COLORADO BUSINESS REVIEW

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Percentage Change of Employment in Colorado

Supersector	2005-2006 Percentage Change Forecast	Mid-Year Employment Percentage Change[a]
Natural Resources and Mining	10.1%	15.7%
Construction	6.0	6.6
Manufacturing	0.1	-0.6
Trade, Transportation, and Utilities	1.9	2.3
Information	-1.0	-2.6
Financial Activities	2.1	2.4
Professional and Business Services	3.7	3.6
Educational and Health Services	3.0	1.9
Leisure and Hospitality	2.2	1.7
Other Services	2.3	1.2
Government	1.2	1.4
Total	2.3%	2.2%

[a]Average employment for the first six months of 2006 as compared to the average employment for the first six months of 2005.
Source: U.S. Department of Labor Statistics and Colorado Business Economic Outlook Committee.

Colorado Economy 2006 Midyear Update:

Sector Highlights

by Richard Wobbekind

Population, Labor Force, and Personal Income

Preliminary data for 2006 suggest that Colorado will continue to outperform the nation, with solid growth rates for population, employment, and personal income. Recent Census Bureau data show that Colorado ranked 11th in the rate of population growth—1.4% for the state versus 0.9% for the country. For 2006, an estimated 70,000 increase in population will result from a projected net migration of 30,000 and natural increase of 40,000.

The Colorado economy has lagged the national economy both in entering and exiting this recessionary period. The state's economy did not begin its recovery until the second quarter of 2004. Sustained growth has occurred since the final quarter of that year. Last year, employment increased by 49,000 jobs, and real gross state product grew by 4.1%. The momentum developed over the past 18 months will allow the state to enjoy solid growth for the remainder of 2006.

Employment growth has occurred throughout the state, with all metropolitan statistical areas (MSAs) reporting increases compared to last

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SECTOR HIGHLIGHTS, CONTINUED FROM PAGE 1

From the Editor

This issue of the *Colorado Business Review* presents a midyear update of the Colorado economy and individual sectors. This commentary is compiled from remarks made by Colorado Business Economic Outlook Estimating Group chairs or their representatives at a midyear roundtable meeting held in July. The analysis compares the current situation in the industry sectors to our forecast presented last December. The key factors influencing current economic trends are also highlighted. We greatly acknowledge the time and input from the individuals who participated in the meeting. For a complete list of contributors, please see page 4. BRD staff members provided additional data collection and analysis for this report.

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

—Richard Wobbekind

year. Most notably, the Greeley MSA has experienced a 3.9% employment increase from the mid-year 2005 average, and the Grand Junction MSA has grown 3.6% in the same period.

Colorado per capita income increased 5.1% in 2005, compared to 4.6% for the United States. The state ranked 22nd in terms of per capita growth. In 2005, Colorado personal income grew 6.5%, which was the 12th highest growth rate in the country. The rate for the nation was 5.6%.

A downside to the current expansion is that the state will begin to experience inflationary pressures in the near-term for the first time since 2002. The CPI is anticipated to increase to 2.2% for the Denver-Boulder-Greeley area this year, compared to 3.0% for the nation. In the June issue of *Current Economic Perspective,* the Governor's Office of State Planning and Budgeting projects that the Colorado CPI will be 0.3 points higher than the U.S. rate next year. This is supported by a recent survey conducted by the Economist Group that rated Denver as the 8th most expensive U.S. city to live in.

Agriculture

While parts of the state have enjoyed varying amounts of precipitation during the summer months, the precipitation received in July was too late to help the wheat harvest, which now stands to reap only 21 bushels per acre rather than the 32 bushels per acre in an average year. With wheat prices increasing from \$3 to \$5 per bushel, some of the revenue lost from production volume shortcomings will be recovered. The recent rains will, however, help pastures and dryland crops, such as corn, beans, and milo. Despite the drought conditions, fruit and various vegetable harvests remain strong.

The beef industry represents about 60% of Colorado's agricultural sales and is a leading influence on the overall strength of the agriculture sector. Beef prices have seen a slight drop from record highs experienced in recent months, yet demand remains good and prices are strong. Signs that the Japanese beef market may reopen are keeping the producers hopeful. Since 2003, when a case of mad cow disease in Washington caused Japanese and Korean leaders to halt beef exports from the United States, Colorado's agriculture sector alone has lost \$450 million. Many cattle farmers have rebuilt their herds after drought-caused reductions, but they have also been pressed by recent dry conditions. As a point of comparison, in some other farming states, 1 acre of land can sustain a single cow. In Colorado it may take 50 acres in good conditions, and in drought times, up to 70 acres. Cattle feed prices are on the rise due to weather-related production decreases, which further affect the market. Higher feed costs result in herd downsizing and a flooded beef market. For the short term, this should reduce beef prices, but in the longer term, prices will ultimately increase from supply shortages owing to reduced herd sizes and difficulty in rebuilding them.

On a more promising note, ethanol production seems to be taking hold in Colorado. The state has two plants currently operating and two more are under construction. Although Colorado is not a large producer of corn, and imports are necessary to account for even livestock feed, signs still point to growth and increased value for ethanol production throughout the state. Due to its location near large corn producers like Kansas and Nebraska, Colorado has the potential to import corn for ethanol processing and then use the concentrated distiller grains for cattle feed.

Natural Resources and Mining

Colorado's Natural Resources and Mining Supersector is expected to exceed growth forecasts for 2006. Employment was projected to increase by 1,700 jobs for the year; however, through June, average employment is up 2,533—15.7%—from the 2005 mid-year average, making this sector Colorado's fastest-growing industry. However, with only 19,800 workers, it is also the state's smallest employment sector, with less than 1% of total nonfarm employment.

High oil and gas prices have been a boon for the Natural Resources and Mining Supersector, and prices are expected to last throughout the year. Increases in natural gas drilling and production around the state will add to value in the sector in 2006 and make for another record-setting year in the Colorado oil and gas industry. Commodity price increases are adding further value to the industry. Early 2006 projections for oil, gas, and carbon dioxide production value in the state totaled an estimated \$9.7 billion, but mid-year estimates indicate the value to be closer to \$12 billion, approximately 24% more than the original forecasted amount.

Coal production is expected to experience slight declines due to mining production problems and closures; however, value will be maintained due to commodity price increases. Colorado's coal production will remain valued at around \$0.8 billion.

Prospects for nonfuel minerals look promising as well. Molybdenum prices have stabilized around

$25–27 per pound, which is down from a peak of $40 in 2005. Because prices remain well above previous years, around $3 per pound, production is expected to increase drastically in the upcoming year. Additionally, production for molybdenum should increase to about 40 million pounds in 2006, up from 32 million pounds in 2005. Furthermore, prices for other minerals such as gold continue to increase. In November of 2005, Cotter Corporation closed its uranium mines, but International Uranium Corporation is set to open at least three mines by late summer in southwest Colorado. These are all auspicious signs for this sector, which has been one of Colorado's strongest growth industries in recent years. Overall value in the sector is projected to reach $14 billion in 2006, exceeding expectations and continuing its burgeoning influence on the state economy.

Construction

Employment estimates in late 2005 called for 6% growth in the sector. Through June, employment has grown 6.6% from the same period last year, with an average of 10,117 more jobs. In terms of residential building, much of the financial growth is due to higher quality, more expensive home building. Permit numbers have not increased substantially, but inflation has driven the value of these permits higher in recent months.

Nonresidential growth continues to be strong, even with a number of large public projects wrapping up. The $1.67 billion T-REX project and the $45 million Broomfield Event Center are two major projects set for completion later in 2006. Yet, even with the termination of these projects, other large construction endeavors are commencing. Building works in Black Hawk are adding high value to construction around the state. Additionally, the $1.3 billion power plant in Pueblo will contribute to future growth across the industry. Other nonresidential work, including construction on the University of Colorado at Boulder and UCCS campuses and a $200+ million cement plant in Pueblo, will further enhance growth across the industry. Medical construction will account for 5–10% of nonresidential growth.

The current strength for residential building permits is perplexing for several reasons. The number of new units built is typically similar to the increase in the population. Most recently, the number of new units built has exceeded population increases. The possibility exists that second-home owners may be influencing the number of units being built.

There is some concern about Colorado being among the nation's leading foreclosure states. According to Realtytrac.com, the state has seen a 96% increase in the number of foreclosures compared to first quarter 2005. A total of 13,267 properties were in some stage of foreclosure during the first quarter of 2006.

Manufacturing

Despite the modest employment growth forecast for 2006, the Manufacturing Supersector is continuing to lose employees. Initial forecasts projected growth of 100 jobs, but the sector has seen an average reduction of 933 jobs through the first two quarters in 2006 compared to the same period last year.

DESPITE THE STATEWIDE LOSS OF MANUFACTURING JOBS, THE METRO DENVER REGION HAS SEEN ABOUT A 1% INCREASE IN MANUFACTURING EMPLOYMENT.

Company outlooks remain optimistic because revenues are not decreasing, but this optimism does not translate into employment numbers because the stabilization is mostly due to productivity increases. Despite this statewide loss of jobs, the metro Denver region has seen about a 1% increase in manufacturing employment. This hike stems mostly from aerospace activity, with a focus not on defense, but on satellite production. Beverage manufacturing, which is a key cluster for metro Denver and the state as a whole, is seeing little or no movement. Though biotech manufacturing growth is on average flat, it remains an area that the manufacturing community has high hopes for and is watching closely.

Initial forecasts projected that durable goods manufacturing would perform well in 2006. With current large public construction projects, the lack of growth thus far is unexplainable as these are typically closely tied. Furthermore, increases in business investment were seen as signs that computer and electronics manufacturing would follow, but this category has actually fallen by 15%, with many of these manufacturing jobs having moved overseas. Business-to-business manufacturing jobs are remaining in the state, but consumer end-product manufacturing jobs are relocating abroad. This will mark the sixth consecutive year of manufacturing job losses.

Trade, Transportation, and Utilities

The Trade, Transportation, and Utilities (TTU) Supersector is Colorado's largest employer, with employment totaling 420,400 in June. Growth for the sector appears to be on par with expectations, with average employment through the first half of the year growing by 2.3% from the same period last year—an average increase of 9,450 jobs compared to 2005. These figures exceed employment forecasts that called for growth of 1.9%, or 7,800 employees, in 2006, and much of the expansion is rooted in growth for retail and wholesale trade occupations.

Retail sales for the first half of 2006 will be about 6.5% higher than last year. This is slightly more than the projected growth rate of 5.6%, signaling the fact that consumers have been willing to spend, despite higher interest rates and energy costs.

DIA enplanements are on track for a record year; however, cargo levels through June are down to approximately 324 million pounds, an 6.4% decrease from 2005 midyear figures. Continued high fuel costs are increasingly affecting business within the air and trucking industries, which may detract from employment and production value added to the state from these industries. Most of the expansion within the air transportation sector, such as Southwest and Frontier's additional flights, will come without significant employment increases.

Numerous projects are in place to develop multimodal transportation throughout the state, including the renovation of Union Station, FasTracks, and the expansion at DIA. These projects will affect construction and service employment levels today, and in the years ahead will add to transportation employment.

Information

The Information Supersector's average employment through June is 2,000 behind last year's numbers. The projected job loss was 800 employees. Despite anecdotal evidence suggesting growth in the sector, for the first six months of 2006 the telecom sector contracted by 5% compared to the same period last year. Furthermore, software employment decreased by 5% as well, and publishing industries fell by 1.7%. The Denver MSA has accounted for the majority of employment losses through June, with an average of 1,866 fewer information jobs than last year's mid-year average.

Similar to manufacturing, this marks the sixth straight year of employment decreases for the information sector. After a peak in 2000, employment has dropped by 32,200 jobs to reach the June figure of 76,200. Information jobs maintain high average wages and add significant value to the GSP. However, the information industry is driven strongly by technology, and with technical advances and the derived gains in productivity, employment growth in the sector is slim. Firms can maintain revenue and cutback employees. Simply stated, the lack of employment growth is directly attributable to strong productivity gains in this sector.

Financial Activities

The Financial Activities Supersector consists of the finance and insurance sectors and the real estate, rental, and leasing sectors. Mixed signs are coming from real estate markets. On any given day a record number of homes may be sold, but days later record foreclosures may offer contradictory evidence. There seems to be no slowdown in the demand for houses in the $400,000 to $2 million range; however, residential builders are experiencing difficulties finding affordable and developable land.

Industrial development is attempting to keep pace with space requirements for workers; currently one full-time employee requires approximately 70 square feet of space. In 2003, it was projected to take 10 years to stabilize vacancy rates, but with increasing employment numbers, those estimates now project vacancies to fill by 2008.

Fears that the market has been overbuilding are beginning to take shape and cause uneasiness for the sector. There are 30,000 resale homes on the market, which is a 10-month supply for the state. Due to 100% financing and interest-only mortgages, the market has been flooded with capital on both a debt and equity level. Even with continued federal interest rate hikes, building projects have not seen a slowdown. Commercial real estate appears strong and is far less worrisome than overbuilding in the residential markets as evidenced by the numerous mall and retail developments and other public works around the state. Building along the E-470 corridor has 80,000 permits lined up, and development in this area should serve as a major boost to the real estate sector both residentially and commercially in the near future. As long as sustainable jobs are created in the state, growth for the sector will remain strong.

Employment in the sector continues to grow, marking a sixth straight year of gains. Our projections called for 3,300 additional jobs for the year, and through the first half, employment is on pace—3,816 jobs ahead of last year's through-June average, for a gain of 2.4%.

Professional and Business Services

The Professional and Business Services Supersector led the state's economy out of the recent recession. The sector had a strong year in 2005, with a 5.5% increase over 2004, and stronger than average growth has continued this year. For 2006, employment was initially forecast to grow to 326,900, or about 3.7%. Through the first two quarters, the sector is on target, with average employment 11,083, or 3.6%, greater than 2005 mid-year numbers.

A variety of labor force issues continue to lurk in the background for this sector. There is concern about the net impact of outsourcing, the aging of the workforce and the potential high number of retirees, and consolidations. It is important to keep an eye on employment impacts, but for the immediate future the outlook is generally positive as constant demand for qualified professionals and support staff is fueling and maintaining the growth.

Educational and Health Services

The Educational and Health Services Supersector was forecast to add 6,700 jobs for the year. Through June, it is an average of 4,250 jobs ahead of the same period last year. The majority of employment gains are in the health services sector, an average 2,283 employees more than last year's mid-year numbers. Still, employment gains have not met expected growth for the year. It was projected that the health services sector would record 3% job growth in 2006, adding 5,900 employees. Employment in educational services has seen lackluster growth—only an average of 350 jobs in front of last year, short of the 1,800 projected.

The boom in health services of the past few years has the sector now confronting a multitude of concerns for the future. Currently, 16% of the nation's GDP goes toward healthcare, and the state devotes a similar amount. Continually rising insurance premiums have positioned Colorado as the nation's leading state in terms of private sector health insurance costs. On average, Coloradans pay $10,000 annually for

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family health insurance coverage. Healthcare costs are a major influencing factor on businesses throughout the state as firms attempt to provide care for their workers while maintaining revenue. Small businesses around the state are dropping their coverage and more Coloradans are left with no coverage. A growing percentage of adults, 17% currently, over the age of 65 are uninsured, and Colorado has a lower portion of its population enrolled in Medicare than the national average. Furthermore, the shortage of nurses in the state adds to an extensive list of factors driving away health professionals. The Colorado Health Foundation gave Colorado a "C+" for overall citizen health, and the American College of Emergency Physicians gave the state a "C" for insufficient funding and quality of the emergency medical care system. Cuts to emergency funding pose additional problems as the lack of funding may deter medical specialists. The passage of Referendum C should bring money to the healthcare sector and hopefully ease some of the mounting pressures in fields spanning from mental health to emergency medicine.

A large provider of Colorado healthcare, United Health, acquired PacifiCare for $8.14 billion, thereby increasing its market concentration. The company is now the largest manager of plans subsidized by Medicare. Estimates are that $60 billion may be spent on Medicare in the nation next year.

In the legislature, Senate Bill 208, a bill to study and develop healthcare reform models, expand coverage, and decrease cost, passed in an effort to advance the state through its healthcare woes. Loan forgiveness funding for nursing students also passed in order to help rectify the nursing shortage across the state. Additional bills aim to reduce prescription drug costs to the state Medicaid program by fund pooling and competitive bidding, all in an effort to lift Colorado from the struggles facing the health services sector in the state and nationally.

Leisure and Hospitality

This large and diversified sector of the economy appears to have a continued positive outlook for the rest of 2006. Employment for the sector is up an average 4,417 jobs from the first two quarters of last year, marking a 1.7% increase. This is below the projected growth of 2.2%. Employment increases in food services, amusement, and gambling are driving the overall growth for the supersector.

A permanent and approved annual allocation of $19 million from the state legislature will help develop the economic impact of Colorado's tourism industry. Providing that external costs and impacts of energy do not nullify the positive impacts of this funding, growth should start in the next year.

Colorado's lodging market continues to diversify, with additional growth in the condo and timeshare market. With hotel costs for construction and operation increasing, few establishments are being constructed. However, as the casino market continues to be the fastest-growing section of the tourism industry, lodging will be added to these businesses in the hopes of attracting more overnight visitors.

Growth in other areas of the supersector, such as restaurants and outdoor recreation, is flat. Although the outdoor and recreation industry has had a good spring with no major fires and ample runoff for rafting, it has seen declining attendance numbers. The industry is supported mainly by residents and drive-in traffic.

The past winter season proved to be the best ever for ski resorts. A report from Colorado Ski Country USA indicates that the state's 26 resorts hosted a record level of more than 12.53 million skier visits during the 2005–06 ski season, eclipsing the previous record by more than 500,000 visits. Timely snows aided the weather-dependent industry, and the stability of the overall economy reinforced Colorado resorts' appeal to destination travelers throughout the state and nation.

DIA air travel through June was up by more than 2.3 million passengers, an 11.1% increase from the same period last year. The airport has seen a 6.7% increase in total operations. The facility is expecting more than 46 million passengers for 2006.

Transportation costs are critical for the tourism industry, so as fuel prices rise, concerns are mounting. With the national average for a gallon of gas at $3.03 according to the U.S. Energy Information Administration, travelers are taking fewer long-distance and summer trips. The industry hopes to make up for this with an increase in travel by Colorado residents and visitors from neighboring states.

Government

Through the first six months, government employment growth is ahead of 2005 mid-year numbers by an average of 5,250 jobs, or 1.4%. This is lower than the overall state employment growth rate, which grew 2.2% for the same period. A more detailed breakdown reveals that most of the momentum for employment increases is coming at the local government level. Through June, federal government employment fell 0.2%, state government employment decreased 0.2%, and state educational services declined 1.1%, while local government rose 2.1% and local educational services increased 1%. In the Boulder MSA, federal government employment dropped 4.2%.

Government revenues are up 7% from the sales and use tax, and 40% from the lodgers' tax in the Denver area. The new convention center is leading the way as a revenue producer.

Looking forward, it seems that municipal government growth will slow to about 1% in 2007. Municipalities stand to face the effects of rising healthcare costs, with smaller local governments feeling the greatest effect of rate hikes given their small risk pool. The City of Denver has changed providers from Pacificare to Anthem to reduce these effects. Other cost drivers for governments, including transportation and construction costs, will further contribute to slower growth. In addition, school budgets for Denver Public Schools show cuts of 195 employees, and other districts around the region face reductions as well. With education as a main constituent of government expenditures and employment, cutbacks in schools will halt growth in the overall sector.

International Trade

International trade is driven by financial activity worldwide. With increased mobility of workers and labor through technological and communicational developments, ideas, services, and labor are transported around the world in addition to mere goods.

Despite challenges among the global community, 2006 Colorado exports show dramatic increases from preliminary estimates of 3%, and are rebounding from the relatively weak 2005 growth of 2.2%. A portion of the low estimate was accommodating for the downward trend in semiconductor sales during 2005. In 2006, however, Colorado has seen a $200 million increase in semiconductor exports compared to 2005, totaling $469 million.

Through May, Colorado has increased its exports to foreign purchasers by nearly $450 million, and free trade agreements have benefited the state's markets. Although import

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growth in Asian markets was forecast to slow, Colorado exports to China have increased 79% and more than 40% to all Asian markets.

Commodities such as metals (beryllium, chromium, and vanadium) and crude oil have demonstrated significant export growth, although they make up a small portion of the total. Electronic integrated circuits and microassemblies remain Colorado's number one export, with 77.5% growth over last year and an overall value of nearly $470 million.

Despite a 1.6% decrease from May 2005 figures, Canada remains Colorado's largest export market. Mexico is the state's second leading export market, with export value increasing nearly 19% over 2005. Exports to Taiwan have increased 203%, climbing from Colorado's 12th largest export market to its 3rd. It has now surpassed Japan, Germany, Malaysia, France, and the United Kingdom in terms of export value. China continues to serve as a major trading partner, not simply as an outsourcing market, importing nearly $200 million in Colorado goods.

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