

# Michiana Business®

## 2005 NATIONAL REVIEW

The national economy fared decently in 2005. Output, measured by GDP, grew approximately 3.5 percent, which was slower than in 2004. The economy showed particularly lackluster performance at the end of the year. GDP expanded only 1.1 percent in the fourth quarter of 2005 due to drops in investment, consumer spending, and government expenditures.

Employment in the United States grew by over 2.5 million jobs in 2005. The unemployment rate averaged 5.1 percent across 2005 – despite the significant disruptions to regional employment caused by the hurricanes along the Gulf Coast. In December 2004, the unemployment rate was 5.1 percent but by December 2005 that rate had fallen to 4.6 percent

Inflationary pressures were more evident in 2005 than in 2004. This was likely to be expected as the economy continued to expand and continued rising energy costs began to contribute to upward pressure on some prices of goods and services. The Consumer Price Index (CPI) rose 3.4 percent in 2005, compared to 2.7 percent in 2004. The price level dropped in November and December as energy prices fell, at least temporarily.

Interest rates continued to climb steadily over 2005. The Federal Reserve raised rates approximately 14 times since June 2004 to head off inflationary pressures from an expanding economy. In January 2005 the average Federal Funds Rate was 2.25 percent, and by December 2005 that rate had almost doubled to 4.25 percent. These Federal Reserve controls were reflected in interest rates throughout the economy, exemplified by the prime rate rising from approximately 5.25 percent to over 7

percent in 2005. These steady, expected rate increases contributed in part to the slowdown in consumer spending and investment.

## 2006 NATIONAL OUTLOOK

Expect a similar looking economy in the year ahead. 2006 will likely resemble 2005 in many respects. The economy should continue to expand at a similar pace. Output is predicted to grow by approximately 3.3 percent. This growth rate may be tempered if spending continues to grow cautious, housing values weaken, energy costs grow more volatile and trend upward, and interest rates rise or at least become more uncertain.

Employment will expand in 2006 but at a slower pace than in 2005. Less than 2 million new jobs are expected to be created in 2006. Unemployment rates will hover around 5 percent in the coming year, near the range for 2005. One positive sign is the low unemployment rates in the first couple months of the new year: 4.7 percent in January and 4.8 percent in February. However, the unemployment rate is mildly climbing from the 4.6 percent rate in December 2005.

Inflation will continue to creep up in 2006 but less quickly than in 2005. The Consumer Price Index will likely increase around 3 percent in 2006, assuming energy costs will gradually stabilize. The CPI in January 2006 was 0.8 percent higher than in December 2005 and 4 percent higher than in January 2005. This early jump in prices was due in part to the short-lived reduction in energy prices in late 2005.

The projected trend in interest rates may be more uncertain in 2006. The economy has not experienced significant levels of inflation as the economy has expanded in recent times, and the change in Federal

Reserve leadership may make policy predictions less certain for awhile. The Federal Reserve raised the Federal Funds Rate in January 2006 to 4.5 percent but implied that it may not continue its steady rate increases of the past year and a half. It is also suggested that the current rate is near the “neutral rate” – a rate which does not unduly influence behavior in the economy and is associated with price stability and economic growth.

Several unresolved issues may affect the economy's performance in 2006. These include any substantive changes in the Federal Reserve's monetary policy, unexpected fluctuations in energy prices, significant devaluation of real estate and other assets, the impact of recent restructuring in the automobile industry, and ongoing low saving rates.

## 4<sup>th</sup> QUARTER SUMMARY

The Michiana region's economy ended the year with little change from the previous quarter. Employment indices and unemployment rates remained fairly constant, while housing activity grew more volatile and industrial electricity usage and labor demand showed mixed signs across the region. The table on page 2 reports regional economic indicators for October through December of 2005. The graphs on pages 2 and 3 show trends in regional economic indicators from January 2004 to December 2005. (Note that these data are for seasonally adjusted indexes and not unadjusted levels.)

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Michiana Economic Indicators

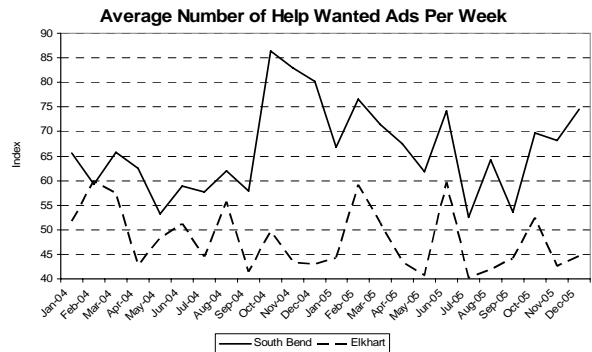
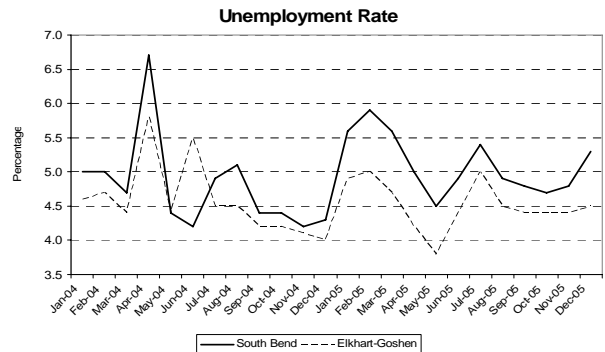
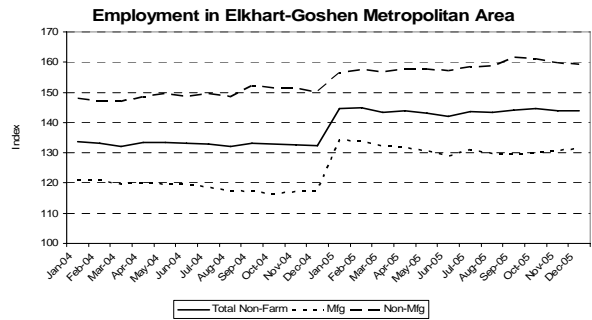
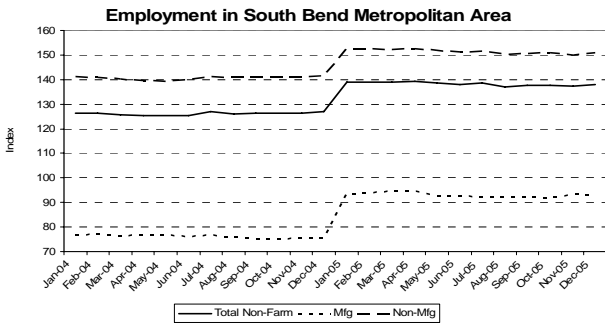
		2005			
		October	November	December	Monthly Average
South Bend	Employment <sup>1</sup>				
	Total non-farm Index	137.7	137.2	138.0	137.6
	Manufacturing Index	92.1	93.2	92.7	92.7
	Non-manufacturing Index	150.8	149.9	151.0	150.6
	Unemployment rate	4.7%	4.8%	5.3%	4.9%
	Help Wanted Ads Index <sup>2</sup>	69.8	68.2	74.6	70.9
	Industrial Electricity Usage Index	111.3	103.0	107.9	107.4
	Single-Family Housing <sup>3</sup>				
	Total Value of New Permits Index	113.3	86.8	65.5	88.5
	Number of New Permits Index	188.8	182.0	126.3	165.7
Average Value of a New Permit Index	160.8	208.0	184.6	184.5	
Elkhart-Goshen	Employment <sup>1</sup>				
	Total non-farm Index	144.5	144.0	143.9	144.1
	Manufacturing Index	122.9	130.8	131.5	128.4
	Non-manufacturing Index	161.2	159.9	159.2	160.1
	Unemployment rate	4.4%	4.4%	4.5%	4.4%
	Help Wanted Ads Index <sup>2</sup>	52.4	42.5	44.7	46.5
	Industrial Electricity Usage Index	68.3	67.0	65.2	66.8

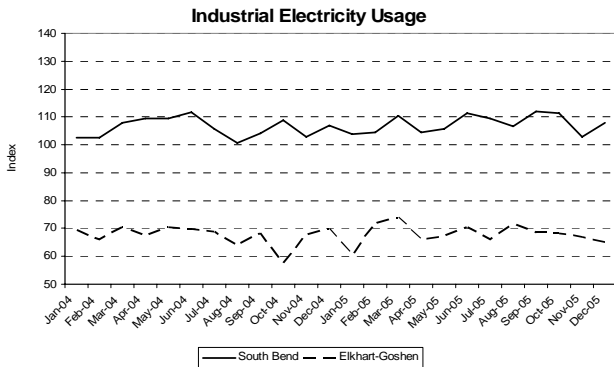
Notes: All figures except for unemployment rates are seasonally adjusted indexes with a base year of 1986=100 using the U.S. Bureau of the Census X11DR seasonal adjustment program.

<sup>1</sup>For South Bend and Elkhart-Goshen metropolitan statistical areas, respectively.

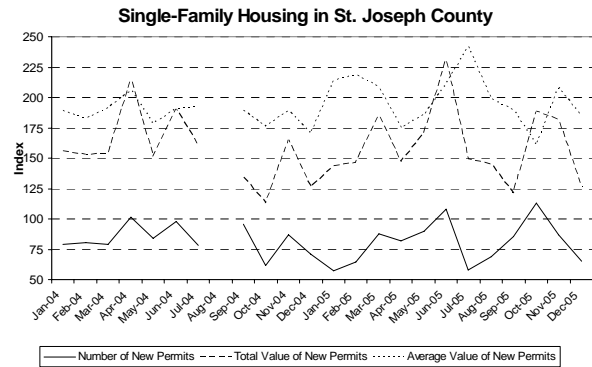
<sup>2</sup>Based on ads listed in the *South Bend Tribune* and *Elkhart Truth*, respectively.

<sup>3</sup>For St. Joseph County; housing data unavailable for Elkhart County.





\*Data unavailable for November-December 2004



\*Data unavailable for August 2004

In the South Bend metropolitan area, employment changed little, though positively, at the end of 2005. Total non-farm employment rose only 0.2 percent from October to December 2005. Employment rose in both the manufacturing and non-manufacturing sectors, with the largest gain in manufacturing. Over the fourth quarter of 2005, manufacturing increased 0.7 percent and non-manufacturing rose by a mere 0.1 percent.

Unlike in many recent quarters, the Elkhart-Goshen metropolitan area fared worse at the end of 2005 compared to South Bend-Mishawaka. The Elkhart area saw employment decline due to a mild drop in non-manufacturing employment. Total non-farm employment in the fourth quarter fell by 0.4 percent. Manufacturing employment expanded by 7 percent, largely due to continued growth in the RV and manufactured housing sectors caused by increased demand for temporary housing connected to the earlier hurricanes. Non-manufacturing employment, on the other hand, fell by 1.2 percent – in part due to increasingly cautious consumer spending during this period.

As in the rest of the year, the region's unemployment rates in the final quarter of 2005 remained at or below the state and national rates. The unemployment rate in South Bend continued to fall in October and November but jumped considerably in December, ending the year at 5.3 percent – equal to the rate in Indiana but exceeding the national rate of 4.6 percent for that month.

Despite its employment downturn, the unemployment rate in the Elkhart-Goshen metropolitan area remained relatively low compared to South Bend. The unemployment rate remained the same throughout October and November at 4.4 percent and barely nudged up in December to 4.5 percent. The average monthly unemployment rate in the fourth quarter of 2005 was 4.4 percent in Elkhart-Goshen and 4.9 percent in South Bend.

Demand for labor, based on employment ads in local newspapers, varied across the region from October to December. This coincides with the differing trends in employment during the same period. From October to December, the South Bend area saw ads in the *South Bend Tribune* increase solidly by 6.9 percent, while the Elkhart-Goshen area saw ads in the *Elkhart Truth* drop by a substantial 14.7 percent.

For the first time in 2005, industrial electricity usage in the Michiana region decreased in the fourth quarter of 2005. Industrial electricity usage fell 3.1 percent in South Bend from October to December and 4.5 percent in Elkhart. Despite growth in manufacturing across the region, these declines may reflect adjustments by industry to rising energy costs and lower consumer demand for many goods and services during this period.

Activity in the new housing market slowed down substantially in the fourth quarter of 2005. The number of new building permits for single-family dwellings issued each month fell by a

substantial 42.2 percent between October and December. The most significant decline occurred in December. The total value of new permits reflects this drop in the number of permits. The total value of new housing permits decreased 33.1 percent over the fourth quarter of 2005, but the average value of a new housing permit rose 14.8 percent. This provides evidence that the strong real estate activity seen in recent times is likely tapering off, at least in the residential segment of the market.

Based on these indicators, the Michiana economy faced a somewhat stagnant performance at the end of 2005. Employment showed only minor signs of gain in South Bend and mild losses in Elkhart; unemployment rates ended the year at higher levels; industrial electricity usage as an indicator of production decreased; and new housing development decreased in terms of numbers and value. The next issue of *Michiana Business* will report on the performance of the regional economy during the first quarter of 2006.

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For information, contact the BBER at 574-520-4133.

## Federal Reserve Seminar

The IUSB School of Business and Economics will host a free seminar by Jerry Nelson on the Federal Reserve and monetary issues. Mr. Nelson is a public affairs specialist at the Chicago Federal Reserve Bank. This informational seminar, targeting students, will focus on the functions of the Federal Reserve, the money supply, the national debt, and the role of the FDIC since the early 1980s.

**Date:** Tuesday, April 4, 2006  
**Time:** 7:00-8:30 PM  
**Location:** Room 223, Student Activities Center, IUSB campus

### **Michiana Business**

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