

UM&A MIMM

Third Quarter 2007 Vol. 06

(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.

Economic Overview

The well-publicized anxiety on Wall Street (and Wacker-to-Rodeo Drive) about credit availability and the housing market has yet to translate itself into a corresponding despondency on Main Street as of this writing. Small and mid-sized businesses are still hiring — in several regions without success — in response to sustained demand for qualified labor. Indeed, several nationally-known small business surveys conducted during the last quarter by the banking community, government agencies and academic institutions show between 80-90% of respondents *who need regular credit access* said availability is the same or easier to obtain now (than it was the previous quarter). Between 80-85% plan to make investments in their businesses in the next six months (up from 70% a year ago), and 20-25% indicated technology equipment would comprise the largest share of such investments, followed by other types of business equipment (14%), and physical plant/employee training (10%).

At this writing, the U.S. Department of Commerce released its adjusted estimates of third quarter economic growth —Gross Domestic Product— showing an annual rate of 4.9 percent, the fastest in four years. This growth “bump” comprised *stronger exports* and *more inventory investment* by businesses, suggesting the economy was more resilient than mass media reports indicated earlier in the autumn season. Business spending was spread across equipment, computer software, and construction of new plants, office and other commercial buildings. Continuing weakness in the Dollar’s value buoyed exports, which grew nearly 19 percent [SAAR] during the quarter; this was the biggest increase in four years. Huge losses reported by financial institutions (from their exposure to the sub-prime mortgage crisis) dragged Corporate Profits down during the quarter; one measure revealed *after-tax domestic profits* decreased 4 percent. Still, overall profits increased 1.9 percent from the same quarter last year, as *net foreign profits* increased 35 percent!!! In defiance of prevailing “sentiment,” *consumer spending* grew at a 2.7 percent annual rate, up from last quarter’s tepid 1.4 percent. In national labor markets, *unemployment*, at 4.7 percent (about 7 million), remained essentially unchanged during the quarter. In fact, these same levels were recorded a year ago. While employment was down in the construction and manufacturing sectors, jobs were added in health care, food services and professional/technical/scientific services. It appears the persistent rise in gasoline prices, and labor market conditions have not yet made an appreciable impact on Main Street.

The Fed’s Recent Actions

Last quarter, the Federal Reserve Board passed up two opportunities (at FOMC meetings in June and August) to lower its targets for *short-term interest rates*, despite recognition of increasing deterioration in financial markets, and tighter credit conditions which “have the potential to restrain economic growth going forward.” Then, in mid-September, the FOMC suddenly decided to take simultaneous steps to lower both its target rate for Federal Funds (the rate its member banks can charge each other for short-term loans) and the Discount Rate

(charged member banks who borrow directly from the Fed), by 50 basis points each. Again in October, the FOMC lowered its target rate for Federal Funds by another 25 basis points. At these [scheduled] meetings, the FOMC acknowledged:

- Moderate economic growth (as defined by U.S. Commerce Dept.'s GDP "Final" Estimates) during the first half of 2007;
- Tightening of credit conditions overall, which has the potential to intensify the housing "correction" and restrain general economic growth;
- Modest improvements in core [price] inflation readings, with some remaining [energy & commodity price] risks warranting careful monitoring of inflation developments;
- Developments in financial markets since August which have increased the uncertainty surrounding the economic outlook.

A major component the Fed's statistical analysis is *Industrial Production/Capacity Utilization*, which is a barometer of future economic activity. Overall, Industrial Production increased 4.0 percent during the third quarter, and is up 1.9 percent year-on-year. Last year at this time, the rates were 3.6 and 5.5 percent, respectively. The present pace however, is 0.5 percentage point faster than the second quarter. While this does not signify an expansion, it is notable that some market segments are standing up better than others as of this writing. Output in *manufacturing* remained nearly flat during September, after a decline of 0.4 percent in August. Industrial Capacity Utilization was unchanged at 82.1 percent; this was just 0.1 percentage point higher year-on-year.

Broken down by market group:

Consumer Goods output fell 0.3 percent in September, but was up 1.6 percent year-on-year. The decrease was driven by both *durables* and consumer *energy products*. Within *durables*, *automotive products* fell 2.8 percent, because of a strike at General Motors. Contrary to media concerns about consumer spending contractions, production indices for home electronics, appliances, furniture and carpeting changed little during the entire quarter. In sync with [U.S. Commerce Department] evidence of continuing *plant and equipment* investment, the output of business equipment rose 0.4 percent in September, driven by *commercial aircraft* equipment, which more than offset decreases in *motor vehicle equipment*. The index for *information processing equipment* climbed 0.8 percent, and that of industrial equipment rose 0.4 percent, reflecting "widespread" gains. Over the third quarter, *business equipment output* rose at an annual rate of 7.0 percent, an increase of 1.5 percent from the last quarter. Output from the defense and aerospace sector jumped 5.1 percent (annual rate) during the quarter, marking the first quarterly gain for this sector since the third quarter of 2006 —despite a continuing war effort to support.

Over the last two quarters, *capacity utilization* has fallen more notably in the *non-durable* sectors than in *durables*. The steepest drops were recorded in *textile mills* (-2.3 points) and *printing/related* (-1.6 points), but [petroleum/gas-sensitive] *chemical products* recorded a 1.6 point increase. Within the *durables* sector, *aerospace/transportation equipment* recorded a 2.5 point increase, followed by *fabricated metals* (1.3) and *nonmetal minerals* (1.2). Year-on-year (unadjusted for market weight), the largest gains were recorded in *aerospace/transport* (4.3), *furniture/furnishings* (3.6), *fabricated metals*, and *chemical products* (3.5). It is notable that capacity utilization in *non-durables* declined, excepting *chemical products*. Anticipating a slowdown in economic growth over the next 3-6 months, these indices are likely to slip, despite a favorable export environment due to the Dollar's weakness. The impact of consumer sentiment in response to the recent

sub-prime mortgage collapse/credit crunch has yet to be realized; this would certainly exacerbate the decline in *durables* indices.

Productivity

Along with Industrial Production and Capacity Utilization, the Fed looks to *labor productivity* among its “resource allocation” indicators. As inferred in our last report, wage pressures had begun to show across several industries because of the economic growth pace in many regions of the country; this pressure has been relieved somewhat.

The Labor Department reported productivity during the third quarter jumped at an annual rate of 4.9 percent — more than double the 2.2 percent rise last quarter— representing the fastest surge in worker efficiency since 2003!!! Usually this phenomenon coincides with the onset of an economic slowdown, but viewing the growth in GDP, it can be attributed to a faster growth in [export-driven] output relative to employment hours during the quarter. Concurrently, wage pressures eased, as *unit labor costs* slid at an annual rate of 0.2 percent, the best results in over a year. This slice was welcome to the Fed in particular, following sizable increases of 2.2 percent last quarter, 5.2 percent the first quarter and 10.3 percent at year-end 2006. Previous *wage increases* had added one more concern to those of energy and food prices in the Fed’s view of inflation-drivers. Normally, rising wages are favorable to living standards (and personal consumption levels), but if they are not accompanied by *strong productivity gains*, they make the Fed’s inflation radar screen.

Small Business Note:

During the last quarter, the U.S. Senate passed and the President signed a statutory increase in the minimum wage, albeit modest in the first year. Effective July 24, this Bill neither assisted most workers, nor those who were victims of the downturn in our housing markets. The largest share of the bill with positive impacts for business comprised a bevy of *tax breaks for small businesses*. These comprise an extension of the *Work Opportunity Tax Credit* —granted to employers hiring workers who face barriers to employment: veterans, high-risk youth, and vocational rehabilitation referrals. Also included in the package was a tax-cut provision for most businesses, which increased *small business expensing limits for capital investments* from \$100,000 a year to \$125,000, and extends the expensing limit through 2010. (The limit’s phase-out threshold is increased to \$500,000.)

Utah’s Labor Market and Manufacturing Trends

While Utah’s labor market continues to show its strongest growth in a decade, accompanied by nearly rock-bottom unemployment, this growth has not come from the usual industry sources. Contrasted with the 1990s, when economic expansion came from the financial, health care and business services sectors, this cycle shows a rebound driven by *manufacturing* and *professional services*. Since this edition of the *UM&A MIME*™ focuses on manufacturing, we provide the following highlights, putting Utah in perspective of other States in the Intermountain Region. At the conclusion, we provide our outlook for the national and regional economy.

Intermountain Region Manufacturing Sector Earnings Trends 2003-2006

We have chosen this period as it is the latest for which data are available on industry earnings for this economic cycle. The scope of our conclusions applies to the States of Arizona, Colorado, Idaho, Nevada, Utah and Wyoming.

As of year-end 2006, Utah's *manufacturing sector* ranked second to Idaho in its contribution to State Gross Domestic Product; regionally, the rankings were:

Idaho: 18%
Utah: 15%
Arizona: 11%
Colorado: 8%
Nevada: 6%
Wyoming: 4%

However, using full year 2006 NAICS detail as a model, the relative contributions of each State's *manufacturing sector* were disproportionately weighted:

- Idaho's Computer/Electronic Components and Food Products segments combined to account for 68% of manufacturing earnings; none of the other 12 segments contributed double-digit shares.
- Arizona's manufacturing sector was dominated by Computer/Electronic Components (33%), Transportation Equipment (23%) and Fabricated Metals (10%); Food Products contributed just 6% of earnings.
- Utah's top contributing segments — Transportation Equipment (15%), Primary Metals (15%) and Fabricated Metals (10%) — also generated the bulk of its high-paying employment. Arguably, Utah had the best *regional balance* in its manufacturing sector earnings.
- Colorado had the second-best *regional balance* in its manufacturing earnings base, but, like Idaho, it too was dominated by industries with short-term economic exposure to global pricing: Computer/Electronic Components (20%) and Food Products (18%), while generating wages sensitive to regional and global volatility.
- Wyoming's tiny manufacturing sector earnings were dominated by *segments tied closely to the natural resources sector*: Chemicals & Pharmaceuticals (35%), Petroleum & Coal Products (13%), Non-Metallic Minerals (11%) and Food Products (10%).
- Nevada had the third-best *regional balance* in its manufacturing earnings: Non-Metallic Minerals (23%), Food Products (13%) and Fabricated Metals (12%) comprised the largest segments, and none of the others contributed in double-digits during 2005.

The ratio of regional Durables earnings contributions to Total Manufacturing generally out-performed the U.S. cumulative total in 2006:

Arizona: 84%
Colorado: 61%
Idaho: 78%
Nevada: 75%
Utah: 71%
Wyoming: 38%

National Total: 28%

Between 2003-2006, growth in Durables vs. Non-Durables earnings varied widely:

<u>Durables:</u>	<u>% Change</u>	<u>Aggregate \$Millions</u>
Arizona	-13%	\$15,834
Colorado	+22%	\$9,221
Idaho	+86%	\$5,584
Nevada	+96%	\$4,307
Utah	+39%	\$7,824
Wyoming	+42%	\$376

<u>Non-Durables:</u>	<u>% Change</u>	<u>Aggregate \$Millions</u>
Arizona	+21%	\$2,993
Colorado	+25%	\$5,791
Idaho	+9%	\$1,609
Nevada	+18%	\$1,453
Utah	+19%	\$3,156
Wyoming	-2%	\$618

In terms of total industry contributions to Gross Domestic Product by State, during 2006:

- Utah's Manufacturing sector was its largest earnings contributor (15%), followed by Real Estate Services (14%), Financial Services (11%) and Construction (8%).
- Idaho's Manufacturing sector was its largest earnings contributor (18%), followed by Real Estate Services (14%) and Retail Trades (10%); Construction, Health Care and Professional/Technical Services tied at 8% each.
- Nevada's Real Estate (18%), Hospitality & Food Services (17%), Construction (12%), and Financial Services (8%) were tied to its population growth.
- Arizona had similar contributions to Idaho: Real Estate (18%), Manufacturing (11%), Finance & Insurance (10%), Construction (9%), but driven by population.
- Colorado led the region with the most balanced contributions: Real Estate (16%), Professional/Technical Services (11%), Information Services (10%) and , Manufacturing (8%);Construction, Financial Services, Health Care, Mining, Retail and Wholesale Trades were tied at 7% each.
- Wyoming's industry earnings contributions were dominated by Mining (36%), followed by Real Estate (10%); Construction, Retail Trades and Transportation/Warehousing were tied at 7% each.

Intermountain Region Manufacturing Industry Earnings between 2003-2006 had the following notable characteristics (Arizona, Colorado, Idaho, Nevada, Utah, Wyoming):

- Arizona led the region, with nearly \$15 billion in manufacturing earnings during 2006; Colorado followed with \$11 billion; Utah ranked third with \$7.5 billion.
- Wyoming had the fastest Manufacturing sector growth between 2003-2006 (36.8%), but the smallest total earnings (\$707 million).
- While Colorado had the second largest Manufacturing Sector in 2006, its 2003-2006 growth rate ranked last in the region, at 11.2%.
- Computer & Electronic Equipment generated nearly \$11 billion in 2006, continuing as the largest contributing segment
- Transportation Equipment ranked a distant second, approaching \$6 billion
- Food Products and Fabricated Metals each generated about \$3 billion
- Between 2003-2006, the region's Manufacturing sector's earnings grew 20.3%, to just over \$42 billion.
- The fastest growth was registered by Petroleum & Coal Products, which grew 102% from 2003-2006, followed by Primary Metals (44.1%), Non-Metallic Minerals (39.8%) and Chemicals & Pharmaceuticals (34.5%).
- Utah led the region in both 2006 earnings (\$460 million) and growth (118%) in Petroleum & Coal Products
- Utah led the region in both 2006 earnings (\$713 million) and growth (43.8%) in Chemicals and Pharmaceuticals.
- Utah and Colorado ranked second (about \$1 billion each) behind Arizona (\$3.2 billion) in Transportation Equipment manufacturing earnings in 2006
- Utah and Colorado ranked second (about \$330 million each) behind Arizona (about \$375 million) in Furniture manufacturing earnings in 2006.

Manufacturing Trends in Utah's major population zones 2003-2006

The time window we selected represents the most recent economic cycle in Utah following the national economic shock-and-awe of 2001-2002.

Industry-wide, Utah's Durable Goods sector consistently accounts for two-thirds of manufacturing earnings, vs. one-third for Non Durables. This is revealed in County performance.

- Utah's largest manufacturing sub-sector is **Transportation Equipment**, which includes aerospace, automobile and trucking components. Of its 14,700 workers, some 10,600 are concentrated in Box Elder, Davis and Weber Counties.
- Of Utah's 13,700 workers in **Food Products**, 10,500 are concentrated in Cache, Salt Lake and Utah Counties. Overall, this industry has shed nearly 5% of its workforce since 2003, and the net loss (700) has come from Salt Lake, Utah and Weber Counties. Of these, Salt Lake County's share is 50%.
- By far the largest business population among Utah's manufacturers is in **Fabricated Metals** (635) which also has the distinction of smallest average size (18). 540 of these businesses are clustered from Utah County north. About half of this cluster is in Salt Lake County.
- Over the period 4Q2003-4Q2006, the largest relative increase in employment among Utah's manufacturers (31%) has been in **Non-Metallic Minerals**, a by-product of demand from the construction and mining industries. Of these 1,500 additional workers, over 1,100 were generated by construction industry activity in Salt Lake, Utah and Washington Counties.

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- Demand from the energy sector since 2003 has spawned an increase in both business populations and employment in Utah's **energy exploration/production zones** —Carbon/Sevier/Duchesne/Uintah Counties— where labor demand has now begun outstripping supply. Overall, the combination of new coal-fired power plants and oil-gas finds have generated a 33% increase in durables manufacturing employment in these zones during this period. Business formation in durables has exceeded 43% concurrently with this demand, which has expanded the **Non-Metallic Product, Fabricated Metal and Industrial Machinery** sub-sectors.
 - Utah's fastest population growth during the first five years of this century has been concentrated in the Southwest region of the State, where manufacturing has generated employment increases of 19% employment increase in Washington County, and 18% in Iron County since 2003. The number of businesses in these Counties has expanded by 22% and 34%, respectively, as well. Main drivers have been **Transportation Equipment, Furniture and Wood Products, Non-Metallic Minerals, and Computer/Electronic Components**.

Utah's Economy/Outlook

As of third quarter 2007, Utah's economy can be characterized as the most balanced and best in recorded history. Unemployment hangs at 2.6 percent (half the national average), job creation is at 4.5 percent, leading the country with a pace three times the national average. It is notable that Wyoming and Montana were second and third with 3.3 percent, and Arizona fourth at 2.6 percent. . Even Utah's construction industry employment remains 12 percent ahead of 2006.

The other side of powerful employment gains is *extremely tight labor availability*. By comparison, Utah's *unemployment rate* averaged 2.9 percent in 2006, 4.1 percent in 2005 and 5.5% from 2002-2004. High levels of in-migration have been key to maintaining strong job creation and balanced economic growth. Central to this growth has been the *construction industry*, which has smoothly evolved from dependency on the single-family residential segment to [more balanced] new and existing commercial/industrial real estate. Such development is considered timely, and in-step with mid-stage economic development, and, particularly, in context of global credit tensions related to *non-traditional home finance programs*. Additional pressures have been recognized in the manufacturing sector, where the main impediment to sustained robust growth is the *dwindling skilled labor market*. A slowdown in the rapid pace of growth would therefore be generally welcome by most manufacturing businesses (which also generate the highest wages in Utah, but are fishing in a stagnant labor pool).

Economists tracking the Intermountain Region anticipate only subtle changes in Utah's economy during the first half of 2008, responding to a slowdown in residential construction growth, and related supply-chain industry sectors. The consensus among government and private industry economists is for a slight rise in Utah's unemployment rate, to about 3 percent, reflecting [3.9 percent] job creation of 48,000 vs. 54,000 in first half 2007. This, however, may not relieve the demand pressures for *skilled manufacturing and scientific/engineering labor*, which eventually may slow growth in those sectors, too. Overall, this means Utah will experience a continuing steady, albeit slower economic expansion, relying on the diversity of its economic base.

<http://jobs.utah.gov/opencms/wi/press/2001press/ratecurrent.pdf>
<http://www.zionsbancorporation.com/zionsbank/sbi/ut200709.html>

National Economic Outlooks

With third-quarter economic indicators in-hand, the White House Council of Economic Advisers reduced the magnitude of *estimated GDP growth* in its forecast for 2008, from 3.1 percent (rendered last June), to 2.7 percent. This forecast acknowledged very recent impacts on the economy resulting from the sub-prime mortgage crisis, which are expected to affect both housing and business credit markets. It is still above the recently-cast outlook offered by the Federal Reserve Board's policy-making committee, which projected 1.8-2.5 percent real (inflation-adjusted) *GDP growth* for 2008. Included in the White House forecast was the expectation that the *unemployment rate* will rise from the previous projection of 4.7 percent to 4.9 percent annual average. It also built recent food and energy price increases into its 2008 [*Consumer Price Index*] inflation forecast of 2.1 percent, compared with 2.5 percent previously. This compares with a projected average of 3.9 percent for 2007.

In their quarterly update, a bellwether group of economic forecasters polled by the Federal Reserve Bank of Philadelphia decidedly downgraded their estimates for economic growth for the remainder of 2007 and the first half of 2008. With the latest profile of *GDP components* and price, employment and corporate earnings data in hand, they projected, using Real [inflation-adjusted] GDP as the growth standard:

- Slowing economic growth at 1.5 percent in the 4th quarter, down from 2.7 percent projected last quarter..
- Downward revisions of about 0.5 percentage point for each of the first two quarters of 2008, projected at 2.2 percent and 2.3 percent, respectively..
- Annually averaged, economic growth of 2.1 percent in 2007 and 2.5 percent in 2008; this represents the third consecutive downward revision since 1Q 2007.
- Slightly weaker labor market conditions, with unemployment rates of 4.6 percent in 2007 and 4.9 percent in 2008 (the latter revised upward from 4.7 percent).
- Core price inflation, as measured by the *Consumer Price Index/Urban* averaging 2.2 percent (4th quarter over 4th quarter) over the next three years; this is unchanged from last quarter's survey, and clearly within the *target range of the Federal Reserve Board*.
- Core price inflation of 2.5 percent over the next five years; this is up 0.05 percentage points from last quarter's survey, and slightly outside the Fed's range.

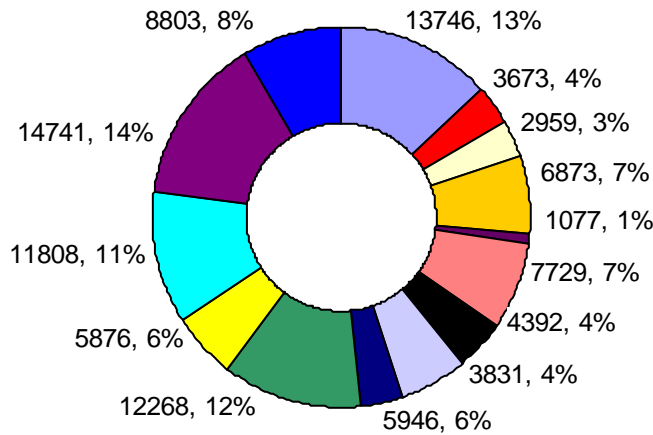
Barring unforeseen financial market turbulence and severely constrained credit conditions, these forecasts are not signaling a recession, just a slowing in the pace of economic growth. For the Intermountain Region, they represent sustained expansion.

Prepared by Dean C. Dinas, Research Director, *United® Mergers & Acquisitions*

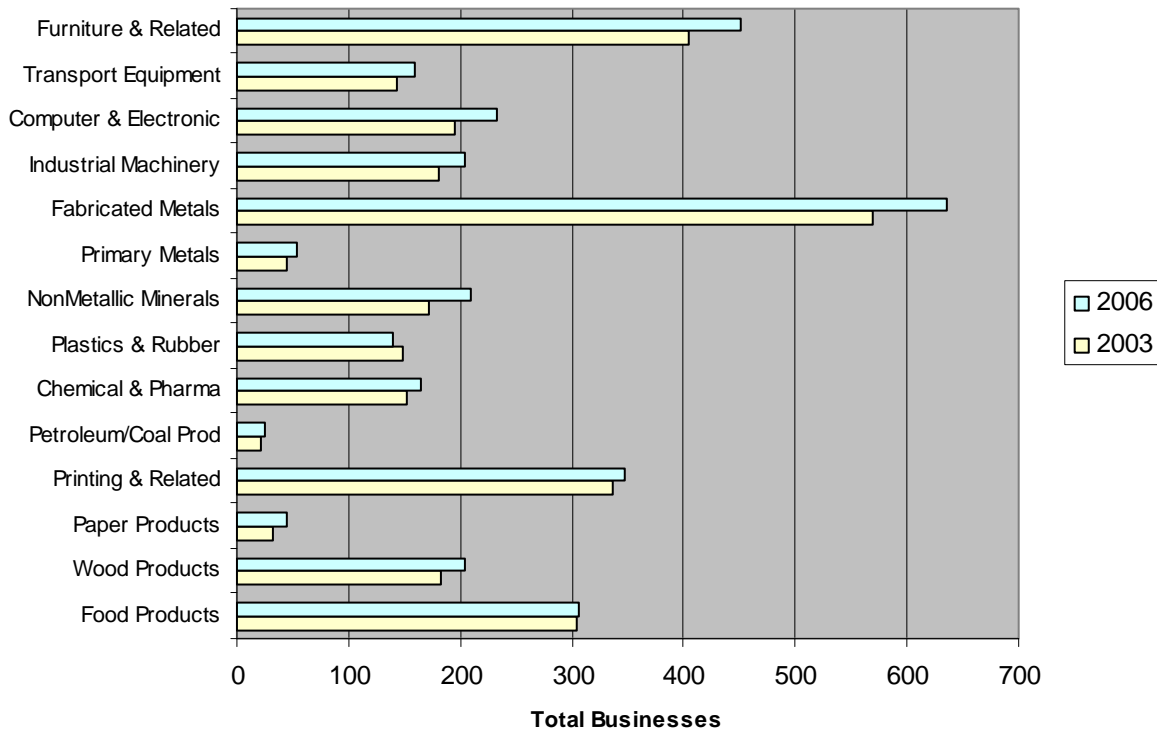
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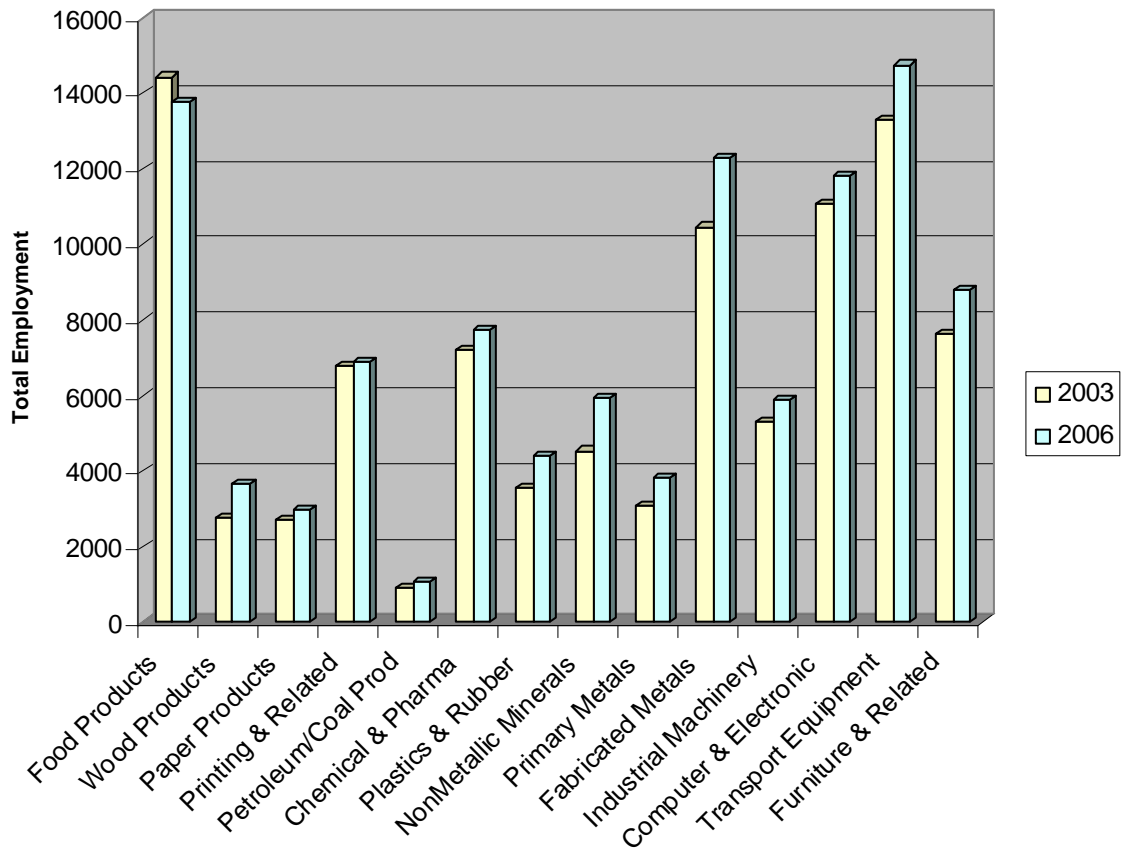
Manufacturing Employment Shares in Utah 2006



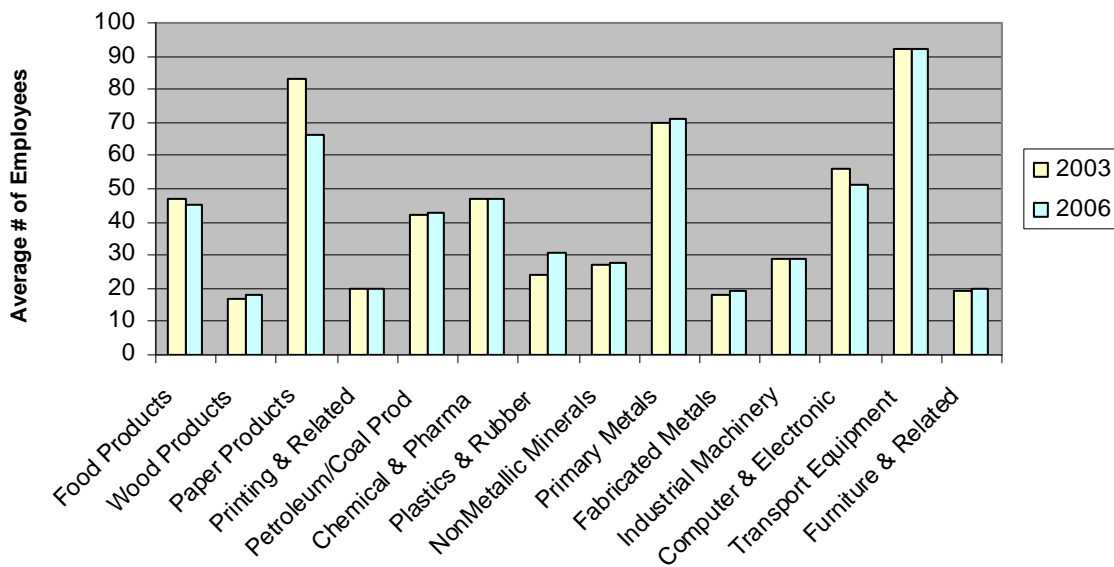
Manufacturing Business Populations in Utah 2003/2006



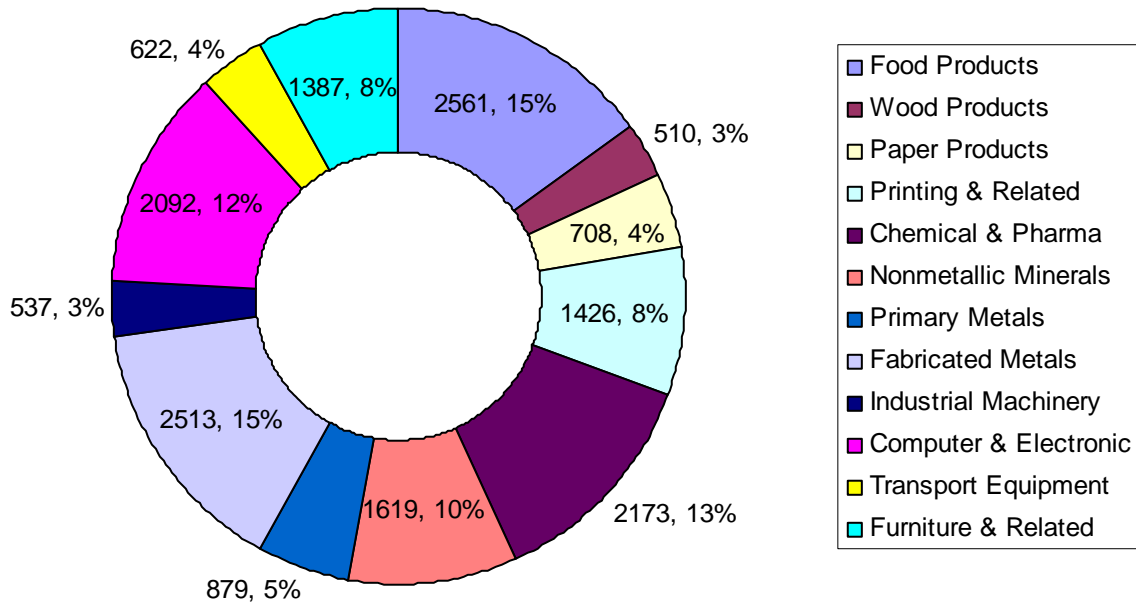
Major Manufacturing Employment in Utah 2003/2006



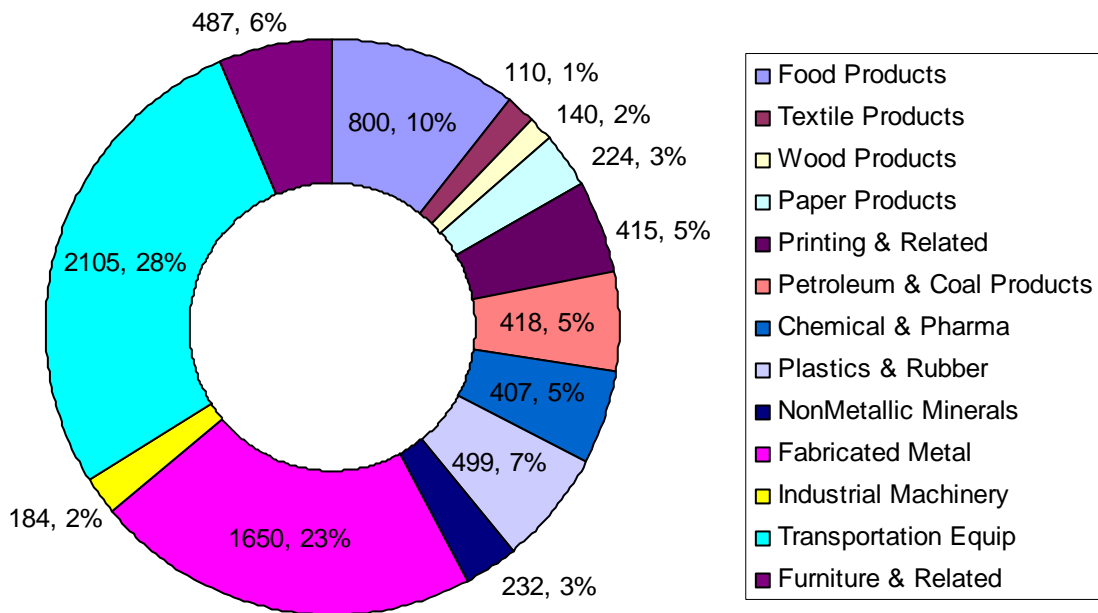
Manufacturing Firm Size in Utah 2003/2006



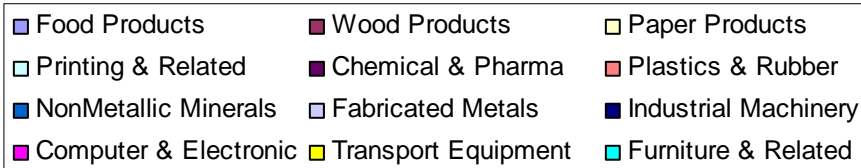
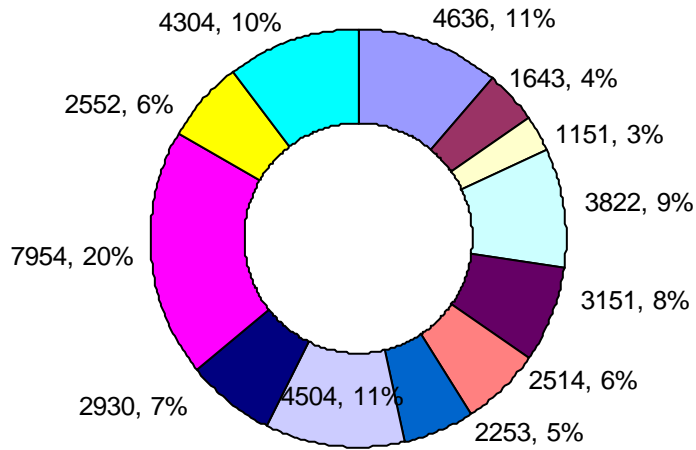
Manufacturing Employment Shares in Utah County 2006



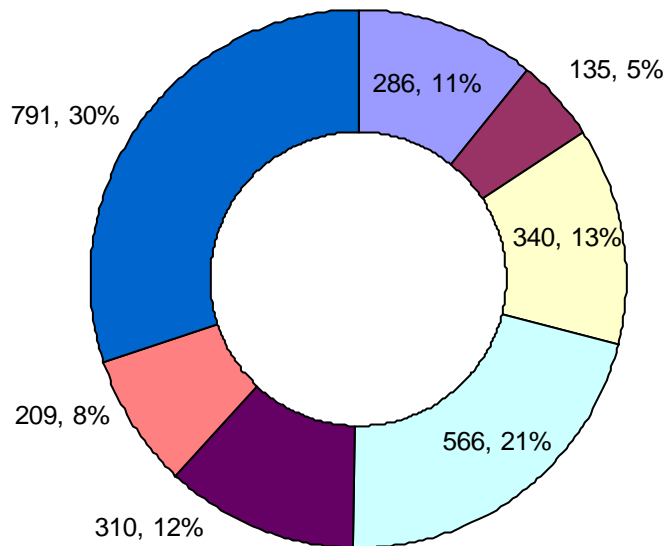
Manufacturing Employment Shares in Davis County 2006



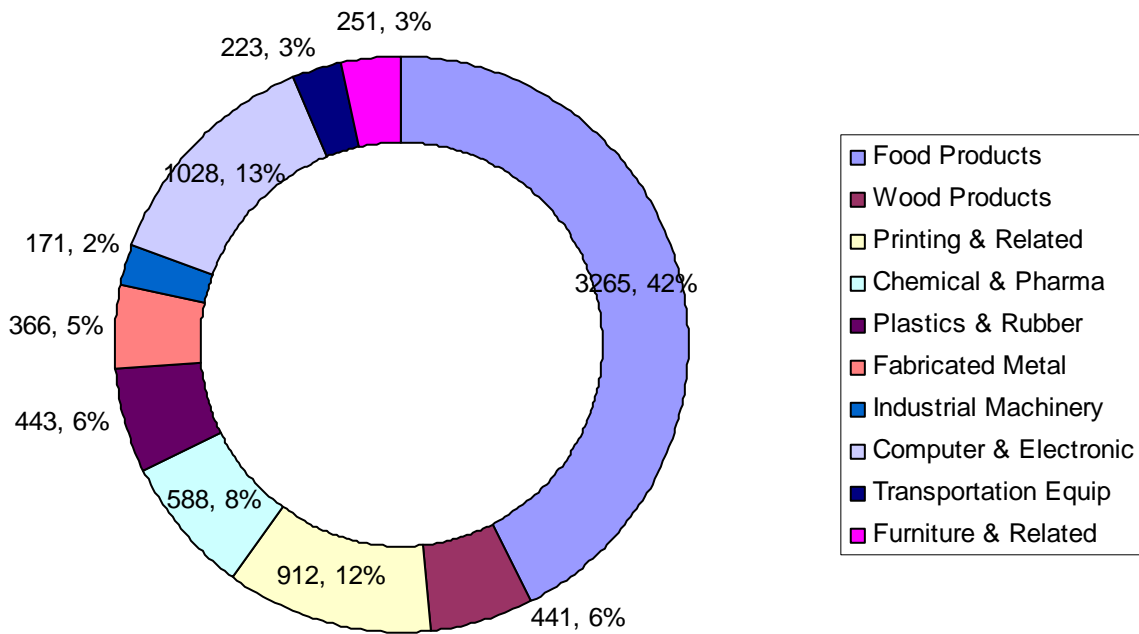
Manufacturing Employment Shares in Salt Lake County 2006



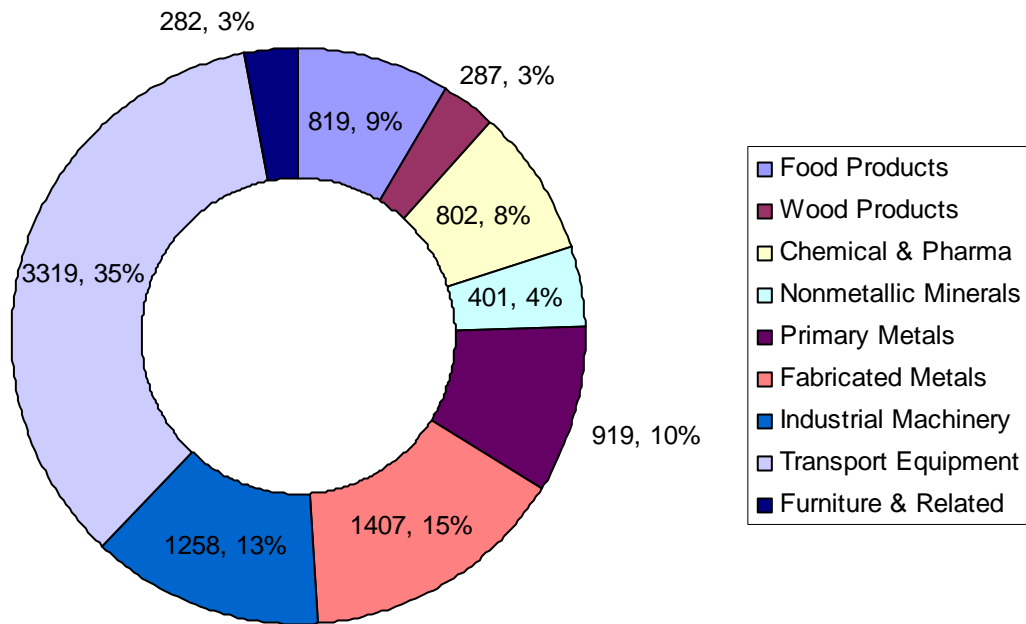
Manufacturing Employment Shares in Washington County 2006



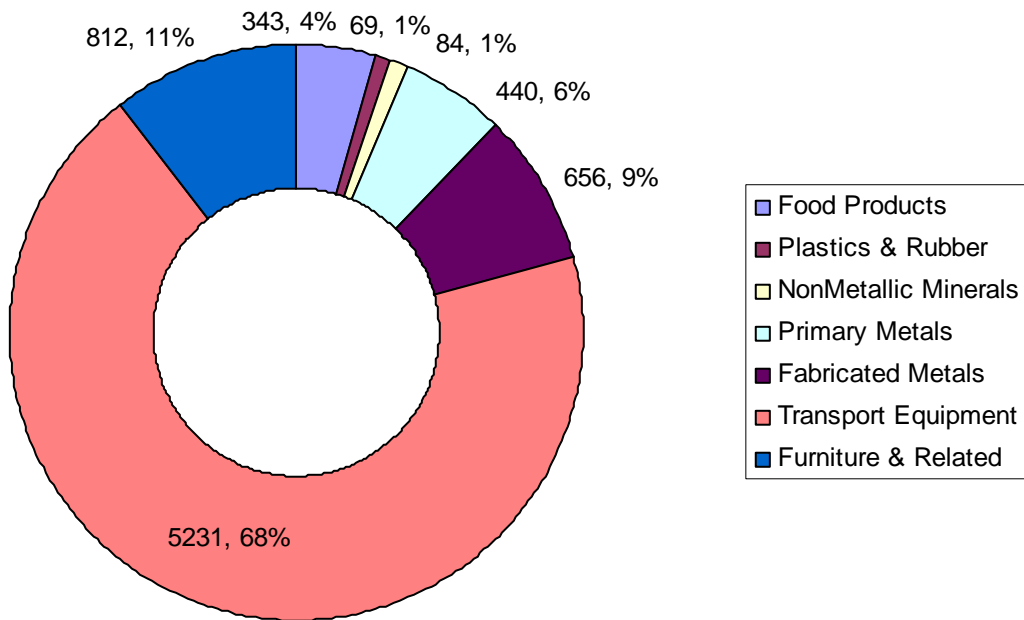
Manufacturing Employment Shares in Cache County 2006



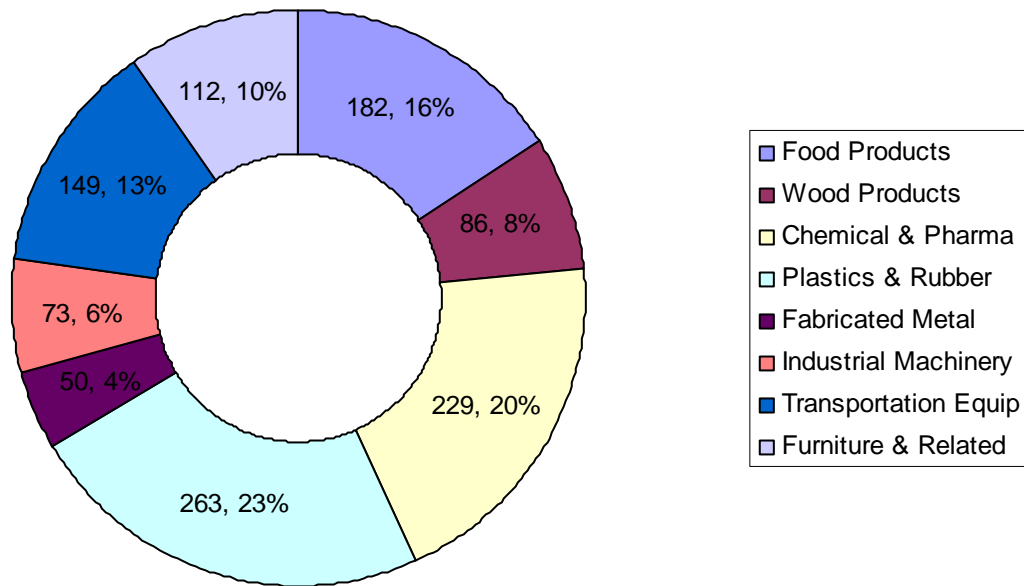
Manufacturing Employment Shares in Weber County 2006



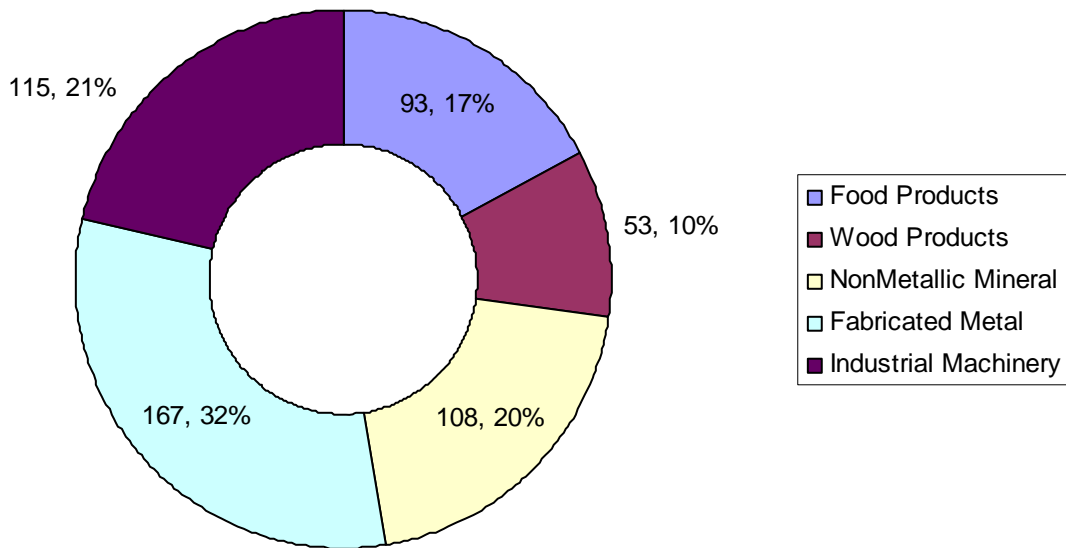
Manufacturing Employment Shares in Box Elder County 2006



Manufacturing Employment Shares in Iron County 2006

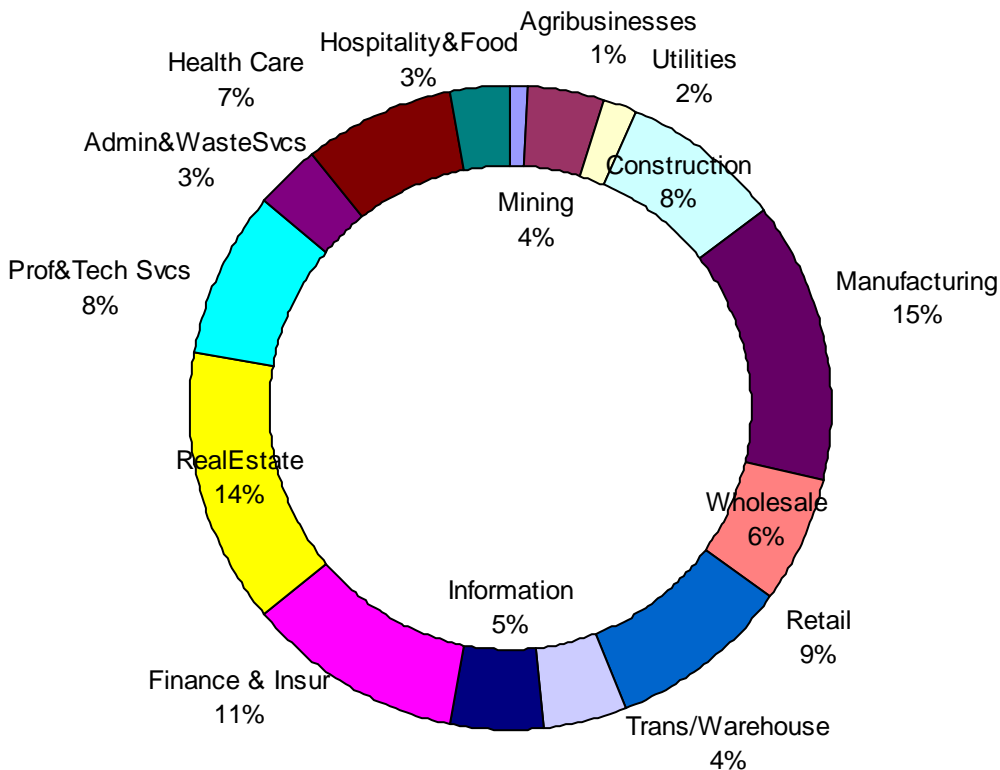


Manufacturing Employment Shares in Utah's Energy-Producing Zones 2006

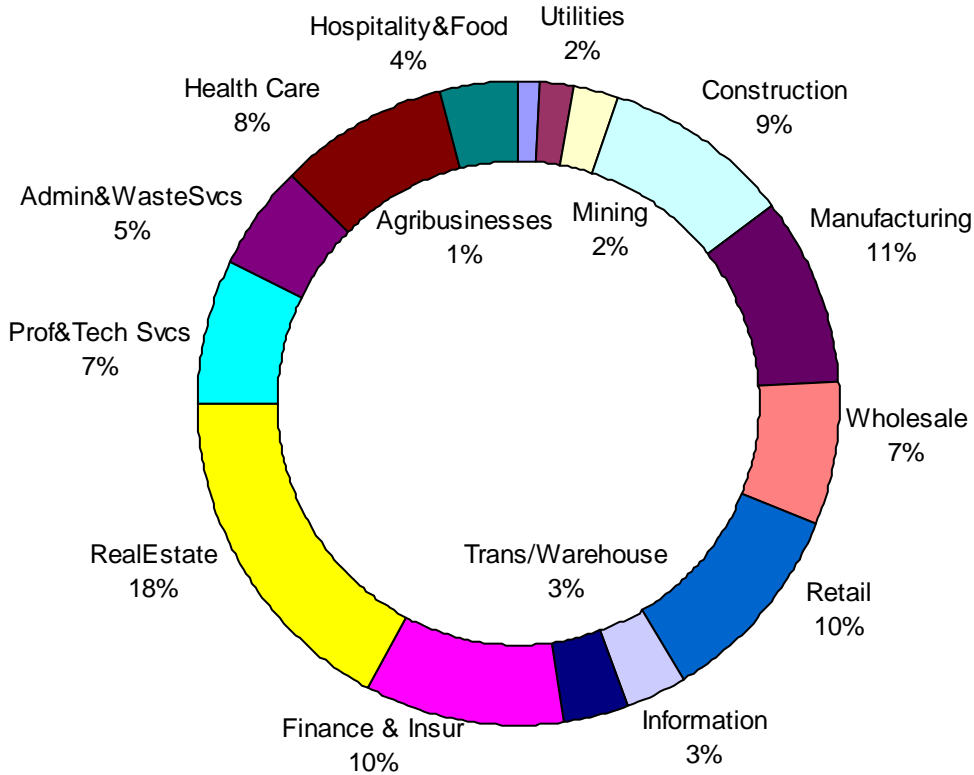


(Uintah, Sevier, Duchesne, and Carbon Counties)

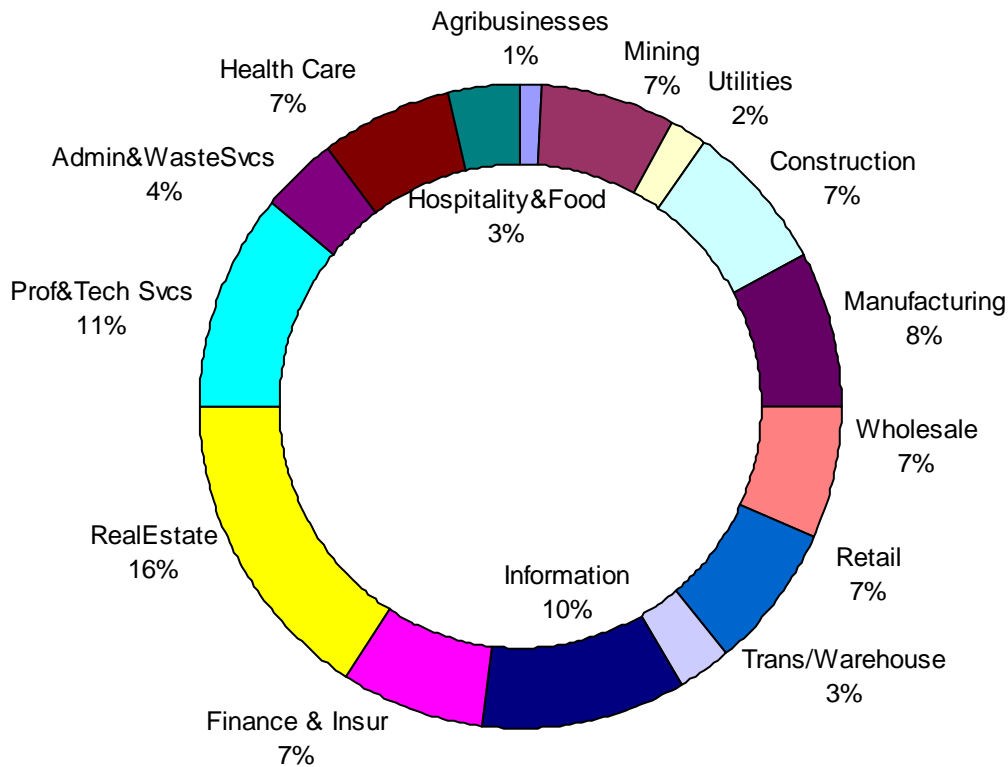
Utah's Industry Contributions to GDP (private) 2006



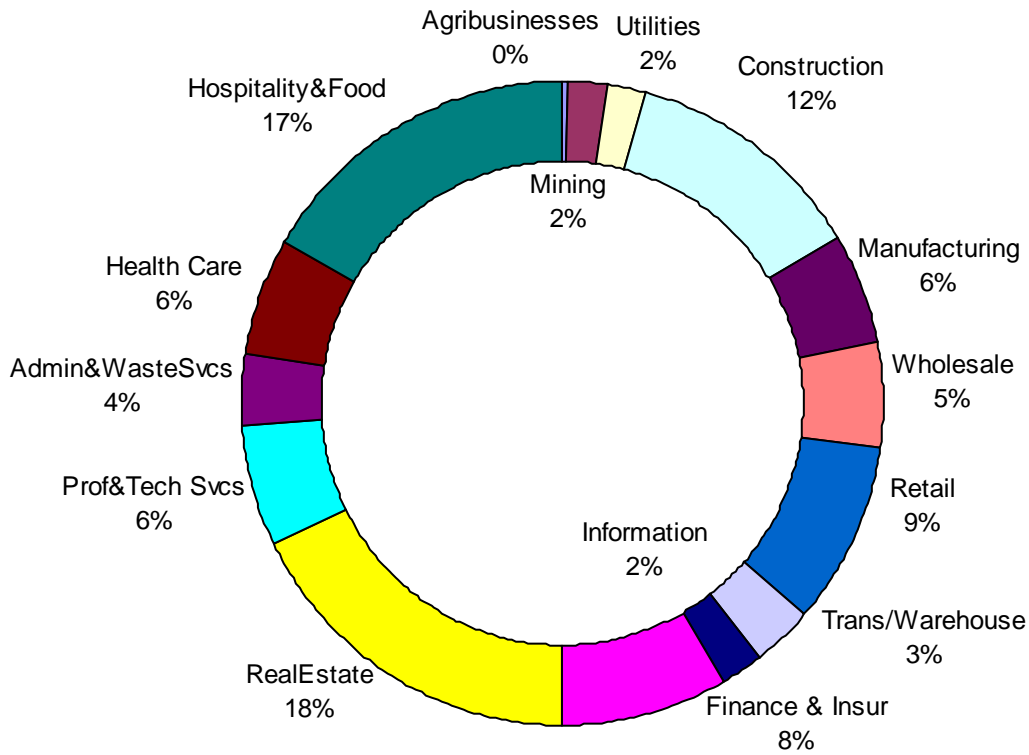
Arizona's Industry Contributions to GDP (private) 2006



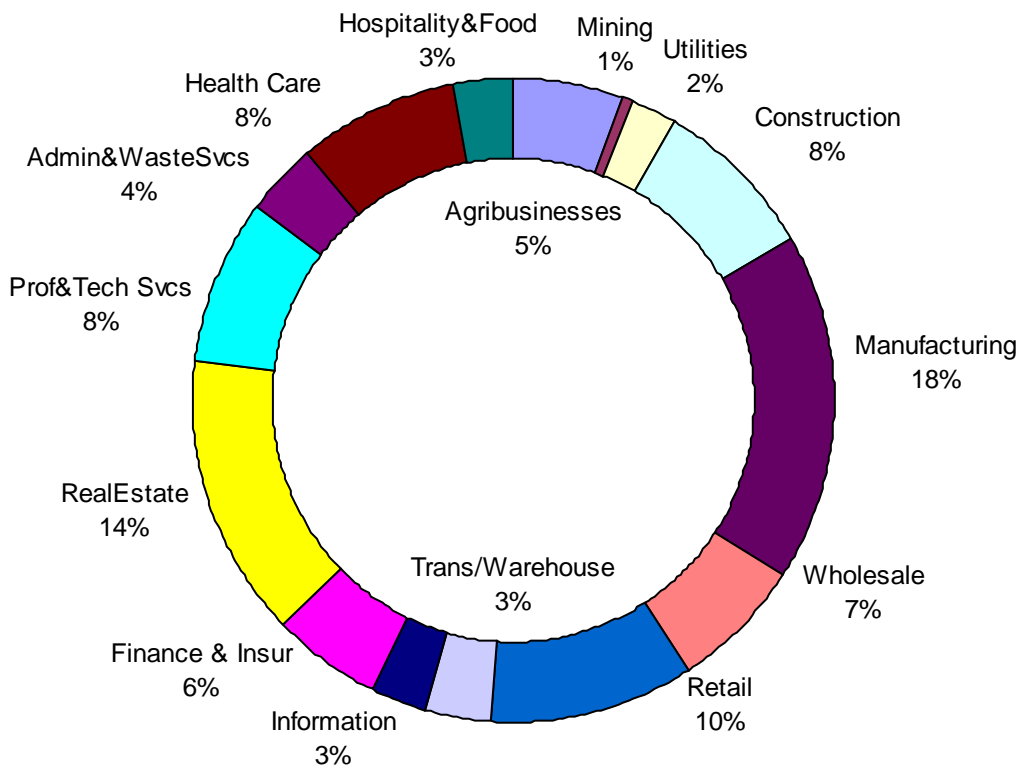
Colorado's Industry Contributions to GDP (private) 2006



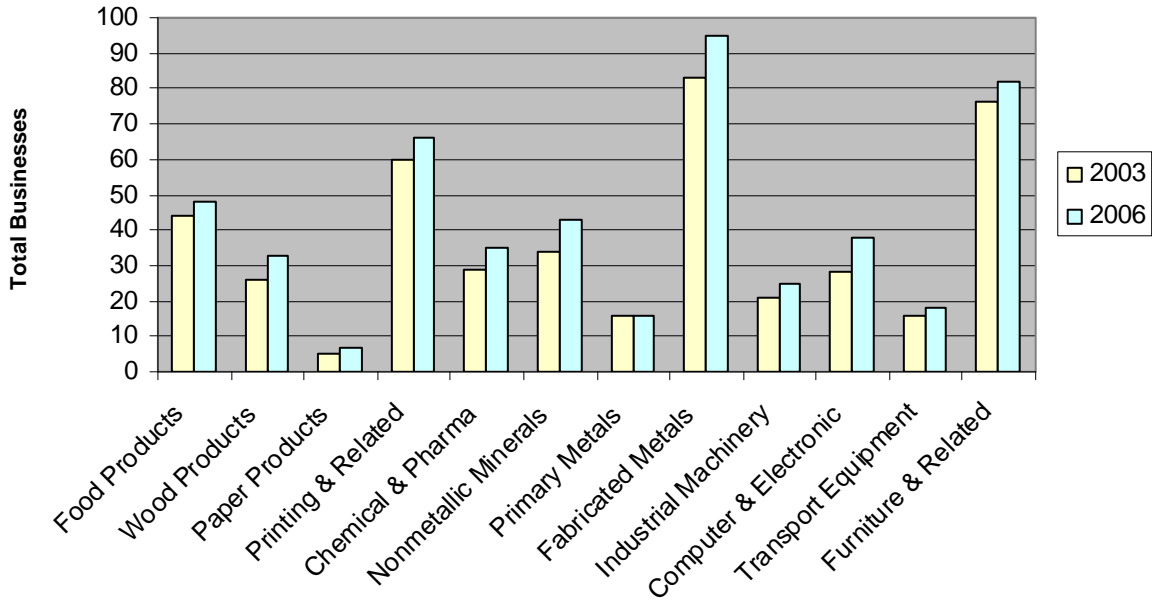
Nevada's Industry Contribution to GDP (private) 2006



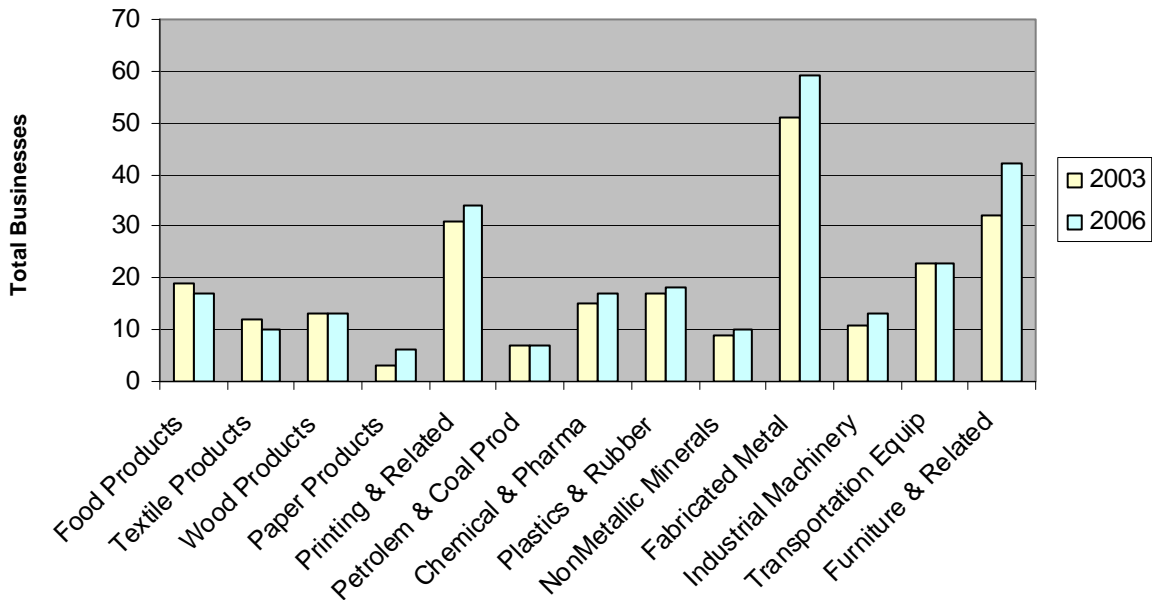
Idaho's Industry Contributions to GDP (private) 2006



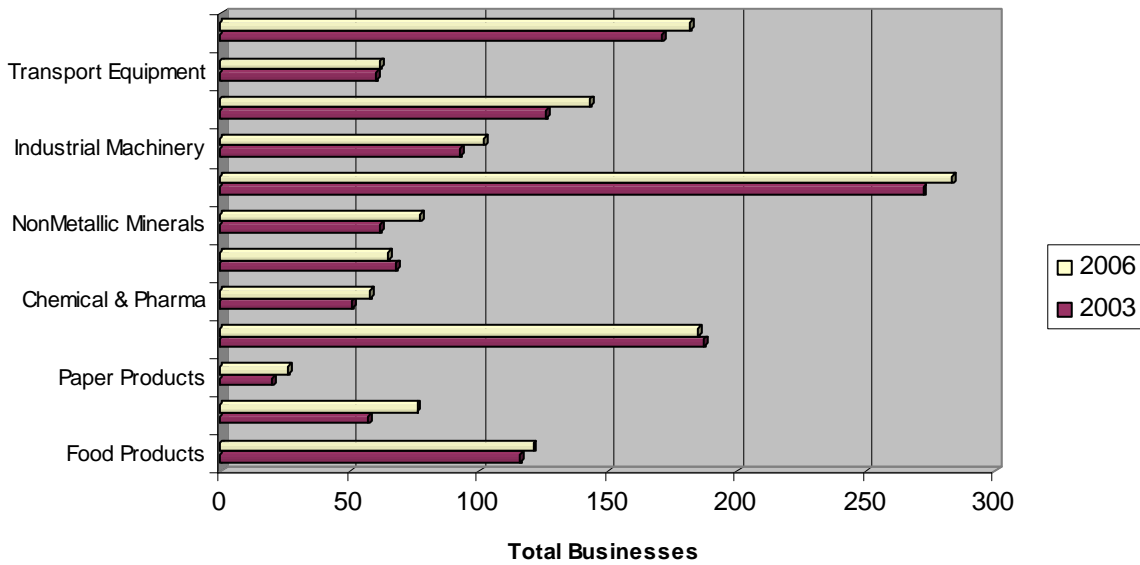
Manufacturing Business Populations in Utah County 2003/2006



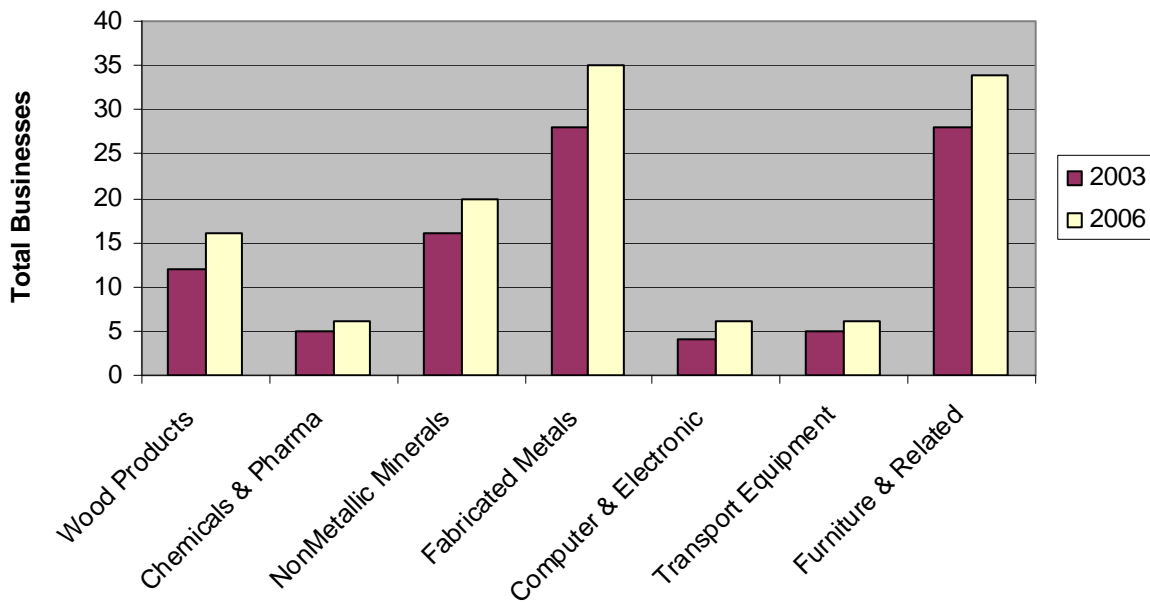
Manufacturing Business Populations in Davis County 2003/2006



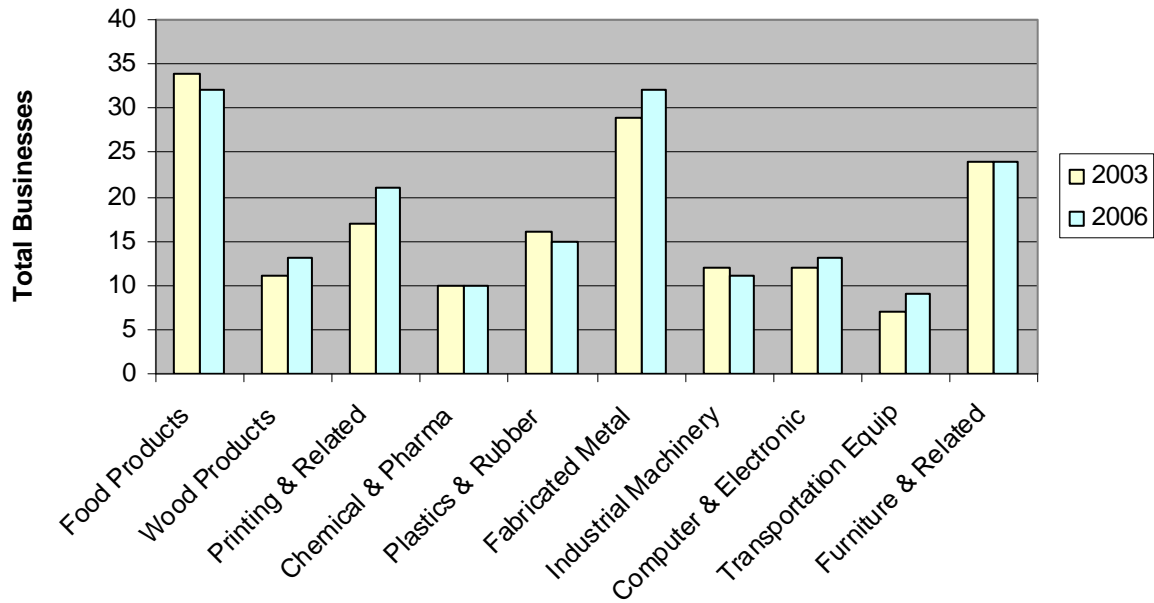
Manufacturing Business Populations in Salt Lake County 2003/2006



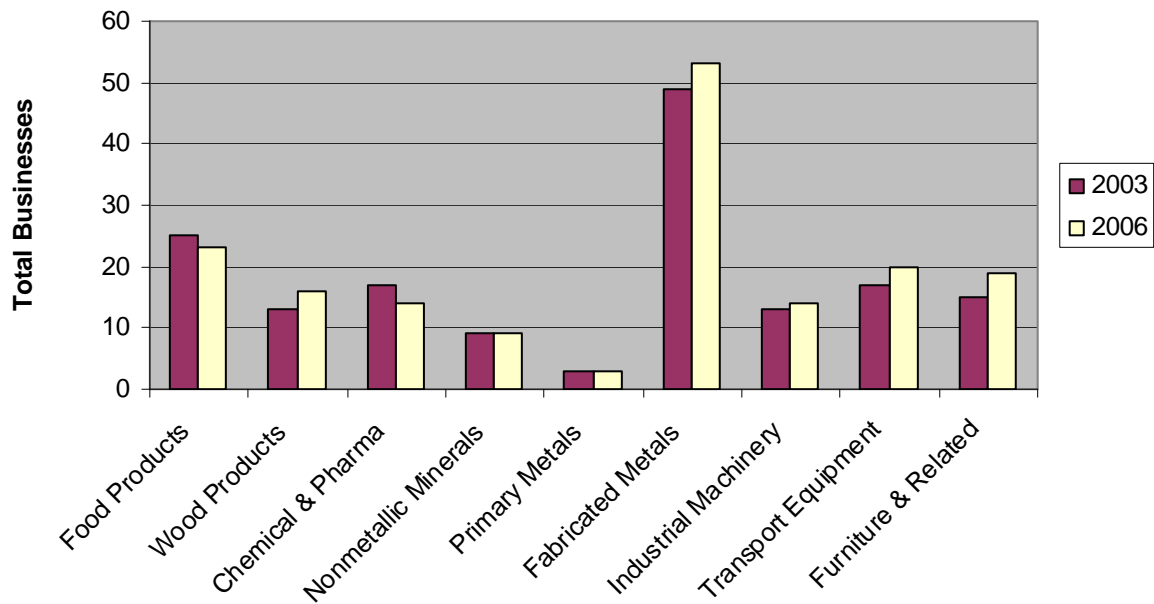
Manufacturing Business Populations in Washington County 2003/2006



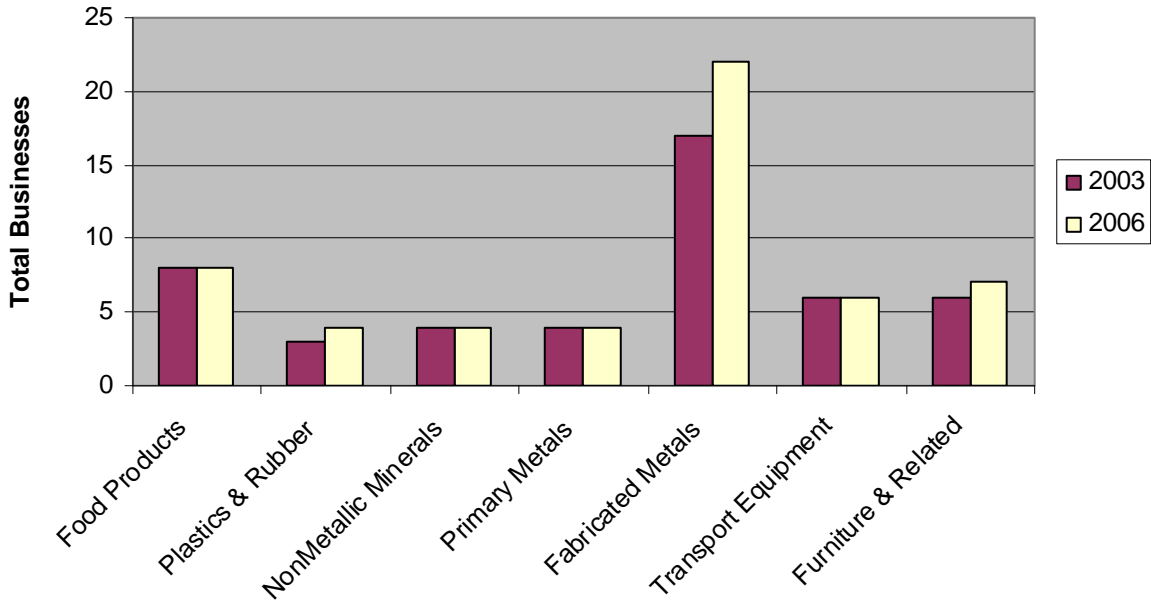
Manufacturing Business Populations in Cache County 2003/2006



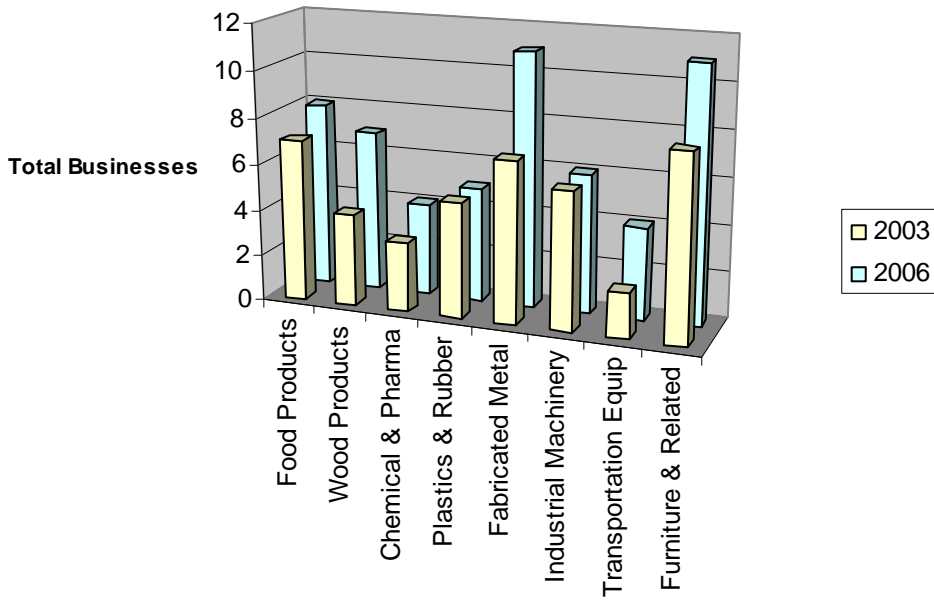
Manufacturing Business Populations in Weber County 2003/2006



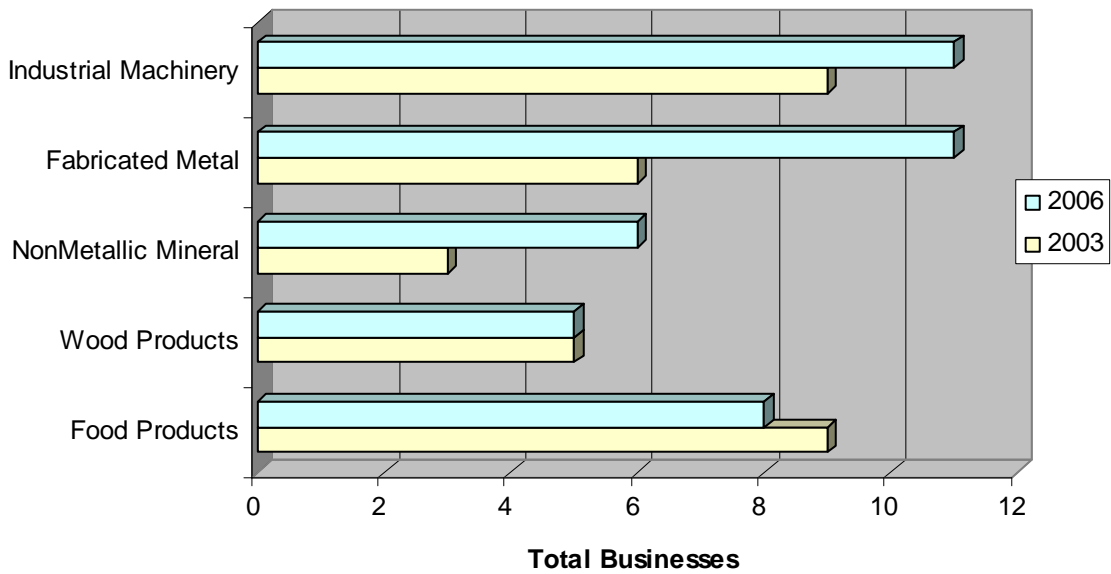
Manufacturing Business Populations in Box Elder County 2003/2006



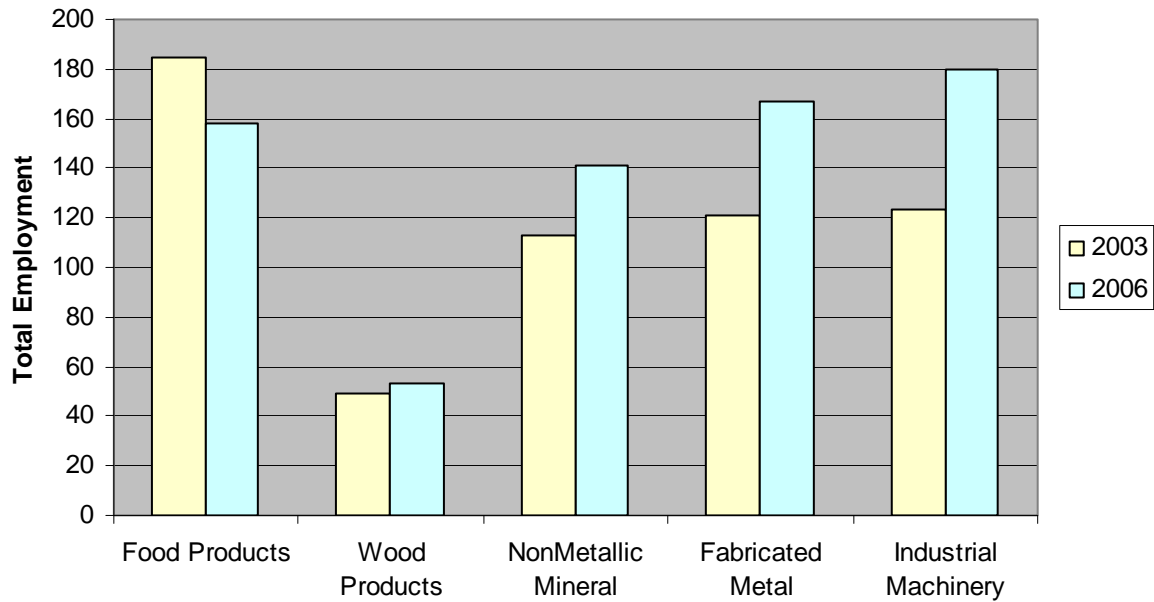
Manufacturing Business Populations in Iron County 2003/2006

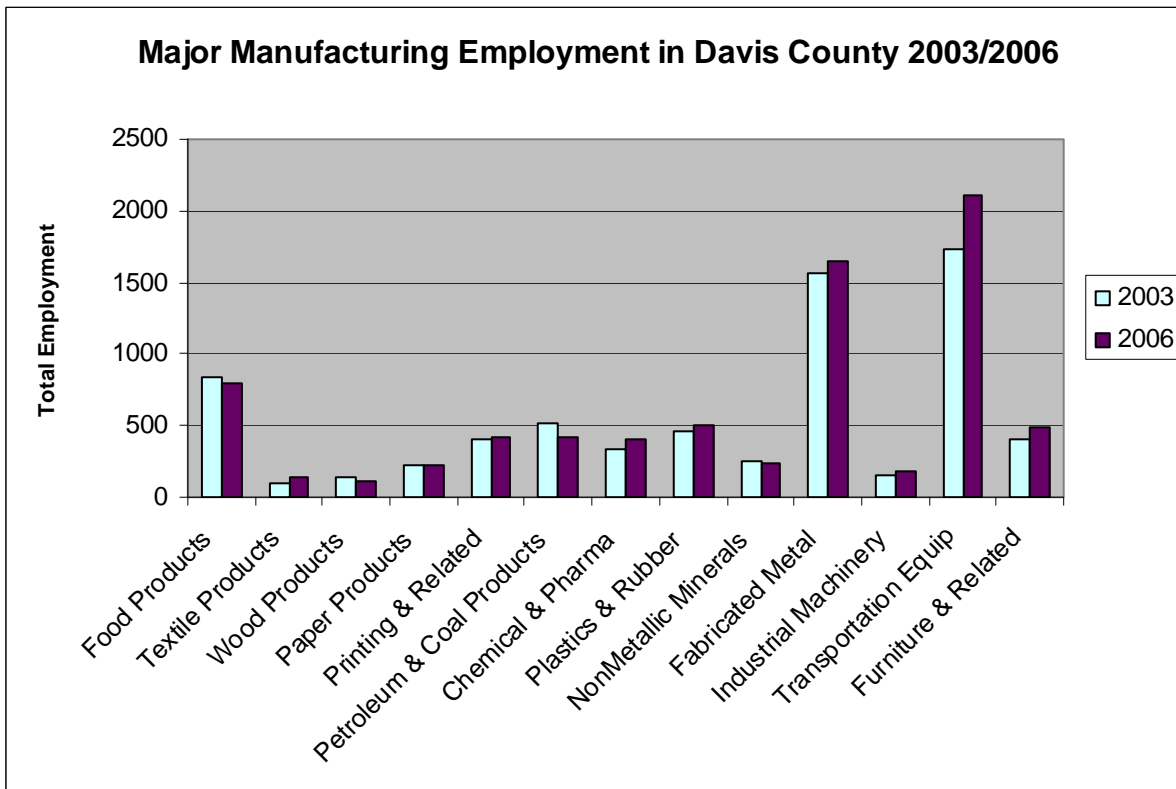
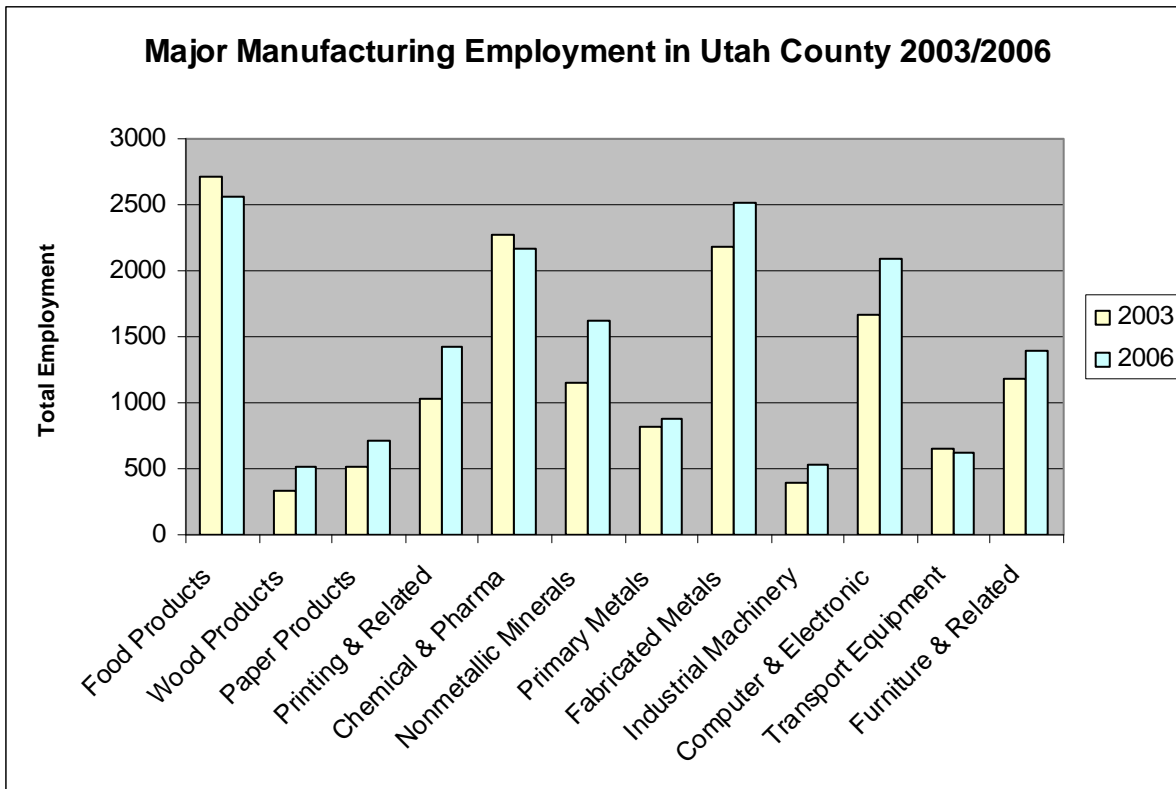


Manufacturing Business Populations in Utah's Energy-Producing Zones (CarbonSevierDuchesneUintah) 2003/2006

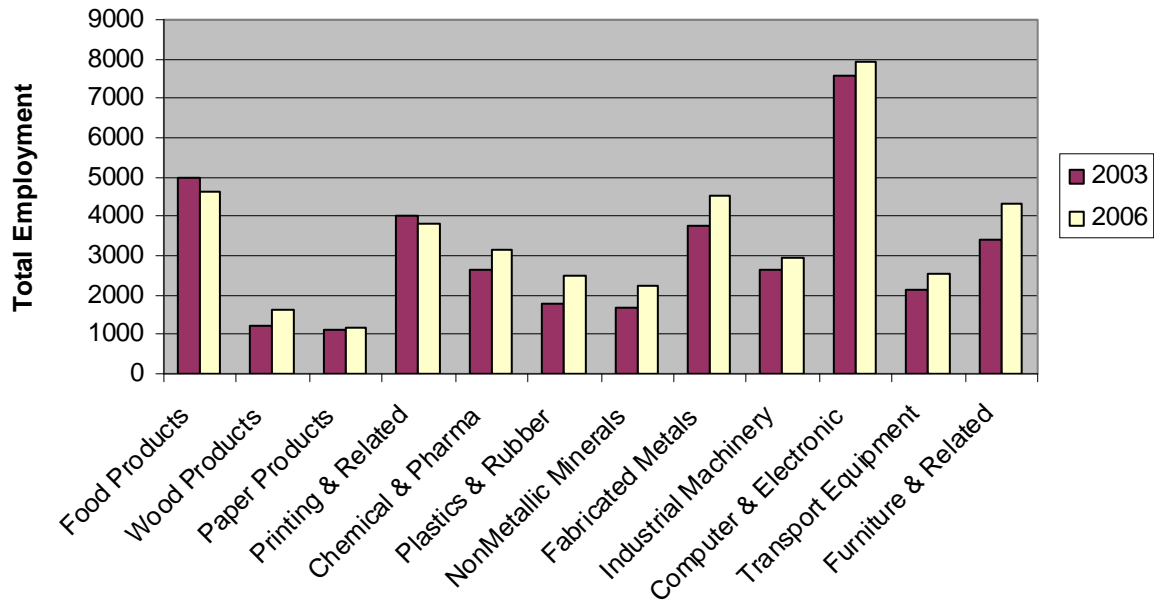


Major Manufacturing Employment in Utah's Energy-Producing Zones (CarbonSevierDuchesneUintah) 2003/2006

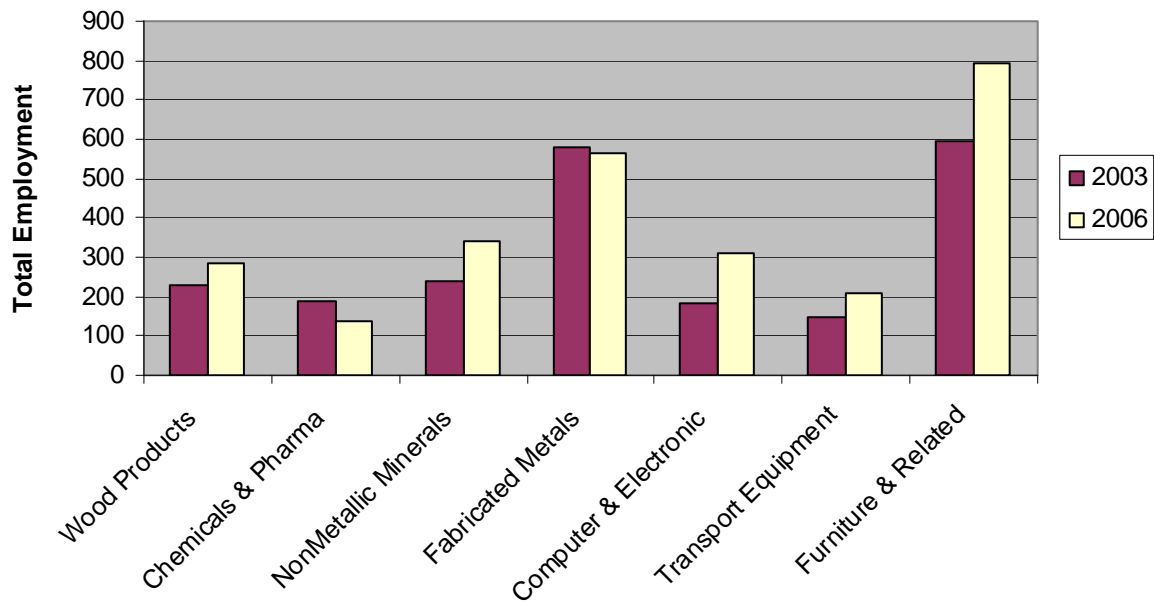


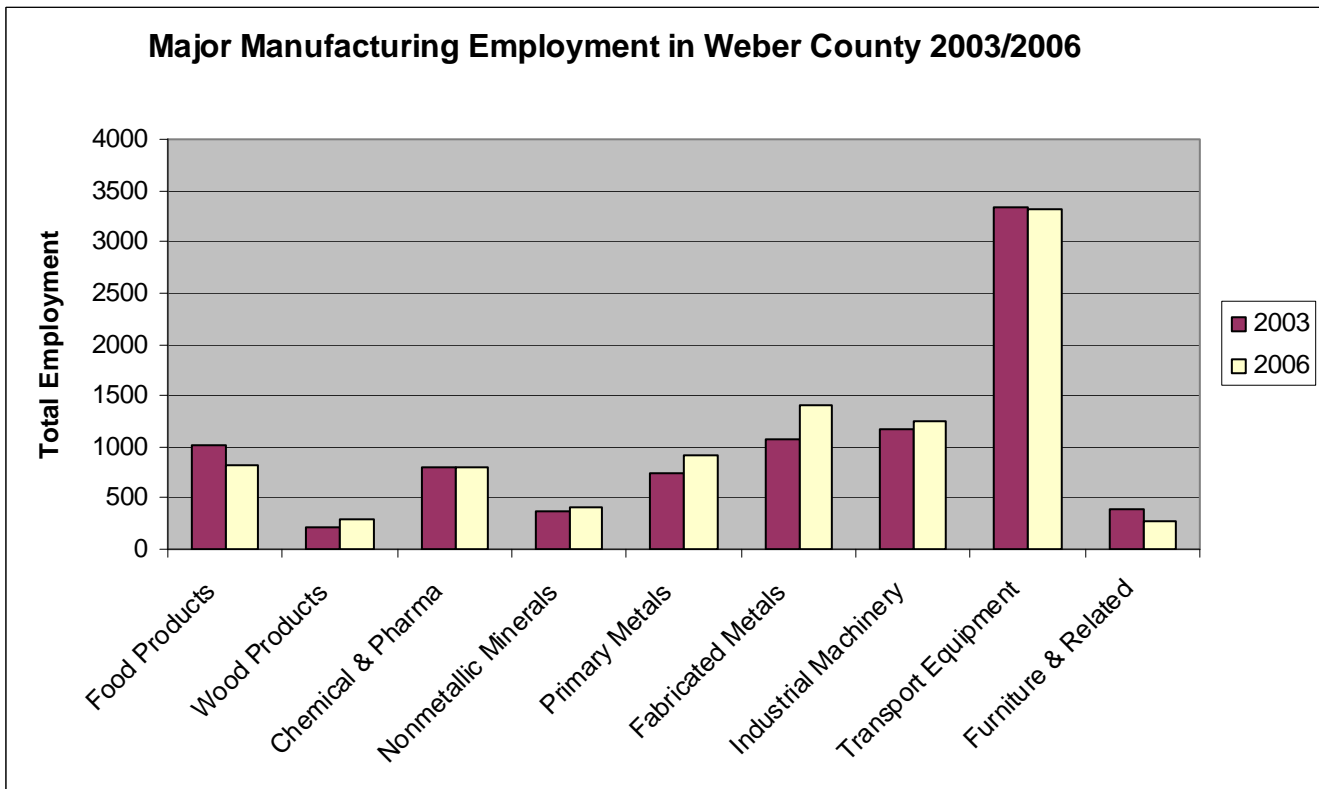
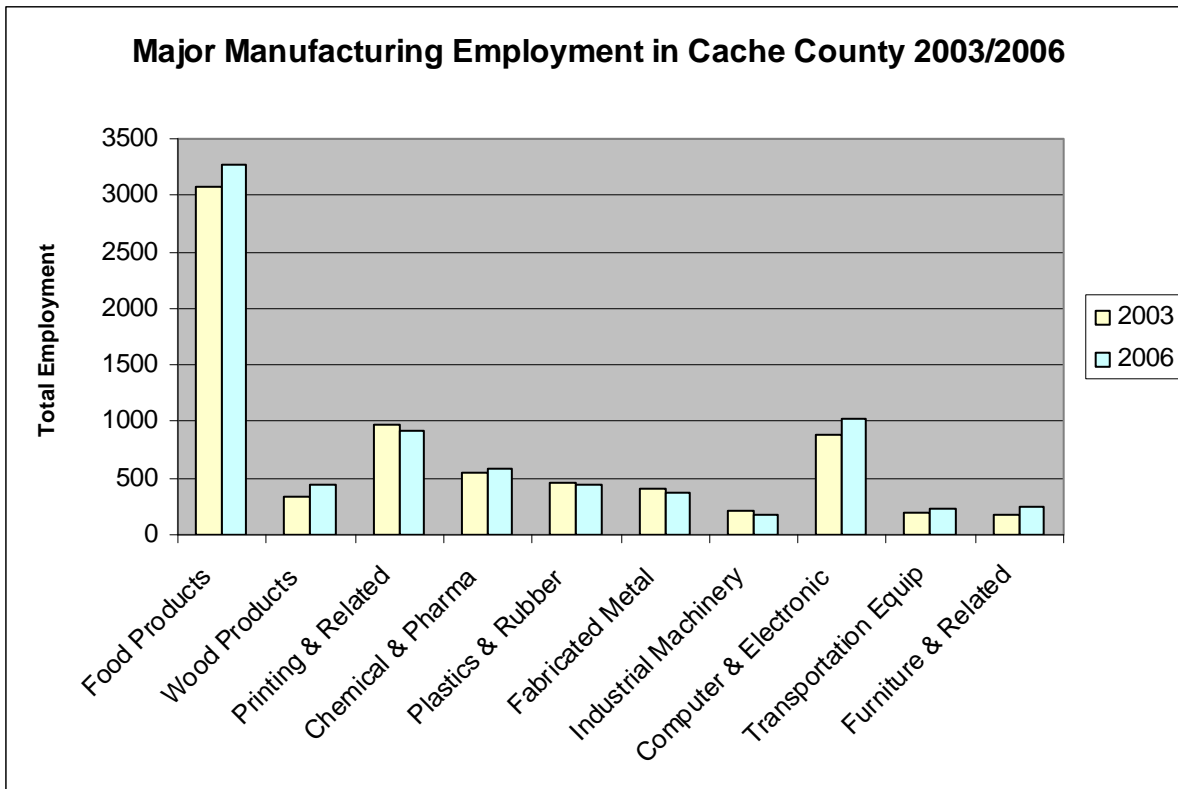


Major Manufacturing Employment in Salt Lake County 2003/2006

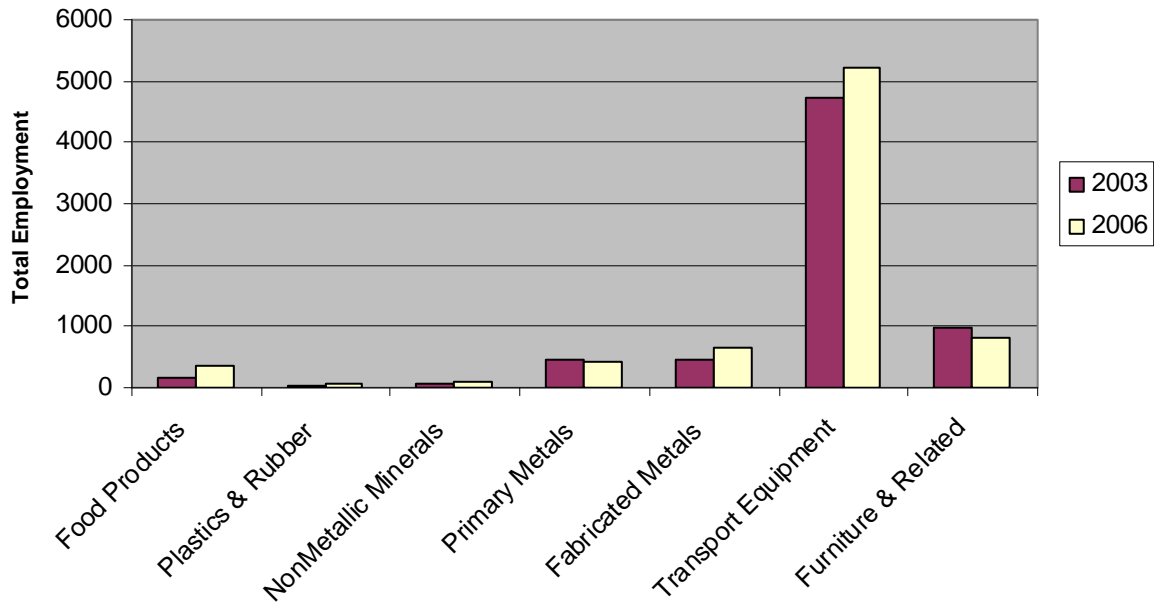


Major Manufacturing Employment in Washington County 2003/2006





Major Manufacturing Employment in Box Elder County 2003/2006



Major Manufacturing Employment in Iron County 2003/2006

