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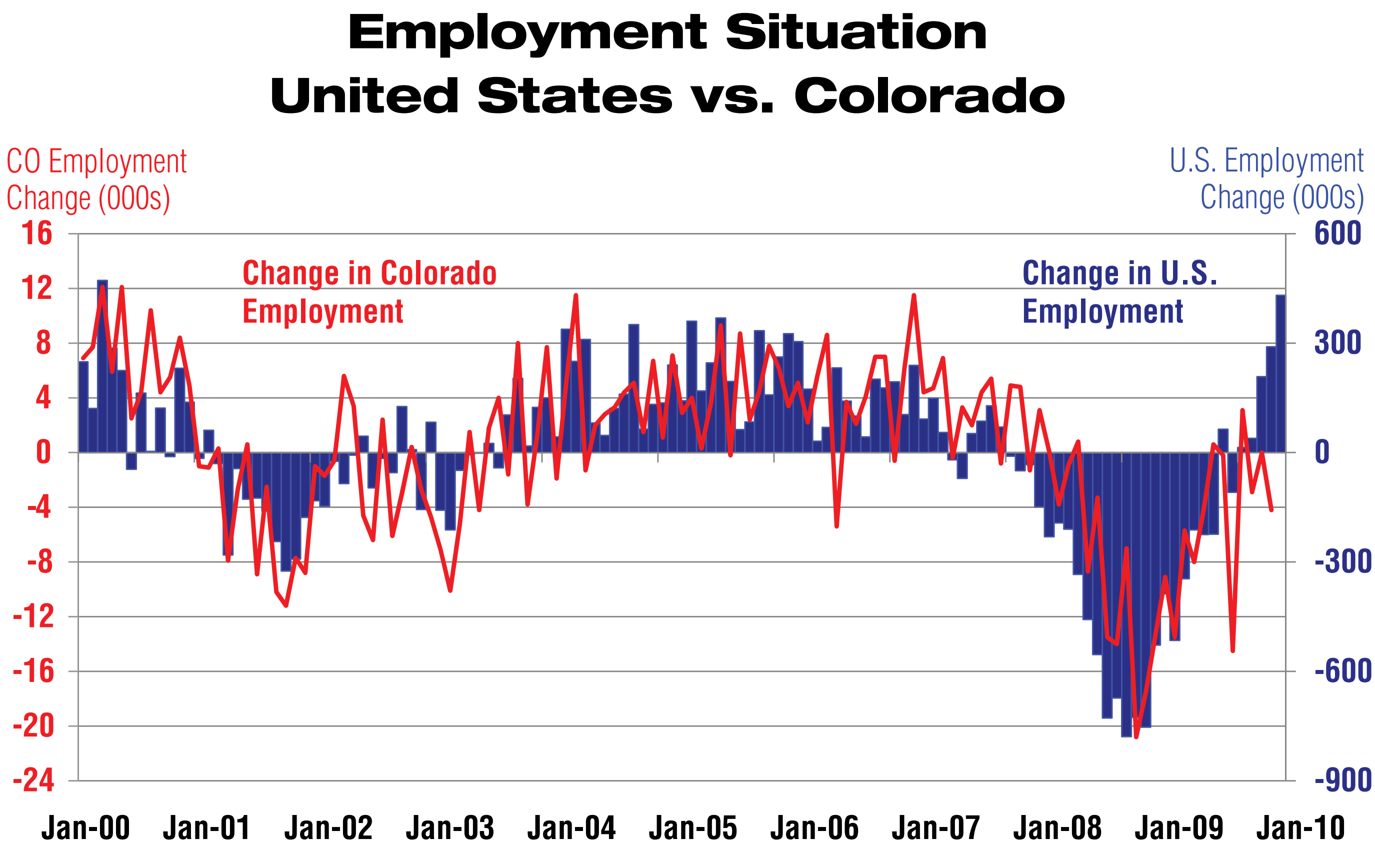

Source: Bureau of Labor Statistics, seasonally adjusted data.

Colorado 2010 Midyear Economic Update

Sector Highlights

Richard Wobbekind

Population and Employment

Colorado lagged the nation heading into the recession, and counter to what we hoped, the state will lag the nation exiting it. While the nation has exhibited five consecutive months of employment growth, the state has seesawed between positive and negative figures every other month. The Business Economic Outlook committee members believe growth in the second half of 2010 will not be enough to offset losses incurred in the first half of the year, and therefore annual employment will be a net loss, albeit a small one.

Average monthly employment for the state is down 3.4% year over year through April.

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From the Editor

We take a look at the Colorado economy midway through the year in this issue of the *CBR.* The information presented is compiled from remarks made by Colorado Business Economic Outlook Estimating Group chairs or their representatives at a roundtable meeting held earlier this month. The analysis compares the current situation in industry sectors to the forecast presented last December.

We greatly appreciate the time and input from the individuals who participated in the meeting. See a complete list of contributors on page 5. BRD research staff collected data and conducted additional analysis for this issue.

Save the Date

It's not too early to mark your calendar to attend the 2011 Colorado Business Economic Forum on December 6 at the Grand Hyatt Hotel in downtown Denver. Check http://leeds.colorado.edu/brd for event updates.

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

Richard Wobbekind

SECTOR HIGHLIGHTS, CONTINUED FROM PAGE 1

Rich Wobbekind

Year-over-year increases will likely not begin until at least July, led by services sectors such as Education and Health Services, and Professional and Business Services. Growth in goods-producing sectors will be constrained by losses in Manufacturing and Construction.

The 2009 population change, at 89,500, was nearly 18,000 higher than expected due to higher in-migration. Net migration, the difference in people moving out of the state versus moving in, totaled nearly 48,000 for 2009, compared to the 30,300 forecast, while the natural increase in population (births minus deaths) was true to the forecast of 41,500. Historically, migration lags economic cycles in Colorado, both during expansionary and recessionary times. A portion of the larger-than-expected increase is derived from an increase in troops at Fort Carson. The net number of retirement-age people (age 65+) moving to the state was nearly flat, while Colorado saw a slight increase in people 85 and older.

The 2010 projections show net migration and the natural increase moving at a fairly equal rate, with each increasing 45,000 and 42,900, respectively.

Government

The Government Sector is comprised of three parts: federal, state, and local. Federal employment has added more than 10,000 jobs this year; however, much of that growth is due to temporary Census jobs, which will end later in the year.

With state government continuing to grapple with budget woes, employment (excluding higher education) is flat year over year. It is anticipated that corporate incomes will come in better than expected, while retail sales (i.e., consumer spending) will remain volatile, though better than expected. Employment in higher education has increased slightly.

Local government has been slow to react to impeding budget crises. However, reality is beginning to sink in as illustrated by the well-publicized service cuts in Colorado Springs, and education cuts at Adams 12 and Jeffco Public Schools, $24M and $14M, respectively. Budget cuts will hurt employment in local government in the second half of 2010 and into 2011.

Agriculture

The Agriculture Sector was hit hard by the economic crash, and is still recovering. Prices in Colorado's major agricultural commodities, wheat and corn, both suffered huge declines from their pre-recession peaks and remain at least 50% below those levels today. While prices are climbing back, the most recent data for both commodities indicate that they remain at least 20% below their price points for the same period in 2009.

Numbers for last year's net income will likely come in uncharacteristically low, under $1B, and estimates for 2010 are no more optimistic. Farmers' balance sheets seem to be continually weighed down by higher expenses and fewer additional revenues or other support coming in. The dairy industry also remains under pressure, and the residual effects of the shake-up of New Frontier Bank's closure are still being felt, particularly in Greeley.

On a brighter note, the sector is experiencing growth in a couple of areas. Colorado wineries have doubled in number compared to five years ago, sparking new interest in wine tourism. The number of farmers' markets has also boomed. Five years ago, they totaled only 30 statewide; now there are 110. By participating in markets, farmers circumvent the supply chain, directly delivering goods to consumers in order to achieve higher price points.

Agricultural exports, particularly for frozen beef, are increasing as well, perhaps due to greater access to Korean markets. In total, agriculture products have a large impact on Colorado exports, accounting for 5 of the state's 25 biggest exports in terms of dollar value. Barring inclement weather that damages crop yields, forecasts for the Agriculture Sector are that it will remain down, but slightly better than last year.

Financial Activities

Investors are cautiously awaiting convincing news that the economy is on a strong footing. Despite some promise, economists and investors are keeping a watchful eye on real estate, looking for indications as to the extent of the impending commercial real estate crisis. Bank failures for the nation have more than doubled since June of last year—a sign that the banking crisis has not peaked (Colorado had three bank failures in 2009, but zero year-to-date in 2010). The Dow Jones Industrial Average rose 7.4% from the start of the year, then fell more than 9%, and as of mid-June, it was below year-end 2009. In Colorado, the Financial Activities Supersector lost 6,500 jobs through April, year over year.

The real estate market is looking for stability. A slew of commercial mortgage-backed securities (CMBS), which were underwritten in 2005 through 2007 during peak economic conditions, are now maturing, and questions remain whether there will be available capital for refinancing. According to Moody's,

Meeting participants Vince Matthews, Paul Morgan, Jim Burnell, all with the Colorado Geological Survey; and Sean Planchard, Business Research Division.

CMBS loan delinquencies continued to climb, with the West experiencing the largest increase. Properties with Class A ratings seem to be finding financing since they are located in high demand areas (i.e., in central business districts, along transit lines, etc.) and have remained leased up. The Class B and C rated properties are the concern—landlords have had to cut rent in order to keep properties occupied, which affects the property's worth and adversely impacts appraisals for refinancing. Opportunity funds may be positioning to take advantage of underwater real estate investments in the coming few years.

Retail properties continue to suffer from high unemployment and weak consumer spending. Offices look slightly better as vacancies have declined and absorption has improved. Industrial real estate has done well this year and seems the most stable given limited new supply. Fortunately for Colorado, nonresidential added inventory modestly over the past decade compared to other states.

It appears that the Colorado residential market has turned the corner. The S&P/Case-Shiller Denver home price index was up 4.1% in March, year over year, and the Federal Housing Finance Agency home price index for Colorado rose 1.5%, year over year. With the April expiration of the home-buyer tax credit, questions remain as to the strength of the housing market. Corporate builders are beginning to make land purchases again in anticipation of a growing market.

Construction

Construction was the hardest hit sector in the state in 2009, losing the greatest number and proportion of jobs compared to all other industries. Spending on nonresidential building, which includes retail, office, and industrial, totaled $3.2B—a 27% drop from 2008 and 40% plunge from 2007. This year the negative trend has continued and is forecasted to fall another 20%, to $2.5B. Many projects that started prior to the recession are now finishing, and little new private commercial development is in the pipeline. The vast majority of new projects are government-related.

Residential building registered an upward tick, but is still very low compared to decade averages. The health of housing is measured by the number of single-family units started in a particular year. For Colorado, a "normal" year will yield around 40,000 units, while 2009 recorded only 7,000 and this year's forecast is cautiously optimistic, at about 8,000. Spring building primarily came from refilling inventory as investors no longer build on speculation.

Permit valuations are well below their peak as resort markets, which skewed valuations, have come to a halt. Some corporate home builders recently closed on land deals—a promising sign for future residential construction.

International Trade

The International Trade Sector has good news and bad news. The bad news: the total value of goods traded internationally fell by 25% as 2009 came to a close. The good news: this decline was below the forecasted 27% decrease—even better, the strength of trade appears to be steadily, albeit slowly, returning. The goods leading the recovery are mainly computer products, medical and surgical equipment, and meat of bovine animals. In terms of Colorado's trading partners, China (Mainland) has replaced Mexico as Colorado's second-largest trading partner (Canada remains in the top position). The question of whether China's yuan will continue to be pegged to the U.S. dollar will have a large influence on Colorado's international trade in the future. If the peg is removed, exports to China will likely increase. This could help compensate for the negative drawbacks of the dollar's appreciation against the euro (e.g., hindering exports, disinclining companies to invest where currency is more expensive, etc.).

Though small, the value of international trade has already climbed into positive territory, up 0.2% for the year. While it is hoped that by the end of the year the value of international trade will reach the double-digit increase forecasted last December, final year-end gains of roughly 8% are more probable.

Professional and Business Services

The Professional and Business Services (PBS) Sector has received no shortage of attention in the aftermath of the Great Recession—media, regulatory, and otherwise. Current employment data as of April 2010 show the sector's employment level at just over 320,000. The fact that employment in this sector stood at 313,000 in April of 2000 lends support to the theory that the '00s were truly a lost economic decade. Over the past 10 years, Colorado has seen impressive gains in this sector, accompanied by equally impressive losses.

Overall, the PBS Sector has been making steady month-over-month employment gains beginning in February of 2010 and has returned to tracking a normal trend line for yearly employment. However, the sector's employment as a whole is still well below where it was at this time last year; no subsector has escaped employment losses. Professional, Scientific, and Technical Services; Administrative and Waste Management Services; along with Management of Companies and Enterprises, are down 4.1%, 1.5%, and 1.1%, respectively. Notably, for the first time in Colorado since the 1990s, employment in legal services has also contracted. These declines are all likely due to reduced demand for professional services. For example, architectural and engineering firms have taken a heavy hit due to the drying up of the construction project pipeline.

Projections for the sector as a whole appear murky as well and subject to some intense volatility. The gains so far in 2010 have been made by successful firms doing significant hiring, which has made up for the steep losses of other companies within the sector. Looking forward, speculation and questions abound concerning the economic consequences, if any, that allowing the Bush tax cuts to expire at the end of 2010 will have on the PBS sector and the economy as a whole.

Natural Resources and Mining

In 2008, the United States experienced a shortage of natural gas, and the Rockies were in year 23 of increased natural gas production. However, the industry took a big hit with the economic crash, and the country is now experiencing an oversupply of natural gas. Production in 2009 was flat, and revenues were lower than the previous year, but production is beginning to recover and increase again. The state has remained largely unaffected by new rules and regulations for the industry. According to Vince Matthews of the Colorado Geological Survey, Colorado has added more rigs in the last six months than neighboring states, which

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may help economies on the Western Slope. This increase is due in part to the type of gas that is being extracted from the rigs—shale gas, which produces decreasing yields over time. With each rig extracting smaller amounts of gas, more rigs are required. Because of this, production may decline very quickly, but only time will tell how quickly and by what amount.

Minerals prices have generally improved over the past year. Molybdenum has nearly doubled from recent lows, but the commodity is still 50% off the 2008 peak. Gold prices continue to set record highs, while coal prices remain the same as in 2009, but are holding strong. Uranium has proven an exception to the mineral sector, and production will remain "asleep" until the price bounces back. Moreover, industrial minerals have been hurt chiefly due to the loss of demand from the construction industry. Once construction rebounds, however, production and prices of these minerals should begin to improve.

Education and Health Services

Continuing its trend from 2009, the Education and Health Service (EHS) Sector remains one of the few bright spots in the Colorado economy for 2010. Year-over-year employment is up 4.6% from April of last year and now stands at just over 260,000 employees. Recently, two overriding factors appear to have bolstered the apparent immunity of this sector from the tremors of the Great Recession. First, Colorado's aging population (the number of citizens in older age cohorts is growing) has placed higher demand on healthcare services, and jobs have chased this demand. Second, the strong movement of people returning to training programs and higher education institutions to retool their skill set has boosted employment on the education side. The expanding menu of educational options to pursue (e.g., the University of Phoenix and other online degree programs) is only helping to strengthen this second factor.

Elizabeth Garner, Colorado Department of Local Affairs, and Patty Silverstein, Development Research Partners.

Joe Winter, Colorado Department of Labor and Employment, and Gary Horvath, Business Research Division.

While the Education Sector may soften in terms of employment once a full recovery is reached, the momentum of the healthcare sector is expected continue well into the future. The expanding Anschutz-Fitzsimons Medical Campus facilities and the addition of two new hospitals to the St. Anthony Medical campus indicate the vitality of this sector. Signs such as these suggest that the healthcare sector's expansion is unlikely to slow anytime soon, and that EHS employment growth is not expected to subside in the short term.

Manufacturing

Manufacturing is continuing to shed workers—a trend that began at the start of the decade. Manufacturing employment fell 10% in 2009, and this year employment has already dropped nearly 7% year over year. Surprisingly, the U.S. exchange rate advantages did not translate into greater goods exports for Colorado. Food and beverage manufacturing exhibited the greatest resilience in the recession, with nearly all other manufacturing posting declines.

Fabricated metal manufacturing and computer and electronics manufacturing are examples of sectors that are sustaining employment losses. The nonexistent demand for construction materials is greatly affecting metal manufacturing. Companies like HP have scaled back their investments in computer and electronics manufacturing in the state.

On the other hand, renewable energy continues to be a growing cluster in Colorado and is forecasted to add employment in manufacturing. Although renewable energy technology, such as wind and solar, creates jobs, the numbers will not be enough to offset other manufacturing losses.

Trade, Transportation, and Utilities

There is no way to sugarcoat the outlook for the Trade, Transportation, and Utilities Supersector—the overall outlook is quite bleak. It has now been 29 months since employment in the sector peaked in December of 2007, at 445,000 jobs. As of April 2010, employment totals stand at 393,000, a decline of 11.8%. Unfortunately, this pattern is consistent with Colorado's track record of underperformance compared to the nation.

Both retail and wholesale trade have slid during 2010, but wholesale trade has been hit the hardest. Wholesale trade's employment, at 88,900 workers, is down 5.2% year over year, and remains 11.7% below its peak in May of 2008. While year-over-year employment numbers are up 1.8% for retail trade, the current estimated total of 239,000 employees is still 6.8% below the sector's highest level recorded in December of 2008. On a positive note, consumers are showing some signs of life, with growing retail sales and improving consumer confidence.

With an estimated 56,900 transportation workers, total sector employment is 0.8% below the total at this time last year, but there are some encouraging signs of recovery. In May, United Airlines made a major $3B stock deal for Continental Airlines, making the conglomerate the world's largest air carrier. Local impacts, including the effects on access and prices, are unclear. Additionally, passenger traffic data at DIA are encouraging, with nearly 16M passengers for the first four months of 2010—an increase of 3.7% over the same period of 2009.

The recession has also softened employment in Colorado's utilities industry, down 1.2% from last year. Xcel Energy has introduced a two-tier summer energy pricing system for the first time in Colorado, whereby residential consumers will pay 9.8 cents for their first 500 kilowatt-hours and 14.3 cents for each additional kWh consumed above that threshold. Additionally, Xcel is also planning on decommissioning a number of coal power plants. While these projects will help aid Colorado's transition to a cleaner energy economy in the long term, the economic investment in these projects are unlikely to have a noticeable impact on the state's industry for a few years to come.

Leisure and Hospitality

Travel to Colorado rose for the sixth-straight year in 2009, a 1.1% increase from

Midyear participants Tim Lipetzky, Colorado Department of Agriculture; Pam Reichert, Colorado Office of Economic Development and International Trade; and Brian Lewandowski, Business Research Division.

2008, according to a study conducted by research consulting firm Longwoods International. Spending in the state, however, fell 11%. Among leisure travelers, overnight trips in the state rose 3%. However, overnight business travel to Colorado fell 13% from 2008. In the transportation segment, passenger traffic data at DIA recorded nearly 16M passengers for the first four months of 2010—a gain of 3.7% over the same period of 2009.

Skier visits for the 2009-10 season were up approximately 0.8%, to an estimated 11.9M skier visits, as reported by Colorado Ski Country USA (CSCUSA), the state's ski industry trade group. International visits to CSCUSA member areas (which does not include Vail Resorts) climbed around 6.5%. Colorado is the top overnight destination for ski trips, with a 1.6M overnight trips in 2009.

With the summer travel months now upon us, the big question is: How will visitors behave in terms of overnight stays and spending? Given moderate gas prices, greater stability in the markets, business spending on the rise, and a rebound in consumer confidence, projections are that this year will be a vast improvement for Colorado tourism.

Information

Information Sector job losses totaled 2.6% in 2009, attributable to sharp declines in publishing (-9.4%) and software (-8.2%). Telecom added jobs, albeit at a decreasing rate through the year, ending 2009 with a 2.9% increase. Overall, strength in telecom and only moderate declines in film caused the sector to perform better than expected in 2009.

With job losses mounting in the first half of 2010, there are no indications that the Information Sector has turned the corner. Through April, year-over-year losses were averaging nearly 4,000 jobs, or 4.5%. Half of these losses come from continued evaporation of print publishing, and the other half is attributable to a lagging slide in telecom. The merger of Qwest and CenturyTel will certainly result in more telecom job losses in the state, though the impact should be deferred until 2011. Many Qwest jobs will remain in the state servicing infrastructure—it is the corporate, high-wage jobs that will likely be relocated. Separately, funding for rural broadband development programs should begin flowing into Colorado next month.

Overall, software employment losses have been significant in the first half of 2010, but they are also an improvement over the sharp declines in 2009. Venture capital has slowed in the state, and many local firms are acquisition targets. In addition, software sales have been damaged by the lack of business investment.

Film, on the other hand, has held its own over the past year, showing only modest declines. Indications are that production is picking up nationally and in Colorado. In the first half of the year, the Colorado Film Commission completed contract processes for three film incentive applications, and is working with others. Like tourism, film productions bring direct out-of-state spending into Colorado.

Other Services

The Other Services Supersector includes companies that provide personal services and nonprofit organizations. Average monthly employment for the first four months of 2010 is down about 200 jobs, or 0.2%, compared to last year. Because many of the workers in this area provide essential services, such as funeral, auto, and appliance repair, employment has declined at a lower rate than in other areas. Anecdotal evidence suggests that most nonprofit contributions are down compared to prior years; however, many groups have reported giving from a larger number of individuals. With continued improvement in the economy, the sector may post a slight employment gain for the year.

CONTINUED ON PAGE 6

Midyear Economic Roundtable Participants

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SECTOR HIGHLIGHTS, CONTINUED FROM PAGE 5

Summary

Job losses have continued into the first half of 2010, hitting Construction, Professional and Business Services, as well as Trade, Transportation, and Utilities, hardest in terms of number of jobs losses. Government and Education and Health Services were the only employment-advancing sectors in the first four months of 2010. However, in the second half of the year, more sectors will come into positive territory, with overall employment recording monthly gains beginning in the third quarter. By year-end, Construction and Manufacturing (two goods-producing sectors) will be a drag on growth in the services-producing sectors, leaving the state with a net employment loss for the annual average.

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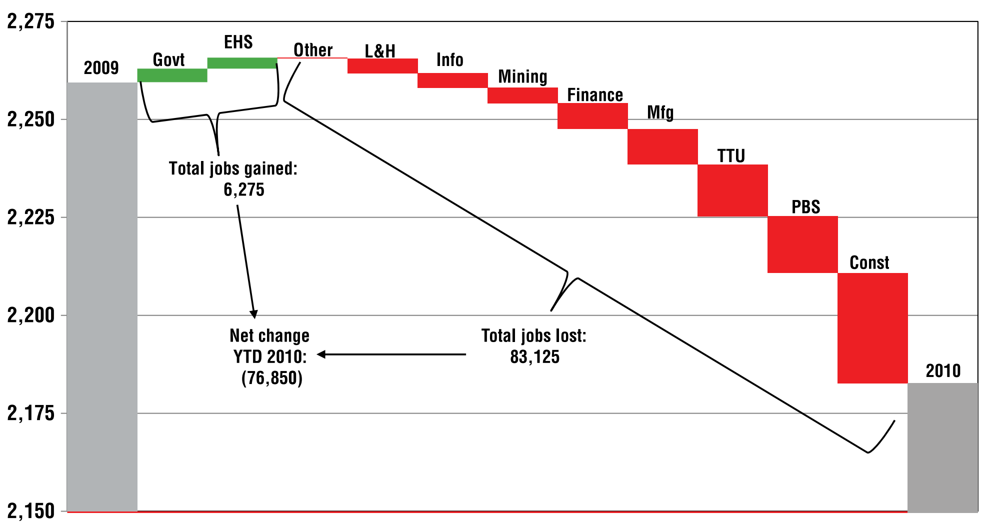
Change in Average Employment January through April 2009 v 2010



Source: Bureau of Labor Statistics.