

RHODE ISLAND ECONOMIC OUTLOOK AND FORECAST: THE NEXT FOUR YEARS

CURRENT ECONOMIC OUTLOOK

The Rhode Island economy has shown mixed signs of improvement in 2012. Net general sales and gross receipt taxes, a proxy for the state aggregate demand, increased 3.8% over the first 10 months of 2012 compared to the same period of 2011. This suggests that Rhode Islanders have increased spending in 2012, indicating an improvement of overall economic conditions in the state. Employment in construction, manufacturing, leisure and hospitality and financial services has also increased over the year. However, other sectors of the economy are still struggling and have shed jobs over the year, including professional and business services, health care and social assistance, government, and wholesale trade.

The Real Gross State Product (RGSP), which measures the total economic output of the state, increased 0.7% in 2011. Estimates of RGSP growth for the first three quarters of 2012 put the rate at below 2%. The slow growth of RGSP, together with a sluggish labor market, has kept the unemployment rate at very high levels since 2008. As of October 2012, Rhode Island had the 2nd highest unemployment rate (10.4%) in the country.

The economic outlook for the State of Rhode Island, however, has not changed significantly over the last months. The NEEP Fall 2012 forecast shows trends similar to the NEEP Spring 2012 forecast, with slow employment growth in 2013 and 2014 and the unemployment rate above 10% until the third quarter of 2013.

FORECAST HIGHLIGHTS

Rhode Island's Real Gross State Product (RGSP) is forecasted to reach \$45.5 billion in 2013, an increase of 1.9% compared to the 2012 Real GSP of \$44.6 billion. By 2016, the state's GSP is forecasted to be \$48.8 billion. The annual growth rate of gross state product is forecasted at 2.3% from 2011 to 2016, compared to -0.6% from 2006 to 2011.

Real per capita income is expected to increase to \$39,590 in 2013, from \$38,991 in 2012, an increase of 1.5%. In 2016, real per capita income is expected to be \$45,059. The annual growth rate of real per capita income is forecasted to be 3.2% from 2011 - 2016.

The unemployment rate is expected to be 10.1% in 2013, 9.1% in 2014 and 6.9% in 2016.

Average total nonfarm employment is forecasted to be 461,400 in 2013, as compared to 458,000 in 2012, an increase of 3,400 jobs. The annual growth rate of employment is forecasted to be 1.3% from 2011 to 2016, as compared to -1.4% from 2006 to 2011. Rhode Island's nonfarm employment is expected to be 479,100 in 2015 and 490,300 in 2016.

In Rhode Island, most of the jobs that are expected to be created from 2012 to 2016 will be in leisure and hospitality, professional and business services, education, state and local governments, health services, and financial activities. The forecast indicates that retail trade, warehousing and utilities, information, wholesale trade, and transportation will add very few jobs in the state over the next few years.

The median price of a home was \$211,400 in 2012 and is expected to be \$221,100 in 2013, an increase of 4.6%. By 2016, it is forecasted that the median price of a home in Rhode Island will be \$233,400, compared to \$285,000 in 2006.

It is forecasted that there will be 1,363 housing permits issued in 2013, as compared to 839 in 2012. From 2011 to 2016, the annual growth rate in housing permits is expected to be 22.7%, compared to -21.6% from 2006 to 2011. In 2016, it is forecasted that 1,947 building permits will be issued.

The population in Rhode Island is expected to grow to 1,053 million in 2013, an increase of 2,000 people from 2012. By 2016, the population is forecasted be 1,057 million. The age cohort 65 and older is the segment of the population showing the greatest growth from 2011 to 2016. Population in this age cohort is expected to grow at an annualized rate of 1.8% during this time period.

OUTPUT AND INCOME

The Fall 2012 forecast projects that Rhode Island's RGSP will grow 1.9% in 2013 and 2.0% in 2014. From 2011 to 2016, RGSP is forecasted to increase 2.3% (annualized rate). This rate is 0.8 percentage points lower than the 3.1% growth expected for the New England region during the same period. The slower growth in Rhode Island has been a long term trend and reflects structural problems.

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EMPLOYMENT

Total nonfarm employment in Rhode Island was 458,000 in 2012Q3, compared to 460,900 jobs in 2011Q3 and 460,100 jobs in 2010Q3. These figures support the widespread perception that the Rhode Island labor market has been stagnant and has failed to recover when both the regional and national labor markets improve. The forecast suggests that Rhode Island's job market will continue trailing job creation in the rest of the nation. From 2011 to 2016, the annual growth rate of employment is forecasted to be 1.3% in Rhode Island, compared to 2.0% in the United States. Total nonfarm employment is forecasted to be 461,400 in 2013 as compared to 458,000 in 2012, an increase of 3,400 jobs. Rhode Island's nonfarm employment is expected to be 479,100 in 2015, an increase of about 21,000 jobs from 2012.

Despite the lack of job creation in Rhode Island, the unemployment rate has decreased from 11.2% in April of 2012 to 10.4% in October. The drop in the unemployment rate is explained by a decrease in size of the labor force and an increase in the number of Rhode Islanders who had jobs either in the state or out-of-state. The total number of employed workers increased from an average of 495,000 in 2012 Q2 to 504,704 in October 2012. Moreover, the labor force decreased from 559,000 in 2012 Q1 to 556,000 in 2012 Q3.

Job creation is expected to be slow in 2013 and 2014, which will keep the unemployment rate above 10% until the end of 2013. The unemployment rate is expected to be 9.1% in 2014 and reach 6.9% in 2016.

Compared to the Spring Forecast, no major change in the employment trend has been observed for information services, professional and business services, education and health services, leisure and hospitality or high-tech. These sectors will not add a significant number of jobs in 2012 or in the first half of 2013, but the forecast suggests that job creation will slowly pick up in the second half of 2013.

Employment levels in education and health services have declined from a peak of 104,100 jobs in 2011Q3 to 103,200 in 2012Q3. However, this trend is expected to be reversed in the near future. Employment in education and health services is forecasted to be 104,500 in 2014 and 109,200 in 2016. From 2012 to 2016, employment opportunities in education and health services are expected to grow by

1.1%. New England will outperform Rhode Island in terms of employment growth in education and health services at a forecasted growth rate of 1.6% from 2012 to 2016.

Employment in leisure and hospitality services is forecasted to grow at an annualized rate of 2.7% between 2012 and 2016. Leisure and hospitality is expected to add just under 6,000 jobs from 2012Q3 to 2016. This puts leisure and hospitality among the fastest growing industries in Rhode Island.

Professional and business services is forecasted to grow at an annualized rate of 1.4% from 2012 to 2016. This represents an increase of over 5,000 jobs during the forecast horizon.

The growth prospect for financial services has improved compared to previous forecasts. In Rhode Island, financial services employed 30,700 in 2012Q3. The number of jobs in this sector is forecasted to 34,200 in 2016. From 2012 to 2016, employment in financial services is forecasted to grow at an annualized rate of 2.3%.

Employment in the high tech industry has been steady since the end of The Great Recession in 2009. The NEEP Forecast, however, suggests high tech jobs will increase from 22,900 in 2012Q3 to 25,700 in 2016. From 2012 to 2016, the Rhode Island high tech industry is expected to grow 2.7% per year, compared to 2.6% in New England.

HOUSING

The median price of a home in Rhode Island has hovered around \$215,000 since early 2010, which is significantly less than a peak median price of \$287,000 in the first quarter of 2007. The Rhode Island housing affordability index (ratio of median house price to median household income) is 4 in 2012Q3, compared to 3.4 in the United States. During the forecast horizon, the housing affordability index in Rhode Island is forecasted to linger around 4 and stay above the U.S. average.

Consistent with previous rounds of forecast, the median housing price is expected to increase modestly until 2016. The median price is forecasted to be \$221,100 in 2013, 229,500 in 2014 and 233,400 in 2016. Sales of existing houses dropped from an average of 13,400 units in 2006 to 8,700 (annualized) units in 2012Q3. The NEEP forecast indicates that sales of existing houses will increase to about 10,000 units (annualized) from 2013 to 2016.

Housing construction is still at very depressed levels in Rhode Island. In 2012, only 839 are expected to be issued. However, the housing market is showing signs of improvement and housing construction is expected to increase significantly in 2013 and 2014. Just under 1,400 permits are expected to be issued in 2013 and 1,920 in 2014. Most of the permits issued will be for single-family housing. From 2011 to 2016, housing permits are expected to grow 22.7% compared to a decline of 21.6% from 2006 to 2011.

DEMOGRAPHICS

Rhode Island has faced a significant change in the composition of its population and a slowdown in the growth rate of the population over the last two decades, which have had major implications for the economy. Rhode Island's total population is expected to grow just 0.1% from 2011 to 2016, which represents an increase of 6,000 people. Net out-migration has been significant from 2005 to 2010 with an average of 5,900 people (net) leaving Rhode Island. Out-migration has slowed down recently but the state is still losing workers to other states. There is also evidence that most people leaving the state are those who hold college degrees and cannot find a job in the state.

The composition of the population, however, deserves attention. The age cohort 65 and older is the segment of the population showing the greatest growth from 2011 to 2016. Population in this age cohort is expected to grow at an annualized rate of 1.9% during this period. The age cohort 5 to 19 years old is expected to shrink at a rate of 0.9% per year. The age cohort 25-44 is forecasted to increase 0.2% while the age cohort 45 – 64 years is forecasted to decrease 0.2%. Hence, the size of the working-age population is expected to stay roughly constant during the forecast horizon. Moreover, the increase of the population in the age cohort 65 and older may reduce the state tax revenues and increase the demand for both public and private services needed to provide care for this population cohort.

POLITICAL ECONOMY

From 2008 through 2012, Rhode Island's economy suffered more than its neighboring New England states for many reasons. Some of these reasons are Rhode Island's high unemployment and underemployment, state and local budget deficits, including underfunded public pension and health benefit programs, as well as the bankruptcy of Central Falls and the threat of bankruptcy of other cities.

The job market issue is compounded when businesses cannot find workers with the right skills to fill job openings. Rhode Island's population is aging with more baby boomers getting ready to retire. In the near future, this will be an even more serious problem because those leaving the workforce will have to be replaced by workers with specialized skill-sets.

The ability of the internet to deliver goods and services to customers quicker and more efficiently is already affecting every employment sector in the state. In a report by the Boston Consulting Group, one of the findings was that mobile access will grow in importance and that smartphones and tablets will account for four out of five broadband connections by 2016. The report also said, "The economic impact of the Internet demonstrate that no one –individual, business or government – can afford to ignore the ability of the Internet to deliver more value and wealth to more consumers and citizens more broadly than any economic development since the Industrial Revolution." Many businesses in Rhode Island have already adapted to this new way of doing business, yet still find it difficult to hire employees with the skills to make this happen faster.

During 2012, there were a number of reports regarding the restructuring of the state's economic agencies and addressing what the state needs to turn the Rhode Island economy around. Most of the recommendations have been concerned with what the government needs to do to promote economic development rather than with what the business community should do to reverse Rhode Island's economic situation. Businesses are reluctant to hire new employees, make major capital expenditures and expand their operations because the state lacks a systematic, well-coordinated, data-driven approach to economic development.

Rhode Island will also be affected if Congress fails to agree on a strategy to reduce the national debt, now referred to as the "fiscal cliff". Under current legislation, automatic spending cuts starting in January 2013 will amount to \$1.2 trillion in deficit reduction over the next ten years. The Bush tax cuts will expire in 2013 which means an increase in taxes for everyone, or an average of \$3,500 per household, which will lead to a reduction in household spending. Over \$55 billion will be cut in defense spending which is about a 10% cut to each government program. The Congressional Budget Office has estimated that approximately \$600 billion would be drained from the U.S. economy in 2013 by not resolving this problem. This fiscal cliff will impact Rhode Island's economy by increasing an already high unemployment rate. The American Action Forum has estimated that Rhode Island would lose between 9,745 and 34,802 jobs with many of them in the defense industry as government contracts are reduced or cancelled. This would affect a high earning and high education level employment sector.

The state election brought few changes. The last hurdle to casino gambling in Rhode Island was approved by state and local voters for one of the gambling facilities in the state. Rhode Islanders were concerned about the loss of revenue and jobs once Massachusetts opened its three destination casino resorts. Gambling revenue is the third largest source of revenue after income tax and sales and use taxes. The state is entering 2013 with a few economic victories: a better funding approach to public pension liabilities, a small surplus in the state budget and Central Falls exiting bankruptcy. On the negative side, the state faces legal challenges from the public employee unions on the changes to the public pension programs and the state may have a budget deficit of \$130 million as it prepares the budget for the next fiscal year.

Economic growth in Rhode Island will take place when the state can creatively use its strategic assets such as location, strong transportation system, quality of life and outstanding colleges and universities to retain and attract businesses. The state's economic future is in small business and the development of new businesses through entrepreneurship. The state has to make it easier and less expensive to do business so that businesses can grow and add employees. A full scale economic recovery in Rhode Island will not happen unless there is a plan that includes government, education, labor unions and business leaders working together. The continuing cost of indecision regarding a realistic economic development plan prevents Rhode Island from heading in the right direction to building a better economy.

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