companies, the 2002 Economic Census counted 45 biotechnology firms—firms that constitute the high-tech heart of the biosciences industry. In 2006, Ernst &Young reported over 50 biotechnology firms in Georgia. Based on this, the state advanced in rank from eleventh to seventh in the nation between 2001 and 2005, breezing past Texas, Florida, and Washington.

Life sciences R&D and medical devices firms together create the base of the biotechnology industry, the youngest branch of the broadly defined life sciences. In addition, many of the traditional pharmaceutical firms have also shifted their focus towards biopharmaceutical R&D and manufacturing.

Most of Georgia's biotechnology firms are located in Atlanta, with significant biotech activity also taking place in Augusta and Athens. Georgia's biotechnology firms are active in both research and development and manufacturing, and the operations of many of the biotech firms combine both. Georgia's bioscience firms primarily are small, with fewer than 20 employees, but a sprinkling of larger firms with more than 250 staffers add to the state's bioscience landscape.

In a recently conducted survey of the life sciences industry in Georgia, a group of 42 bioscience firms reported 470 products in various stages of development or approval, and 335 products on the market. With an average of one out of every five compounds entering clinical trials subsequently approved, survey respondents are likely to see 59 new applications enter the market over the next eight years. In the long run, however, the relatively low number of products in the R&D and preclinical stages may be a cause of concern, since very few compounds under development even make it to clinical trials. So, this particular metric needs to be monitored closely to ensure the continued health of Georgia's bioscience industry.

Half of the respondents manufacture some or all of their marketed products in Georgia. For the 16 drug manufacturers, products dealing with inflammation, pain, neurological and gastrointestinal conditions are the mainstays. Among the 20 medical devices manufacturers, general, restorative and neurological devices, and reproductive, abdominal and radiological devices are the main products.

The operations of biopharmaceutical and medical devices firms involved in product development differ from the traditional pharmaceutical manufacturing and other bioscience branches due to high development costs and a long approval process, which may take an average of 15 years before the product hits the market. Therefore, access to capital is a major obstacle, especially for young companies with no marketed products. More than half of the state's biotechnology firms operated at a loss in 2005.

Although access to capital is cited as a serious challenge, growth in bioscience industry funding in Georgia has been impressive over the last three years. The amount of capital that the survey respondents expect to raise by the end of 2006 is almost equal to the sum raised between 2003 and 2005 ($977 million). Founders, family and friends, private equity, partnerships, and angels were the most often reported sources of funding. The role of venture capital funding, grants, and public offerings is consistently growing, however.

Venture capital is an important source of funding for the life sciences industry, especially for life sciences R&D firms and medical devices companies. Venture capital backing reflects investors' confidence in the industry's future and the assessment of its present state, and provides a valuable measure of the industry's strength.

Between 1995 and the first quarter of 2006, Georgia's bioscience firms in life sciences R&D and medical devices secured $687 million in 109 deals. Although medical devices firms raised twice as much ($462 million, compared to $224 million in life sciences R&D), life sciences R&D firms got more money per deal ($7.8 million compared to $5.8 million in medical devices). Although the average amount per deal is lower than the national average for both life sciences R&D and medical devices firms in Georgia, medical devices firms are much closer to the national average.

It is important to note that while medical devices firms in Georgia historically were able to attract more venture capital funds, the gap between these two branches of the bioscience industry has been narrowing since 2002, with 2005 being the best year for life sciences R&D in the number of deals—nine—and second best in the amount of capital raised since 1995 ($50 million).

The rapidly growing life sciences industry has become an object of intense competition among states. Within the last five years, biotechnology has become a targeted industry for most states. For example, forty-four states currently are engaged in building life sciences R&D capacity (up from thirty-three states in 2004), forty-six offer support to life sciences firms (up from twenty-two in 2004), and twenty-seven states make capital available.

The life sciences industry has also found support in Georgia, through research initiatives, funding for eminent scholars, support for life sciences business incubators and other facilities. But serious challenges exist: the most important of them is access to capital, and the limited number of skilled workers.

The competition for successful companies and talent is especially noticed when comparing professional salaries in Georgia and other states. Salaries for some of the life sciences professions rank among the highest in the nation, which reflects continued efforts to attract or retain a skilled workforce. Although the availability of facilities and high salaries are a definite draw, the access to capital remains a serious challenge.

As shown by the recently conducted survey of Georgia's bioscience companies, most of the respondents are actively looking for business partners for funding. If the prospective partners are located in other states, the lure may be irresistible and some successful companies will leave. ■

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