

# UM&A MIMME

Winter 2005 Vol. 01

(Memorandum of Industry Momentum and Economics)

*This publication will address economic and industry performance important to Utah and Intermountain businesses, as well as specific industries and sectors of significance to UM&A. We will attempt to include as many national and regional indicators as needed to convey need-to-know information that can assist us in business development and on-going projects. When applicable, we will also wave our own flags of achievement.*

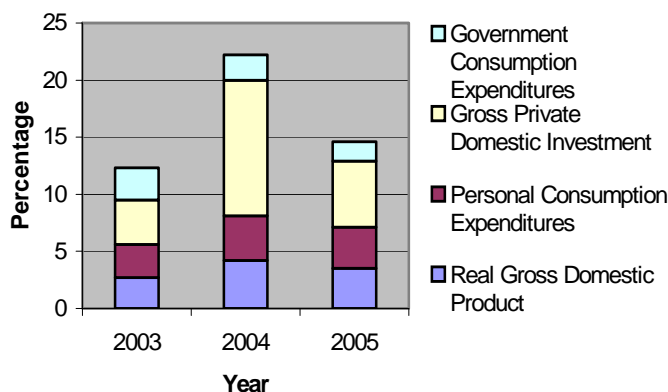
## National News

Growth in the domestic economy slowed to an annual rate of 1.1% in the last quarter of 2005, compared with the previous quarter's brisk 4.1% annual rate. The U.S. Commerce Department indicated this was the slowest pace in three years, and reflected —perhaps portended— some degree of belt-tightening by consumers and businesses. We note the last time the economy grew at such a crawl (0.2%) was in the fourth quarter of 2002, when consumers and businesses were still recovering from the terrorist attacks of a year earlier. Still, at that time the Federal Reserve Board was lowering interest rates and the Federal Government was spending at a record pace. Times have changed, in two respects: one monetary, the other fiscal. This past week, for the fourteenth consecutive time since 2004, the Fed raised its 1) *federal funds rate* (the rate U.S. commercial banks charge each other) another 0.25 percent and 2) *discount rate* (the rate Federal Reserve District Banks charge their member commercial banks) another 0.25 percent. Both are key drivers of short-term interest rates and will affect businesses and retail consumers:

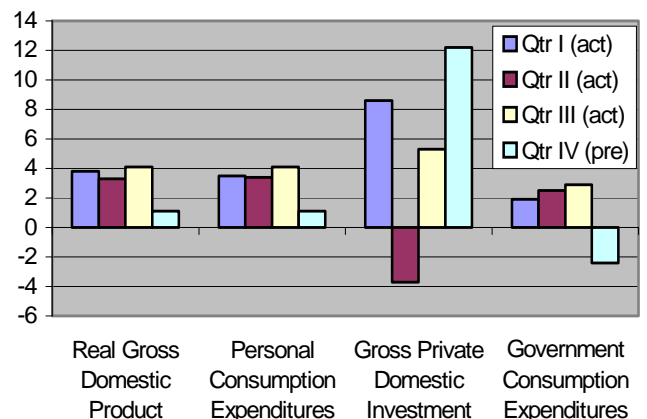
- Discount rate increases are generally passed along by commercial banks to their customers through corresponding rises in their Prime Rates (base rate charged to their best credit risks or valued accounts).
- Interest rates on most credit cards, bank loans and many adjustable mortgages are tied to the Prime Rate; this may slow consumer spending.

Long-term interest rates —which reflect both inflationary expectations and the perceived credit-worthiness of the federal government— have yet to respond to the Fed's monetary tightening, however. The yield on 10-year Treasury notes is still lower now than it was when the Fed began its rate increases, and the Treasury Department has now decided to resurrect its 30-year bond. Considering global economic conditions and who holds these debt obligations, it appears at this time our creditors are watching 1) the Fed's determination to hold down nascent inflation without stifling our economic ramp-up and 2) the Congress's courage in cracking the pork-barrels which have sunk our national budget into deficit waters. In the mid-term of a presidency, challenge #2 is most daunting, even to the bravest of legislators.

Annual GDP & Components Growth



2005 Quarterly GDP Component Growth Rates



## Interest Rate Outlook

Plotting the path of interest rates has been easy since June 2004, when prospects for economic growth were brightening. Interest rates had bottomed, and the Fed was responding to inflationary signs. Its target for the federal funds rate was 1.0%, and was considered to have reached the floor of its range. Today, however, after fourteen upward adjustments, there is a widening consensus the cycle is approaching its end. Respondents to a survey of NABE (National Association for Business Economics) members the last week in January revealed two-thirds believe the Fed will continue to tighten interest rates at its next two FOMC meetings (into April). They cite higher energy and supply-chain prices as drivers of cost-push inflation already in the pipeline. Ignoring last quarter's lackluster 1.1% GDP growth, some anecdotal respondents add the economy has:

- No spare capacity to absorb significant additional demand
- Core inflation (excluding food and energy) approaching the upper part of the Fed's [stated] 1%-2% tolerance zone
- Unemployment rates dropping to a tipping point where there is demand exceeding supply in key industries

In addition, we recognize the new Fed Chairman, Ben Bernanke, has to show toughness as an inflation fighter during his honeymoon period with global central bankers, and the Fed cannot appear to be reactive to global primary materials demand-pull. Both have an impact on eroding the U.S. dollar's purchasing power, weakening bond prices/raising bond yields and wreaking havoc with the dollar.

National Unemployment Trends			
(Seasonally-adjusted, December)	2003	2004	2005
Unemployment Percentage, Full-time	5.8	5.4	4.8
Total Unemployed Workers, 000's	7,009	6,604	5,920
Number Unemployed 27 weeks+, 000's	1,904	1,650	1,350
<i>Source: U.S. Department of Labor/Bureau of Labor Statistics</i>			

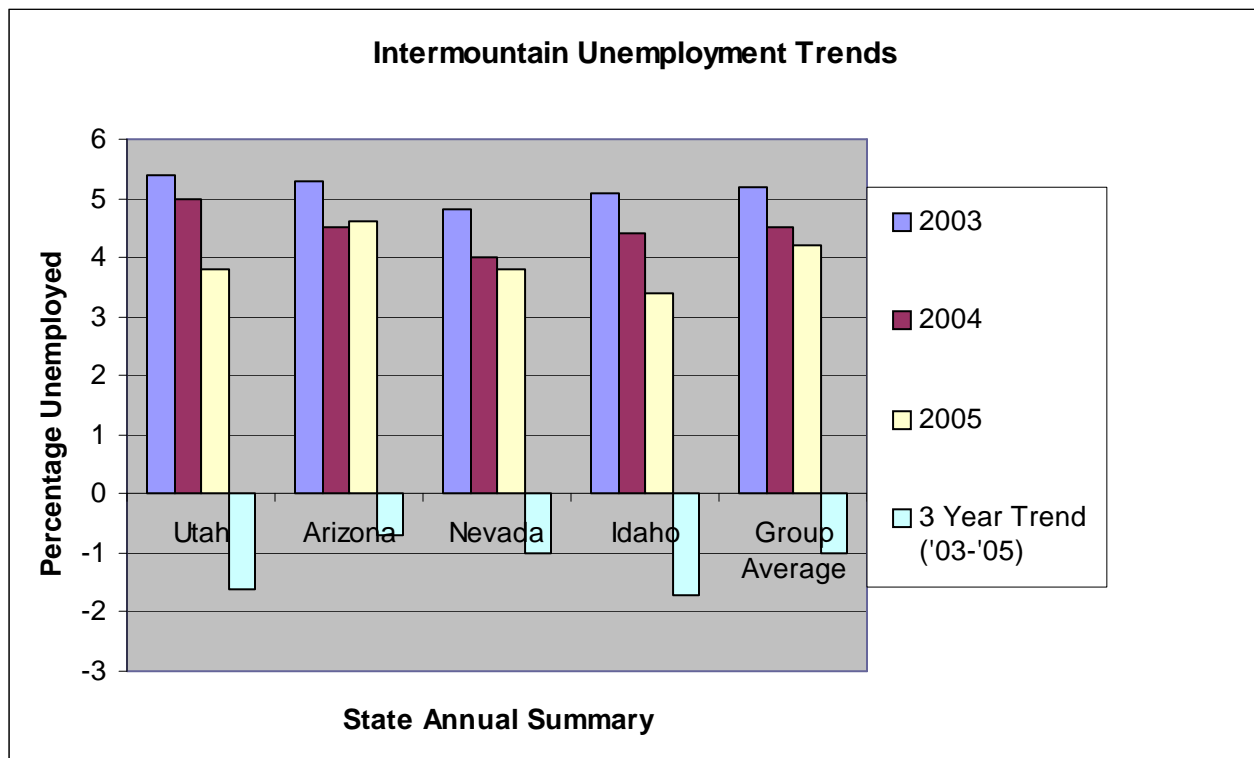
Capacity Utilization in Major Sectors					
<i>Total Industry (percent of plant/equipment capacity)</i>					
	Average	1994-1995	2001-2002	2004	2005
	1972-2004	High	Low	December	December
Total Industry	81.0	85.0	73.9	79.7	80.7
Manufacturing	79.8	84.5	72.0	78.3	79.6
Mining	87.3	89.0	85.6	89.3	84.7
Utilities	86.8	93.7	83.7	85.6	88.1
<i>Source: Federal Reserve Board</i>					

## Utah and Regional Issues

During the last twelve months, Utah's economic growth has —along with leading pace-setters in the Intermountain region— led the nation, as measured by employment gains. Nevada ranks #1, Arizona #2 and Utah/Idaho alternated #3-4 during the period. Utah's economy added 42,000 net new jobs, a gain of 3.6%, while its unemployment rate dropped to 4.0% in December 2005. This is the strongest performance since 1996 (considered the middle of the last economic expansion), when Utah added nearly 47,000 jobs. All eleven major employment sectors participated:

NET NEW	UTAH INDUSTRY SECTORS	Y-O-Y GROWTH
10,000	Construction	12.8%
7,800	Professional & Business Services	5.5%
6,800	Trade, Transportation & Utilities	3.0%
4,700	Education & Healthcare	3.7%
3,100	Government (Federal, State, Local)	1.5%
9,000	Manufacturing, Information Services, Financial, Hospitality & Leisure, Natural Resources	4.5%

The corollary has been a substantial tightening in the labor market, as total unemployment fell from 5.7% in 2003 to 4.0% at year-end 2005. This tightness was first realized in the construction sector, where regional labor demand in Nevada and Arizona —where wages are generally higher than Utah— bled into the oil and gas sub-sector of the energy industry. It is in part a result of sustained low mortgage interest rates and in-migration, which have driven residential construction growth, followed by rapidly-rising regional and global demand for [mined] oil, gas and minerals. Labor markets in these relatively high-paying sectors have yet to pass along their higher operating costs to the consumer in the Intermountain region, at least to the extent they approached in 1995-2000. It is notable that office vacancies and residential apartment vacancies are on the decline; the former reversing a trend that began in mid-2000. Improving growth in these sectors is projected to continue through 2006, according to the FDIC and Creighton University, which track the Intermountain region.



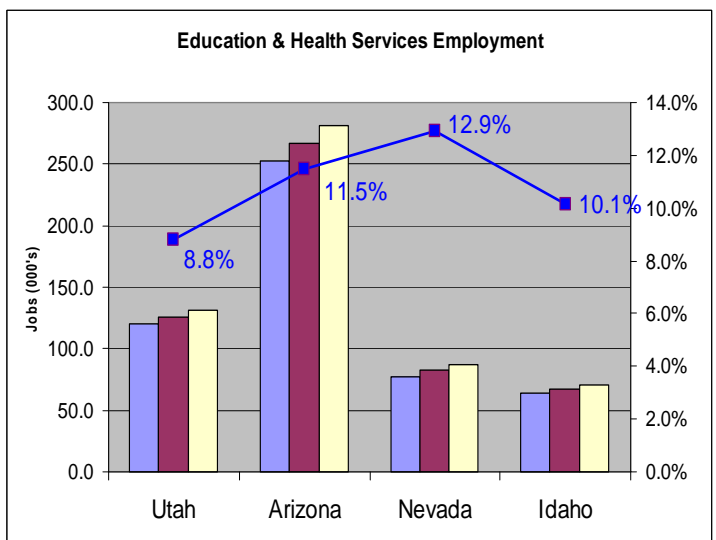
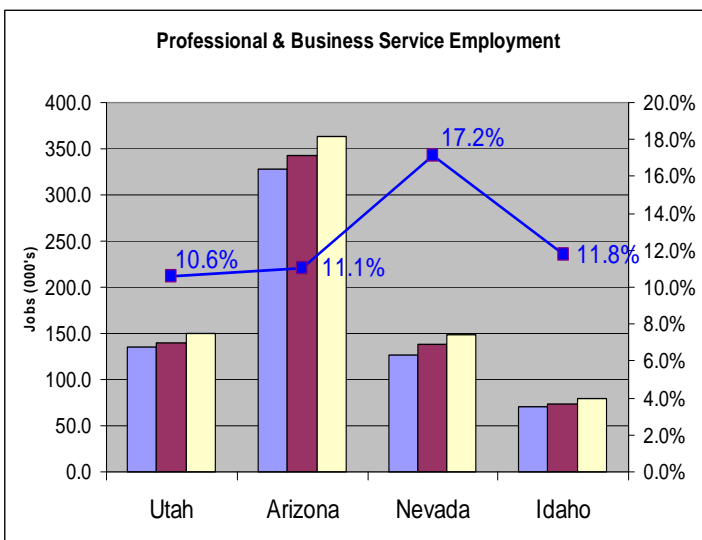
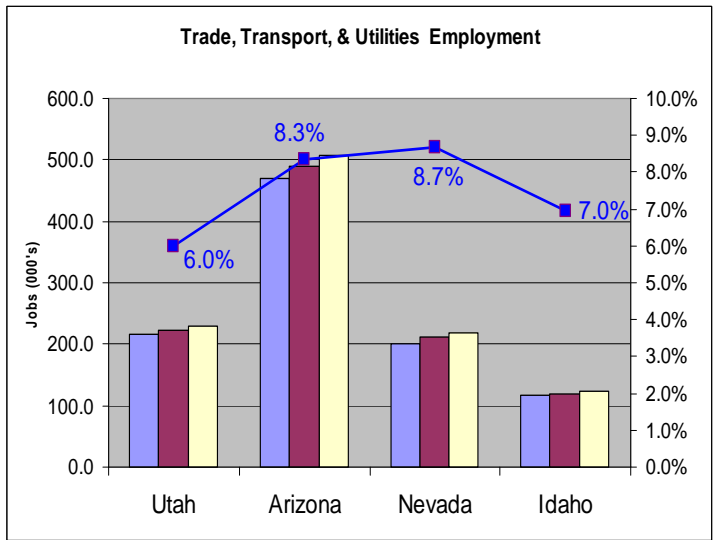
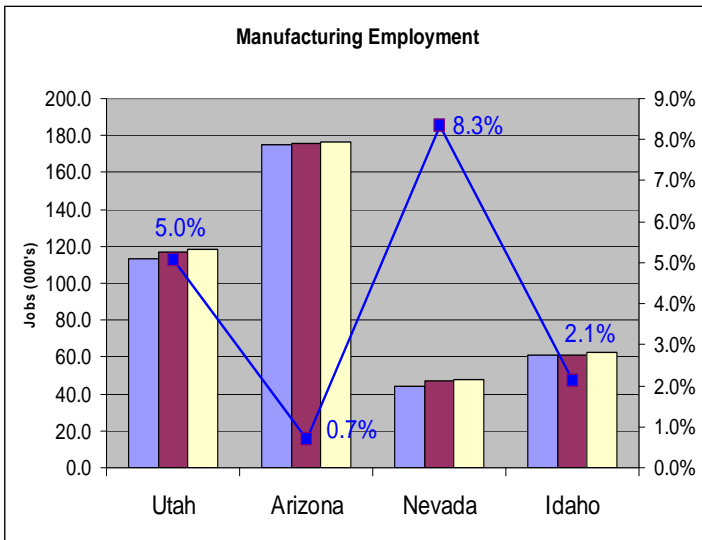
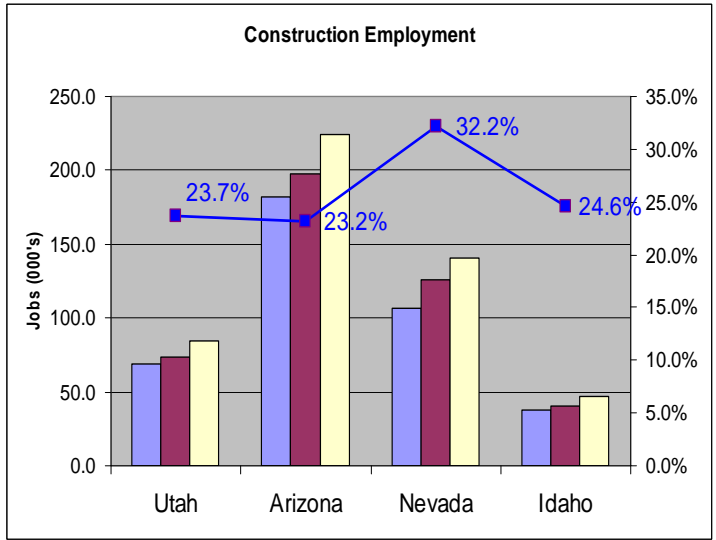
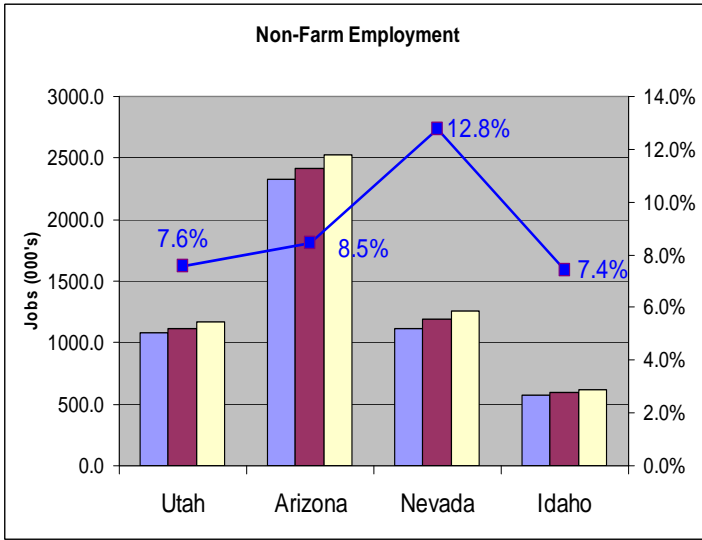
The only weak sectors in Utah were perceived to be in food processing and telecommunications, where there is intense competition.

2003

2004

2005

%ch 2003-2005



By far the fastest growth over the last three years in the Intermountain region has been realized in the construction industry, where Nevada —whose employment magnitude increased by nearly one-third— continues to lead a select group. However, when we examine two major indicators —residential permits and non-residential construction contracts awarded— Utah appears to stand out in *growth consistency* over the last year and the last three months.

<b>Residential &amp; Non-Residential Construction Indicators - Selected Intermountain States</b>			
	3-month	Moving Average % change	
	Average	3-month	12-month
<u>Residential Permits</u>			
Utah	2,427	6.5	15.8
Arizona	7,231	-4.1	5.1
Nevada	3,793	-16.9	11.2
Idaho	1,576	-18.7	25.2
<u>Non-Residential Construction Awards</u>			
Utah	165	15.8	17.2
Arizona	362	-40.5	28.6
Nevada	291	-13.2	-2.6
Idaho	53	-11.3	-1.8
<i>Sources: U.S. Department of Commerce/Bureau of the Census and F.W. Dodge</i>			

Double-digit employment growth was also recorded by all States of the group in the Professional & Business Services sector, which includes professional specialties, scientific, technical and management occupations. Similarly, the Education & Health Services sector generated double-digit employment growth overall, but Utah trailed in this category. Not surprisingly, Arizona and Nevada led in the Hospitality & Leisure sector, linked to their construction booms referenced above.

Public sector surpluses are the next [political and] economic challenge this coming year, which will determine where tax cuts and industrial stimuli will drive Utah's economy. Major slices will be allocated to education and economic development in emerging industries like biotechnology, medical nano-equipment and composite materials. Special attention has been directed at the defense/electronics sectors, where mature firms are still at a competitive advantage. The new Utah budget for fiscal year 2007 is expected to provide both industry-specific and geographic tax incentives to stimulate these sectors. In subsequent editions of this publication, we will address such issues.

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