

State of Utah
Jon M. Huntsman, Jr.
Governor



Preface

This is the 20th anniversary of the *Economic Report to the Governor*. Throughout the last two decades the *Economic Report to the Governor* has served as the preeminent source for data, research, and analysis about the Utah economy. It includes a national and state economic outlook, a summary of state government economic development activities, an analysis of economic activity based on the standard indicators, and a more detailed review of industries and issues of particular interest. The primary goal of the report is to improve readers' understanding of the Utah economy. With an improved economic literacy, decision makers in the public and private sector will then be able to plan, budget, and make policy with an awareness of how their actions are both influenced by and impact economic activity.

Council of Economic Advisors. The Council of Economic Advisors (CEA) provides guidance for the contents of this report. The CEA is an advisory committee to the Governor and includes representatives from state government agencies, Wells Fargo Bank, Thredgold Economic Associates, Federal Reserve Bank of San Francisco, Utah Foundation, and all of Utah's major research universities. The mission of the CEA is to provide information and analysis that enhances economic decision-making in Utah. This report is the primary means of the CEA to communicate economic information to the general public.

Collaborative Effort/Contributors. Chapter authors, many of whom are special advisors to the CEA and who represent both public and private entities, devote a significant amount of time to this report, making sure it contains the latest economic and demographic information. While this report is a collaborative effort which results in a consensus forecast for the next year, each chapter is the work of the contributing organization, with review and comment by the Governor's Office of Planning and Budget. More detailed information about the findings in each chapter can be obtained by contacting the authoring entity (see list of Contributors).

Statistics Used in This Report. The statistical contents of this report are from a multitude of sources which are listed at the bottom of each table and figure. Statistics are generally for the most recent year or period available as of mid-December 2005. Since there is a quarter or more of lag time before economic data become final, the data for 2005 are preliminary estimates (p). Final estimates (e) can be obtained later in 2006 from the

contributing entities. Forecasts will be indicated in tables and figures with an (f). An (r) indicates the data has been revised. An (na) indicates that the data was not available at the time of printing. All of the data in this report are subject to error arising from a variety of factors, including sampling variability, reporting errors, incomplete coverage, non-response, imputations, and processing error. If there are questions about the sources, limitations, and appropriate use of the data included in this report, the relevant entity should be contacted.

Statistics for States and Counties. This report focuses on the state, multi-county, and county geographic level. Additional data at the metropolitan, city, and other sub-county level may be available. For information about data for a different level of geography than shown in this report, the contributing entity should be contacted.

New This Year. While the content of this report, other than introducing a new year of data and analysis, is similar to prior years, several updates and new data series or research efforts are worthy of highlighting. A chapter on Education has been added to the Economic Indicators section. The Special Topics section of this report contains five chapters, including: Tax History; Tax Reform; Transportation; Economic Development Activities; and Occupational Wage Adjustments.

Electronic Access. This report is available on the Governor's Office of Planning and Budget's Internet web site at <http://www.governor.utah.gov/dea>.

Glossary. Terms and definitions used in this report are available on the Governor's Office of Planning and Budget web site at the address listed above.

Suggestions and Comments. Users of the Economic Report to the Governor are encouraged to write or call with suggestions that will improve future editions. Suggestions and comments for improving the coverage and presentation of data and quality of research and analysis should be sent to the Governor's Office of Planning and Budget, State Capitol Complex Suite E210, Salt Lake City, Utah 84114. The telephone number is (801) 538-1027 or send email to dea@utah.gov.

Executive Summary

Overview

Utah's economy grew strongly during 2005. For the second year in a row, the state outperformed the nation, with job growth of 3.5%, compared to 1.6%. After two years of solid performance, Utah appears poised to repeat the long expansion of the 1990s.

The list of records set during 2005 was truly remarkable. Total construction value, residential construction value, and total dwelling unit permits set all-time highs. The growth rate in state revenue collections was the highest in over 25 years. As a percent of total population, net in-migration was the strongest in 13 years, and was the highest level since World War II. Even the marketed production of natural gas set an all-time record of 293 billion cubic feet. The fact that Hill Air Force Base survived the current round of base closings helped Utah set these records.

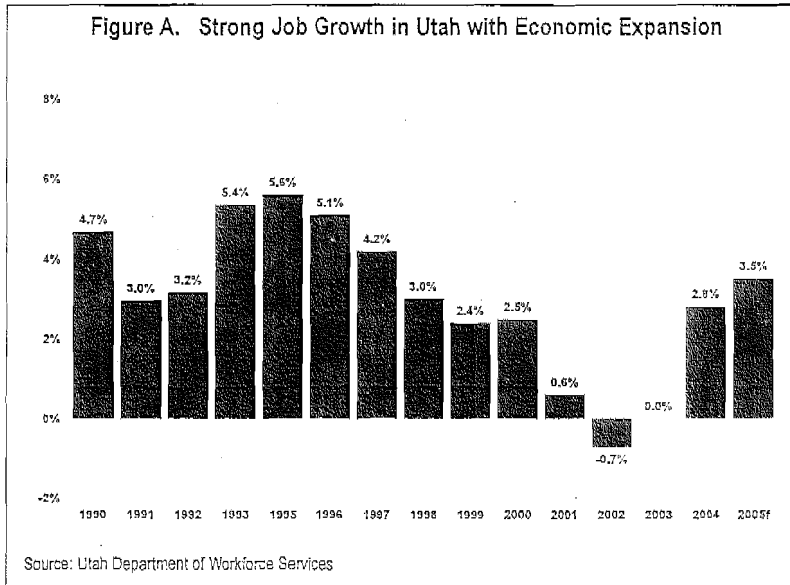
Outlook

The outlook calls for continued strong growth during 2006. Employment growth of 3.3% will be slightly lower than the 3.5% for 2005. Population growth will approach 2.9%, nearly matching the 3.2% of 2005. Net in-migration will remain high at around 37,000 because the Utah economy will continue to outperform the national economy. Construction will be up with 7.4% job growth and slightly higher valuation.

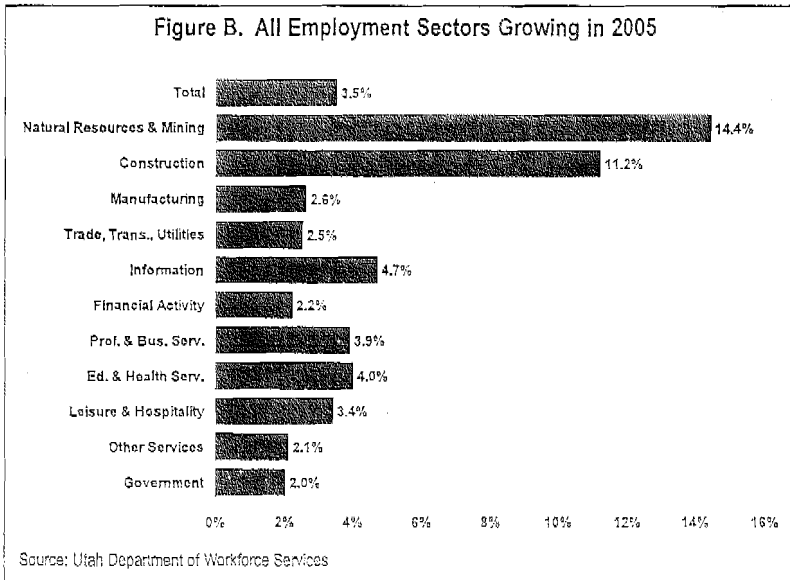
International, National, and Regional Context
Global Growth. During 2005, the world wide expansion remained broadly on track, with global GDP growing 4.3%. While global manufacturing and trade continued to strengthen during 2005, the rise in oil prices dampened growth. Looking forward, the

global expansion will continue, with global GDP growing over 4.0% during 2006. World growth continues to be driven by U.S. demand, but increasingly by Chinese production and investment as well. The U.S. trade deficit, the excess of imports over exports, reached a record 6.1% of GDP during 2005 and is expected to remain at this level through 2006. Most observers feel some deficit, perhaps in the range of 2.0% of GDP,

might be sustainable for an extended period, perhaps several decades, if the world views America as a safe place to invest. None argue deficits in excess of 6.0% reflect a stable situation in the sense they are desirable and sustainable. China is emerging as a key force behind the imbalance, so the extent to which it is willing to finance its trade by investing in America is the extent to which the U.S. trade deficit is sustainable. The upside is the Chinese stake in smoothly re-balancing the world economy is at least as great as America's.



Continuing National Expansion. With growth accelerating during 2004 and 2005, the US may be at the beginning of a solid economic expansion. Job growth was 1.6% in 2005 and is expected to remain at that level in 2006. After remaining below the February 2001 peak for almost four years, US non-farm payroll



employment began to expand in January 2005. Oil prices are expected to remain above \$50 per barrel, which means consumers will spend more for gasoline and less on other goods and services. For more than five years, monetary policy has been accommodative, but this is likely to change during 2006. If short term interest rates move above 5%, as most observers expect. Accordingly, the growth rates in both consumer spending and business investment are expected to fall from the 2005 levels, but remain healthy. GDP is expected

to grow 3.4% in 2006, down slightly from 3.6% in 2005.

Robust Mountain States Expansion. The mountain region is expanding more rapidly than the nation and appears to be emerging as a growth center. Comparing October 2005 over October 2004, mountain state employment grew 3.5%, more than twice the nation's 1.4%. Further, the region held four of the top five fastest growing states. As has been the case for most of the past decade, Nevada was the fastest growing state in the nation and the region. Arizona, Idaho and Utah, respectively, were the next fastest growing states in both the nation and the region. However, the mountain region continues to pay lower wages, with only Colorado above the national average.

Population

Utah's population grew 3.2% during 2005, over three times the national rate. With a strong economy, net in-migration was nearly 41,000, accounting for over half of Utah's population growth. For the first time in over a decade, births fell in 2005, to 50,431, from 50,527 in 2004. Utah continues to lead the nation in total fertility, or the number of births each woman can expect during her lifetime, so births should remain around of 50,000 per year.

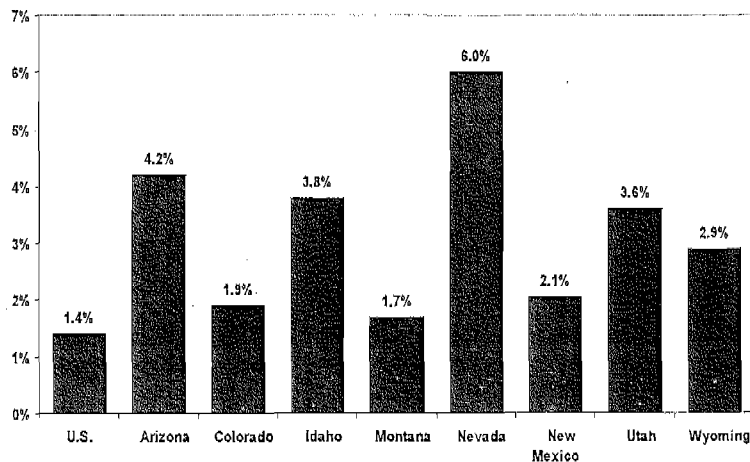
Education

In 2005, there were an estimated 510,000 students in Utah's public education system, a 2.9% increase over 2004. These students are becoming increasingly diverse, and score respectably with their national peers. In 2005, Utah's per pupil expenditure was \$4,900, the lowest in the nation. However, Utah's total current expenditure as a percent of total personal income was 4.2%, above the national average, ranking Utah 24th highest in the nation. Enrollment in 2005 increased by 14,300 students: 8,700 due to Utah's high birthrate and 5,800 to migration, the largest increase due to net in-migration in history.

Jobs and Wages

At 3.5% in 2005, for the first time in seven years, employment growth exceeded the 55-year average of 3.3%. Since September of 2004, year over employment growth rates have been above 3.0%, rising to 3.6% in the 12 months ending with October 2005. Employment growth is expected to temper somewhat as 2006 progresses, averaging 3.3% for the year. With employment growing steadily, the unemployment rate is expected to fall from 4.7% in 2005 to 4.4% in 2006.

Figure C. Mountain States Employment: October 2004 to October 2005



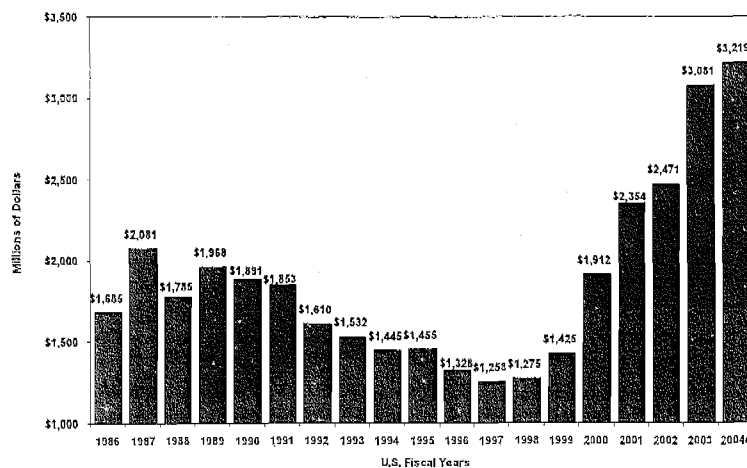
Source: U.S. Bureau of Labor Statistics and Utah Department of Workforce Services

Each of Utah's major employment sectors grew during 2005, with growth rates ranging from 2.0% in government to 14.4% in natural resources and mining. Construction grew 11.2%, information grew 4.7%, while the other sectors grew between 2.0% and 4.0%.

Utah's average annual nonagricultural pay was \$32,890 during 2005, up 3.8% from 2004. For the second year in a row, wages exceeded inflation during 2005. From 1994

to 2000, wages increased significantly faster than inflation. In stark contrast, wages essentially matched inflation from 2001 to 2003. With the economy growing well, wages should outpace inflation for the third year in a row during 2006, thereby improving Utah's standard of living.

Figure D. Defense Spending in Utah at a Record High



Sources: U.S. Census Bureau; Department of Defense; estimate by the Governor's Office of Planning and Budget

Economic Performance Up in All Sectors

For the first time in recent history, all sectors of Utah's economy performed strongly during 2005. Strong demand and prices boosted agriculture. Continuing low interest rates combined with growing employment and population powered construction to another all-time high. The ongoing geopolitical conflicts and the primary role Hill Air Force Base plays in air logistics kept defense growing. Minerals were up as well with global economic

growth accelerating. Higher energy prices lead to more production of natural gas, coal, and oil. Most other sectors had varying levels of improvement.

Agriculture. Utah's agricultural production and income rose in 2004 and 2005. With near normal weather, the value of agricultural production in Utah during 2006 should hit record levels, with most sectors growing. Net farm income grew a modest 3.8%, from \$368 million in 2003 to \$382 million in 2004, apparently setting a record in 2005, and should continue growing in 2006. Relatively high prices for livestock and crops are generating welcome income growth for Utah's ranchers and farmers.

Construction. Continuing low interest rates and a growing economy powered construction value to an all-time high in 2005 of \$6.4 billion, up 25.0% from the 2004 record of \$5.1 billion. Residential construction again led the way with a record \$4.5 billion in new construction activity. The number of new dwelling units receiving building permits totaled a record high of 26,800. Relatively low mortgage rates throughout 2005 drove demand for new single-family homes to a record high of 20,000 units. From 1998 to 2004 Utah had the lowest rate of price appreciation of existing homes in the nation. This changed during 2005 as existing home prices grew over 11.0%, moving Utah up to 22nd in the nation. With long term interest rates below 7.0%, 2006 should be another record year, though value will climb less than 2.0% to \$6.5 billion.

Defense. Utah's defense industry continued to expand in 2005, due to continuing geopolitical tensions. The Defense Base Realignment and Closure Commission (BRAC) made final recommendations for military base closures and realignments to the President in September 2005. Utah fared well under the commission's recommendation, the Deseret Chemical Depot was not closed, contrary to the Department of Defense's recommendation. Hill Air Force Base and Fort Douglas would be slightly realigned, with minimal impact; additionally HAFB gained modern F-16s as replacements to older aircraft. Defense related spending in Utah in FY 2004 was estimated at \$3.2 billion, rising 4.5% from the previous year. The current level of defense activity is expected to continue in 2006, a result of military involvement overseas and base realignment.

Energy. Utah experienced significant increases in all areas of energy production in 2005. Production of coal and natural gas continued to satisfy increasing demand, while crude oil production, despite its recent rebound, was only 31% of Utah's total petroleum product consumption. Increasing energy prices in Utah are related to national events and have been driven up by high demand, foreign conflicts, and recent hurricane damage to petroleum and natural gas production facilities in the Gulf Coast region. Prices for oil and natural gas were at record highs during 2005, and with increasing demand, supply constraints, and instability in the Middle East, should continue to be high in 2006. The abundance of

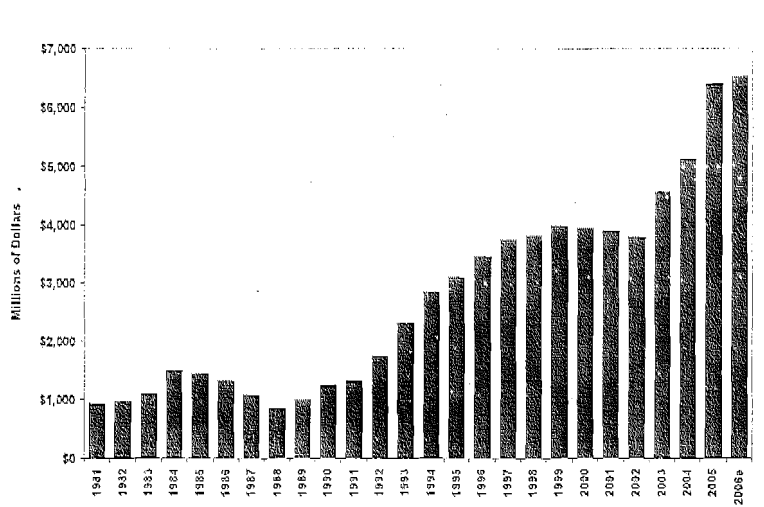
relatively low-cost Utah coal will assure affordable, reliable electric power in Utah for the foreseeable future and will help keep Utah's electricity prices well below the national average.

Minerals. The value of mineral production in Utah grew 52% during 2005 to \$3.5 billion, from \$2.3 billion in 2004. This record is due to significant increases in all precious-metal and nearly all base-metal prices, and the increased production of both base and precious metals, coal, and most industrial minerals. Although the number of producing mines statewide appears to be decreasing over the long term, the overall level of mineral exploration increased during 2005, to levels not seen since the late 1990s. Prices for coal, most industrial-minerals, and all metals except magnesium were higher in 2005. Utah's mineral valuation will remain nearly the same in 2006, with projected increases in production offset by some moderation in select metal and industrial mineral prices.

High Technology. Utah's technology sector posted a modest year over employment gain of 386 workers in 2004, ending the decline that began in 2001. During the first two quarters of 2005, average employment crept up

to 59,107, an increase of about 2,200 workers more than the 2004 average of 56,884. However, despite this increase, more than 5,800 jobs have been lost in the technology sector since 2000, a drop of 9.0%. In 2004, 11 high tech industries posted job gains, seven of which were more than 100 workers. Eight industries posted job losses, the largest of which occurred in computer and peripheral equipment and motion picture and video production.

Figure E. Construction Value Powered to Record High by Low Interest Rates



Source: Bureau of Economic and Business Research and the Governor's Office of Planning and Budget

Tourism. Utah's travel and tourism sector saw improvements in nearly all leading indicators in 2005. Each of the five major tourism sectors (transportation, eating and drinking, hotels and lodging, amusement and recreation, and car rentals), experienced gains. For the second year in a row, the Utah ski industry enjoyed record breaking skier visits. Hotel occupancies were also up. Visitation decreased slightly at national parks but increased at National Recreation Areas and Monuments. These increases resulted in higher traveler spending and increased travel-related employment in 2005. The outlook for the industry for 2006 is cautiously optimistic, as it is expected that travel among business and leisure travelers, both international and domestic, should increase. There are still concerns about consumer confidence, gasoline prices, home heating costs, terrorism, the war in Iraq, and the U.S. image abroad, but industry experts forecast continued (but slower) growth in 2006.

Exports. Utah's merchandise exports grew from \$4.7 billion in 2004 to an estimated \$6.1 billion in 2005, an increase of 28.4%. Utah's exports have been at or above \$3.0 billion since 1999 and above \$4.0 billion since 2002.

Shipments of gold accounted for approximately 35% of the total during 2005, continuing this new trend in the global economy. Utah's exports to China exceeded \$100 million for the third year in a row, ranking China as Utah's number five market. As the world economic recovery strengthens during 2006, Utah's exports should continue to grow.

Significant Issues: Tax History, Tax Reform, Transportation, Wages

Tax History. Until the Great Depression, the property tax was the major source of revenue for Utah state and local governments. In 1931, revenue shortfalls were so dramatic the Legislature enacted the individual income and corporate franchise taxes. At the time, the taxes were designed to generate revenue from individuals and corporations that could afford the additional burden. In 1933, because of persistent revenue shortfalls, the Legislature enacted the state sales tax. The effect of the Depression era tax reform was to broaden and stabilize the tax base creating what is called the "three legged stool": property, income, and sales taxes. In 1959 the sales tax was expanded to city and county governments. Currently, the state relies primarily on the income and sales tax, while local government relies primarily on property tax, and to a lesser extent sales tax.

Tax Reform. Following the economic fluctuations of the past ten years and their impact on state revenues, Utah's legislative and executive branches undertook a comprehensive study of the state's tax system. Topics examined include the income tax, sales and use tax, property tax, local government taxes, and other taxes. Heading into the 2006 General Session, tax reform appears to be one of the major issues likely to be considered by the Legislature and Governor. Depending on which proposals are ultimately enacted into law, the tax reform effort could result in a major impact on individuals, businesses, and state and local governments.

Transportation. Because Utah is growing strongly, and is projected to continue growing strongly over the next few decades, traffic congestion will only worsen unless actions are taken to improve highway and transit capacity. Even with past efforts to increase transportation funding by over \$3.6 billion through the Centennial Highway Fund, traffic congestion continues to be a major issue in Utah. Now, with rising construction and land costs, building needed highway infrastructure has become even more expensive.

Governor Huntsman and Lt. Governor Herbert held a transportation summit in 2005 as well as smaller group meetings with legislators, local officials, and businesses to come up with a solution to Utah's growing congestion problem. The legislature is also taking an active role in trying to find alternative solutions to transportation funding. This 2006 legislative session should give the people of Utah some indication of how the Governor and Legislature will deal with transportation issues in Utah.

Utah Wage Comparison. Utah's wages are below the national average, but so is its cost of living. The U.S. Bureau of Labor Statistics (BLS) measures occupational wages within most metropolitan statistical areas (MSAs) across the United States. A complete analysis of wage rates adjusts occupational pay for cost-of-living. In Salt Lake City, the results of the adjusted wage comparison revealed that 63.1% of occupations pay above the national median, and 19.7% pay above the 75th percentile. Salt Lake occupations below the national median include management occupations, life, physical, and social sciences, healthcare support, and

production work. Salt Lake was above median in computer and mathematics, architecture and engineering, legal, and transportation and material moving occupations.

Looking Ahead

As the expansion progresses, Utah's economy will continue on the growth path that began in 2004. With strong growth during 2005 and the continuing momentum of expansion, employment should grow 3.3% during 2006. The unemployment rate is expected to fall from 4.7% to 4.4%, a level that signals little economic slack. Resuming the trend of the 1990s, wages will increase faster than inflation during 2006, thereby improving Utah's standard of living.

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