UNIVERSITY OF COLORADO AT BOULDER LEEDS SCHOOL OF BUSINESS

COLORADO BUSINESS REVIEW

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Colorado: Then and Now

	Rate		Rank	
	2000	2004[a]	2000	2004[a]
Population growth	2.4%	1.2%	3	14
Employment growth	3.8	1.3	2	20
Unemployment	2.8	5.5	6	31
Wage and salary growth (2003)	8.7	2.5	3	37
Personal income growth	12.1	5.6	1	33
Per capita personal income growth	9.4	4.3	3	39
Gross state product growth	7.4	3.8	3	30

[a] All data 2004, except average wage and salary growth.

Note: Rankings out of 51, District of Columbia included. Gross state product calculated with year 2000 dollars.

Source: Bureau of Labor Statistics, Bureau of Economic Analysis.

U.S. Economic Outlook

Output Growth Expected to Slow

In a recent meeting at the Advance Colorado Center in Denver, the Colorado Business Economic Outlook Forum Steering Committee agreed that U.S. economic growth will proceed at a strong, but slower rate through the end of the year. After a gain of 3.8% in the first quarter, real GDP is expected to close out the year with average growth of 3.5%. This decline will be a result of decreased business investment and government spending.

Consumption Will be Higher

Stronger than anticipated consumption is expected to continue through the remainder of the year. This increase will be driven primarily by better than expected personal disposable income, a rise in the wealth effect derived from an appreciating stock market, and a strong labor market. The Conference Board's Consumer Confidence Survey is just above where it was a year ago, and is expected to remain at that level or show slight growth in 2005. This points to sustained consumption through December.

Creative discount programs by the nation's automakers have driven retail sales higher this year. Light truck and auto sales are expected to exceed sales of 16.6 million units in 2005. Overall, midyear retail growth was about 10.0% higher than for the same period last year. While growth may not continue at this level for the remainder of the year, it should easily exceed the rate of 5.2% projected last fall.

Investment Remains Strong

Business investment growth for 2005 is projected to be about a point below last year's rate of 10.6%. Growth will be driven by both continued replacement investment and demand for expansionary investment.

In partial response to slower investment, industrial production is now expected to post a 3.7% rate of growth for 2005. Expansion of business inventories will be slightly stronger than expected, showing an increase of about $60 billion in 2005. Finally, housing starts are expected to match the 2004 total of about 1.95 million units due to continued low mortgage rates and increased employment levels.

Government Spending Expected to Taper Off

Government expenditures are expected to continue, albeit at a slower rate than anticipated last fall. Decreased spending and higher than anticipated revenues may generate a slightly smaller federal budget deficit by year-end.

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Think Broadly.
Act Boldly.

by Richard Wobbekind

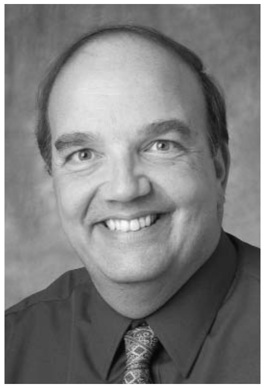
Colorado Economy 2005 Midyear Update: Sector Highlights

From the Editor

This issue of the *Colorado Business Review* presents a midyear update of the Colorado economy. The article on the front page presents a snapshot of the national economy. An update for all sectors of the Colorado economy starts on this page.

We are interested in your suggestions for topics of future issues of this newsletter. Please contact me at 303-492-1147.

—Richard Wobbekind



Population, Labor Force, and Personal Income

During the past five years, Colorado's population has continued to grow, even with a net decrease in jobs for the period. However, the growth has slowed by more than half, falling to an annualized growth of 1.2% during the past year, or roughly 55,000 additional residents. For the past year, approximately one out of every three new residents in Colorado moved here from another state (after accounting for Colorado residents moving to other states).

Even with this increase in population, labor force estimates have remained steady for the past six months, growing by about 5,000. Compared to December 2004, the unemployment rate is holding relatively steady, at about 5.0%. While our annual forecast indicated slightly stronger labor force growth, along with a decline in the unemployment rate (down to 4.8% by year's end), the Colorado economy has stabilized, with a number of signs of strengthening in various local areas. Therefore, it seems possible that these forecasted economic outcomes of lower unemployment and larger total available labor force will be met.

Recently released estimates show that personal income levels in Colorado are rising again, and are near the top of income growth compared to other states throughout the United States. The workers of Colorado have tended to be higher paid compared to others throughout the nation, primarily due to higher levels of education and skill levels.

One of the most surprising factors affecting the Colorado economy in general has been the low inflation rates experienced over the past year or two. Many of us readily think about the higher costs of energy for heating our homes, running our appliances and computers, and operating our automobiles and trucks. However, the impacts of these rising energy prices on the economy and our pocketbooks are not as strong as many expected. For the past year, the local Denver-Greeley CPI-U increased only 0.9% over the previous year.

Agriculture

Colorado's agriculture industry is on target with the projections made last fall. Cattle prices and demand remain high, due some extent to the reduction in the state's cattle herds resulting from the recent drought. Cattle accounts for 59.0% of all farm and ranch sales in the state and is expected to continue on the upward side of the cycle through the rest of the year. Cattle ranchers are rebuilding their herds, but this effort is expected to take another year or two. Of course, smaller numbers of cattle have resulted in higher prices, so increasing herds is a mixed blessing.

The greatest surprise in this area of the state's economy has been the growth of ethanol production (one plant just opened in Sterling and two more—one in Windsor and another in Lamar—may be built in the coming year). Colorado does not have a large scale production of corn, such as states in the Midwest. Yet ethanol production plants have, and are likely to continue, to locate within the state due to the fact that a primary by-product of ethanol production is ddg (distillers dry grain). This has a strong market within Colorado for feeding cattle. The ethanol industry is recognizing the strength of the state as a location where both the primary and by-products of ethanol production can be sold at relatively high prices.

Two primary factors on the horizon make the agricultural community upbeat. The first is another good snow and rain year, ensuring continued supplies of surface and ground water, as well as increase the moisture content of the soil. The second is the Central American Free Trade Agreement, which, if adopted, would further bolster the demand for Colorado beef in international markets.

Natural Resources and Mining

Growth in the Natural Resources and Mining Supersector is being led by the natural gas and oil industry, which has experienced a substantial increase in drilling permits (up 31.0% this year alone), production levels, and prices. Most of the activity in Colorado is in natural gas, which has become a leading energy source for residential and business uses. The value of mineral and mineral fuel production in the state totaled \$8.5 million at the end of 2004, a 30.0% increase over 2003. This number is projected to rise another 14.0% by the end of 2005 for a total of \$9.7 million.

These increases in production value are comprised both of higher prices and increased activity. Employment in this supersector is estimated to be up nearly 2,000 jobs from a year ago, and almost 1,000 jobs from the start of the year.

Hard rock mining is also booming in Colorado in 2005. Coal production, which was at record levels last year and is on a similar pace this year, is likely to reach and possibly exceed 40 million tons. The primary limiting factor in the production of Colorado coal is the transportation system within the state.

High gold prices (currently at about $400 an ounce) are driving a rise in production. Prices are expected to stay relatively constant through the rest of the year. Molybdenum production has been increasing and should reach a total of 32 million pounds by the end of 2005. Molybdenum prices are sustaining high levels, around $36 per pound, which is significantly higher than even a few years ago. Most of the demand is being driven by the worldwide demand for steel, which is not expected to recede in the near future. With increased demand, mining operations have significantly increased and consideration is being given to reopening the Climax Mine in Clear Creek County.

Although they make up a small percentage of the total natural resource production in the state, uranium and vanadium have increased in price, which is driving production growth.

Construction

Continued low interest rates, coupled with continued population gains, have resulted in unexpected strength in residential construction. The greatest concern in residential construction has been the supply of existing housing in all aspects (both geographic and price) within the housing markets. The inventory of for-sale existing homes is beginning to decline and return to a more normal level, although not to the tight housing market most recently experienced. This inventory level, combined with a good management of new home inventory by home builders, may keep the market from suffering as interest rates continue to rise.

New home construction is slowing in response to immediate market conditions. Without increased job growth activity in the general economy, this suggests the forecasted slowdown in new home construction has been delayed, but not avoided. With a strengthening of the state economy, the slowdown may be relatively soft and short in duration.

Nonresidential construction (commercial and office buildings) is lagging behind expectations, primarily due to the high prices of building materials (steel, gypsum, and cement). The price of these materials is 30.0% or more higher than just one or two years ago, and the demand has risen considerably, due to international development and growth and the rebuilding of Florida after last year's hurricane season. The primary activity in this sector has been public school and hospital construction in the last several years. An increase in activity is expected in the second half of the year in both Colorado and across the nation.

Nonbuilding construction has fallen considerably due to weak municipal revenues, the completion of a number of major projects, and long lead times for the next tier of major state and regional projects. Normally, a number of local projects fill in the gaps between the large projects, but with the impacts of the recent recession affecting local government budgets, local capital projects have also been delayed. Furthermore, with the high cost of materials, projects have been delayed or shelved as the construction bid costs are coming in significantly higher than the design cost estimates. The longer term prospects are strong for this sector, but this activity could still be several years in the future. As an example, even with the passage of FasTracks, construction is still three or four years in the future. The evaluation, design, and other activities are or will be underway in the next year or so.

Manufacturing

Manufacturing job growth has stagnated over the first half of 2005, continuing the trend of little to no growth. While nonmetallic mineral production has grown more than 6.0% since December, this sector, which is linked to construction activity, may have some weakness in the next year or two (see Construction discussion). Almost every other portion of the manufacturing sector is down from a year ago and even the beginning of the year. The recent announcements about coming job losses in Larimer County suggest that this sector is still weaker than expected for this year. The silver lining is that the rate of decline is slowing.

While employment in this supersector has been falling, most analysts agree that productivity and output have been on the rise. The anchors for this supersector remain computer and electronics and nondurable goods, but its strength has moved to transportation equipment. Firms such as Lockheed, Ball, and Boeing have announced additional projects, contracts, and operations for their Colorado locations.

THE GREATEST SURPRISE IN THE AGRICULTURE HAS BEEN THE GROWTH OF ETHANOL PRODUCTION. ONE PLANT OPENED IN STERLING, AND TWO MORE MAY BE BUILT NEXT YEAR.

Overall, the number of total jobs in the Manufacturing Supersector is virtually the same as a year ago. It is unlikely to achieve the 1,600 net new jobs forecast by year-end.

Trade, Transportation, and Utilities

This supersector is one of the strengths of the Colorado economy in 2005. Activities such as retail sales, utility usage, and tons shipped are all increasing. Xcel Energy has had several record days in July due to the high temperatures. Retail sales are exceeding everyone's expectations, rising more than 6.0% so far this year. Strong tourism seasons (both winter and summer) have played a role in strong retail activity.

Employment growth in the sectors that make up this part of the economy has been positive, except for air transportation. However, that sector is showing signs of improvement, with United Airlines calling back another block of employees. Denver International Airport (DIA) is showing growth in both enplanements and cargo levels, up about 1.4% and 2.0%, respectively.

Looking forward, higher interest rates (affecting home buying), energy prices, and rising consumer debt are the clouds on the horizon. Energy prices play a role in several aspects of these sectors and the Colorado economy. High automobile fuel costs can impact both household budgets and tourism activity; aviation fuel prices affect both the demand for air travel and the profitability of airlines; utility rates cause increased conservation and affect household budgets; and diesel prices influence motor freight and trucking within the state and, consequently, business activity and competitiveness.

Still, this supersector is very likely to hit and exceed the forecasted job growth of 6,900 jobs in 2005.

Information

The most surprising supersector in the Colorado economy has been Information.

Our forecast suggested a gain of 1,300 jobs in 2005. Compared to a year ago, Colorado has shed another 4,500 jobs in this supersector. Since January 2001, Colorado has lost 45,800 jobs (or 40.0% of the total peak employment). Recent declines in software publishing have had the greatest negative effect, while telecom has moved slightly upward over the first half of the year. The strength in telecommunications is a possible result of VoIP (voice-over internet protocol) growth experienced by those companies with VoIP investments. However, many analysts are suggesting some consolidation in the wireless communication industry, which may result in some future job loss in this part of the sector in the coming year or two.

Despite this continue setback, Colorado still boasts a higher concentration of information-driven jobs compared with the rest of the nation. The numbers for the first half of 2005 mirror previous trends as most of the losses are from the Denver area. Current issues for this sector include the competition in printing media; the wireless consolidation trend; and the evolution and future of Qwest Communication, one of the state's largest employers in this sector.

Financial Activities

Since January 2005, this supersector has gained a net 700 jobs statewide, or about 0.5%. This upswing is being driven by banking activities, which gained more than 2,000 jobs compared to a year ago. Most of this growth is a result of an expansion in neighborhood banking institutions. Over the past few years, the banking industry has danced between virtual and physical banking. With the reemergence of storefront, interpersonal banking, a greater number of financial professionals are being hired to interact with walk-in customers.

Real estate employment is stable, but rental and similar activities are showing reasonable employment growth in the first half of 2005. Residential real estate activity remains strong due to low interest rates. Commercial real estate activity is improving because of job growth within the state, resulting in lower vacancy and improving lease rates. The strongest market has been in the retail area, but it is anticipated that the office and flex-industrial markets will experience growth in 2005 and 2006. Local market areas of strong growth include northern Colorado, particularly along the I-25 corridor near Loveland. Colorado Springs is also seeing strength in commercial activity as vacant properties are absorbed, resulting in vacancy rate of 11.0%.

In total, this supersector will very likely achieve the forecasted employment growth of 1,200 jobs for the year. Commercial real estate should experience some further improvement, which may offset any weakness in the residential real estate side. Growth in banking and related areas is expected to continue into the immediate future, with any resulting market corrections occurring a year or two in the future.

Professional and Business Services

This supersector led the state's economy out of the recent recession and continues to provide overall strength to the economy. Firms in these industries have created 13,000 new jobs for the first half of 2005, according to current estimates. Opportunities for further growth are strong as the state is still 16,000 below historic peaks in this supersector. Employment is expected to grow to a peak in July or August, then remain fairly stable to the end of the year.

Performers in this supersector appear to be those subsectors with lower wage jobs, such as employment services and services to buildings (11.0% and 21.0% growth, respectively). While every subsector in this category has grown since December, in most cases higher paying jobs are showing slower growth than lower wages jobs. Legal services, management, and computer systems design all are growing at rates less than 1.5%, and even architecture and engineering services is only growing at about 3.0%.

Given that the low-paying growth sectors make up 26.0% of the supersector and the high-paying slower growth sectors about 35.0%, the relative average wage and salary levels are likely to move downward this year and into the short-term future.

The firms in this supersector are likely to meet or exceed our employment forecast for the current year. Several drivers are likely to influence continued growth in the future. The engineering/architecture industries will likely experience additional work if Referenda C and D are passed in November (however, not as much as some may think as many of the projects have already completed designs and reviews). Temporary employment, often considered a leading indicator of the economy, is showing strong growth.

Educational and Health Services

The educational and health services supersector has gained on average 6,000 jobs a year since 2000. These jobs tend to be concentrated in the health services, generally in Front Range communities. This job growth is a direct result of new hospitals and medical centers opening, which is being driven by two factors in the demographics of the state: continued population growth and an increase in the portion of the population age 50 and older.

New hospitals have opened in Douglas and Boulder counties, and another is under construction in Larimer County. Refurbishments and expansions are occurring at locations throughout Colorado, and several hospitals are relocating to new sites (including the CU Health Sciences Center, Children's Hospital, and Veterans Administration from Denver to Aurora; and St. Anthony's Central from Denver to Lakewood).

Health care costs to individuals and businesses continue to rise. Premiums paid by patients are up 8.5% this year, and firms are again looking for premium costs to rise at or above that level. Firms are evaluating insurance coverage and participation, while trying to maintain an equal cost footing with competing firms throughout the United States and the world.

Due to these rising costs, a growing number of uninsured (or underinsured) people, and a limited supply of trained employees, our public health care system is struggling to operate in a cost effective manner.

The incorporation of information technology into this industry may offer some relief. The Regional Health Information Organization (RHIO), a method for improving health care information access and sharing, is slowly moving forward in Colorado and the United States. The system will improve communication and the transmission of health information throughout the industry, and it may likely lead to increased efficiency and productivity.

The other portion of this supersector is private education (public education is incorporated in the government supersector). While small in comparison to health care, this portion of the supersector is growing at a strong 3.4% rate, or 900 jobs. Much of this grow is occurring in adult education (retraining and

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COLORADO SKI COUNTRY USA REPORTS AN INCREASE OF MORE THAN 550,000 SKIER VISITS FOR ITS THIRD-BEST YEAR EVER.

certification programs), along with the new and expanding private options for K-12 education. The forecast for this portion of the sector remains strong.

Overall, job growth will meet and exceed our forecasted expectations for the year.

Leisure and Hospitality

This supersector is one of the most recognized and varied of the Colorado economy. Compared to the last year, this part of the economy has grown by more than 4,000 jobs, and is well on track to meet the goal of 5,300 new jobs for the year. Most of the job growth has occurred in restaurant and accommodations, both of which are strongly related to the visitor and tourism activities in the state. The following sections highlight four key factors in the strength of the visitor and tourism business, both locally and outside the state.

Denver International Airport

In 2004, DIA served 42.4 million passengers, a 13.0% increase over the previous year. Through May 2005, passenger numbers are up 1.4% compared to the same period a year ago. Frontier continues to increase the number of cities served throughout the United States. Other carriers are also increasing service to communities, both for destination travel to Colorado and connections to other locations.

Skiing

Good and timely snowfalls contributed to a strong winter tourism season. Colorado Ski Country USA reports an increase of more than 550,000 skier visits for its third-best year ever. Skier visits grew from 11.25 million in 2003-04 to 11.81 million in 2004-05. This was a healthy increase—200,000 more visits than were forecasted. The best news was that Colorado ski resorts saw record international growth in visitation, up a dramatic 28.0%. International and out-of-state skiers tend to spend significantly more per skier day than local skiers.

Summer Travel

Summer leisure travel is expected to increase 2.3%, with 328 million trips predicted (Travel Industry Association of America [TIA]). Nearly every sector will be up, especially air travel. A 4.0% increase in volume is anticipated. Colorado ranked seventh in terms of states that travelers would most like to visit this summer (TIA).

Gaming

The gaming industry in Colorado has been stable for the last several years. A new four-lane highway connecting Central City directly to I-70 opened in November 2004 and has given Central City gaming locations a significant boost. In the first full month the road was opened, gaming revenue rose 39.0% over the same month in 2003; a 75.0% year-over-year increase was recorded in May 2005.

Unfortunately, U.S. Highway 6 has been closed for most of the summer gaming season due to a rock slide. This is likely resulting in some lost activity for this industry as a whole and a significant hurdle for Black Hawk businesses.

In all, Colorado's leisure and hospitality firms are experiencing a strong year. Looking forward, it seems likely these firms can meet activity and employment forecasts, providing automobile fuel prices remain stable or fall.

Other Services

This supersector is comprised of businesses that provide basic business services to the consumer, ranging from beauty salons to auto repair shops and Laundromats. Employment growth typically depends on population growth and increases in personal income as much as it does on overall economic conditions. For this reason, it is one of the few supersectors that grew during the recent recession, adding more than 1,500 jobs compared to a year ago. With population continuing to grow and personal income rising, these sectors are likely to maintain their growth patterns through 2005 and into 2006.

Government

Government is made up of three levels (federal, state, and local) and two primary activities (general government and education). Our forecast suggested a job growth of 3,200 over the 2005 year. Preliminary estimates reveal job growth of more than twice that number compared to the same period a year ago. This nearly 4.9% increase is primarily being driven by the demands for K-12 and secondary education.

During this same period, local and state government employment has risen. Much of this growth has been occurring in enterprise operations rather than general budget activities. As an example, the state provides services that are funded by federal grants and programs. In this way, some program areas have expanded to meet citizen demands and needs, even though Colorado general expenditures are tight. At the local government level, enterprise and grant revenues have grown, while more traditional revenue sources, such as property and sales tax, have experienced limited growth.

State and local general government job growth is about 5,500, or approximately 4.0%. Part of this growth is a result of the population increase and a portion of it is meeting demands in programs and services.

Looking forward, this supersector will meet and exceed its job growth forecast. In the longer term, it is likely to experience continued moderate job growth.

International Trade

Unlike the other areas of the economy, this sector is not focused on industry activity areas but rather on the final customer. Colorado products are purchased by firms and individuals throughout the world. Three industry categories make up the largest portion of the state's exports: agricultural, natural resources and mining, and manufactured goods. In addition, Colorado increasingly exports ideas and professional services to others around the world.

Colorado's chief export markets are Canada, Mexico, and the Far East. After a record year in 2004, it is unlikely that exports will achieve the projected growth of 5.0% in 2005. It appears that exports will increase 2.9% this year.

The slower growth is being caused by a lower level of demand for computer and electronic manufactured equipment. After being the top export product in recent years, these products have fallen to third on the list. While all other product categories are up, the size of this area is dragging down what could be a better-performing year.

While some traditional concerns for product exports continue, the two primary issues are the global economic recovery and the new rules and business environment in the European Union.

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U.S. ECONOMIC OUTLOOK, CONTINUED FROM PAGE 1

Net Exports to Increase

Despite decreases in the trade deficit in March and May, it is expected to exceed $650 billion in 2005. Strong demand for textiles and other Chinese products will further increase the deficit. The strength of the global marketplace is especially important to Colorado's export-dependent sectors, such as agriculture, international tourism, and manufacturing.

Prices to Climb Higher

Strong price spikes in energy, and subsequent increases for transportation, food, and construction supplies, raised concerns about inflation during the first half of the year. Increases in these areas will push the CPI rate to at least 2.8% this year, which is slightly higher than the 2004 rate.

This increase in energy costs has also caused the committee to raise its projections for 2005 for producer prices, as measured by the Producer Price Index (PPI), to 3.8%. This is approximately twice as high as the forecast set at the end of 2004.

On average about 175,000 jobs have been added each month through the first half of the year. Despite this strong employment growth, wage pressures have been felt in only a few areas. Unfortunately, health care and other benefit costs will cause employment costs to increase by 3.8% in 2005.

Employment and Population Growth Will be Flat

Nationally, the unemployment rate is expected to slowly decline, with a rate of 5.2% projected for 2005. Employment should average at least 175,000 new jobs per month for the remainder of the year. Indications are that the depth and diversity in job creation have declined, although most sectors are steady or expanding. Service-providing subsectors are expected to continue to grow more rapidly than goods-producing sectors. This same trend is expected to hold true in Colorado. It seems reasonable to think that Colorado employment will meet or exceed the 43,100 jobs projected for 2005.

Finally, expectations for population growth remain the same as those projected in late 2004. Nationally, population is expected to increase 1.0% in 2005.