

## **RHODE ISLAND ECONOMIC OUTLOOK**

### **Economic Outlook**

Rhode Island's economic outlook improved over the last year. The unemployment rate dropped from 11.9% (peak) in March 2010 to 9.7% in December 2012, and to 7.7% in July 2014. Between December 2012 and July 2014, the state added 9,700 jobs. According to an index released by Bryant University and RIPEC, the Rhode Island Economy expanded 3% in the second quarter of 2014, compared to an expansion of 2.2% in the first quarter. The Rhode Island economy expanded 1.4% in 2013, 1.3% in 2012, and contracted 0.1% in 2011, according to the U.S. Bureau of Economic Analysis. However, there are significant uncertainties and challenges on the road to economic growth in Rhode Island. As of August 2014, just under 43,000 Rhode Islanders were unemployed and the state's unemployment rate of 7.7% was the third highest in the nation. Rhode Island is also among the few states with total employment still below pre-recession levels. In addition, Rhode Island's housing market and construction industry are still subject to significant volatility, thus making it hard and risky for both individuals and developers to engage in transactions and make decisions related to housing in the state.

The fall 2014 NEEP forecast for the state of Rhode Island considers the most recent trends highlighted above, the state's internal dynamics, as well as the regional and national economic conditions. It is also assumed no major changes to the state's underlying structure including regulations and the tax structure. Overall, this report shows that the state economy is still operating with "brakes on" and that the pace of growth will continue to be slow, particularly in key industries including manufacturing, construction, information, financial services, and trade, transportation and utilities.

Policymakers need to recognize that the state's poor economic performance is not something new that started with the 2008 Great Recession. Rhode Island performed below average in the 1990s and experienced little economic growth during the post-2001 recession. Between 1991 and 2000, Rhode Island was among the worst performing states in the nation in terms of job creation, experiencing just over 8% total employment growth during this period. The pre-recession period in the 2000s was no different: the state added just over 22,000 jobs between 2000 and 2007.

Rhode Island has structural problems and a cost-structure that is misaligned with that of competing states, which has sent away businesses and people who would contribute to create jobs and income in the state. Thus, policymakers need to consider the right set of measures to remove the brakes from the economy and put it back on track of growth. The November elections provide a unique opportunity for the state to consider and take on measures that can accomplish that.

The list of things "to do" includes several key items. The state (including cities and towns) has to create a tax system that aligns sales taxes, corporate taxes, unemployment insurance, and local property taxes with that of competing states, thus making the state tax-competitive. However, potential loss of revenues implies that a major revamp of the tax structure can only be accomplished by taking bold steps to improve service quality and cut costs of public services in Rhode Island. Moreover, efforts already on course to improve the easiness of doing business in the state must be quickly expanded, so that the state creates a uniform, predictable, efficient, and simplified regulatory environment.

The state's demographics are also challenging and demand significant attention. The population is getting relatively older while the prime working-age group is stagnant, thus limiting the growth of

the labor force. In addition, the state has a large number of adults without a college degree whose skills are unaligned with labor market needs. These people face significant difficulties to secure a job and a stable source of income and, thus, are subject to structural unemployment and poverty. Active educational policies targeting this population cohort together with significant investments in infrastructure and capabilities to deliver workforce training are needed in the state.

Rhode Island has also a branding problem. It is crucial to identify the state's key assets and focus on branding the state as a modern economic environment that is strategically located and offers exceptional business opportunities and great living conditions.

A comprehensive policy package that addresses these issues and removes all major barriers to human capital accumulation and business development will be a game changer for the state and create the base for economic growth and job creation in Rhode Island.

### **Forecast Highlights**

The outlook for the unemployed rate and nonfarm employment has improved over the forecast horizon. The unemployment rate declined faster than previous estimates and is expected to continue shirking until it reaches 5.3% by 2018. The number of nonfarm jobs based in Rhode Island has also increased faster than previous estimates, but will continue to be below pre-recession levels until 2017.

From 2013 to 2018, Rhode Island's growth of the Real Gross State Product (RGSP) is forecast to increase on average by 1.9%. This rate is higher than the average of 0.9% observed between 2008 and 2013, but slower than the forecast of an average 2.4% growth for the New England region and 2.7% growth for the U.S. economy during the same period.

Per capita income is expected to increase to \$48,287 in 2014 from \$47,039 in 2013, an increase of 2.7%. Accounting for expected inflation, from 2013 to 2018 the annual growth rate of real per capita income is forecast to be on average 1.3% in Rhode Island compared to 2.4% in the New England region.

The Rhode Island labor force is forecast to stay at 556,000 in 2014, the same level observed in 2013 and slightly smaller than the 559,000 in 2012. By 2018, the labor force is forecast to be 568,000. From 2013 to 2018, the labor force is forecast to increase 0.4% per year compared to reduction of 0.6% from 2008 to 2013. The unemployment rate is expected to be 7.5% by the end of 2014, 7% in 2015 and 5.3% by 2018. The unemployment rate in Rhode Island will continue to be higher than that of all New England states over the forecast horizon.

Total nonfarm employment is forecast to be 479,400 in 2014Q4 as compared to 471,200 in 2013. Rhode Island's nonfarm employment is forecast to be 498,300 by 2018. The annual growth rate of employment is forecast to be 1.1% from 2013 to 2018 compared to -0.4% from 2008 to 2013. In New England, total employment is expected to increase by 1.2% per year from 2013 to 2018.

From 2014 to 2018, jobs are forecast to be added in the following sectors: financial activities, professional and business services, leisure and hospitality, education and health services and high-tech. The lack of growth in some industries will affect job creation in manufacturing, construction, trade, transportation and utilities, information services and government employment.

The median price of a home is forecast to increase to \$228,100 in 2014, a 2.1% increase from 2013. The median price of a home is forecast to increase at an average of 2.8% from 2012 to 2017,

compared to a decline of 1.7% between 2008 and 2013. By 2018, the median price of a house will be \$256,500 in Rhode Island.

The lack of momentum in the housing market has affected both prices and construction activities in the state. It is forecast that it will be issued 1,272 housing permits in 2014 as compared to 928 in 2013. In 2018, it is forecast that about 1,442 housing permits will be issued in the state, which represents roughly half of the number of permits issued during the first half of 2000s.

The population in Rhode Island is projected to be 1,053 million in 2014 and 1,061 in 2018. From 2013 to 2018, the annual growth rate of population is forecast to be 0.2% as compared to -0.1% from 2008 to 2013 and -0.3% from 2003 to 2008. From 2013 to 2018, the annual average growth rate of the population in the age cohort 65 and older will be 2.2% compared to an increase of 0.9% in the age cohort 25-44 and a decline of 2.1% in the age cohort 20-24 and of 0.5% in the age 45-64.

### **Real Gross Domestic Product**

Between 2003 and 2008, Rhode Island experienced near stagnation with an annual average growth rate of its GDP of just 0.2%, compared to GDP growth of 1.7% in New England and 2.2% in the United States. From 2008 to 2013 the state's GDP increased 0.9%, which was slightly faster than the growth of the New England region (0.7%), but slower than the national average of 1.2%. From 2013 to 2018, the forecast projects that Rhode Island's Real GDP will grow 1.9% (annualized rate), compared to 2.4% in the New England region and 2.7% in the United States. Despite the fact that Rhode Island growth is expected to be slightly slower than that of New England and the nation, the forecast is somewhat optimistic because it indicates a fundamental shift for the state's economy from economic stagnation toward a period of slow to moderate growth. This growth will be supported by the expansion of service sectors in the state.

### **Employment**

Nonfarm employment in Rhode Island increased to 476,300 in 2014Q2, compared to 470,600 jobs in 2012Q2 and 464,800 jobs in 2012Q2. The forecast indicates that Rhode Island's job market will continue to improve. Total nonfarm employment is forecast to be 484,300 in 2015 and 498,300 in 2018. Between 2014 and 2018 the state is expected to add just over 21,000 jobs. From 2013 to 2018, the annual growth rate of employment is projected to be 1.1% in Rhode Island, compared to 1.2% in New England and 1.7% in the United States. These figures, however, suggest that the number of jobs based in Rhode Island will continue to increase at a slower rate than that observed in New England or the United States.

The unemployment rate has ticked down and reached 7.7% in July 2014, which is 2% lower than the 9.7% in December 2012 and 5.2% lower than the peak rate of 11.9% in 2010Q1. However, the state still has the highest unemployment rate in the country and, because job creation in outer years will be modest, Rhode Island's unemployment rate will stay above the national average until 2018. The state's unemployment rate will continue to converge toward the national average and be roughly the same by 2018. In Rhode Island (United States), the unemployment rate is forecast to be 7.7% (5.7%) in 2015 and 5.3% (5.1%) in 2018.

The construction industry employed 17,100 workers in 2014Q2 compared over 23,000 workers in 2007Q1, a reduction of 5,900 jobs. Employment in manufacturing was also greatly affected, dropping from 51,600 in 2007Q1 to 40,800 in 2014Q2. The forecast suggests that these "lagging"

industries will continue to operate below pre-recession levels for several years. Employment in manufacturing is expected to increase on average 1% from 2013 to 2018 and be 42,000 by 2018. Construction is forecast to employ 17,800 workers by 2015 and 18,000 by 2018. Employment in trade, transportation, and utilities is projected to be 74,700 in 2015 (no growth compared to 2014) and 75,600 in 2018 compared to 79,800 in 2007. The information industry employed 10,600 workers in 2007 and is expected to employ 8,600 workers in 2015 (no growth compared to 2014) and 9,000 workers in 2017. In Rhode Island, financial services employed 32,600 workers in 2014Q2, compared to 34,900 workers in 2007. The recovery has been slow and the number of jobs will only be back to pre-recession levels in financial services by 2017Q1. From 2013 to 2018, employment in financial services is forecast to grow at an annualized rate of 2.1% in Rhode Island compared to 1% in New England.

The poor performance of these key industries is worrisome because it limits the speed and scope of the economic recovery and creates difficulties for workers with skills only applicable/usable in these industries. Unless displaced workers obtain training and skills that are demanded in other industries, they may be subject to long-term unemployment and poverty.

The leisure and hospitality industry and professional and business services have experienced significant job growth since 2011 and are expected to continue growing at relatively high rates. From 2013 to 2018, leisure and hospitality services are forecast to grow at an annualized rate of 2.7% in Rhode Island compared to 1.8% in New England. Leisure and hospitality is expected to add more than 5,000 jobs from 2014 to 2018. Professional and business services employed 60,700 workers in 2014Q2, compared to 56,100 in 2007. This sector is forecast to employ 62,300 workers in 2015 and 64,700 by 2018. From 2013 to 2018, professional and business services are forecast to add about 4,000 jobs and grow at an annualized rate of 2% in Rhode Island compared to a growth rate of 2.7% in New England.

Education and health services together account for 25% of the private employment in Rhode Island. These industries have showed resilience during the 2008 Great Recession and added jobs on a sustained pace. Employment in education and health services increased from 99,200 in 2007 to 104,000 in 2014Q2. Employment in education and health services is forecast to be 105,000 in 2015 and 108,000 in 2018. From 2012 to 2017, employment in education and health services is expected to grow by 0.6% per year. New England will outperform Rhode Island in terms of employment growth in education and health services at a forecast growth rate of 1.4% during the same period.

The high-tech sector -- which comprises both high-tech manufacturing and high-tech services -- has also demonstrated resilience, but the pace of job creation has been slow in this sector. The high-tech industry employed 22,200 workers in 2014Q2 and is expected to employ 23,700 workers by 2018. The forecast indicates that from 2013 to 2018 the high-tech industry is expected to grow 1.4% per year in Rhode Island, compared to 2.1% in New England.

## **Housing**

Despite modest improvements, the Rhode Island housing market and construction industry continue to operate at levels well below pre-recession levels. Construction activity is at historical lows, home prices are stagnant, and the number of house transactions is as low as that seen in the early 1990s. In 2013, 928 housing permits were issued in the state compared to about 3,000 permits in 2006. Housing construction is expected to recover slowly with housing permits reaching 1,272 units in 2014 and then hovering around 1,500 units until 2018. This level of construction is significantly lower than the pre-recession level and will affect job creation in the construction industry.

Lower housing prices have caused the affordability index (ratio of median house price to median household income) to improve in Rhode Island. The state's housing affordability index was 4 in 2014Q2, compared to 5.6 in early 2006. This implies that as of 2014Q2 the relative cost of a house is about 29% lower than that in 2006. The housing affordability index in Rhode Island is forecast to hover around 4 and convergence towards the U.S. index, suggesting that the relative cost of a house in Rhode Island will turn similar to the average in the United States.

The median price of a home in Rhode Island increased to just under \$230,000 in 2013Q3, then it dropped to \$222,800 in 2014Q1 and increased to 228,100 in 2014Q2. The median price is forecast to stay roughly constant for the rest of 2014, increase to \$241,900 in 2015, and be \$56,500 by 2018. From 2013 to 2018, the average price of a house is expected to increase on average 2.8% per year both in Rhode Island and in New England. Sales of existing houses dropped from an average of 13,400 units in 2006 to 8,300 (annualized) units in 2012Q1, increased to 10,500 in 2013Q3, and declined to 9,400 units in 2014Q2. The forecast indicates that from 2013 to 2018, sales of existing houses will decrease 0.4% per year, compared to an increase of 1.2% between 2008 and 2013.

Overall, the figures above show that Rhode Island's housing market and construction industry are still subject to significant volatility, thus making it hard and risky for both individuals and developers to engage in transactions and make decisions related to housing.

## **Demographics**

Rhode Island's demographics are also worrisome for the future of the state. Population has been stagnant for more than a decade and out-migration of qualified individuals has reduced the pool of qualified labor available for businesses operating in the state. The forecast indicates that the state population will grow 0.2% from 2013 to 2018, which represents an increase of 7,000 people in the state. However, this growth is concentrated in the age cohort 65 and older. From 2013 to 2018, the annual average growth rate of the population in the age cohort 65 and older will be 2.2% compared to an increase of 0.9% in the age cohort 25-44 and a decline of 2.1% in the age cohort 20-24 and of 0.5% in the age 45-64. The population in Rhode Island is projected to be 1,053 million in 2014 and 1,061 in 2018.

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