

**Florida Economic Outlook 2006**

	2002	2003	2004	2005P	2006F
<b>Population (millions)</b>	16.77	17.19	17.63	18.01	18.43
change (000s)	353	414	439	393	420
% change	2.15	2.47	2.55	2.23	2.31
<b>Employment (millions)</b>					
<b>Total</b>	7.616	7.764	7.997	8.490	8.780
change (000s)	-18	148	233	493	290
% change	0.0	1.9	3.0	6.0	3.4
<b>Non-Agricultural</b>	7.198	7.261	7.504	7.943	8.204
change	27	63	243	439	261
% change	0.4	1.0	3.4	5.8	3.3
<b>Unemployment Rate (%)</b>	5.70	5.30	4.80	3.50	3.30
<b>Housing Starts</b>	185,430	213,570	255,900	290,000	280,000
change	18,400	28,140	42,330	34,100	-10,000
% change	11.0	15.2	19.8	13.3	-3.45
<b>Personal Income (\$billions)</b>	500,751	522,703	569,850	604,041	646,324
change	17,218	21,952	47,147	34,191	42,283
% change	3.56	4.40	9.02	6.00	7.00
<b>Gross State Product (\$billions)</b>	522,340	553,709	599,068	638,000	679,400
change	25,479	31,369	45,359	38,940	41,400
% change	5.13	6.00	8.20	6.50	6.50
<b>Per Capita Income (\$)</b>	29,489	30,098	31,455	33,540	35,069
change	223	609	1357	2085	1529
% change	0.08	2.06	4.51	6.63	4.56
Fl. as % of U.S.	95.5	95.6	95.7	95.9	96.0

**2006 Outlook for the Florida Economy**

Florida's economy will register another robust performance in 2006 – continuing the strong uptrend in growth that started in early 2002. Despite four destructive hurricanes, high energy prices, and rising short-term interest rates, when the final economic data for 2005 are tabulated it appears Florida will retain its national leadership in areas such as job creation, population growth and housing starts.

What can we look forward to in 2006? Will the state's stellar economic advance continue? In a nutshell, Florida's growth prospects clearly are tied to the larger national and global economic outlooks.

Assessments for the national and global economies in 2006 (see box at the bottom) provide a solid base for continued healthy growth in Florida's population, as well as further advances in important sectors of the state's economy such as tourism, defense and defense-related industries, business, financial and professional services, health care, international trade, and international investment. The accompanying table at left provides forecasts for important measures of Florida's economy and historical data on these variables.

Higher labor productivity growth has emerged as a key cause of Florida's strong economic growth, in addition to the stimulus provided by the national and international economies. Labor productivity is simply the amount produced per worker. The growth rate of labor productivity measures the increase in the amount

Sources:

Office of Economic and Demographic Research, The Florida Legislature State of Florida, Agency for Workforce Innovation U.S. Department of Commerce, Bureau of Economic Analysis U.S. Department of Commerce, Bureau of Census P.Bauer and Y.Lee, "Labor Productivity Growth Across States." Economic Commentary, Federal Reserve Bank of Cleveland, June, 2005

produced per worker, and is the fundamental source of higher Gross State Product, wages and incomes and competitiveness. Recent research by the Federal Reserve Bank of Cleveland indicates labor productivity in Florida increased at a roughly 1.00 percent annual rate from 1977 to 2000, but beginning in 2001 labor productivity has been advancing at a rapid clip of about 2.78 percent per year.

The fundamental causes of Florida's rising labor productivity growth are unclear. Moreover, it is unusual to see such strong labor productivity growth during a period of accelerating job creation as less and less productive workers are generally hired to fill additional, newly created jobs. One possible explanation is that structural change is taking place in Florida's economy, and new jobs are increasingly being created in more productive enterprises. This view is consistent with the acceleration in Florida's Gross State Product growth, which has increased at a 6.45 percent annual average rate from 2002 through 2005 compared to a 4.92 percent average pace of advance from 1997 through 2001. Regardless of the cause, rising labor productivity will be the foundation for continued economic growth in Florida in 2006.

Housing is the only major sector of the state's economy expected to soften in 2006, and this is attributed to rising interest rates. There will be more likely a leveling in new housing starts rather than a sharp decline, as population gains and international demand partially offset the effects of higher interest rates. In this regard anecdotal data suggest the pace of new home sales has recently moderated. And, as we discussed in the August edition of Economic Commentary, a collapse in housing prices seems remote but a flattening of prices in dollar terms and gradual erosion of prices in inflation-adjusted terms is likely.

A number of policy issues at the national, state and local levels will also have a potentially considerable influence on Florida's economy in 2006. Fiscally, Florida is in excellent shape, owing to ongoing sound fiscal discipline. As evidence, each of the three bond rating services upgraded Florida's full-faith and credit bond ratings in 2005 including Standard and Poors, which gave Florida its most coveted AAA rating. It is hoped this sound fiscal discipline will be a legacy for the future. The state's business climate is also attractive to entrepreneurs, businesses based in Florida looking to expand, and those contemplating investing in Florida. Maintaining and enhancing the state's business climate, however, requires continuous attention. Growth management issues are also likely to be a source of debate at the state and local levels in 2006. Care must be taken to balance interests in this arena, otherwise a cornerstone of the state's healthy economy could be eroded. At the national level, international trade, immigration policy, and homeland security issues could have important bearings on the state's economic prospects.

Florida is poised to enter the fifth year of a robust economic expansion in generally excellent health with the housing sector the only imbalance of concern. The expansion is fundamentally changing the nature of the state and its economy. We are no longer just a large state in terms of population but rather a national economic leader setting a pace for the rest of the country to follow.

## **The U.S. and Global Economies in 2006**

The U.S. economy ended 2005 with a healthy momentum that should carry well into 2006. Employment, incomes and GDP accelerated in the latter part of 2005, notwithstanding the devastation wrought by Hurricane Katrina as well as the dampening effects of soaring energy prices and higher interest rates. Initial reports suggest retail sales advanced moderately during the Christmas season, indicating consumer spending continues to increase.

More importantly for the economic outlook has been a strengthening of business capital expenditures. This key driver of productivity and economic growth has expanded at close to a 10 percent annual pace for the last four quarters. Improved corporate profits, balance sheets, and cash flows should support additional capital expenditure growth in 2006. At the same time, inflationary pressures should remain in check owing to a combination of productivity gains, a flattening of energy prices, global competitive pressures, and the delayed effects of tighter monetary policy.

Higher interest rates represent the primary risk to the U.S. economy in 2006. At present, interest rates on shorter- term maturity Treasury securities are higher than those on longer- term maturity Treasury bonds. This so-called yield curve inversion has proven in the past to be a reasonably accurate harbinger of economic recessions. Forecasters who rely on it have raised their probabilities of a 2006 U.S. recession from about 1.00 percent in mid-2005 to about 3.00 percent recently. However, with the Federal Reserve likely to end its tightening cycle in early 2006, short-term interest rates should peak in the 4.25 to 4.50 percent range. In contrast, as businesses increase their borrowings to finance capital expansion and consumer and public sector credit demands remain reasonably high, longer term interest rates are likely to rise a full percentage point from current levels to the 5.50 to 7.00 percent range. All-in-all the U.S. economy should experience solid growth in the 3.25 to 3.50 percent range in 2006.

The global outlook for 2006 is mixed, although there are reasons for cautious optimism. Economic activity with Florida's important though somewhat fragile Latin America and Caribbean trading partners expanded modestly in 2005, and should continue in 2006. Progress on the FTAA (Free Trade Area of the Americas) Agreement would be a sizable boost to growth prospects for all countries involved. Countries in the European Union continue to confront structural reform issues, requiring tradeoffs of painful short run adjustments in exchange for higher long-term economic growth. Germany and Spain appear to be advancing in this regard while progress is less apparent in France and Italy. The UK is poised for continued expansion in 2006. Asia should remain the global growth leader in 2006. After more than 10 years of lethargy, Japan's economy, the world's second largest, is expected to record its second consecutive year of robust growth in 2006. Growth should remain strong in China and India.

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