



2011 REGIONAL ECONOMIC OUTLOOK



2011 OVERVIEW

We are pleased to present to you, for the third year in row, the Regional Economic Outlook—presented by the Cincinnati USA Partnership for Economic Development and the Northern Kentucky Chamber of Commerce. This outlook understands that the economy does not recognize rivers or borders, but functions regionally, and we are proud to partner on this effort.

We hope that the Regional Economic Outlook, prepared by the Cincinnati USA Partnership's Regional Economic Advisory Committee (the Committee), is a helpful tool for you in your 2011 business planning. The 2010 Outlook was on point, with the Committee projecting that the national economy was “turning the corner” and would show positive growth in the 3rd quarter of 2009; however, growth would be “slow and uneven.” In fact this is exactly how the economy has behaved over the last 12 months.

Economic growth [as shown for Gross Domestic Product (GDP) in Table 1] increased 1.6 percent in the 3rd quarter 2009, followed by a 5 percent increase in 4th quarter 2009, but recently this growth dropped to just 1.6 percent in the 2nd quarter of 2010.

This recovery has been anything but smooth. Manufacturing activity demonstrated significant strength initially. While the drive to rebuild depleted inventories generating an 8.3 percent annual rate of growth for industrial production in the 3rd quarter 2009, the rate of growth has leveled off and slipped back a little.

At the same time, while overall job growth has been very weak, the surprise has been manufacturing employment showing the most improvement.

The organization charged with identifying the beginning and end of recessions, the National Bureau of Economic Research (NBER), pronounced in Sept. 2010 that this economic downturn ended in June 2009. However, with the slow progress in overall employment, it has not felt like the Great Recession has morphed into a “great” recovery.

This year's report examines where we stand in this business cycle and tries to answer the following questions:

- Will the current lull in the economy turn into a double-dip?
- When will employment growth pick up?
- When will this feel like a recovery?

We intend for the information contained in this report to serve as a helpful guidepost in your planning work for 2011.



Ellen G. van der Horst

President & CEO

Cincinnati USA Regional Chamber



Steve Stevens

President

Northern Kentucky Chamber of Commerce





NATIONAL PERSPECTIVE

Review of Key Economic Indicators

The Great Recession made everyone feel as if the economy dropped into a big hole. The question is: since the recovery began, how much have we climbed back from the bottom? The following table (Table 1) summarizes the depth of the decline and the extent of the recovery.

Table 1: Economic Indicators, Percent Change

Indicator	Peak to Trough	Trough to Latest
GDP (Q2 2010)	-4.1%	3.0%
Industrial Production (Aug. 2010)	-15.1%	9.0%
Retail Sales (Aug. 2010)	-11.7%	8.4%
Total Employment (Aug. 2010)	-6.1%	0.6%
Manufacturing Employment (Aug. 2010)	-17.7%	1.3%
Housing Starts (Jul. 2010)	-79.0%	14.5%
Light Vehicle Sales (Aug. 2010)	-46.9%	22.7%

Some key indicators have shown remarkable improvement from their cyclical bottom. But most indicators, especially housing, autos and employment, have quite a way to go to get back to pre-recession levels. The recovery to date has been primarily driven by substantial growth in the industrial sector due to re-stocking of inventories.

From our review of several key economic indicators, we believe the economy has traction, but the path will be slow and uneven.

Consumer Spending

- Growth in consumer spending is critical for this economy to move ahead. After bottoming out mid-year 2009, retail sales experienced a recovery in demand through the end of the year and into first quarter 2010 (Figure 1). Since then, retail sales have been sluggish resulting in a narrowing of year-over-year gains. While this is partially a result of comparison to the “Cash for Clunkers” program last year, further increases in activity by consumers will depend on their continued efforts to reduce their debt.
- Even though retail sales have improved, vehicle sales and new housing starts have yet to participate in the recovery. Since the end of the “Cash for Clunkers” program, vehicle sales have remained flat.
- Consumer debt obligations have declined somewhat from a high of almost 19 percent of disposable income to roughly 17 percent; however, until the debt hangover improves further, gains in vehicle sales and housing will be slow.
- As foreclosures increased, the inventory of new homes for sale weakened, backing up past gains.
- After peaking above a 12-month level of homes for sale, the inventory dropped below seven months, but now is back up to nine months (Figure 2).
- This needs to drop in half before we will see a sustainable pickup in housing starts.

Figure 1: Retail Sales (\$MM)

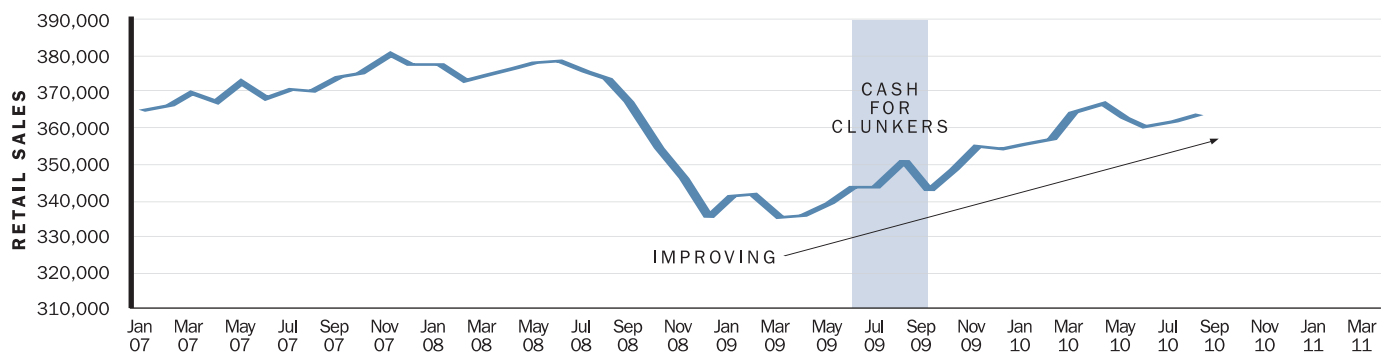
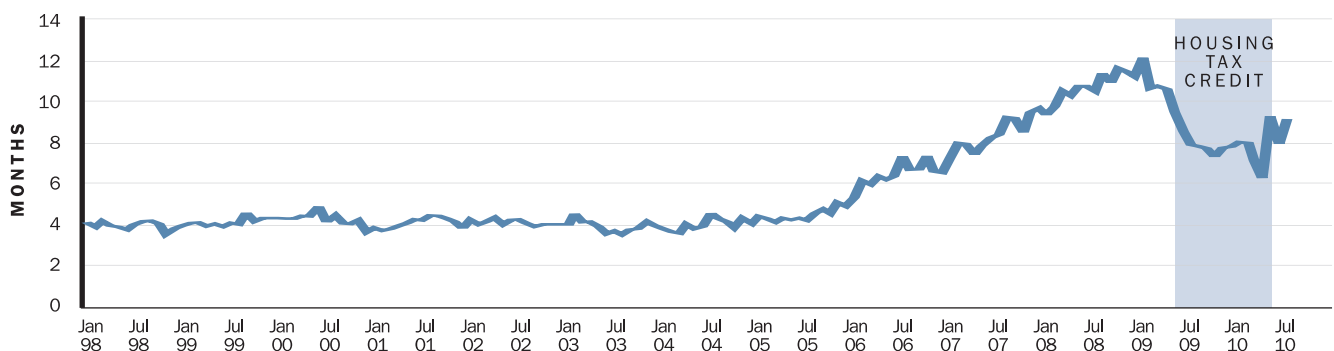


Figure 2: Months of New Houses Available for Sale





NATIONAL PERSPECTIVE

Business Activity

- In last year's outlook, concerns were raised that the refunding of commercial debt coming due could pose a major challenge. While such an impact has not come to pass, the concern persists. Businesses have been able to continue to operate because banks have provided more flexible payment plans. However, over the next two-to-three years, this issue could force asset sales.
- When the Institute of Supply Management index of manufacturing activity is above the level of 50, the economy is in an expansion mode. Since this index indicated a recovery in manufacturing in August 2009, it has stayed positive with the latest reading of 54.4 in Sept. 2010.
- The recovery in manufacturing began in the auto and steel industries, but has now become broad-based across most industry groups.
- Manufacturing is part of the story of this recovery. While the performance of industrial production has fallen behind that of a typical recovery, it does represent a bright spot and builds the foundation for further improvement through its increase in jobs.
- Through August 2010, the index has recovered almost half of the decline. However, it is off roughly 12 percent from where it would be in a typical recovery.
- In this business cycle, industrial production continues to parallel the 1973–1975 recession rather closely, though at a slightly lower level (Figure 3).

Employment

- A critical component missing from this recovery has been a sustained rebound in employment. As Figure 4 shows, we did not see any increase in employment until almost six months after the end of the recession. And from that point, five months of increases were followed by three months (to date) of declines. Granted, the hiring and laying off of Census workers has disrupted the data. However, there is no question that strong employment growth is lacking.
- Unemployment claims have declined from its peak, but there is still some way to go to get claims below 400,000, which is usually the point indicating labor markets are truly improving.
- While manufacturing employment took the brunt during the decline, it is now a bright spot in the employment picture posting increases in seven out of the last eight months (Figure 5).
- Other sectors showing gains are education, health and business services. The wholesale and retail trade and construction sectors are not growing, needing further strength in consumer spending. Employment in the wholesale sector will continue to see pressure as businesses take advantage of more computerized inventory management practices as one factor.

Figure 3: Industrial Production

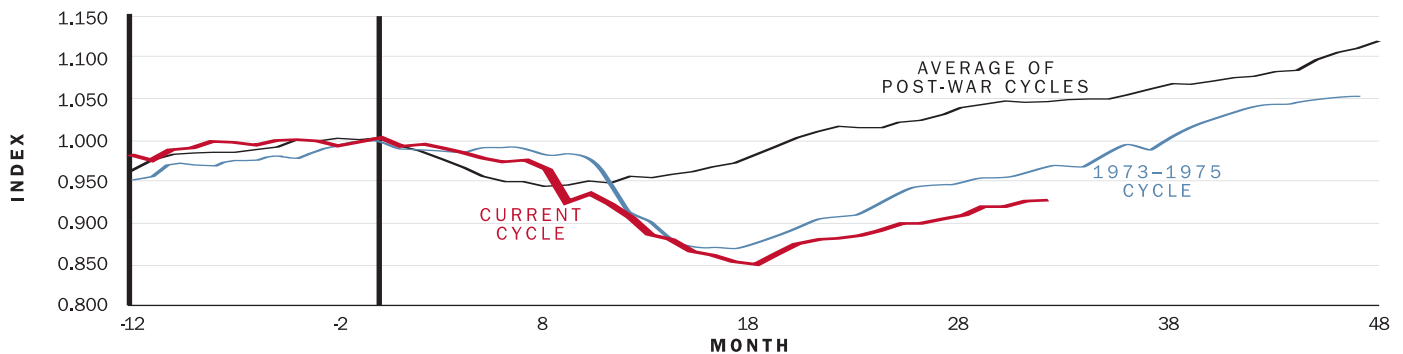


Figure 4: National Employment, Monthly Percent Change - Annual Rate

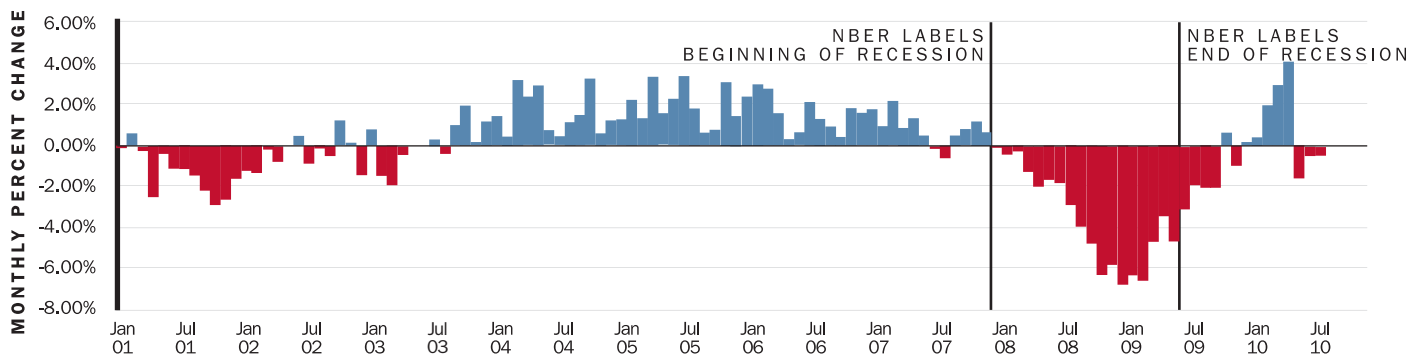
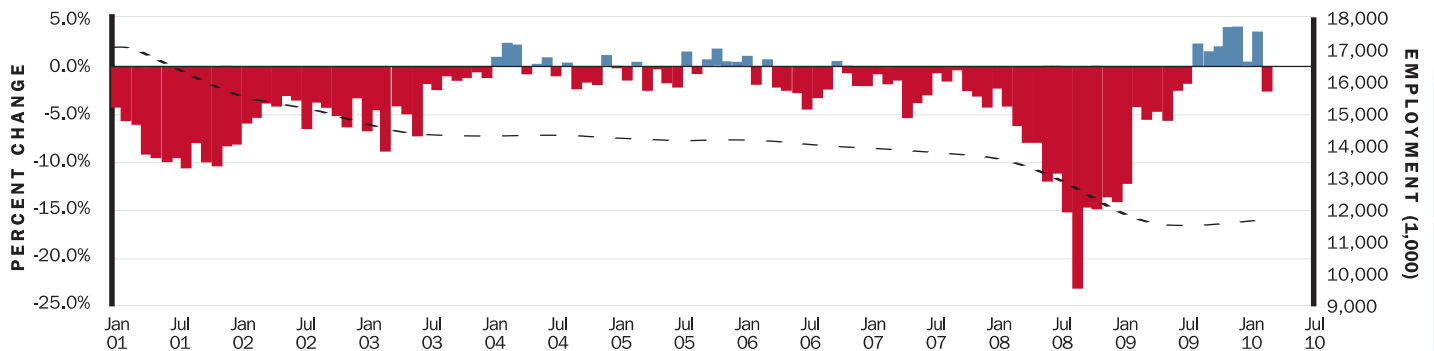


Figure 5: Manufacturing Employment, Monthly Percent Change - Annual Rate



Fundamental Changes

- Employment weakness raises the question: ‘what is different about this business cycle? Has there been a fundamental change?’ During 2010, the economy experienced some notable increases in productivity.
 - Many people have attributed this increase in productivity to a workforce reduction which was proportionally greater than the decrease in production. However, over the long term, productivity growth can only be achieved through changes in the method of production; through the use of higher-skilled labor or investment in better tools and machinery.
 - Some observers of the economy have worried that more efficient production will reduce the need for labor, increasing unemployment rates over the long term. We do not anticipate that this will be the case.
 - For the economy as a whole, higher productivity tends to lead to higher wages and profits. These higher income levels will increase demand for goods and services which, in turn, will increase the demand for labor. Enhanced productivity also will increase the competitiveness of the national economy relative to other economies which will lead to increased production and employment.
- Thus, increases in productivity, rather than reducing work opportunities are most likely to increase employment and generally benefit the large majority of citizens. In fact, these benefits could be enhanced by implementing policies that would increase the education and quality of the workforce, as well as the investment in capital goods that increase productivity.

Financial Sector

- Monetary policy continues to be extremely accommodating with very low short-term rates and a dramatic expansion of the monetary base (deposits at the Federal Reserve + currency).
- The spread between the 10-year Treasury Bonds and the short-term three-month Treasury Bill rate has shrunk with activities of the Fed including buying bonds, as well as pension funds and investors looking for greater yields than that offered by short-term instruments.
- However, low short-term rates in this cycle continue to signal weakness and uncertainty in the economy. Further, the recent drop in the growth rate of the money supply signals a rising risk of a slower growing economy.

Government

- Efforts by the Federal government to boost the economy as well as fund entitlements continue to rapidly increase the level of the Federal debt. The deficit over the last 12 months was another \$1.3 trillion.
- This growth in the level of the debt poses longer-term risk to the recovery and the overall economy.

Foreign Trade

- The current account balance represents the net outflow of dollars for the purchase of goods and services from foreign countries. The dollars flowing out of the country are being used to purchase our rising debt burden.
- While the level of outflow has diminished somewhat, continuation of large outflows raises risk on the value of the dollar.



NATIONAL OUTLOOK

Introduction

Last year, the Committee projected that the economy was turning the corner and showing positive growth. This year, the Committee projects that economic growth will continue through 2011, but the path will be slow and uneven. Until there is recovery in the housing market, this will be a “two-steps-forward, one-step-back” environment. Unemployment levels will remain relatively high, but will slowly begin to improve, more so in late 2011.

The following table (Table 2) summarizes the outlook for the national economy as prepared by the Committee.

Table 2: National Economic Outlook

Indicator	2010	2011
Real GDP	2.70%	2.90%
Total Employment	-0.40%	1.10%
Manufacturing Employment	-1.0%	0.50%
Unemployment Rate	9.60%	9.10%
Inflation - CPI	1.50%	1.50%
Retail Sales - Nominal	5.50%	5.00%
3 Month T-Bills	0.15%	0.30%
10 Year Treasury	3.25%	3.40%
Prime Rate	3.25%	3.40%

Real GDP

Recent Trends: Gross Domestic Product (GDP) has been rising over the last four quarters, but now is proceeding through a slow period that appears to be a reaction to the acceleration of vehicle sales and housing activity from the “cash for clunkers” program and housing tax credits. Those sales decelerated once the programs ended, creating a valley in economic activity. One other contributor is the significant increase in imports in the 2nd quarter.

Forecast: The economy will continue to show slow and uneven growth through 2011 (Figure 6). We have achieved lift-off from the bottom of the recession, but uncertainty about the future continues to hinder faster growth. The process will be slow until consumer finances have recovered enough to increase spending and absorb more debt.

Total Employment

Recent Trends: Lack of employment growth is now the story in this business cycle.

Forecast: Employment will continue to be weak and annual growth will not show a positive gain until 2011 (Figure 7).

There will be bright spots in manufacturing, health services and business services. However, growth in employment in the retail sector will suffer until consumers domestically and globally pick up the pace of consumption. In addition, business will continue to drive for productivity improvements that will keep manufacturing employment under pressure over the longer term. Unemployment will remain relatively high into early 2011 and then slowly improve.

Figure 6: Gross Domestic Product, Forecast 2010 & 2011

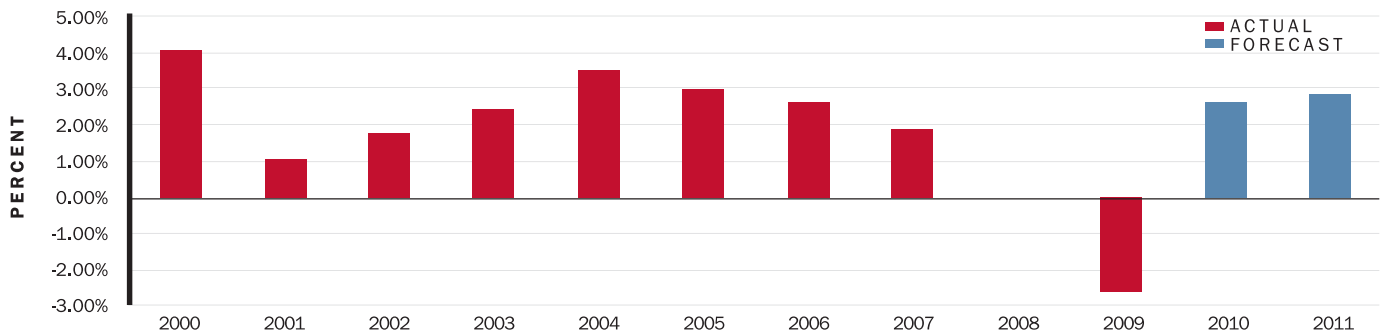
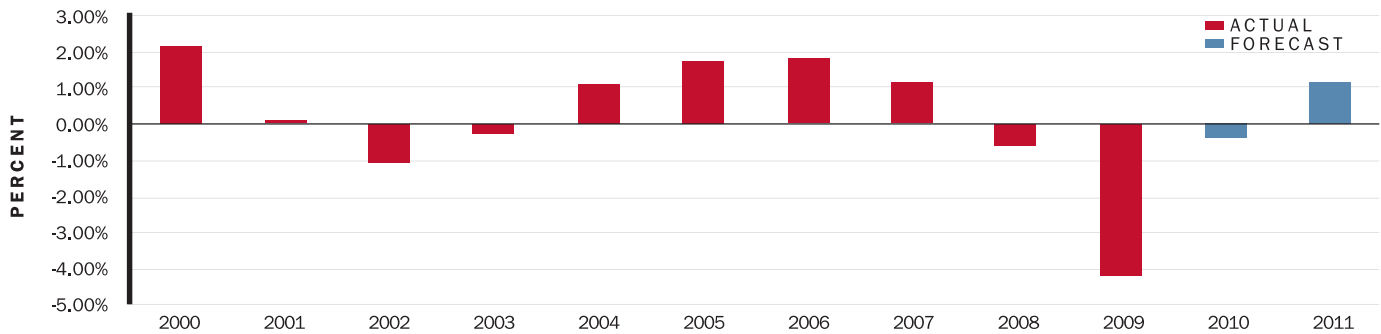


Figure 7: National Total Employment, Forecast 2010 & 2011



Inflation

Recent Trends: Inflation remains low due to the general weak nature of the economy. Concerns continue to be raised about deflation, but it is not a risk due to the amount of monetary and fiscal stimulus in the pipeline.

Forecast: Inflation will remain low and is not expected to move up quickly—staying below 2 percent. One risk factor that could escalate inflation is the pressure on the dollar from financing the federal deficit and the overall level of debt.

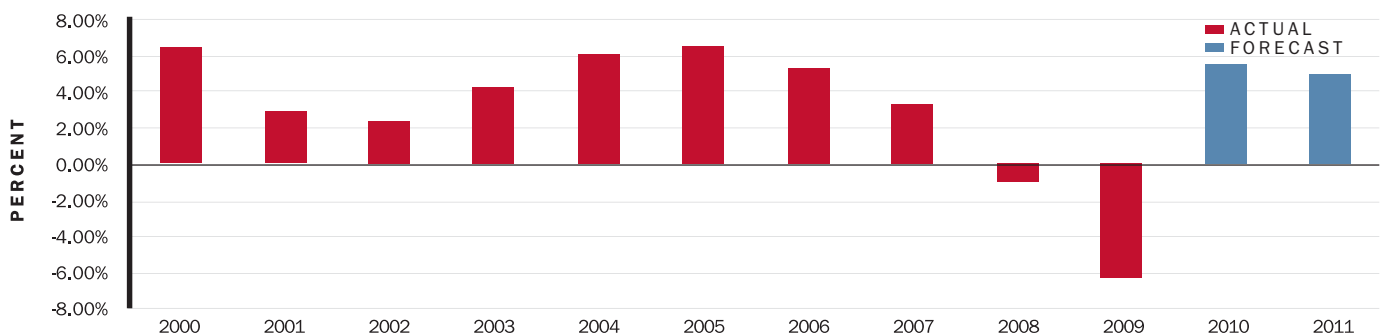
Retail Sales

Recent Trends: Retail sales growth has been improving, but like the rest of the economy, growth has slowed recently.

Forecast: 2011 gains in retail sales are expected to slow to 4.5 percent (Figure 8). This reflects the generally modest overall economic recovery and poor job growth. Pent-up demand helped to produce strong growth for six-to-nine months. But, without better job and wage growth, that trend is not sustainable.

For retail sales to break out to higher levels of growth, we will need to see consumer finances return to balance and job growth accelerate above our modest expectation.

Figure 8: Retail Sales, Forecast 2010 & 2011





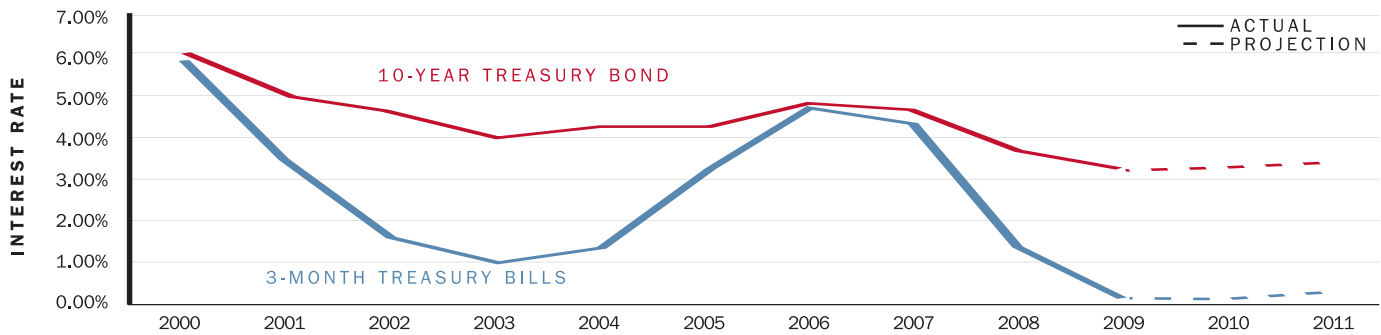
NATIONAL OUTLOOK

Interest Rates

Recent Trends: Short-term rates remain low, but the spread between short-term and long-term rates has narrowed recently due to actions of the Federal Reserve, as well as investors.

Forecast: As the economy picks up strength, we look for the Federal Reserve to begin increasing rates and removing the massive monetary stimulus in the financial system (Figure 9). Their execution on these moves needs to be watched to make sure it does not short-circuit the recovery.

Figure 9: Interest Rates, Forecast 2010 & 2011



Conclusion

We have experienced the worst recession since the Great Depression. Even though the National Bureau of Economic Research has declared victory over the Great Recession, the effects linger on in terms of weak employment growth and elevated debt levels. It will take time before we once again reach the levels of economic activity seen before this recession.

The Committee views 2010 as a year of regaining our footing, like achieving a sense of balance after a major shock.

Ripple effects of the shock will appear from time-to-time, such as real estate loans yet to come due and a weakening dollar.

However, the economy will continue to grow and expand; and the Committee projects that 2011 will be better than 2010. A revitalization of the entrepreneurial spirit, a key strength of this country, will go a long way to more quickly rebuild business and consumer confidence, thus moving this economy forward.



REGIONAL OUTLOOK

Introduction

While the recession is officially over, the recovery has yet to gain much steam. Given the length and depth of the recession, it will likely take several years for the economy to rebound. So while the region will see positive income and job growth in 2011, the unemployment rate will remain high. Likewise, it appears that the slide in housing is over. Given the drop in prices, coupled with a weak labor market, foreclosures are expected to remain at high levels in 2011.

At this point, business and industry are carrying the ball for the recovery while consumers sit on the sidelines. However, the recent surge in manufacturing to rebuild inventories is almost complete, leaving near term growth to be shaped by the effects of recent business investments in equipment and software and the health of international export markets.

The bottom line for 2011 is that it will be better than 2010, but only incrementally.

During the duration of the recession, the regional economic trends have closely followed national trends. At the same time, differences do exist. We highlight those differences in this report.

Gross Regional Product

Gross Regional Product (GRP) is a measure of the total production and consumption of goods and services in the area. It provides the single most encompassing picture of economic activity available.

Recent Trends: After declining an estimated 2.7 percent in 2009, Cincinnati USA's real GRP increased an estimated 2.7 percent in 2010 (Table 3).

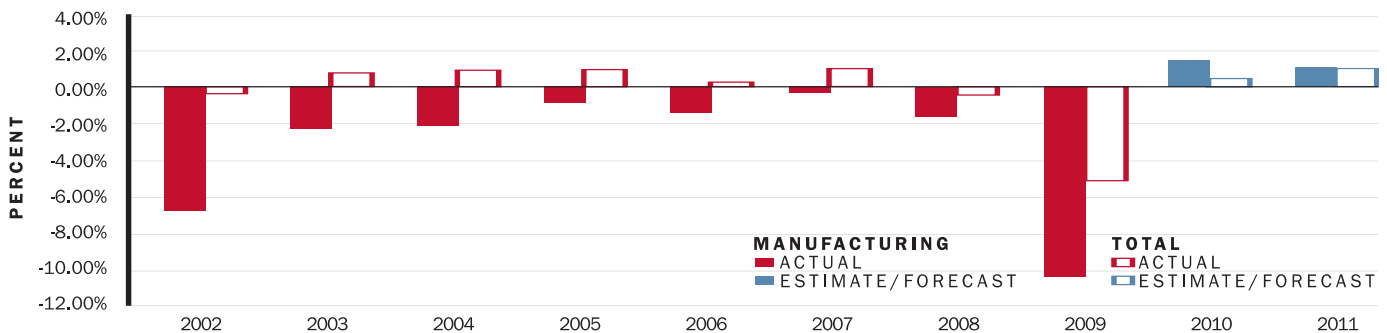
Forecast: Based on the anticipated strength of the national economy, regional GRP is expected to increase 2.9 percent in 2011, matching the forecasted increase nationally.

Table 3: Real Gross Regional Product (Millions of Dollars*), Cincinnati USA

Year	Gross Regional Product	Percentage Change
2002	\$77,912	2.6%
2003	\$79,137	1.6%
2004	\$80,777	2.1%
2005	\$82,169	1.7%
2006	\$81,199	-1.2%
2007	\$81,775	0.7%
2008	\$81,831	0.1%
2009 Estimate	\$79,581	-2.7%
2010 Estimate	\$81,730	2.7%
2011 Forecast	\$84,100	2.9%

Source: 2001-2008 U.S. Bureau of Economic Analysis; 2009-2011 Consensus Forecasting Committee.
* Measured in 2001 dollars

Figure 10: Wage and Salary Employment in Cincinnati USA



Wage and Salary Employment

For most consumers the business cycle is defined by the ability to attract or retain a job. As such, job numbers have a psychological impact on consumers, in addition to providing a measure of the labor market. There is probably no other data indicator that is as widely monitored by financial markets.

Recent Trends: The regional labor market fared a bit worse than the rest of the country during the recession and the pace of recovery is a bit slower. During the recession the Cincinnati USA region lost 57,400 jobs, a decline of 5.5 percent compared to a decline of 5.3 percent nationally. Since the end of the recession, the area has lost 4,300 jobs, a decline of 0.4 percent compared to a decline of 0.2 percent nationally.

While the labor market continues to shed jobs, the pace has slowed from this time last year. Between January and July 2009 the region lost 48,200 jobs (a 4.6 percent decline) compared to the prior year. Between January and July this year, the region lost 16,300 jobs (a 1.6 percent decline). The results across industries vary considerably. While the manufacturing sector appears to have halted the decline along with education and healthcare, other sectors such as information services and financial services are shedding jobs at a faster pace than this time last year.

Forecast: Based on these recent trends in employment and unemployment, the members of the Committee expect total employment to increase by 1.1 percent in 2011 compared to 2010's estimated 0.5 percent decline (Figure 10).



REGIONAL OUTLOOK

Manufacturing Employment

Recent Trends: Manufacturing employment, after a steep decline during the recession, has started to see some modest recovery. Through the first seven months of 2010 the year-over-year change in the number of manufacturing jobs has returned to positive territory (Figure 10).

Forecast: Employment in the manufacturing sector is forecasted to finish 2010 up 1.5 percent, climbing another 1 percent in 2011.

Unemployment

Recent Trends: In July the unemployment rate in Cincinnati USA was 9.8 percent—unchanged from a year earlier. The number of unemployed stood at 113,000 with an estimated 40 percent of the unemployed having been without a job for six months or longer.

Forecast: Next year the unemployment rate is forecast to average 9.4 percent, down slightly from 2010's estimated annual average of 9.9 percent (Figure 11).

Even with job growth, the unemployment rate is not forecasted to decline much. Why? As the labor market improves it is anticipated that discouraged workers will jump back into the labor market keeping the unemployment rate high throughout 2011.

Figure 11: Unemployment Rate in Cincinnati USA



Average Hours Worked

Last year's report projected that real GDP would grow in 2010 even as employment continued to decline, which indeed is what happened. In response, many ask how that could happen.

Part of the answer lies in how employment numbers are generated. A person working 20 hours a week and a person working 40 hours a week are each counted as having one job. With millions of workers employed part-time involuntarily, employers can easily ramp up output without adding new workers by simply adjusting hours. The underemployed, especially those involuntarily working part-time, were forecasted to see an increase in average hours worked per week in 2010.

Therefore, much of the economic growth in 2010 was forecasted to show up not in the employment numbers, but in rising hours worked and payroll income.

In the Cincinnati USA region the average hours worked per week bottomed out in April 2009 at 32.6 hours and has increased to an average of 33.8 in July 2010. Average pay bottomed out in July 2008 at \$20.77 per hour and has climbed back up to \$21.23 in July 2010. The number of private-sector jobs bottomed out in February of this year and now stands at 865,600. As a result of these improvements, total payroll income through the first seven months of the year has kept pace with last year and is on track for a net increase by the end of the year.

Construction and Real Estate

The bursting of the housing bubble is frequently pointed to as the trigger for the recession. In prior recessions, it has often been housing that first turned upward and led the U.S. out of a recession. That is not a likely scenario for the current recovery.

Recent Trends: Permits for new residential housing units declined for four years between 2006 and 2009. Permits are on track to end the year with a net increase at 4,050 units (Figure 12).

Like residential construction, non-residential square footage has declined for several years and is expected to continue through

the end of the year. In 2010, an estimated 3.8 billion square feet of additional non-residential space is expected to come online.

Forecast: The Committee expects new residential units to increase 33 percent in 2011 rising to 5,400 units. By comparison, in 2005 units totaled 12,690 or 57 percent more (Figure 12).

In 2011, the forecast calls for 4.2 billion additional square feet of non-residential, an increase of 10.5 percent. By comparison, non-residential square footage totaled 14.4 billion in 2005, or nearly 70 percent more than the 2011 forecasted amount (Figure 13).

Figure 12: Residential Housing Units, Permits in Cincinnati USA



Figure 13: Non-Residential Square Footage in Cincinnati USA



Regional Forecast Summary

The Committee's consensus forecast presented in this Outlook predicts recovery. However, with continued weakness in the labor market, and a very slow recovery expected in the housing market, only modest growth is forecasted for 2011. Forecast details are listed in Table 4.

Table 4: Regional Forecast Summary 2011

Indicator	2010 Estimate	2011 Forecast
Gross Regional Product (in constant dollars)	2.7%	2.9%
Total Employment	-0.5%	1.1%
Manufacturing Employment	1.5%	1.0%
Unemployment Rate	9.9%	9.4%
Construction Activity		
Residential Dwelling Units	4,050	5,400
Non-Residential Square Footage (in millions of square feet)	3,800	4,200



2011 REGIONAL ECONOMIC OUTLOOK

REGIONAL ECONOMIC ADVISORY COMMITTEE

Richard Stevie

Chairman
Chief Economist
Duke Energy

Janet Harrah

Senior Director
Center for Economic
Analysis & Development
Northern Kentucky University

David Hehman

President & CEO
*Federal Home Loan Bank
of Cincinnati*

Brian Richard

Operations VP, Economics
and Sales Forecasting
Macy's

George Vredevel

Director, Economics Center
for Education & Research
University of Cincinnati

Gary Wright

President
Wright Futures

Special thanks to:

Bob Jennings

Vice President of Sales
Datalliance

Craig Thomas

Vice President,
Senior Economist
*The PNC Financial Services
Group*



300 Carew Tower
441 Vine Street
Cincinnati, Ohio 45202-2812
Phone: 513.579.3107

CincinnatiUSA.org



300 Buttermilk Pike
Suite 330
Ft. Mitchell, KY 41017-0416
Phone: 859.578.8800

NKYChamber.com