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IOWA ECONOMIC SCORECARD

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State Policy Makers Should Carefully Study and Heed Economic Indicator Data

By Deborah D. Thornton

The Iowa Leading Indicators Index, (ILII) first developed in 2006, was modeled on the national Leading Economics Index (LEI) developed by the Conference Board. It is designed to provide an indication to government and business policy makers as to the future direction of the economy. It is supposed to signal both economic contractions (recessions) and expansions (growth). Most specifically it is supposed to predict future non-farm employment increases or decreases.

Importantly, the ILII provides key information to the members of the Revenue Estimating Conference (REC) for their use in projecting state tax collections and the resulting money available for the budget. If non-farm employment is expected to increase, then tax collections can be expected to go up and money available to the state for spending on government needs and wants should increase. The ILII is not widely known and used by the general public, though possibly it should be.

The Iowa index is made up of eight components, modeled on the national components, but targeted specifically to the Iowa economy. These components are both weighted for seasonal variations and weighted within the index. Some are monthly reports and others are 12-month moving averages.[1]

The eight are:

1. Agricultural futures profits index - a composite of corn, soybeans, hogs, and cattle expected profits in a 12-month moving average.
2. Diesel fuel consumption - the number of taxable gallons of diesel fuel sold in Iowa in a 12-month moving average.
3. Average weekly initial unemployment claims - which are inverted when added to the index.
4. New orders index - the share of purchasing managers who report increases in orders for manufacturing output, again on a 12-month moving average.
5. Treasury bond yield spread - which is the difference between the interest yield on a 10-year Treasury bond and a 3-month Treasury note.
6. Iowa stock market index - which is made up of 34 Iowa-based or focused publicly traded companies.
7. Average weekly manufacturing hours - which are on a 12-month moving average.
8. Building permits - the total number of permits issued for residential housing, on a 12-month moving average.

The components of the ILII were selected based on six factors, the Moore-Shiskin criteria for appropriate data to be used for predicting economic cycles. These criteria are conformity, consistent timing, currency, economic significance, statistical adequacy, and smoothness. All eight criteria of the ILII meet these standards. Each year the Iowa Tax Research and Program Analysis Section of the Department of Revenue review the prediction ability of the index, and make appropriate updates or changes.

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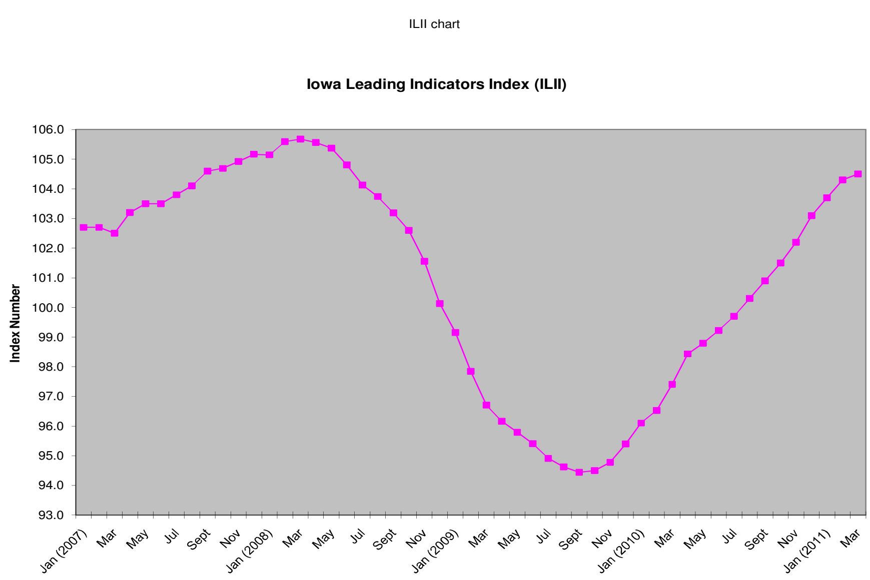
Since 2006 the changes have been minor in nature. The August 2010 assessment states that the ILII "successfully forecasted the contraction in Iowa employment experienced between November 2008 and May 2010."[2]

According to the national Conference Board standard, a contraction or recession is signaled and considered reliable when (1) the index declines by at least 2 percent over a six-month period (using an annualized rate) and (2) a majority of the individual components decline over those six months (the six-month diffusion index less than 50.0).[3]

The ILII issued April 1, for February 2011, put the index at 104.4 (100 = 1999). This was an increase of 0.7 from January's 103.7 and the 17th straight month of increases. The index is now only 1.3 points away from the all-time high of 105.7 in March of 2008 – three years ago. The ILII low was September 2009, at 94.5, and has increased every month since then. The chart details the monthly changes since January 2007.

According to the Conference Board standard, the ILII began predicting the recession as of September 2008, when the index had fallen for the last six months (to 105.9) by over 2 percent, and six of the components had fallen by at least 0.5 percent.[4] This was a year before the bottom of the index in September 2009.

As of April 2010, when the index had risen for six months to 98.4, and had a majority of components in the positive, the index indicated the recession was over. The National Bureau of Economic Research declared in September 2009 that the recession had ended in June 2009, after beginning in December 2007.[5] That was the low of the ILII, with the recession-ending indication for Iowa not coming until a year ago, April 2010, again seven months after the national indication. This overall process would seem to indicate a consistent three-month lag for economic changes in Iowa and a six-month lag in the indicators, versus the national economy.



Iowa Statewide Economic Indicators

Latest Economic Indicators	Updated as Of:	Actual Number	Amount of Change	Time Period Reported
New Vehicle Registrations	4/1/2011	18,481	30.9%	Feb 2010 - Feb 2011
New Housing Permits	3/25/2011	389	-28.6%	Feb 2010 - Feb 2011
Existing Home Sales	2/11/2011	55,800	-3.8%	2009 - 2010
Total Resident Jobs	4/19/2011	1,581,200	2,300	Feb - Mar 2011
Non-Farm Employment	4/19/2011	1,480,500	4,400	Feb - Mar 2011
Factory Jobs	4/19/2011	202,400	1,400	Feb - Mar 2011
Initital Unemployment Claims	4/19/2011	21,903	12.3%	Feb - Mar 2011
Jobless Rate	4/19/2011	102,700	6.1%	March 2011
Personal Income	4/1/2011	$38,281	0.2%	2009 - 2010
Exports of Goods	2/17/2011	$10.9 billion	NA	2008
Farmland Values	2/25/2011	$5,064	18.0%	Dec 2009 - Dec 2010

Data source: <http://www.iowaworkforce.org/trends>, <http://www.iowa.gov/tax/taxlaw/econindicators.html> accessed on April 20, 2011

The ILII did confirm the recession in Iowa, based on the six-month steady direction requirement. However, by that time we were already well into the effects, including reduced tax collections. Further, the Iowa Revenue Estimating Conference (REC) did not heed these indicators. Instead they offered an increased budget estimate in December 2008 – projecting estimated net receipts for FY 2008 of $6.084 billion, the same number as in their estimates of October 2008, up $22.3 million from April 2008 and $100 million from December 2007.

The REC estimate for FY 2009 was reduced at that same time, by $100 million, from October to December. The March projection was then reduced by another $84 million, but that was not enough to prevent the significant mid-year budget cuts required by fall. The REC then made additional reductions in their projections throughout the recession, to the current $5.76 billion for FY 2011 (the current fiscal year, which ends in June).

The fact that the ILII is showing consistent growth out of the recession has lured the REC into projecting growth in the state tax collections again. The last three projections, October and December 2010 and March 2011 have all steadily increased – from $5.9 billion, to $6.0 billion, to $6.1 billion as of March.[6]

Much of the growth indicated by the ILII comes from the four agriculture indicators – expected profits on corn, soybeans, hogs, and cattle. The broader based Midwest Economy Index produced by the Chicago Federal Reserve also shows positive economic growth, driven by the manufacturing and service sectors and consumer spending. Yet, as the charts in this issue of the IOWA ECONOMIC SCORECARD show, initial unemployment claims are up, and there is lackluster hiring and employment growth. Job destruction has slowed, but strong job creation has not happened, according to the Federal Reserve. The employment/population ratio for Iowa is at 66.9, indicating that only 6 of 10 working-age people have jobs.[7] New housing starts are down by 28 percent, with existing sales still down as well. Properties are

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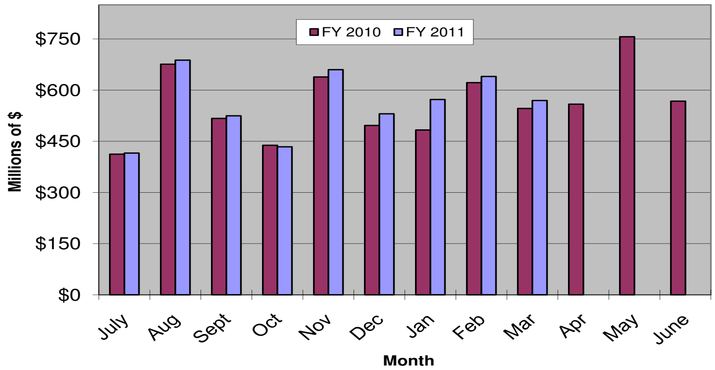
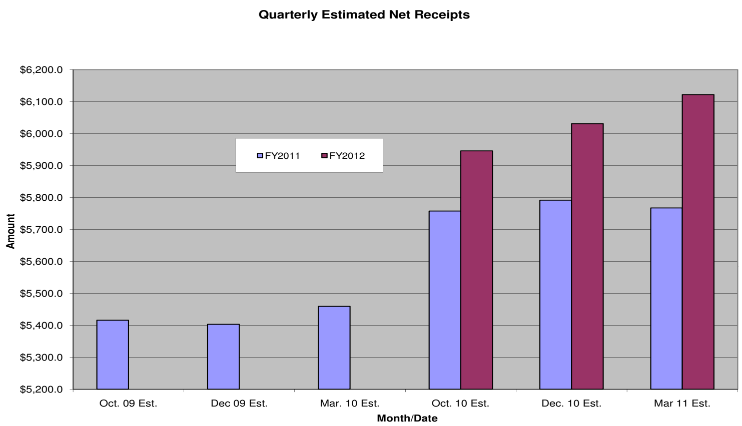
Iowa's Monthly State Revenue and Estimated Net Yearly Revenue (in millions)





Monthly State Revenue:

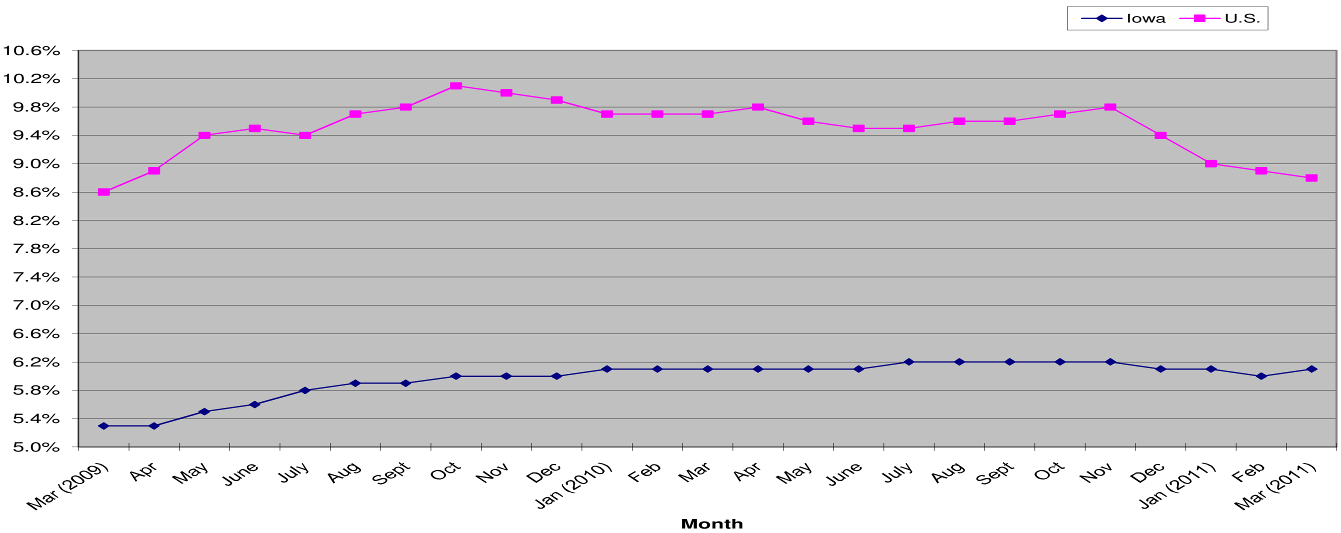
Monthly FY 2011 state revenue was $569.6 million in March. This is $23.4 million more than March 2010. Tax collections for FY 2011 year to date total $5,034 million, $205 million more than a year ago, and slightly more than the FY 2009 amount of $5,030 million.

Estimated Net Yearly Revenue:

The revised Revenue Estimating Conference March estimate for FY 2011 is $5,767.2 million, down slightly from the December estimate of $5,791.6 million. The official December 2009 estimate, the basis for the FY 2011 budget, was $5,403.2 million. The revised estimate for FY 2012, which starts in July, is $6,122.2 million, $90 million more than the official December 2010 estimate.

Source: Legislative Services Agency "Monthly General Fund Revenue Memo," and Revenue Estimating Conference Report

U.S. and Iowa's Unemployment, March 2009 - Present



The U.S. unemployment rate in March 2011 continued a slight decline, to 8.8 percent. The Iowa rate remains significantly lower, at 6.1 percent. This was the same rate as March 2010, but still up from 5.3 percent in 2009. Total Iowa employment in December was 1,581,200, slightly below March 2009. There were 102,700 unemployment claims, compared to only 88,000 in March 2009.

Source: Iowa Workforce Development, Labor Market Information Bureau, "Monthly Unemployment Rate News"

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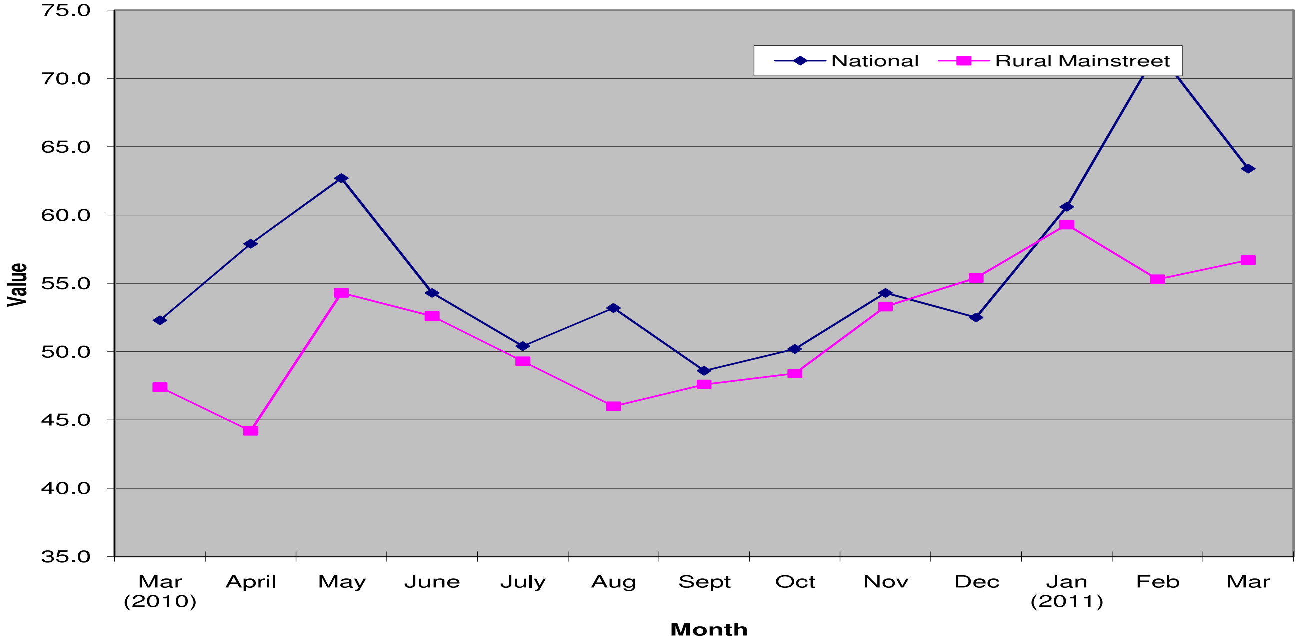
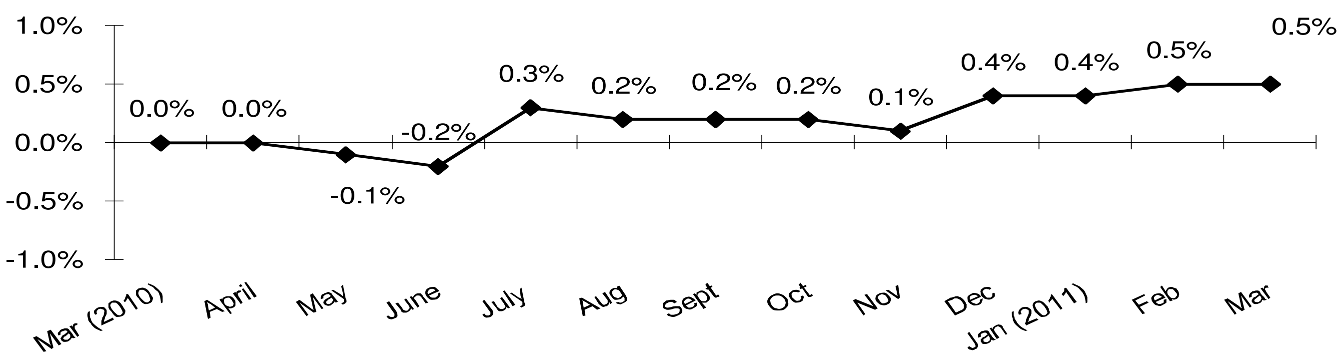
Consumer Confidence Index



The national Consumer Confidence Index (CCI) continues a radical up and down pattern. In December it was 52.5, rising to a 12-month high of 72 in February, then dropping in March to 63.4. Iowans are more stable in their view, with a Rural Mainstreet Index of 56.7, up slightly since December 2010. According to the Conference Board, "Inflation expectations rose significantly in March and income expectations soured." RMI creator Ernie Goss said, "An expanding global economy, a cheap dollar and alternative energy production are pushing the economy into territory not experienced since the early 1970s."

Source: Conference Board, "Consumer Confidence Survey" and Creighton University

Consumer Price Index, Monthly Change



The seasonally adjusted Consumer Price Index increased 0.5 percent in March. Gasoline and food prices continued to rise and accounted for almost three-quarters of the increase. The gasoline index posted its ninth consecutive increase and has now risen 14.4 percent over the last three months. Household energy rose with advances in fuel oil and electricity, more than offsetting a decline in natural gas. The all-items index rose 2.7 percent in the last 12 months, the largest increase since December 2009.

Source: U.S. Department of Labor, Bureau of Labor Statistics

Midwest Economy Index:
Index shows Midwest economic growth picked up in February

By Scott Brave, Senior Business Economist and
Laura LaBarbera, Media Relations, Federal Reserve Bank of Chicago

On March 31, 2011, the Chicago Fed began releasing on a monthly basis an index designed to measure growth in non-farm business activity in the Seventh Federal Reserve District states of Illinois, Indiana, Iowa, Michigan, and Wisconsin. This monthly index, called the Midwest Economy Index (MEI), will serve as a regional counterpart to the Chicago Fed's National Activity Index (CFNAI). Our motivation in creating the MEI is to better understand the relationship between growth in national economic activity and growth in Midwest economic activity.

What is the Midwest Economy Index?

The index is a weighted average of 128 state and regional indicators encompassing the entirety of the five states in the Seventh Federal Reserve District (Illinois, Indiana, Iowa, Michigan, and Wisconsin). The index measures growth in non-farm business activity based on indicators of four broad sectors of the Midwest economy: 1) manufacturing, 2) construction and mining, 3) services, and 4) consumer spending. As with similar indexes of regional economic activity, the majority of the indicators in the MEI are based on data from the Payroll and Household Employment surveys and State Initial Unemployment Insurance claims. However, for the manufacturing and construction and mining sectors, the MEI also captures production indicators, while for consumer spending it additionally includes data on personal income and home and retail sales.

Why are there two index values?

Over long periods, growth in Midwest economic activity has tended to coincide with growth in national economic activity. However, over shorter periods of time this has not always been the case, particularly around the beginnings and ends of recessions. To highlight such differences, we construct two separate index values. The MEI captures both national and regional factors driving Midwest growth, and the relative MEI provides a picture of Midwest growth conditions relative to those of the nation.

What do the index numbers mean?

A zero value for the MEI indicates that the Midwest economy is expanding at its historical trend rate of growth; positive values indicate above-average growth, and negative values indicate below-average growth. A zero value for the relative MEI indicates that the Midwest economy is growing at a rate historically consistent with the growth of the national economy. A positive value of the relative MEI indicates that regional growth is farther above its trend than would typically be suggested based on the current deviation of national growth from its trend, while a negative value indicates the opposite.

February 2011 MEI Report

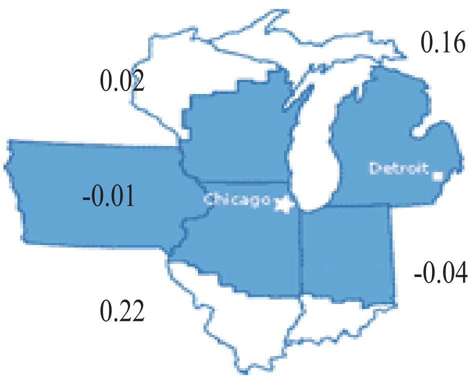
Led by gains in the manufacturing sector, the Midwest Economy Index (MEI) increased to +0.35 in February from +0.19 in January. February marked the fifth consecutive month that Midwest economic growth has been above its historical trend. In addition, Midwest growth continued to outperform national growth, as the relative MEI was also +0.35 in February, up from +0.28 in the previous month.

Manufacturing's contribution to the MEI improved to +0.45 in February from +0.31 in January. February's contribution was the manufacturing sector's largest to the index since July 2010. All five Seventh District states posted gains in manufacturing activity in February. Manufacturing's contribution to the relative MEI also increased, rising to +0.58 in February from +0.48 in the previous month.

The construction and mining sector's contribution to the MEI decreased to –0.28 in February from –0.22 in January. The decline in construction and mining activity was regionally broadbased, with the sector's contribution to the index reaching its lowest point since September 2010. Construction and mining's contribution to the relative MEI was also lower in February, declining to –0.22 from –0.16 in the previous month.

The service sector contributed +0.01 to the MEI in February, up from –0.05 in January. This sector's contribution came in slightly positive for the first time since May 2007. Illinois, Iowa, and Michigan made gains, while Indiana and Wisconsin saw declines. The sector's contribution to the relative MEI remained negative, increasing to –0.07 in February from –0.12 in January. The contribution from consumer spending to the MEI was +0.17 in February, ticking up from +0.16 in January. February's contribution marked the largest from consumer spending since March 2006. However, consumer spending's contribution to the relative MEI edged lower to +0.06 in February from +0.08 in January.

February 2011 MEI Seventh District



What does the current MEI mean?

When manufacturing has thrived, so has the region. However, the contributions of the service sector to Midwest growth have become increasingly important. Consumer spending indicators show a similar pattern, making sizable contributions at business cycle peaks and troughs. Finally, the region has historically been less prone to large fluctuations in growth coming from the construction and mining sector than other parts of the nation. Looking at regional versus national growth, the manufacturing and service sectors explain the vast majority of movements in the relative MEI. However, the contribution of services to the relative MEI is larger than it is to the MEI and nearly equal to that of manufacturing. This reflects the importance of the service sector during periods where the Midwest economy has expanded or contracted faster than the nation. A good example of the former is the early- to mid-1990s, while the early to mid-2000s exemplify the latter. Other periods in which Midwest growth deviated substantially from national norms include the 2001 recession, which more adversely affected the region, and the 1990–91 recession, which was milder but was preceded by a period of relative weakness.

No single state dominates growth in Midwest economic activity, although Illinois tends to make the largest contribution. Growth trends in non-farm business activity across states are similar, with the exception of the weakness of the Michigan economy over the past decade. During the recent recovery, all five Seventh District states have made positive contributions at one time or another to the MEI and relative MEI, suggesting that the manufacturing-driven recovery has benefited the region disproportionately. *Reprinted with permission of the Federal Reserve Bank of Chicago.*

Sectoral and Geographic Contributions to the Midwest Economy Index (MEI) and Relative MEI

Midwest Economy Index **February 2011**

	Illinois	Indiana	Iowa	Michigan	Wisconsin	Regional Total
Manufacturing	0.21	0.01	0	0.11	0.12	0.45
Construction	-0.06	-0.05	-0.04	-0.01	-0.11	-0.28
Services	0.03	-0.03	0.01	0.02	-0.01	0.01
Consumer	0.05	0.03	0.02	0.04	0.02	0.17
State Total	**0.22**	**-0.04**	**-0.01**	**0.16**	**0.02**	**0.35**

Relative Midwest Economy Index

	Illinois	Indiana	Iowa	Michigan	Wisconsin	Regional Total
Manufacturing	0.33	0.01	0	0.11	0.15	0.58
Construction	-0.04	-0.03	0.02	0.02	-0.13	-0.22
Services	0.05	-0.12	0.03	0.03	0.03	-0.07
Consumer	0.02	0.01	0.02	0.02	0.01	0.06
State Total	**0.35**	**-0.14**	**0.18**	**0.18**	**-0.01**	**0.35**

Source: Midwest Economy Index, Chicago Federal Reserve Bank, March 31, 2011

Notes: The table summarizes the most recent contribution to the MEI and relative MEI by sector and geography. The sectoral (rows) and geographic (columns) contributions may not sum to the index in each time period because of rounding. Manufacturing, construction, and mining are composed of production and employment indicators. Services contains only employment indicators, while consumer spending contains employment, unemployment, per capita personal income, and home and retail sales indicators.

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continuing to sit on the market for several months. Consumer confidence is fluctuating and inflation beginning to rise. Gasoline prices are at record highs, with $4.00 per gallon the new norm.

While the indicators show that the recession is officially over, those in policy and budget decision-making positions would be well-served to proceed in a conservative manner, keeping a tight hold on the state's checkbook – as well as their own.

(Endnotes)
[1] "Iowa Leading Indicators Index February 2011 Report," Iowa Department of Revenue, Tax Research and Program Analysis Section, April 1, 2011, p. 2.
[2] "Iowa Leading Indicators Index: Fourth Annual Assessment and Update," Iowa Department of Revenue, Tax Research and Program Analysis Section, August 2010, p. 1
[3] "Iowa Leading Indicators Index February 2011 Report," p. 3
[4] "Iowa Leading Indicators Index September 2008 Report," Iowa Department of Revenue, Tax Research and Program Analysis Section, March 1, 2008, p. 1.
[5] "NBER's statement on recession's end," MarketWatch, September 20, 2010, <http://www.marketwatch.com/Story/story/print?guid=65D1960A-C4C3-11DF-BA89-00212804637C> accessed on April 27, 2011.
[6] Revenue Estimating Conference Quarterly REC Reports, October 2010, December 2010, March 2011, <http://www.dom.state.ia.us/state/REC/rec_quarterly.html> accessed on April 25, 2011.
[7] Bill Testa and Max Lichtenstein, "Job Recovery in the Seventh District," Federal Reserve Bank of Chicago, <http://midwest.chicagofedblogs.org/archives/2011/04/job_recovery_in.html> accessed on April 26, 2011.

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Question of the Quarter:

The state budget process was quite difficult and contentious this year.
Do you have suggestions for improvements in 2012?
Send your thoughts on this issue to us at Public.Interest.Institute@LimitedGovernment.Org.
We may publish your thoughts in the August 2011 issue of *IOWA ECONOMIC SCORECARD*.