GEORGIA BUSINESS AND ECONOMIC CONDITIONS

GBEC

VOLUME 64, NUMBER 4 • THE UNIVERSITY OF GEORGIA • FOURTH QUARTER 2004

Georgia's economic outlook for 2005

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Despite slowly rising employment, Georgia's economic growth will be relatively uninspired in 2005. The gross state product (GSP)—the inflation-adjusted sum of goods and services produced within Georgia—will increase by only 3.2 percent, which is lower than the 3.8 percent advance in GSP estimated for 2004. This marks Georgia's fifth-straight year of sub-par GSP growth.

Many of the forces underlying the slowdown in Georgia and in the U.S. are the same: rising interest rates; dwindling federal fiscal stimulus; and overextended consumers. Nonetheless, there are several short-term developments that will make it difficult for Georgia's economy to grow substantially faster than the U.S. economy in 2005. For example, because businesses rather than consumers will power economic growth in the coming year, the anticipated slowdown in consumer spending reduces the prospects for above-average growth in places like Georgia where the industrial base is consumer-oriented. Another problem is that several of the state's largest employers are not doing very well. It will be difficult for small and medium-sized companies to grow fast enough to compensate for sluggish or declining activity of corporate giants.

A slowdown in new construction activity in Atlanta also will make it difficult for Georgia to outperform the nation in 2005. Atlanta is the nation's largest home building market, and higher mortgage rates therefore are likely to affect the metro economy more than the national economy. Atlanta's 23 percent office vacancy rate—one of the nation's highest—also limits immediate prospects for new nonresidential construction. Compounding this particular problem is a glut of unoccupied industrial space.

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Georgia's concentration of federal employment and high dependence on federal spending implies that the gradual tightening of the federal purse strings will slow growth here more than it will in the nation as a whole. Also, the next round of base closing and realignments will be announced in late 2005, and the state's 13 bases are susceptible; therefore this threat makes the overall business climate in a number of Georgia's cities much more tentative than normal.

Employment

Hampered by large IT, air transportation, hospitality, and manufacturing clusters, Georgia's labor market was bludgeoned by the recession, and it will take all of 2005 to recoup the losses. On an annual average basis, the state's nonagricultural employment will rise by 1.5 percent in 2005, which exceeds the 1.1 percent increase estimated for 2004. Total employment will climb by 57,800 jobs, from 3,900,700 jobs in 2004 to 3,958,500 jobs in 2005, while the

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unemployment rate declines from 4 percent to 3.8 percent over the same period. The lower unemployment rate reflects both job creation and an unusually high proportion of discouraged people who have stopped looking for work, and therefore are no longer counted as unemployed.

In 2005, year-over-year employment gains will be shared by service-producing and goods-producing industries, which will increase by 1.7 percent and 0.6 percent, respectively. The broadening of the expansion to include more industries and more occupations will be one of the main distinctions between the 2005 economy and the 2004 economy. Of the four business clusters that took direct hits in 2001, only air transportation will still be in trouble. In contrast, both IT and hospitality will be major sources of job creation in 2005, and the manufacturing "depression" will have ended.

Services-Producing Industries

Professional and business services will create 27,700 jobs—more than any subsector. The expansion of corporate profits, rising markets for most goods, the expense of maintaining in-house experts, and the ever-increasing complexity of business operations are the primary forces behind the projected 5.4 percent increase in employment. Surging export markets also will stimulate demand for businesses that provide services to Georgia's export-oriented companies. Meanwhile, private firms that provide education and health care will add 11,800 jobs, prompted by above-average population growth and favorable demographic trends that spur demand for these basic and increasingly essential services.

The leisure and hospitality cluster did very well in 2004 and will do even better in 2005. Employment will grow by 3 percent, or 11,100 jobs, and most hotels will see a boost in occupancy rates. Restaurants will see moderate increases in overall sales, powered by population growth, more business activity, more tourism, more choices, and healthier menus.

After some extremely difficult years, characterized by relentless layoffs and bankruptcies, information services companies are hiring. After inching up by 0.2 percent in 2004, employment will accelerate by 1.9 percent in 2005 (but the pace would be even higher if not for large productive gains). The upturn reflects that fact that the industry has addressed most of its overcapacity issues and demand is surging for a broad range of service offerings. Demand for DSP and broadband connections will grow extremely rapidly. Mobile telecom services will be a major source of revenue growth, and the transformation potential of the wireless Internet is just beginning to be felt. Despite these generally favorable trends, however, it will be several years before employment in information services fully recovers from the 2001 recession.

Financial services companies will hire 4,000 additional workers. Banks that cater to business customers especially will need more personnel to handle the growth in demand for commercial and industrial loans, and more active capital markets. In contrast, softer conditions in the housing market and slower growth in consumer spending for durables will temper hiring at community banks. The soft residential and nonresidential real estate markets will reduce hiring by real estate firms.

Total employment in government will expand by only 0.6 percent, or 3,800 jobs. Virtually all of the new jobs will be with local governments, where a heavy dependence on property tax collections provides a solid boost to revenue collections. Intense budgetary pressures will cause a drop in state government employment. The federal government also will not be a source of new jobs in 2005.

The trade (wholesale and retail), transportation, and utilities grouping will lose jobs for a fifth-straight year. Most of the losses will be in the air transportation sub-sector, reflecting Delta Air Lines' plight. In contrast, cyclical increases in demand and increasing volumes of cargo moving through Georgia's deepwater ports will generate new jobs in Georgia's trucking industry. Hiring will be strongest as less-than-truckload and short-haul carriers than for truckload and long-haul carriers. Retailers, meanwhile, will see both top-

GEORGIA BUSINESS AND ECONOMIC CONDITIONS

Fourth Quarter 2004
Volume 64, number 4

SELIG CENTER FOR ECONOMIC GROWTH

GEORGIA BUSINESS AND ECONOMIC CONDITIONS (ISSN 0297-3857) is published quarterly by the Simon S. Selig, Jr. Center for Economic Growth, Terry College of Business, The University of Georgia, as a service to the business and academic communities. Signed articles reflect the author's opinion but not necessarily those of the Selig Center for Economic Growth, Terry College of Business , or The University of Georgia. This publication is sent free of charge upon request.

Manuscripts and letters to the Editor should be sent directly to us. **Postmaster** send address changes to: Selig Center for Economic Growth, Terry College of Business, The University of Georgia, Athens, GA 30602-6269.

Periodicals postage paid at Athens, Georgia

and bottom-line growth, but productivity gains and competitive restructuring will temper job creation. Employment in the utilities sector probably will be stable.

Goods-Producing Industries

From December 1998 through September 2004, Georgia lost 100,000 manufacturing jobs, or nearly one out of every five factory jobs. But now they are beginning to regain some footing, and expect to create an annual average 5,400 manufacturing jobs. Although the projected gains are meager compared to jobs that have already been lost, they are a distinct change from years dominated by plant closings and layoffs. Somewhat less excess capacity in many manufacturing subsectors, decreased competition from imported goods—due to the weaker dollar, the continued migration of auto manufacturers and parts suppliers to the state and region, and rising export markets for many manufactured products are four primary factors behind the turn in manufacturing employment. Even as demand for factory goods accelerates, gains in manufacturing productivity will tend to limit employment growth, however.

Overall spending on new nonresidential construction probably will increase, but the gains will come off an extremely depressed base. Developers saw the bottom of the cycle in 2004, but extremely high vacancy rates coupled with limited demand growth will limit office and industrial construction. Also, rising interest rates and the increasing appeal of the stock market will reduce investors' interest in both residential and commercial real estate. With many construction projects still on hold, construction employment will drop by 4,000, or 1.4 percent.

As mortgage rates climb, there will less new residential construction. The 2005 housing forecast calls for permits authorizing 9.7 percent fewer new homes. The slide in multi-unit residential construction is much steeper: 36 percent fewer units will be authorized in 2005. In contrast, the recent high levels of sales of new and existing homes coupled with recent appreciation in the values of homes will support higher spending on home renovations and repairs.

Prospects for MSAs

Atlanta On an annual average basis, the twenty-county Atlanta MSA will add 23,700 jobs, a year-over-year increase of 1.7 percent that is only slightly larger than the 1.5 percent gain predicted for the state as a whole. Atlanta's high concentration of services-producing industries and its very

TABLE 1

GEORGIA'S GROSS STATE PRODUCT, 1990-2005, IN CURRENT AND CONSTANT (2000) DOLLARS WITH YEAR-TO-YEAR PERCENTAGE CHANGES (billions of dollars)

			Percentage Change from Previous Year	
Year	Current $	Constant (2000) $	Current $	Constant (2000) $
1990	141.4	164.8	4.8	1.2
1991	148.7	167.2	5.2	1.4
1992	160.8	175.6	8.1	5.1
1993	172.2	183.2	7.1	4.3
1994	187.6	195.3	9.0	6.6
1995	203.5	206.4	8.5	5.7
1996	219.5	219.5	7.9	6.3
1997	235.7	231.8	7.4	5.6
1998	254.9	246.0	8.1	6.1
1999	276.5	261.5	8.5	6.3
2000	295.5	274.9	6.9	5.1
2001	299.9	273.9	1.5	-0.4
2002	309.2	277.7	3.1	1.4
2003	323.8	285.8	4.7	2.9
2004	343.8	296.6	6.2	3.8
2005	361.6	306.1	5.2	3.2

Source: Data for 1990-2001 were obtained from the U.S. Department of Commerce. Data for 2002-2005 were obtained from the Selig Center for Economic Growth, Terry College of Business, The University of Georgia (September 13, 2004).

low concentration of manufacturing and government jobs (the lowest in the state), partially explains the slightly above-average growth. Factors that will hinder growth are the continuing downturn of Atlanta's large air transportation industry and limited prospects for employment gains at several major companies.

Albany After five consecutive years of job losses, Albany's labor market improved in 2004. Many of the new jobs were in education, health care, professional services, and business services, and the forecast suggests the area will see additional improvement in 2005.

Nonagricultural employment will rise by 1 percent, or 600 jobs. But Albany is the state's smallest MSA, so the actions for the better or for the worse by one major company probably will determine the area's actual economic performance. Also, Albany's long-term outlook could be significantly impacted by the BRAC. Still, Albany will capitalize on its many assets, including a low cost of doing business, an excellent telecommunications infrastructure, reputation as a good place to raise a family, and the area's low crime rate.

Athens This MSA has the largest share of government jobs in the state. Since a large proportion of spending and employment at the University of Georgia is tied to state appropriations, an upturn in university-related spending will severely lag the overall macroeconomic cycle. Thus, employment growth rates will be modest relative to the rest of the state and the nation. Unfortunately, other sectors of the local economy will not absorb the slack created by a heavy dependence on government spending, so employment will not rise appreciably in 2005.

Augusta Now fully recovered from the repercussions of the 2001 recession, employment is hefty in the services-producing industries, notably health care, private education, hospitality, and financial services. Federal government employment also expanded vigorously. The area continued to lose manufacturing jobs, however. The 2005 outlook calls for continued gains in these industries and more stability in manufacturing. Augusta therefore will see a 1.6 percent increase in total employment, which represents about 3,300 new jobs. Moreover, the presence of the Medical College of Georgia is a major advantage in the plans to establish Augusta as a center for the rapidly growing biotechnology sector.

Columbus Without an immediate catalyst for above-average growth, employment in this MSA will rise to 120,000, which is still 500 jobs short of where it stood in 2000. Ultimately, the demonstrated commitment of business, government, and residents to business and economic development will reinvigorate the area's economy.

Columbus's skilled labor force is attractive to technology-oriented companies; and in time, the MSA could benefit from successful efforts to move some state government operations out of Atlanta. Fort Benning is by far the area's largest employer and its importance as an economic mainstay will be even more vital as the economy stabilizes.

Macon Despite setbacks in manufacturing, total employment soared to new heights in 2004 and will soar even higher in 2005 with a year-over-year increase of 1.1 percent. Two clusters account for much of the area's growth: transportation, logistics, and warehousing; and financial, business, and professional services. The area's role as a

TABLE 2

GEORGIA'S ECONOMIC FORECAST, 2004-2005

Georgia	2000	2001	2002	2003	2004	2005
Real Gross State Product, Bil of 2000$	274.9	273.9	277.7	285.8	296.6	306.1
Percent change	5.1	-0.4	1.4	2.9	3.8	3.2
Nonfarm Employment (thousands)	3949.3	3943.2	3869.5	3859.8	3900.7	3958.5
Percent change	2.5	-0.2	-1.9	-0.3	1.1	1.5
Personal Income, Bil of $	230.4	239.7	246.2	255.7	273.3	287.0
Percent change	8.6	4.1	2.7	3.8	5.5	5.0
Housing Permits, Total	91820	93859	97523	94900	105300	90500
Percent change	2.5	1.3	4.8	-2.7	11.0	-14.1
Unemployment Rate (percent)	3.7	4.0	5.1	4.7	4.0	3.8

Source: The Selig Center for Economic Growth, Terry College of Business, The University of Georgia, September 13, 2004.

remote bedroom community for the southern portion of the Atlanta MSA is increasingly important, too.

Macon's extensive surface transportation system and its proximity to Atlanta are pluses, as is its strategic location at the intersection of I-75 and I-16. Also, as Atlanta becomes more congested, sites in Macon will become very attractive to both private businesses and state government operations.

Savannah The number of jobs in this coastal MSA is growing twice as fast as that of the state and the nation as a whole, and employment is projected to rise by 3.1 percent in 2005, which is the largest percentage gain predicted for any of the state's metropolitan areas. Its dual personality—that of a major tourist attraction and an extraordinarily successful port—gives it a vibrancy that few other places can match. The city also is a premier destination for national conventions and trade shows, thus convention business will be one of the area's fastest growing economic sectors. ■

TABLE 3

GEORGIA'S EMPLOYMENT FORECAST, 2004-2005

Georgia	2000	2001	2002	2003	2004	2005
Nonfarm Employment[1]	3949.3	3943.2	3869.5	3859.8	3900.7	3958.5
Goods Producing	748.7	715.6	674.8	659.0	660.7	664.9
Natural Resources and Mining	13.7	12.9	12.3	11.9	12.2	12.4
Construction	204.4	204.3	195.9	195.4	201.8	200.4
Manufacturing	530.5	498.3	466.7	451.6	446.6	452.0
Services Providing	3200.6	3227.6	3194.7	3200.9	3240.0	3293.6
Trade, Trans., Utilities	858.0	851.7	832.3	822.8	819.5	808.9
Information	143.5	143.8	131.8	127.0	127.3	129.7
Financial Activities	209.4	211.4	212.8	216.7	221.0	225.0
Professional and Business Services	537.3	527.4	515.8	493.7	507.5	534.9
Education and Health Services	347.3	359.3	372.0	387.1	394.8	406.7
Leisure and Hospitality	332.5	334.7	337.3	349.5	358.2	369.3
Other Services	175.3	188.6	167.9	171.7	175.3	179.0
Government	597.2	610.3	624.8	632.5	636.3	640.1
Percent Change						
Nonfarm Employment	2.5	-0.2	-1.9	-0.3	1.1	1.5
Goods Producing	-1.1	-4.4	-5.7	-2.3	0.3	0.6
Natural Resources and Mining	-2.1	-5.8	-4.7	-3.3	2.8	1.6
Construction	1.9	0.0	-4.1	-0.3	3.3	-0.7
Manufacturing	-2.2	-6.1	-6.3	-3.2	-1.1	1.2
Services Providing	3.3	0.8	-1.0	0.2	1.2	1.7
Trans., Trans., Utilities	2.7	-0.7	-2.3	-1.1	-0.4	-1.3
Information	6.6	0.2	-8.3	-3.6	0.2	1.9
Financial Activities	2.4	1.0	0.7	1.8	2.0	1.8
Professional and Business Services	2.9	-1.8	-2.2	-4.3	2.8	5.4
Education and Health Services	2.5	3.5	3.5	4.1	2.0	3.0
Leisure and Hospitality	2.1	0.7	0.8	3.6	2.5	3.1
Other Services	19.7	7.6	-11.0	2.3	2.1	2.1
Government	1.3	2.2	2.4	1.2	0.6	0.6

[1] Indicates thousands of workers.

Source: The Selig Center for Economic Growth, Terry College of Business, The University of Georgia, September 13, 2004.

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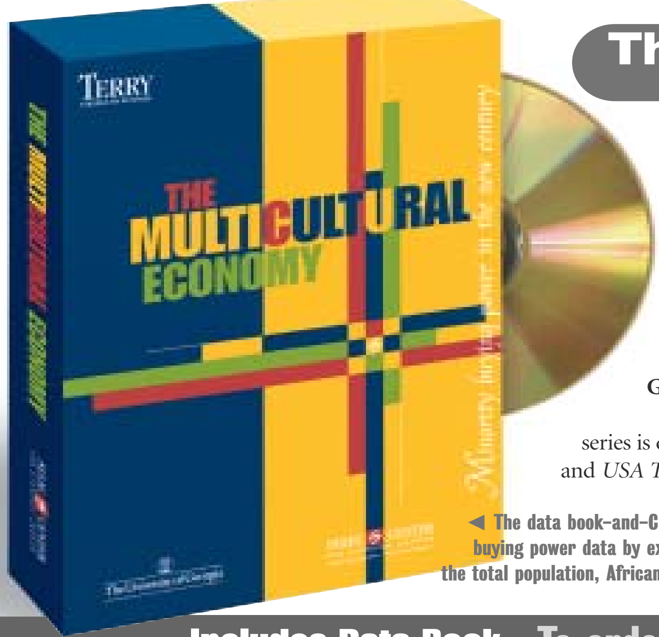

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The National Outlook 2005

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The outlook for 2005 calls for slower growth of inflation-adjusted GDP and slightly higher inflation. GDP will increase by 3 percent in 2005—a full percentage point lower than the 4 percent rise expected for 2004—largely because of a slowdown in consumer spending. Businesses also will make a smaller contribution to growth, although they will account for a substantially larger share of it. The federal government's contribution to, and share of, growth will be smaller as well. Moreover, since job creation over the last several years was too scant to create a vigorous self-sustaining economic expansion, the risk of recession will rise in 2005. There is a 30 percent chance of a double-dip recession in the first half of 2005, but the risk climbs to 40 percent chance if this occurs in the second half of the year.

In addition to more restrictive monetary and fiscal policies, there are other reasons to be circumspect about the economic outlook. The nation's current account deficit and federal budget deficit make the economy increasingly vulnerable to an unexpected financial crisis or economic shock. For example, should Asian investors lose their appetites for U.S. dollar- denominated assets, the dollar's value could nosedive rather than decline gradually, which would severely injure the U.S. economy, domestic interest rates, and asset values. A truly massive overhang of household debt—especially when coupled with a record low savings rate and rising interest rates—also makes the overall economic environment riskier than usual for this stage of the business cycle. Moreover, tight conditions of supply and demand suggest that further oil price shocks are possible. Finally, SARS—or a similar contagion—and terrorism are wildcards for the U.S. and global economies.

Tighter conditions of supply and demand in many commodity markets, the continued depreciation of the dollar, higher unit labor costs, and relatively easy monetary policy will push up core inflation (excluding food and energy) to 2.5 percent in 2005, with the inflation most evident for services. By comparison, core inflation was only 1.5 percent and 2 percent in 2003 and 2004, respectively. The Federal Reserve therefore will continue to raise short-term interest rates throughout 2005. Meanwhile, the federal budget deficit and the current account deficit will exert upward pressure on long-term interest rates.

Nonetheless, there are reasons to be optimistic. Conditions in the nation's labor market will improve as businesses across a broad swath of industries step up their hiring. Businesses are expected to continue to spend aggressively for new productivity-enhancing equipment, too. The high-tech bust is over. The geopolitical risks appear to be lower than they were in 2002-2004. Energy prices are expected to recede from last year's peaks. Spending by state and local governments will rise. Finally, capacity utilization will recover gradually.

Consumer Spending

Despite jobs losses and limited gains in wages and salaries, consumers kept the nation's economy moving. Tax cuts, low interest rates, substantial increases in household debt, rising home values, cash freed-up via the refinancing of home mortgages, greater need for medical care, the recent rally in the stock market, and low prices for manufactured goods are some of the factors that made U.S. consumers economic stalwarts.

In 2005, however, consumer spending will grow more slowly, because job creation and wage and salary growth have not been high enough to create a vigorous self-sustaining recovery. In addition, many people are heavily indebted and very short on savings.

Many of the factors that buttressed consumer spending during the job-loss and job-less phases of the current economic cycle either are reversing course or are less intense. For example, interest rates are now rising rather than falling. The major impacts of the federal tax cuts have already been received. Wealth effects are becoming less powerful as the values of stocks, real estate, and most other household financial assets began to appreciate more gradually. There is also a lack of pent-up consumer demand for durable goods such as new cars.

So, assuming that business leaders step up the pace of hiring, consumers' inflation-adjusted spending will increase by about 2.5 percent in 2005, which is lower than the 3.2 percent increase expected in 2004. Consumers will remain confident, but a stubbornly high unemployment rate will keep them from becoming more optimistic about the current state of the economy.

In 2005, increases in inflation-adjusted disposable personal income will account for most of the projected rise in consumers' spending. The number of jobs is forecast to expand, supporting this income growth. The annual increase in workers' compensation will be larger than in recent years, but fringe benefits rather than wage and salary increases will account for the overall gains.

With many consumers heavily in debt, personal bankruptcies are expected to climb from over 1.6 million in 2004 to almost 1.8 million in 2005. Massive debt, limited appreciation of residential real estate, and lingering uncertainty about the job market are among the factors that will produce a dramatic slowdown in the rate of increase in consumer borrowing. In recent years, high levels of personal debt have not slowed consumer spending, but the situation will be different in 2005. Even though consumer credit outstanding will not rise very much, debt service will rise in tandem with increasing interest rates. Consequently, high levels of consumer debt will be a greater drag on spending in 2005 than in 2001-2004.

Home values rose sharply over the last six years, but prices of new and existing homes probably will climb only slightly in 2005. Nonetheless, many homeowners have seen their housing investments increase in value.These recent gains plus the recovery of the stock market increased the net worth of many households, which boosted outlays by consumers. In 2005, households' net worth will rise much more gradually, providing only slight stimulus to spending.

In the coming year, people will be much less likely to use cash-out refinancing and home equity loans to buy consumer goods. This reflects two developments: first, the pool of eligible homeowners who have not refinanced their mortgages yet is dwindling; and second, mortgage rates already are higher than they were in mid-2003 and are expected to rise continuously throughout 2005. Thus, the push to consumer spending from cash-out mortgage refinancing will be absent, but the ongoing benefits from previous refinancing will keep consumers' wallets open.

Consumers' spending for services will increase much faster than their spending for goods. Among services, spending on medical care, recreation, and personal business services will increase substantially. Among goods, spending for non-durables will grow faster than spending for durables. Outlays for drugs, pharmaceuticals, and used cars will increase briskly. Moderate gains are expected in spending for clothing, shoes, and car parts.

Labor Markets

Despite a potential slowdown in GDP growth, employment will increase as businesses capitalize on pent-up demand for workers. Total non-farm employment will expand by 1.5 percent, and this will be enough to shrink the unemployment rate slightly.

Although net hiring will expand, there are several factors that will ensure that the pickup in job growth remains gradual. First, the anticipated slowdown in GDP growth will restrain hiring. Second, productivity will continue to rise, and GDP will grow only slightly faster than productivity. Third, the outsourcing of U.S. jobs to developing countries will continue to spread from blue-collar occupations in

UNITED STATES ECONOMIC FORECAST 2004-2005

United States	2000	2001	2002	2003	2004	2005
Gross Domestic Product, Bil. of 2000$	9817.0	9890.7	10074.8	10381.3	10796.6	11120.5
Percent change	3.7	0.8	1.9	3.0	4.0	3.0
Nonfarm Employment (Mil.)	131.8	131.8	130.3	129.9	131.1	133.1
Percent change	2.2	0.0	-1.1	-0.3	0.9	1.5
Civilian Unemployment Rate (%)	4.0	4.8	5.8	6.0	5.7	5.5
CPI-U, Ann. % Chg.	3.4	2.8	1.6	2.3	2.8	2.5

Source: The Selig Center for Economic Growth, Terry College of Business, University of Georgia,September 13, 2004.

manufacturing to white-collar jobs in high tech and service industries, which historically have been relatively immune to such practices. Fourth, high and rapidly rising benefit costs make it much more expensive for U.S. companies to hire workers. Finally, venture capital still will not be superabundant, but it will be more available in 2005 than it was in 2001-2004.

In the coming year, employment will rise fastest in the nation's professional and business services. Leisure and hospitality, transportation and warehousing, and health services also will see substantially above-average employment gains. Average growth is expected in information services, wholesale trade, construction, and mining. Below average growth is expected in retail trade, financial markets, and state and local government. Manufacturing employment will end its prolonged decline, but only a few new manufacturing jobs will be created. The manufacturing sub-sectors with the best immediate prospects for job creation include machinery, fabricated metal products, nonmetallic mineral products, and printing. Areas that will continue to shed jobs include apparel, textiles, wood products, beverage and tobacco products, and chemicals. Fewer jobs will be available with the federal government, too.

Corporate Profits

Improving conditions of supply and demand will be the primary driver of corporate profits in 2005. Excess capacity in many industries will continue to diminish,and companies increasingly will be able to raise the prices of the goods that they produce. Moderation of oilprices is another positive sign. Finally, the lower value of the dollar will help bolster sales ofmany export-oriented companies and will help companies producing for the domestic market to compete with foreign rivals.

But there are counterbalances to consider, too. One is rising unit labor costs. The share of national income devoted to profits has been unusually high, and it is expected to diminish as the share devoted to labor income increases. Productivity growth is expected to slow down; and higher interest expenses will curb bottom-line growth. Finally, the expiration of the accelerated depreciation allowance will reduce after-tax corporate profits.

Due to strong growth in profits, American companies are expected to increase both spending and hiring. The business sector therefore will be a substantial contributor to economic growth in 2005. Unfortunately, net hiring will not increase rapidly enough to prevent the slowdown in consumer spending.

Industries expected to see the fastest growth in profits in 2005 include health care,information technology, telecommunications, and financial services companies. Average growth is expected from manufacturers of consumer goods and materials. If oil prices declineas expected, energy companies will see below-average growth.

Business Spending

The sustained pickup in spending reflects strong cash flow, the growth of corporate profits, higher rates of capacity utilization, slightly more confidence in the economy, and better corporate discipline. Higher rates of capacity utilization reflect higher demand, depreciation of the capital stock over time, and recent low levels of capital spending. It also is likely that many companies cut their capital spending budgets too sharply during the recession. Another factor boosting outlays for labor-saving equipment and software will be rising unit labor costs, especially accelerating fringe benefit costs.

The after-tax cost of corporate debt will rise in 2005, but because the modest increase springs from a very low base, it should have little impact on investment in equipment and software. Also, for many companies cash flows will continue to grow faster than the amount of funds they need for investment. One significant negative factor is that changes in federal tax laws that allow more rapid depreciation expires at the end of 2004. Since many companies will have accelerated their 2004 capital outlays to take advantage of "bonus" depreciation, there inevitably will be some payback in 2005.

Overall spending on non-defense capital equipment and software will rise in 2005, but the percentage gain will be smaller than it was last year. The increase in spending, however, will be more broadly based. Spending for computers, transportation equipment, light vehicles, and software will increase the fastest. Spending for industrial equipment and aircraft will grow modestly.

Businesses have kept a tight rein on inventories, maintaining low inventory to sales ratios. As sales rise in 2005, businesses' spending on inventories will increase, which will reinforce GDP growth. The positive contribution to GDP growth will be very modest, however.

Government Expenditures

The federal fiscal policy push will be substantially smaller in 2005 than it was in 2004. Real federal purchases will grow by only 3 percent, compared to a more than 7 percent increase in 2004. The sub-par expansion, tax cuts, accelerated outlays, and the reverberations of the terrorist attacks are making expenditures rise much faster than receipts. The 2005 budget deficit will be more than $300 billion, or just over 2.4 percent of GDP. It is increasingly apparent that, absent changes in tax laws, the budget deficit is structural rather than cyclical. Thus, over the medium- to long-term, large budget deficits will have large adverse side effects on the nation's economic health and prosperity.

Fiscal actions by state and local governments are expected to aid in the nation's economic recovery. Receipts will increase more rapidly than in calendar year 2004, and as revenue collections improve, most jurisdictions will see hiring accelerate and increased discretionary spending on travel, equipment, and facilities. Fewer governments will be forced to lay off workers. Businesses dependent on spending by state and local governments therefore will begin to benefit.

The lagged effects of the recent peaking of both the housing marker and new car sales will make property tax collections rise substantially in most jurisdictions. Personal income tax collections will rise modestly, restrained by limited capital gains, scant use of stock options, and the slow-paced recovery of the labor market. Sales tax collectiions should increase moderately, but corporate income tax collections will spike in most jurisdictions.

Housing Markets

Nationally, sales of both new and existing homes are expected to drop. Also, after several years of strong gains in home prices, the average sales price of existing homes may not outpace inflation in 2005. The downturn in housing can most be attributed to two factors. First, mortgage rates hit their lows for this cycle in the middle of 2003, and rates are expected to rise slowly in 2005. Second, because activity levels were extraordinarily high in 2001-2004, there is virtually no pent-up demand for homes. The motivated buyers who were qualified to buy have taken the bait. The other fundamental determinants of demand for homes—growth in employment, population, personal income, relocation activity, and consumers' confidence—are positive, and will help to shore up demand for homes in 2005.

Several factors will help to support demand for home renovation. Since this business cycle has seen booming sales of existing homes, owners are likely to invest in repairs and improvements. They can readily afford to do this, thanks to appreciating values that have increased equities, and refinancing that has lowered monthly payments. Also, those who bought new homes over the last three years soon may be ready to tackle some home improvement projects—finishing unfinished space, adding exterior decks and structures, or home landscaping.

International Trade

Real exports will increase substantially faster than imports, allowing net exports to make a small contribution to GDP. A weaker U.S. dollar will help exports and deter imports, but trade will not add too much to growth as long as foreign GDP grows more slowly than U.S. GDP. Also, the decline in the dollar's value is most pronounced with respect to the currencies of industrialized countries rather than those of developing countries. Lower oil prices would significantly improve the outlook for trade, however.

In 2005, both imports and exports are expected to rise, and exports will rise much faster than imports. Nonetheless, because the volume of imports is so much greater than the volume of exports, the net effect on trade will be only slightly positive for U.S. GDP growth. The level of imports is almost 50 percent higher than the level of exports, which implies that exports must grow 50 percent faster than imports to reduce the trade deficit. Another problem is that foreign investments in the U.S. are heavily tilted towards portfolio investments and U.S. investments abroad are tilted towards direct investments. Thus, as U.S. interest rates rise, U.S. payments will rise more than U.S. income. Consequently, the already massive current account deficit will rise to over 5.4 percent of GDP, which will be an all time record.

The sheer size of the deficit will continue to weaken the value of the U.S. dollar, but the loss will be gradual, thanks to the dollar's role as a de facto reserve currency and to faster growth in the U.S. than in the rest of the developed world. Nonetheless, the deficit increases the risk that a serious problem for the dollar—and financial markets in general—could develop and spill over into the overall economy.

Inflation

Many of the forces that have held consumer price inflation to a thirty-year low are weakening. Now the signs of reaccelerating inflation are hard to miss: capacity utilization is rising, unemployment is falling, and the dollar is weakening. Inflationary expectations are rising, too. Core inflation (which excludes food and energy) therefore will rise from 2 percent in 2004 to 2.5 percent in 2005.

Despite these trends, there are still significant labor surpluses, and there is still significant excess capacity in many economic sectors. Also, heightened competition for jobs from foreign workers help to will keep the lid on U.S. wages and benefits. The bottom line: businesses will find it only slightly easier to raise the prices of the goods and services they produce, which implies that inflationary pressures will increase slowly rather than dramatically.

The trade-weighted value of the dollar is forecast to decline in 2005, and it will continue to deteriorate for the next several years, which provides a tailwind to prices. The anticipated slowdown in productivity growth also will lead to higher inflation, but current slack capacity will prevent this from happening soon.

The forecast assumes that the Federal Reserve's monetary policy will be biased towards higher interest rates. The monetary stimulus is still huge. Interest rates will be raised unless the pace of growth decelerates sharply. Given the movement toward a more neutral policy, the federal funds rate is projected to be 3 percent by the end of 2005. ■

The biotech industry will continue its rebound in 2005, thanks to rising revenues, promising product lines, and an improved regulatory environment.

Biotech Outlook

Beata D. Kochut

Overall, publicly traded biotechnology firms saw a 16.9 percent increase in product sales and a 32.4 percent jump in revenues in 2003, while net losses dropped significantly. Biotechnology emerged a clear winner in equity markets, too, and the trend continued in the first two quarters of 2004, with major biotech index funds outperforming both the Dow Jones and NASDAQ. As a result, approximately 30 biotech firms are expected to go public by the end of 2004. According to Ernst & Young, the industry is poised for continuing growth in 2005. Experts predict that the industry as a whole will turn profitable in 2008, which will further improve access to capital and stabilize stock prices.

The relatively slow growth in the number of biotech companies, paired with a much faster growth in employment, marks the industry's ongoing consolidation. In 2003, only seven new biotech companies were created in the U.S., bringing the total to 1,473, and the year ended with a net loss of four of the 314 publicly traded firms. Although consolidation is expected to continue in the coming years, the biotech scene is still dominated by small, private firms that are the springboards for research and innovation upon which the big players depend.

In the first two quarters of 2004, stocks and convertible debt comprised the main source (77.2 percent) of biotech financing, with convertible debt's share of funding (31.4 percent) falling significantly compared to 2003 (43.9 percent). Money raised in the Initial Public Offerings jumped from 2.8 percent of financing in 2003 to over 12.2 percent in 2004, with several biotech companies entering the market.

Venture capital is the second most important source for biotech financing. In 2003 venture capital provided 17.4 percent of the total biotech funding, but in the first two quarters of 2004 that share climbed to 21.4 percent. Overall, the industry raised 77.2 percent of its funding from public sources, and the remaining 22.8 percent from private sources, venture capital being the main portion. In addition, partnering deals provided an influx of cash, and the trend is expected to continue.

The average money per deal increased triple-fold in the last decade, with the number of deals rising at a slower pace than the amount of money invested, another sign of the industry's ongoing consolidation. In the first two quarters of 2004, biotechnology investment exceeded the comparable period of 2003 by an impressive 51 percent and 29.4 percent, respectively, and remained basically at the very high level reached in the second half of 2003. Biotechnology followed investment in software companies as the second largest venture capital recipient, and medical devices took the fourth place, following telecommunications.

How Georgia Stacks Up

In terms of the number of biotech firms, Georgia ranks eighth in the nation. The majority of firms are located in the Atlanta-Athens area, although Augusta's biotechnology scene is quickly rising in size and prominence. Atlanta has developed as a center of the biomedicine and medical devices industry, while Athens is focused on genomics and animal science. Augusta, with its thriving medical establishment, banks on medical devices and software. Other biotechnology firms are scattered around the state, attesting to industry boosters' claims that biotechnology can add to the local economies. The fact remains, however, that specialized infrastructure is a must for this continued growth.

Most of Georgia's biotechnology firms are small, and many reside in state, university, or locally sponsored incubators. The shortage of capital, however, forces some of these successful companies to move elsewhere, lured by cash or incentives granted by other states.

In terms of venture capital funding, Georgia's biotechnology and medical devices firms raised over $469 million between 1995 and 2004, with an average deal raising $5.9 million. By comparison, an average deal in California (the industry giant) netted $8.4 million. Compared to the rest of the top 12 biotech states, Georgia ranks ninth in the value of an average 1995-2004 deal, and eleventh in terms of the total sum raised. The state is seventh among the top 12 states in terms of an average amount of money per deal invested in biotechnology firms, and seventh in medical devices, which is a strongpoint.

A closer look at the gap separating industry giants from the rest of the states reveals that biotechnology is still a relatively open field. Although California has about 7 times the number of biotech firms as Georgia, neighboring North Carolina is third—with 88 companies. Georgia, meanwhile, clocks in with 63 firms. Nevertheless, it is important to acknowledge that biotechnology firms tend to concentrate in areas that possess a critical mass of life science research, highly trained labor force, and thriving entrepreneurial environment. On all of these accounts, therefore, California and Massachusetts are well ahead of the rest of the field.

Coveted for its potential to bring in a vast number of well-paid jobs, biotechnology became a priority industry in most states, and most of them today have programs that promote it. In Georgia, statewide leadership has begun to take shape with the Georgia Research Alliance, Georgia Biomedical Partnership, Metro Atlanta Chamber of Commerce, and the Georgia Department of Industry, Trade and Tourism all embracing the bioscience industry as one of their top priorities. Legislative action aimed specifically at this industry has thus far produced a bill to grant tax credits to biotech firms that have jobs that pay more than $1,250 a week. The Georgia Seed Capital Fund, meanwhile, has $1 million in seed money to help qualified bioscience companies, and the Bioscience Facilities Finance Fund provides funding for bioscience research labs. All these steps, although modest in scope, directly address the most pressing needs of the state's bioscience industry, and puts Georgia ahead of many states competing for biotechnology dollars.

Although relatively small, Georgia's bioscience industry stands on solid ground. Major pharmaceutical companies have located their headquarters, sales, research, and manufacturing facilities here, and a large number of companies that provide equipment and supplies to medical and biotech firms are scattered around the state. By the end of this decade, the Georgia Department of Labor projects that employment in bioscience-related fields will increase by 31.8 percent or 6,950 jobs.

Considering its small size, Athens has a relatively high concentration of life science companies. Out of the total of eighteen companies, fifteen are biotechnology firms, including Bioniche, Merial, Wingo, and Abeome, which report employment of at least 25, or sales of $1million. In addition, Noramco, a major pharmaceutical facility is also located in the area. The industry's consolidation has hit home last year, however, when Texas-based ViaGen bought Prolinia, though the cloning company's research staff remains here. Also in Athens, Bresagen Ltd., one of a handful of stem-cell research firms eligible for federal research funds, merged with Cythera, and then with Novocell, a California based mid-stage biopharmaceutical company. Now it is uncertain if the company will remain in Georgia.

Atlanta's bioscience landscape consists of 165 companies, including major employers such as Ciba Vision, Solvay Pharmaceuticals, Immucor, and Theragenics. Industry stars, such as Serologicals, Pharmasset, Atherogenix, and Inhibitex, have garnered national acclaim and highlight Atlanta's 59 biotechnology firms. For example, Pharmasset's drugs targeting HIV and Hepatitis C are expected to hit the market in 2007, and put the company in the black. Moreover, it recently secured a $40 million venture capital investment, a record for the Southeast. Serologicals and Atherogenix have been added to the NASDAQ Biotechnology Index, and Inhibitex recently has gone public.

Although not among the country's hottest biotech metropolitan areas, such as Boston, San Francisco, or San Diego, Atlanta ranks high in the number of life scientists, major biotech companies (public companies, or those with employment of at least 100), and NIH funding. The area is also relatively strong in the number of pharma-biotech alliances. Additional luster would be added if efforts toward hosting the annual BIO Convention in Atlanta are successful. If so, Atlanta will follow Philadelphia, Chicago, Boston, and San Diego, all major biotechnology hubs, as the 2009 host of this most important industry gathering, which is sure to bring vital exposure and interest in Atlanta's and Georgia's life science industries.

In the northern part of the state, Gainesville has attracted four biotechnology and two pharmaceutical companies. Lohman Animal Health, Kiel Laboratories, Merial Select, and Elan Drug Delivery together provide over 600 jobs locally.

Exciting news continues to come from Augusta, where plans developed by the Georgia Medical Center Authority, and the Medical College of Georgia include biosciences incubator space and a biotechnology research park designed to house firms that outgrow incubator space. The $27 million, 94,000-square-foot addition to the Interdisciplinary Research Building is already open for business, and the college's $54 million, 160,000-square-foot Cancer Research Center is expected to be completed by May 2006.

Augusta's strategic approach to fostering a bioscience industry banks on the existing medical establishment to recruit companies and researchers. By providing incubator space for startups and facilities for fledgling companies, Augusta is likely to attract existing companies, grow firms that spin off from the academic research, and keep them in town when they succeed. Augusta's life science scene is centered on major manufacturers, such as Monsanto, Pharmacia, and Pfizer, which together provide over 500 jobs. A small group of biotechnology firms also is located here.

Meanwhile, southern Georgia is becoming a player, too. Pharmaceutical giant Merck & Co. is an important presence in Albany, supplying 500 jobs in the area. Another pharmaceutical firm, Optima Chemical Group, is located in Douglas, and biotech firm Cancer Therapeutics is based in Thomasville.

Specialized medical equipment and supplies manufacturers are located mainly in the metro Atlanta area,but Augusta also has a sizable group of companies. Other locations include Washington, Jesup, Hoschton, and Savannah. Manufacturers making equipment and supplies for medical needs, ranging from electronics to paper and textile companies, are also located in Valdosta, Swainsboro, Macon, and Moultrie. Over all, 84 major manufacturers of devices, equipment and supplies for biomedical and health industries are located in Georgia, and supply 10,834 jobs. ■