

November 1, 2013

Consensus Economic Forecasting Commission (CEFC)

Summary of CEFC Data Gathering Session on October 18, 2013

For the third year in a row, leaders of several Maine business and industry groups assembled at the State House to share economic data and industry-specific information with the Consensus Economic Forecasting Commission (CEFC) prior to the fall forecasting meeting. Following is a summary of those presentations. Any economic data, observations or forecasts contained in this summary appear as they were heard and interpreted at the meeting, so the CEFC is not responsible for their accuracy. Nothing in this summary necessarily reflects the views of the CEFC. The current official forecast of the CEFC can be found at <http://www.maine.gov/economist/forecasts/index.shtml>.

Alicia Sasser Modestino, Senior Economist, New England Public Policy Center, Federal Reserve Bank of Boston

Ms. Modestino provided an update on current economic conditions in New England. In general, the New England economy has been experiencing a modest recovery, although Maine has lagged behind some of the other states. The job market in particular has had a sluggish recovery, with Maine and Rhode Island experiencing the slowest recoveries. However, Maine's labor force participation rate and employment to population ratio did not dip as severely as in most of the New England states.

The housing market in New England has been improving, although growth in housing permits has not been as robust as for the nation as a whole. Home prices have been increasing, with much of the activity in Maine being led by first-time homebuyers. Foreclosures remain elevated in Maine, which is tied with Connecticut for the highest rate in New England.

Consumer confidence had been rising both in New England and nationally until just recently. Personal income for New England has increased just fast enough over the past year to keep pace with inflation.

Employment growth is projected to continue, although Maine's growth will likely be among the slowest in New England, driven in part by the sequestration. The timing of economic activity may change due to the recent government shutdown; IHS Global Insight estimates that annualized GDP decreases two-tenths of a percentage point for each week of a short-term government shutdown. Growth in home prices may slow through the remainder of the year before picking up again in 2014.

The looming budget and debt ceiling deadlines (January and February 2014) pose a risk to the economic forecast. According to Federal Reserve Bank of Boston President Rosengren, the government shutdown has made it more difficult to pinpoint a potential change in interest rates because of the lack of data availability.

Larry Wold, President of TD Bank, on behalf of Maine Bankers Association

Mr. Wold reported that Maine banks are well-capitalized and very liquid on their balance sheets, but income and earnings have been more challenging due to four factors: the interest rate environment, weak loan demand, increasing regulatory costs, and the protracted foreclosure process. Both loans and deposits have increased; some of the industry loan movement has come from manufacturing and upgrades to rolling stock. Housing permits are up over 2011 and 2012, but they are not increasing as fast as they would like to see. The foreclosure forecast is for very gradual improvement. The backlog hasn't changed much and the process (570 days) simply takes too long.

Bankers are generally bearish on the future; while things are stabilizing, much of the growth has come as a result of expense control rather than true growth. While banks are looking to lend money, commercial and private demand remains flat, probably due to uncertainty around jobs, healthcare, and retirement. In addition, regulatory costs have been a heavier burden for the smaller banks.

The shutdown had a small effect, primarily on loans requiring federal approval, but the backlog should clear up soon.

Bart Stevens, 2013 President of the Maine Association of REALTORS®

Mr. Stevens noted that real estate in Maine has been improving over the past two years. Home sales for 25 of the past 26 months have shown year-over-year improvement. Median prices have stabilized and have started to slowly grow. The statewide median of \$175,000 over the first nine months of 2013 is similar to prices of 2004. Through September of 2013, 44% of home sales occurred in York and Cumberland counties, up from 42% in 2012. During 2012, 13 of 16 counties had price increases and 14 of 16 had increases in the number of sales.

Half of Maine homebuyers were first-time buyers, which is considerably higher than the national rate of 39%. Of the new homes purchased in Maine, 11% were new construction, compared to 16% nationally. The National Association of REALTORS® did a recent economic impact study for Maine indicating that every home purchase results in \$25,621 more in Maine's economy for real estate and related industries.

Moving forward, there are several areas that will impact the real estate market in Maine: the interest rate environment, federal and state tax policy, Government Sponsored Enterprise (GSE) reform and FHA reform, and Maine's shrinking population and slow job growth environment. For every 1% increase in the interest rate the cost per month increases about \$30-\$50 per month for each \$100,000. Maine households finance higher percentages than the national average. Removal of the mortgage interest deduction, property tax deductions, and/or homestead exemption may have a dampening effect on home sales volume. Any change that would impact the low down-payment, 30-year, fixed rate mortgage could result in a slowdown of sales.

The growth in sales tends to be in year-round housing statewide, but in coastal areas, seasonal home sales have ticked up. There is a continuing "urban migration" towards the cities from the suburban and rural parts of the state. In Portland, there is around 3 months of inventory available, while 6-8 months is comfortable. Much of the growth of retiree purchases is coming from former residents or long-time visitors returning to the state.

The government shutdown did not really have an impact, however, a longer shutdown would likely have resulted in some delays.

Lisa Martin, Manufacturers Association of Maine

Ms. Martin presented a variety of data from the Maine Department of Labor about the manufacturing sector. Average employment is around 53,769, which is 9.6% of total statewide employment and makes manufacturing the sixth largest sector overall. In 2011, manufacturing generated \$5.9 billion of Maine's GDP, which was 11.4% of the statewide total and a 6% increase from the previous year. The average annual wage is just over \$54,000, which represents a 36% premium compared to the average for all jobs. The aerospace industry is especially strong, with average employment of 9,273 and a 65% wage premium over the average of all industries (\$62,649 average annual wage).

The industry continues to transition from a job shop economy to an innovation economy. A partnership between the University of Maine, Maine Technology Institute, Blackstone, and the Manufacturers Association of Maine is working with small job shops to assist in design and development of new products as well as product and process improvement. The partnership intends to work with around 20 companies over this next year.

The top issues for the manufacturing sector are the availability of workforce and the business climate. The skills gap is significant and a major issue for the industry – a recent job tally identified 37 companies with 212 job openings. Work continues on building the pipeline of skilled workers to replenish the aging workforce. The average age of the manufacturing industry is 54 years, and some businesses have been turning down contracts due to a lack of skilled workers. It is important for the industry to have Maine marketed/branded as a good place to do business by showcasing the high tech products and applications happening here. This ties in with the move to "technofactoring."

The federal government shutdown had very little, if any, impact on manufacturing businesses in the state. Even those relying on federal contracts were well into those contracts and saw them continue without any problems. The exception was that the Navy cancelled the christening of the new DDG 1000, originally scheduled for October 19, and has postponed it until a future date.

There are a number of business expansions taking place in a variety of different types of firms in Maine. Some examples are: Allagash International, with a product line of valves and controls; Mega Industries, which makes microwave transmission equipment; Curran Co., which does vegetable processing; and Jill McGowan Collections, which is a textile manufacturer. Overall, manufacturers are mostly stable, with very few closing and more expanding and adding workers. Access to capital is a challenge and many companies are having trouble finding financing. The expansion of natural gas has been beneficial to manufacturing, as lower costs increase competitiveness.

Thomas Brown, Maine Automobile Dealers Association

Mr. Brown shared that employment in auto dealerships has remained relatively stable at around 5,625. This is up 2% from last year. Payroll is around \$245 million, which is up 6% from a year ago. There have been 3-4 years of growth in employment and business activity. Sales for the U.S. are up about 8.2% year-to-date while sales for Maine are up around 5.6% (from 49,000 new units last year to 52,000 units this year). Used sales are fairly steady at around 85,000 units. Trucks, which include SUVs and crossovers, are a growing piece of the new unit sales, making up around 60% of sales. Cars are down a bit in Maine. This may indicate some shift towards more multiuse vehicles for households.

Leases have increased; around 25-30% of new vehicles are leases, which is about where we were before the auto industry bankruptcies. These vehicles are turned over on a more regular basis, which should contribute to higher used vehicle sales in a couple of years as leases run out.

The low interest rates are a big factor for vehicle sales as over 80% of sales involve some sort of financing. The increase in construction has been good for truck sales, and many fleets are investing in newer technologies to lower costs from energy.

Payscales and jobs are a concern for the industry as lower income makes it harder to purchase vehicles. Economic growth has been slow, and September/October sales have been down a bit, perhaps due to lower consumer confidence. Uncertainty around the Affordable Care Act is also a concern, as increased medical costs make it more difficult to afford vehicles. When interest rates increase, they will hit both the cost of operations and sales of vehicles. The industry continues to have workforce development issues, especially in service departments.

Gordon Smith, Maine Medical Association

Mr. Smith explained that the physician sector has been seeing a lot of change in recent years. Around 70% of the Association's members are employed by hospitals or large practices. This is a dramatic shift from the past, when most physicians owned their own practices. Unemployment is not an issue in this industry; the recruitment center currently lists 112 physician vacancies.

Physicians have been experiencing a number of stressors recently, including the move away from autonomy that comes with employment in a hospital or large practice, the large percentage of medical dollars coming from federal/state funding (around 60% in Maine), the move to electronic medical records, and uncertainty around modes of payment. In addition, there is still a great deal of uncertainty around the Affordable Care Act. However, there is a continued growth in income. The Affordable Care Act is unlikely to cause a shortage of physicians as some are anticipating due to the fact that most people are already in the system somehow and there are a robust number of physician's assistants, nurse practitioners, etc. There is likely to be continued aggregation of physicians, especially in hospitals.

Patrick Strauch, Maine Forest Products Council

Mr. Strauch provided a copy of a recent report on Maine's forest economy that includes a section on the economic impact of the forest industry. Overall, the industry has been following the same trend as manufacturing in terms of doing more with fewer people. Employment is down, but wages are up. The older workforce is a concern for the forest industry as well.

Many companies are looking for ways to innovate and expand their product lines. Many of the paper mills are making investments and getting involved in the energy field. Lumber mills are investing in anticipation of housing and construction increases and some new lumber mills are starting to come online. The economy is rebounding, but employment won't return to historical levels.

The conversion to pellet burners is opening up new products and diversified revenue streams for many companies. Pulp is being exported as prices increase and tissue is strong, but there is limited capacity for it in Maine. In general, the forest products companies have weathered the economic downturn and are starting to see some improvements.

Maine Hospital Association

The Maine Hospital Association was unable to participate in the meeting but sent a written summary.

Overall, things were worse in 2012 than in 2011 and are expected to remain so for the foreseeable future. Discharges were down 3.5%, emergency department visits were down 2.7%, inpatient surgeries were down 0.7%, and outpatient surgeries were down 3.1%. While the reasons for this decrease in output are unclear, the lingering poor economy is likely the central explanation. Outpatient visits were up 11% and physician visits were up 5%, although this may reflect the growth in hospital-based physician employment rather than an increase in workload.

Payroll growth remained solid at 7%, reflecting employment growth rather than wage growth. Total full time equivalent employment increased 8%. Uncompensated care grew significantly at 15%, reflecting the growing trend in high-deductible insurance plans where consumers can't pay their share.

Operating margins are very troubling, as 20 of 39 hospitals had negative operating margins, up from 12 in 2011. This is likely to continue based on data from the first quarter of 2013, including the fact that the 2% federal sequestration cut to Medicare reimbursements took \$20 million from Maine hospitals in February 2013 and the state legislature's 10% cut to Medicaid hospital outpatient reimbursement. However, it is possible that hospital finances will improve down the line as health insurance coverage increases.

The \$500 million Medicaid debt payment made in September helped hospital finances in terms of providing relief to vendor payments, getting out of lines of credit, and meeting "cash on hand" requirements.