

# EastBay

Q4 08



## ECONOMIC OUTLOOK



**Created for the  
East Bay Economic Development Alliance  
&  
The Contra Costa Council**

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# **East Bay Quarterly Forecast:** **The Incipient Slowdown**

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## **Summary**

Over the last eighteen months the sluggishness in the East Bay economy has been characterized by housing and housing related weakness. We have been closely monitoring the East Bay economy for a spread of this weakness to the broader economy since the housing market began to weaken two and a half years ago. In the last East Bay Report we discussed the fact that the East Bay, with its significant bedroom communities, residential construction industry, and home finance industry had generated very ugly employment numbers and had fared worse than the rest of the Bay Area. The East Bay economy has continued to weaken since the 2<sup>nd</sup> quarter and job losses have become increasingly large and more widespread. The 3<sup>rd</sup> quarter also provides evidence of a turning point in the national economy and as a consequence, it predicts a broader downturn in personal income and employment in the East Bay. Inflation eating away at the value of stagnant nominal income, more than a severe contraction in economic activity, is the story of the 3<sup>rd</sup> quarter, and an outright contraction of income, employment, and output is expected in the 4th. More than most regional economies in the U.S., the Bay Area economy is better positioned to weather the current economic storm. It has the advantages of its geographical proximity to the Pacific Rim, its export oriented manufacturing logistics and port, and its dynamic innovation and knowledge based services sector. Nevertheless, the Bay Area will not escape the storm and the East Bay will bear the largest share of the Bay Area's contraction. This East Bay Report begins with a review of labor markets and the jobless growth of the East Bay's manufacturing driven by growing export demand, then follows with a re-examination of the turning point for the housing market, and concludes with the impact of the downturn in the U.S. economy on East Bay economic activity and the East Bay forecast.

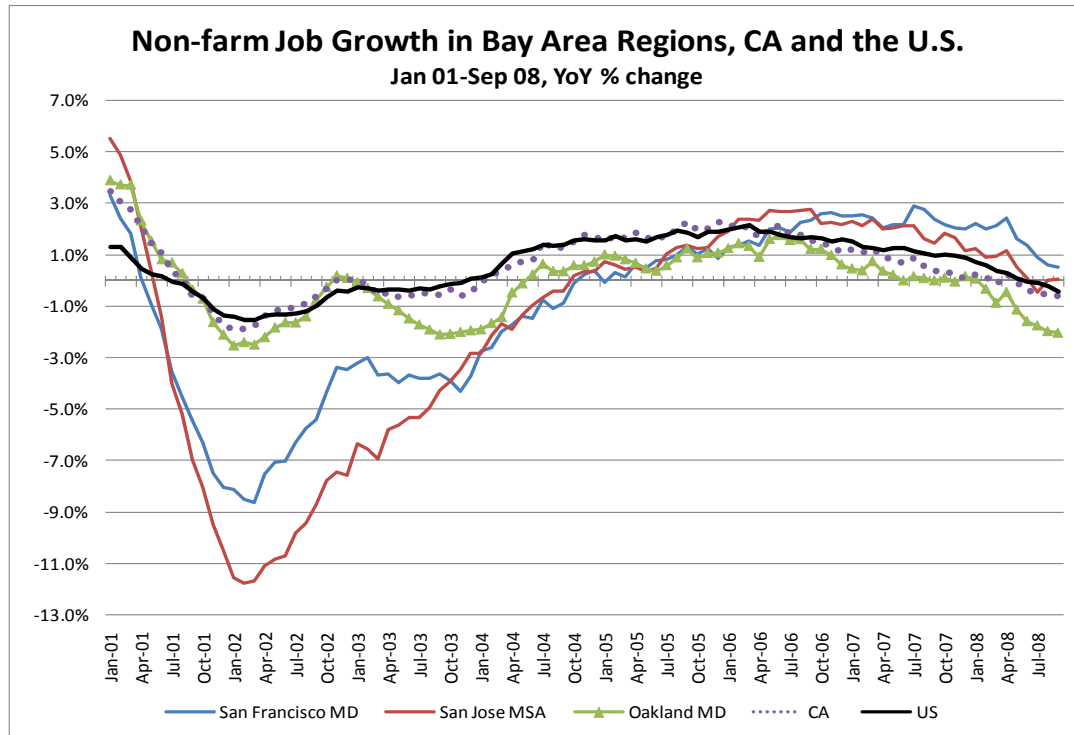
The U.S. economy has weathered considerable bad news the last two years. The first credit crunch hit in the Fall of 2007. The first half of 2008 saw soaring gas and food prices. Housing prices and sales volumes plummeted at the same time. And yet, consumption, which represents 70% of all economic activity, held up. When we studied the impact of similar events in the past, the S&L meltdown in the late 80s, the collapse of asset values at the end of the dot-com speculative bubble in 2000, and a wide spectrum of economic studies on wealth effects, it was clear that the problems of Wall Street, the real estate sector and the residential construction sector, as bad as they were, were insufficient to cause a downturn in overall economic activity. Manufacturing, retail, exports, jobs were all holding up at levels that were anything but recessionary.

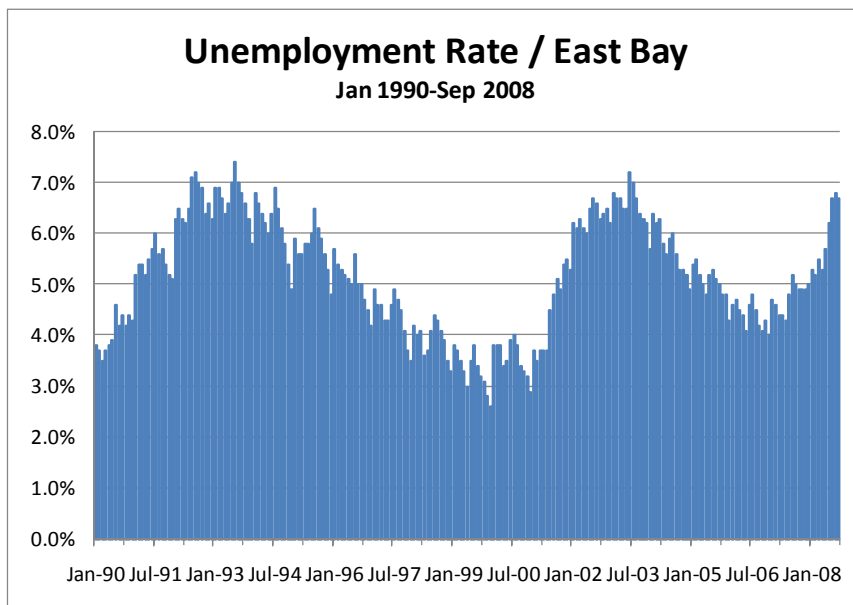
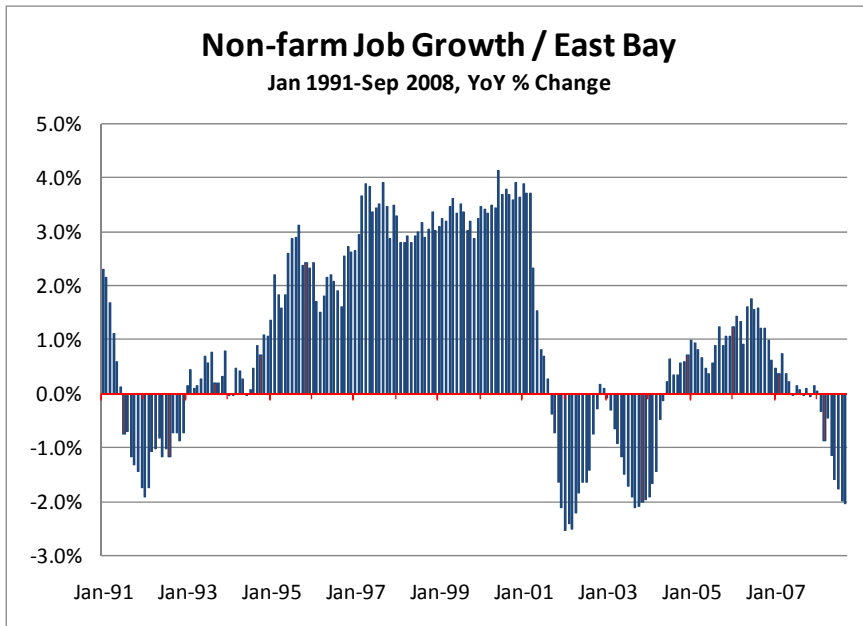
All of this held true until September. The month of September 2008 will be remembered as one of an unexpected, spectacular failure of the financial sector and a massive, yet poorly articulated, intervention by the Federal Reserve and the Treasury. This is a totally new event which while it reminds us of the Panic of 1907 and the Bank Crisis of 1933, differs in the existence of the Federal Reserve System and the electronic age of international finance. The story is as much a story of fits and starts in economic policy as it is weakness in the large investment banks and non-bank financial institutions. As such, the

precursors of it are not seen in the non-financial economic data, nor in the pronouncements of the banking sector, Federal Reserve, or Treasury. Indeed it caught the Federal Reserve by surprise. All of this was enough to cause a collapse of consumption in September. Since this is more a crisis of confidence, of uncertainty about the future than of structural imbalance in the “main street” economy, we do not expect the impact to last for more than a few quarters. Nevertheless, it has caused us to ramp down our forecast for the East Bay significantly. The new forecast shows the East Bay with three quarters of declining economic activity, three quarters of declining payroll employment and four quarters of declining overall employment and of declining real taxable sales. As events unfold in the 4<sup>th</sup> quarter, we will be looking for signs that the uncertainty currently prevalent in the U.S. economy, in California and in our local economy are abating. At present we are forecasting a mildly bad holiday season for retail. If consumer uncertainty remains at elevated levels and it turns worse, the forecast will need to be ramped downward even more.

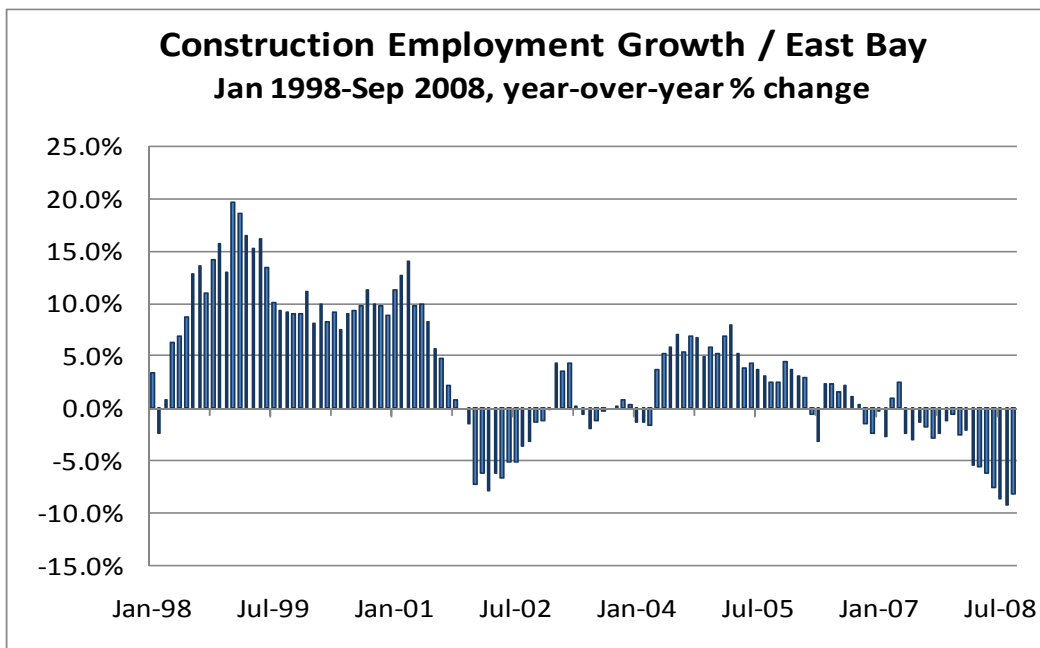
## A Review of Employment and Unemployment

Bay Area employment growth turned negative during the last two quarters. The three district areas- San Francisco MD, San Jose MSA, and Oakland MD (the East Bay) - are a mix of positive and negative employment trends. While San Francisco is still adding jobs and Silicon Valley is holding its own, job loss in the East Bay has tipped the growth scale for the entire region to the negative side. There were approximately 4,000 payroll jobs lost in the 1<sup>st</sup> Quarter compared to the previous year and 11,000 or 1.1% of payroll employment lost in the East Bay in the 2<sup>nd</sup> quarter. The employment picture in the East Bay went from bad to worse in the 3<sup>rd</sup> quarter. Payroll employment is 2% below 3<sup>rd</sup> quarter 2007 and total employment, which includes the self employed, is down by 9,000 jobs or 0.7%. Unemployment in the East Bay is now at levels not seen since the recession of 2001.





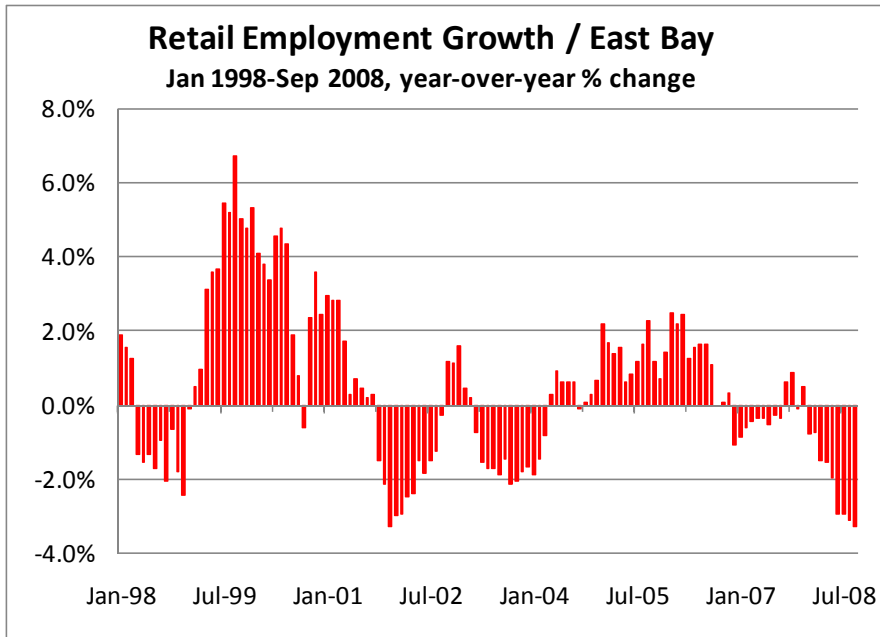
While job losses are widespread in the East Bay, the bulk of these losses are concentrated in construction, finance, retail and manufacturing. Construction and finance are a continuation of the housing downturn. The new twist is a weakness in non-residential construction in the Bay Area. This is a direct consequence of nervousness on the part of investors about the future demand for office space<sup>i</sup> and the increased difficulty in closing funding for new projects. In a later portion of this report, we conclude that while these job losses will continue, the end is in sight. As will be discussed in the section on the housing market, job losses in construction will continue through the middle of 2009 and abate with the bottom of the housing downturn.



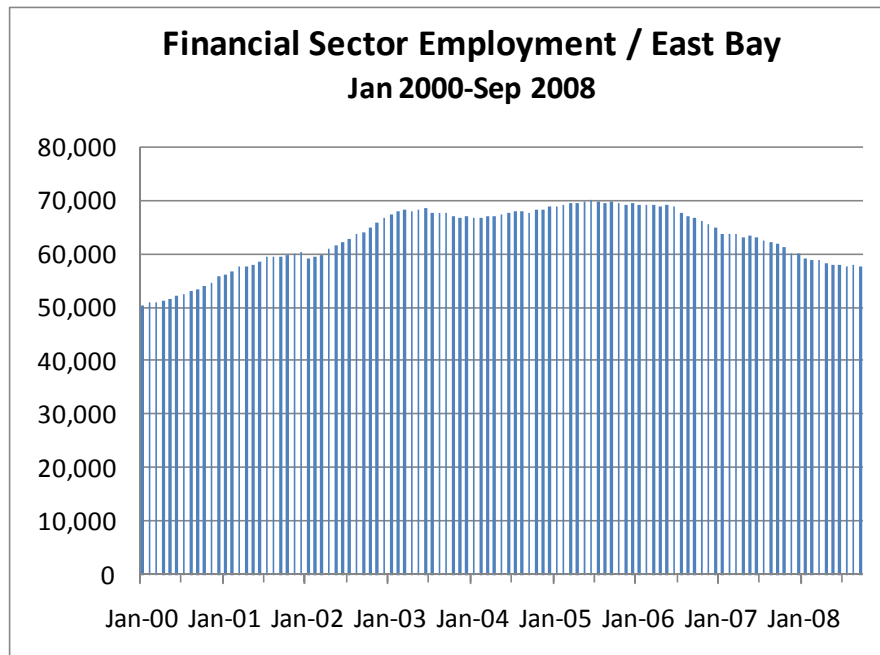
The weakness in retail is important as retail represents 11% of all East Bay payroll employment. Job loss in the second quarter was due to the failure of Mervyns, and Linens and Things, and the cut back in other retail outlets. This will accelerate with consumer spending led deteriorating economic conditions in the 4<sup>th</sup> quarter. Nationally, consumer spending collapsed in September. The 3<sup>rd</sup> quarter employment numbers reflect this and all indications are that the 4<sup>th</sup> will as well.

The puzzle that exists in the retail sector performance is that while retail sector employment has been falling each month this year, retail sales have been holding up. How can we explain this? First, the national competitive environment for chain retail stores has created a cost squeeze on national and local retailers, and, second, the East Bay population movements have changed over the last two years. Economic theory tells us that expectations play a role in investment decisions. The greater the expected rate of profit growth is for a company, the more it is valued by investors. If company reports lower sales and profit growth, investors will tend to switch to other assets and the stock price of the company will fall. This puts pressure on the management to reduce costs and increase the efficiency of its workers, and ought to lead to cuts in payroll employment. Thus, a mere slowdown in sales growth is enough to trigger some layoffs. In general, U.S. retailers have been struggling to maintain profit levels in the face of stiff competition. The evident weakness in the East Bay employment picture would be reason enough for local retail employers to be cautious about hiring and about replacing workers who have left jobs.

In addition the eastern portion of the East Bay region saw a rapid expansion of home development from 2002 to 2006. Retail tends to follow home building in expanding areas. During the building boom retail employment expanded by about 3,000 jobs, approximately the same level of decline seen in the last 12 months. One consequence of the housing crisis is the temporary cessation of population expansion in the eastern part of Contra Costa County. Retail establishments put into place to serve a projected larger population, now must size their staffing to the smaller existent population.



The financial sector, which has been hit hard by the downturn in home mortgage finance and real estate, lost over 4,000 jobs this last year. However, the rate of job loss has slowed considerably. Finance employment, which grew to support the speculative bubble in East Bay housing, has now retreated to pre-bubble levels, and while some additional job losses are expected, the magnitude should be small. This picture is confounded somewhat by the consolidation of banking in the U.S. The purchase of Golden West Financial by Wachovia in 2006 and subsequent consolidation certainly dampened the finance employment picture in the East Bay. The return to the Bay Area with Wells Fargo's acquisition of Wachovia may have the opposite effect. Assuming a neutral effect of these shifts in corporate headquarters, the level of transactions which need to be supported by the financial system over the next few years, ought to be similar to 2001/2002 recession and East Bay finance employment is at those levels today.



## Employment / East Bay Jobs Created in Last 12 months

Sector	Sep-07	Sep-08	Sep-2007 to Sep-2008	
			Change	% Change
Total Farm	1500	1500	0	0.0%
Natural Resources and Mining	1200	1300	100	8.3%
Construction	74600	68500	-6,100	-8.2%
Durable Goods Manufacturing	59300	58000	-1,300	-2.2%
Non-durable Goods	34400	33900	-500	-1.5%
Wholesale Trade	48500	47600	-900	-1.9%
Retail Trade	112600	108900	-3,700	-3.3%
Transportation, Warehousing and Utilities	36200	36400	200	0.6%
Information	29100	28300	-800	-2.7%
Financial Activities	61700	57600	-4,100	-6.6%
Professional and Business Services	156300	155300	-1,000	-0.6%
Educational and Health Services	124600	125500	900	0.7%
Leisure and Hospitality	88100	87100	-1,000	-1.1%
Other Services	36600	35700	-900	-2.5%
Federal Government	17000	16700	-300	-1.8%
State and Local Government	168900	166900	-2,000	-1.2%
<b>Total</b>	<b>1,050,600</b>	<b>1,029,200</b>	<b>-21,400</b>	<b>-2.0%</b>

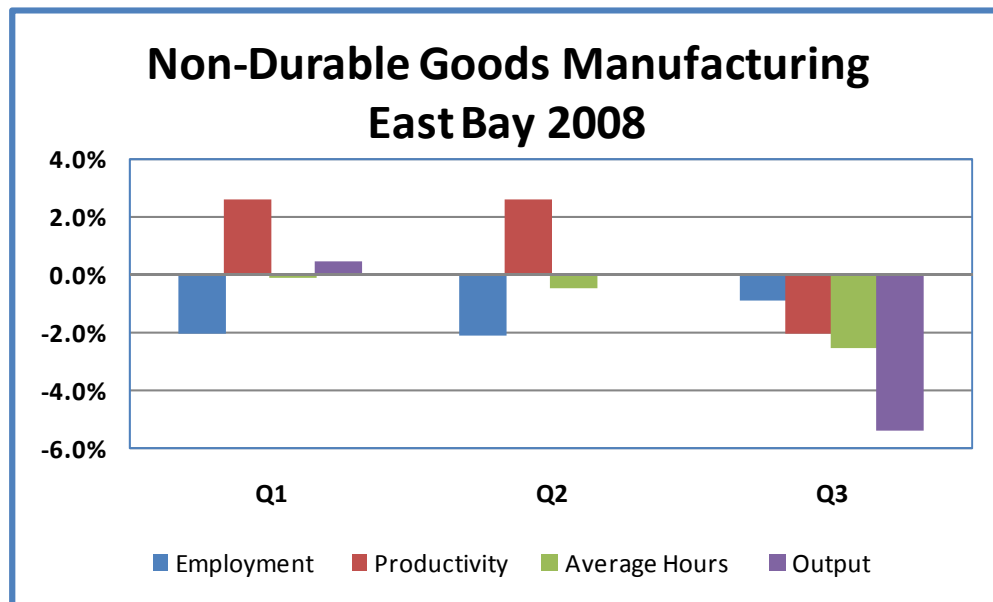
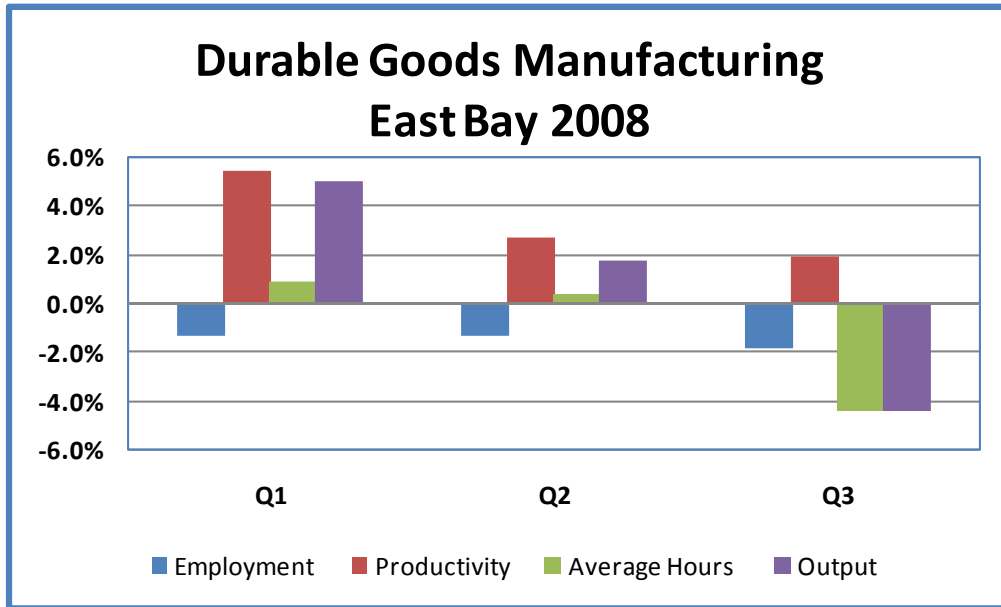
Sources: CA EDD and UCLA Anderson Forecast

### Export Led Growth: Where Are the Jobs?

Exports from the U.S. grew at an astonishing 9+% this year. It was that growth that kept us out of a recession through the first half of the year, and in the absence of the uncertainty emanating from the financial crisis, might have averted one altogether. For the East Bay this should be good news. Manufacturing is an important part of the East Bay economy. It amounts to approximately 9% of the regions employment. With the port of Oakland nearby, goods manufactured for export to Asia have a short, direct logistics chain. With such rapid growth in exports we would expect to see a jump in East Bay manufacturing employment. However, it did not happen. Employment in manufacturing shrunk by -1.6% in the 1<sup>st</sup> and 2<sup>nd</sup> quarter, and again by -1.5% in the 3<sup>rd</sup>, as compared to a year earlier. Employment in transportation and warehousing grew a modest 0.6% in the 3<sup>rd</sup> quarter due in part to increased exports of agricultural goods from the Central Valley.

Often we consider employment as our gauge of economic activity. It works well in most cases but it is not the entire story. Economic activity is the production of goods and services and labor is but one input. Capital, production processes, raw materials, and innovations are the other inputs. Since the recession of 2001, American manufacturing has become increasingly efficient. Labor intensive manufacturing and manufacturing which was not amenable to rapid gains in productivity left California for the labor abundant economies of Asia. Throughout the recovery from the 2001 recession, manufacturing productivity grew as American firms competed in the world market place. This has remained true over the past year. Though manufacturing employment, both in durable goods and non-durable goods contracted in the first half of the year in the East Bay, output actually increased. Most of

this increase was in the 1<sup>st</sup> Quarter. Nevertheless, the increases in durable goods production in the 2<sup>nd</sup> more than offset the small decline in non-durable goods production.



Looking at the numbers, in durable goods 2<sup>nd</sup> quarter employment fell by 1.4%. Productivity improved by 2.7% in the same quarter for a net increase in output of 1.3%. Add to that a 0.4% increase in the number of hours worked per employee and you have a 1.7% increase in output. For non-durable goods the decline in employment and hours worked just about matched the increase in output due to productivity gains. The primary mover in non-durable goods in the East Bay was food processing. This is

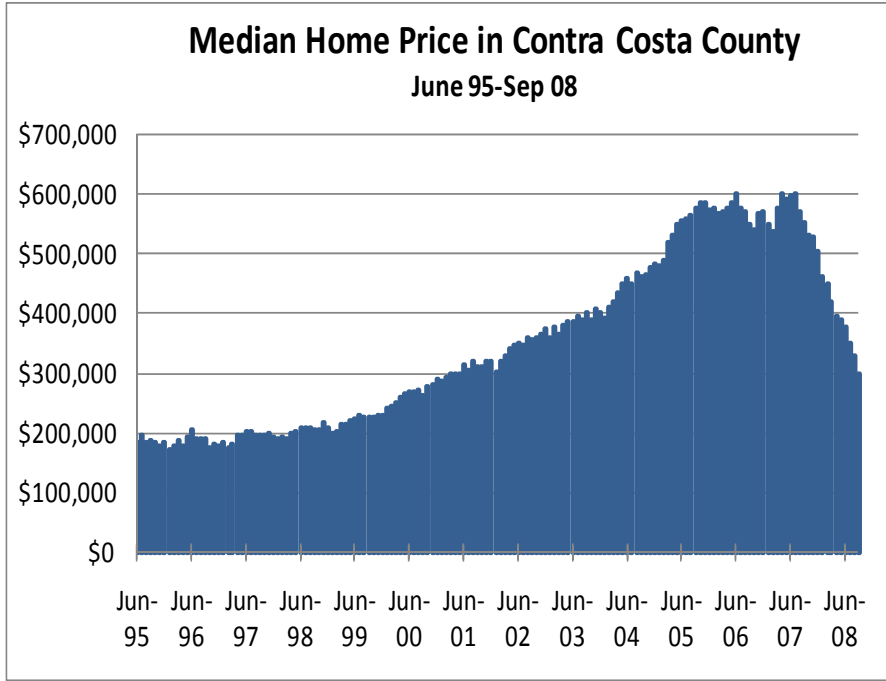
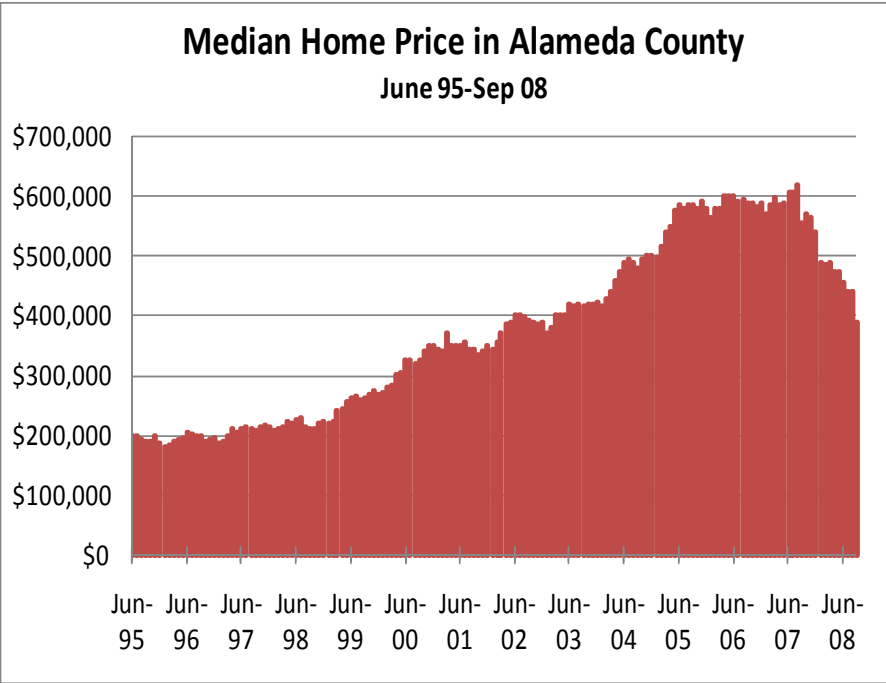
typically a locally produced and traded good and does not benefit from the increase in exports. So, the shifting of the consumer budget in the face of higher gasoline prices in the 2<sup>nd</sup> quarter showed up in non-durable goods manufacturing employment. Though total manufacturing output for the 1<sup>st</sup> and 2<sup>nd</sup> quarter was up, and income was up, employment was down.

Employment in durable goods in the 3<sup>rd</sup> quarter was down by 1.9% and non-durable goods by 0.9%. The preliminary numbers on productivity for the 3<sup>rd</sup> quarter show an increase of 1.9% for durable goods and a decline in productivity of nearly -2.0% in non-durables. The drop in employment in durable goods is offset by the increase in productivity, but the number of hours worked is down. So output and income in durable goods in the 3<sup>rd</sup> quarter declined. However, the largest sub-sector to decline is transportation equipment manufacturing. While we do not know how much of this was due to the Boeing strike, there is at least some direct and indirect impact on East Bay manufacturing. With respect to non-durable goods, the decline continues to be in food processing.

What does all of this portend for the East Bay economy going forward? With the slowing of economic growth in Europe, Canada, Mexico and Asia we expect a deceleration, if not decline, in export demand for the balance of 2008 and into early 2009. So, an expansion in manufacturing overcoming the reduction in employment due to productivity gains is not in the cards. The fall off of U.S. consumer demand means a contraction in trade and transportation as well. The good news is that with the weaker dollar, the underlying strength in the emerging Asian economies and the shift in consumption to more normal levels, exports will lead the U.S. recovery. As the East Bay is well positioned to benefit, we expect to see increases in manufacturing, warehousing and transportation as well as the ripple effects of this growth in the East Bay towards the end of our forecast horizon.

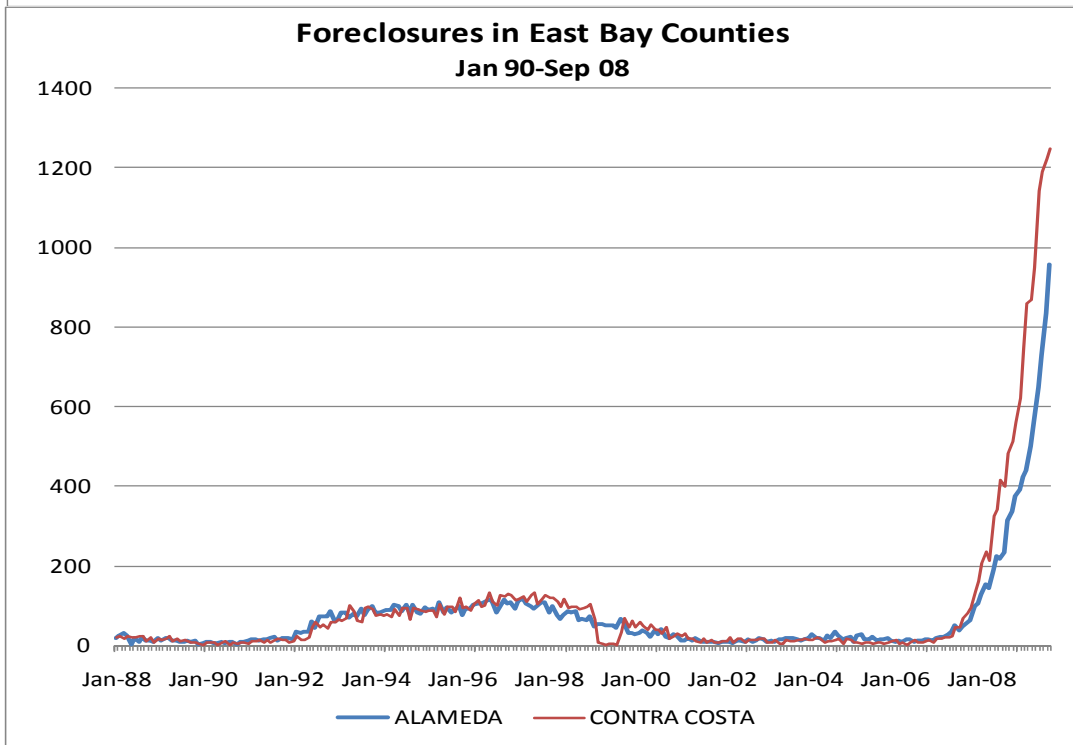
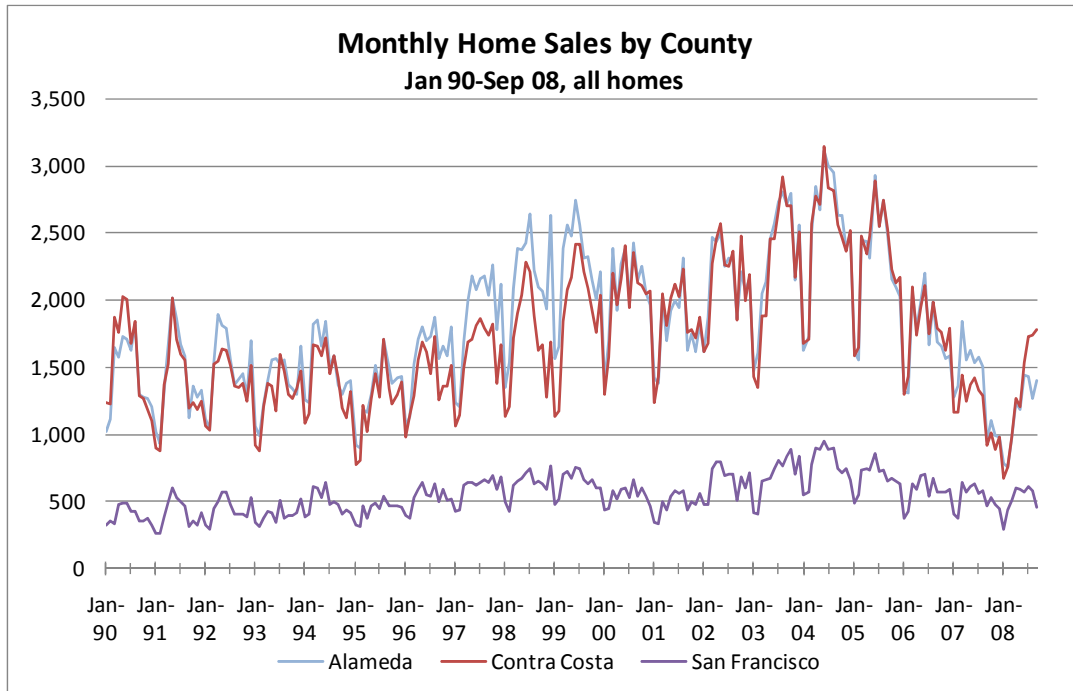
### **The Housing Downturn: Where Is The Bottom?**

Median home prices are still in freefall in the East Bay, as in most of California. The year-over-year rate of decline, as measured by the median home sales price, has now reached 30% in Alameda County and 46% in Contra Costa County. These are astonishing, record declines. By comparison, the largest decline during the 1991 downturn was just -8.2%. The declines in prices were needed to work off the excess appreciation in home values and bring prices back in line with what Californians would and could pay for home ownership. In September DataQuick reported that home sales transactions jumped across California. Contra Costa County home sales rose by 94% and Alameda County home sales by 48.7%. Moreover, according to the Federal Housing Finance Agency, inventories of unsold homes are on the decline in most California markets. All of this is, in its own way, good news. Clearly home prices were higher than market clearing equilibrium prices. In order to achieve stable housing markets at equilibrium price levels, they had to fall. The rapid fall in home prices brings us closer to that equilibrium and therefore closer to the end of the housing downturn. Thus there is indeed light at the end of the tunnel, and it is not very far away.



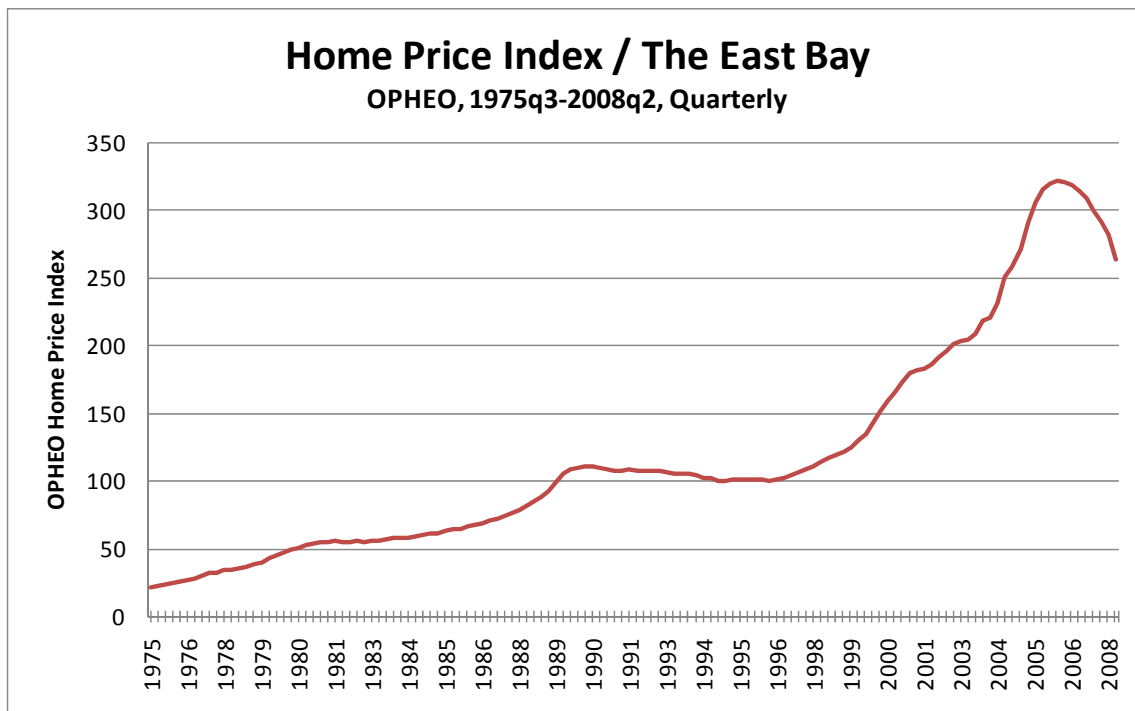
The recent steep decline in prices across the State and specifically in the East Bay counties is driven by the record number of foreclosures. Foreclosure sales accounted for 37.9% of Alameda and 58.7% of Contra Costa home sales in September, compared to 9.5% in San Francisco. But are the sales increases simply a temporary phenomena? Let's take a look at the graph below. In part the increases look like typical seasonal jumps; the sales dip in the winter and rise in the summer. But the last three months' sales levels, particularly in Contra Costa County, are larger then what would be explained by normal seasonality. The sales volume in September 2008 is now at about at the same level as the sales volume in December 2006. The

next few months will be interesting to watch. If the general decline in economic activity, through job loss, does not depress the housing market further, then these trends clearly point to the bottom of the market. What is unusual about this housing downturn is that record foreclosures and finance company-driven home sales have propelled the market more rapidly to its equilibrium. In addition, 2008 is the information age and those who do not have to sell their house, but want to sell it, have much better information about the price required to affect a transaction. These two forces are bringing the housing market into equilibrium much faster than in the early 80s or 90s downturns.



Sources: DataQuick and UCLA Anderson Forecast

Though median price data gives us a good indication of trends in housing prices, the issue of burning off excess appreciation is distorted by the composition of houses sold. If the median house is smaller, has less land, or is in a less desirable locale than the previous year, a fall in the median price will be recorded. This is simply because the median is a different house. As sub-prime foreclosures affected the lower end of the housing spectrum to a greater degree than the upper end of the spectrum, this compositional distortion in the data may be occurring. As an alternative the OFHEO HPI is a “same house” index and does not suffer from these distortions. For the East Bay, this index shows 18% decline since its peak in 2006, a smaller decline than the median price declines, but substantial nonetheless.



The long run appreciation rate of homes is a good indicator of how far we are from equilibrium. Homes carry both an investment quality and a place-to-live quality in them. The investment must earn a return sufficient to induce a home purchaser to make the investment and therefore, long run home values must appreciate over time. When there is excess appreciation, that must be worked off before potential buyers decide that the investment quality is such that they are willing to come back into the market. From 2003 through 2006 home prices increased by nearly 48% in the East Bay. After adjusting for inflation and normal appreciation, there is an excess appreciation due to the speculative asset purchases of 25%. To burn off that excess a combination of time, inflation, and price declines are required. At the current rapid rate of decline in home prices, most of that excess appreciation is already burned off. However, buyers are reticent to enter the market until they are confident a bottom is hit, and soft labor markets portend some overshooting of long run appreciation. Thus, while the prices and sales volumes indicate a bottom is near, we do not expect it to be achieved until the U.S. economy begins to grow again in the latter part of 2009.

## **Near Term East Bay Forecast**

After a review of the 3<sup>rd</sup> quarter performance, one could be reasonably optimistic about the near term prospects for the East Bay. Export led growth has been increasing income, and if productivity growth ever slows down, will increase employment. The end of the housing downturn, which has had a significant impact on all aspects of the East Bay economy, is in sight and it will be a decreasing drag on economic growth. Outside of retail, services are growing, albeit slowly. But the events of the past two months cause us to take a more pessimistic view, even more pessimistic than our early September national forecast would suggest.

Our forecast of personal income growth reflects the uncertainty created by the national economic crisis in September. The consumer held up under the housing slump, high gas prices, and a loss of value in equity markets through August. National retail sales excluding autos and adjusted for inflation showed slight growth each month. September changed the game. Beginning the first week of September we received a spate of bad news with the failures of AIG, Lehman, Merrill, Fannie Mae, Freddie Mac, Wachovia and Washington Mutual. To be sure, not all of these were outright failures, but all made the headlines as companies in danger of failing. The policy pronouncements from Washington were clear - the economy is in deep trouble. Each day consumers heard of new policies to counteract the economic crisis being proffered in Washington. The Federal Reserve and the Treasury went from a loan guaranteed with convertible warrants to nationalization, to opening the discount window to non-bank financial institutions, to lending in the commercial paper market, to purchasing toxic loans, and to investing in commercial banks. As late as the first week of November Wall Street financial firms were balking at participating in the "bail out" as a consequence of a "lack of clarity" in the program.<sup>ii</sup> All of this added up to a huge scare to the U.S. consumer. The bottom line was that we did not have a coherent economic policy whose consequences were well understood. The debate in Congress over the bailout plan is the most prominent, but just one case in point.

What did all of this mean for the East Bay Economy? Consumers are resilient in the face of changes in asset values. Basically, consumers know that their portfolios and their homes are going to go up and down in value over time and they discount this in making their consumption purchases. But what consumers don't like is uncertainty. The meltdown on Wall Street and seeming inability of Washington to stop the continued bad news created a level of uncertainty greater than any time during the housing downturn. With September's uncertainty about future job prospects, future prices, future economic health, and the ability of the financial sector to protect hard earned wealth, the consumer pulled back purchases. We already see evidence that October was more of the same. The bottom line is a collapse in consumption leading to a much deeper downturn in economic activity in the East Bay.

We have reduced our forecast in light of the events of the last two months. Real Personal Income, which had been stronger than expected earlier this year, when a declining 4<sup>th</sup> quarter is factored in, will decline by -0.2%. The decrease in Real Personal Income in early 2009 will result in a further decline over 2008 of -0.5%. The export led growth recovery in 2010 will show a return to normal growth rates of around 2.0%. Inflation (including energy and food) elevated to nearly 5% in the first half of 2008. 3<sup>rd</sup> quarter Bay Area CPI grew at 3.2% and with the weak

economy is expected to moderate further to about 2% after 2009. Our forecast for taxable sales for the East Bay has been revised downward dramatically. Taxable Sales for the two-county region is now expected to decline at a -3.5% rate this year, continue to decline at a -1.7% rate in 2009 and return to over 4% growth rate in 2010. As a consequence, sales tax revenues, particularly non-gasoline sales tax revenues, for the 2008/2009 and 2009/2010 fiscal year will be declining. This combined with reduced transfer taxes and possible declines in property assessments translates into lean fiscal revenues for county and city governments.

The employment forecast for the coming year calls for construction to shed an additional 6% of its remaining jobs and finance to shed approximately 5%. This will mark the end of large declines in housing market related layoffs. However retail and temporary business services are expected to continue shedding jobs through next year. Overall the forecast is for a contraction in payroll jobs in the East Bay in the current year and no net gain in jobs over 2007 levels until 2010. The East Bay unemployment rate, now at the same levels seen during the 2001 recession, will increase and it will peak next year at 7.5% and will abate only slightly in 2010.

On a quarterly basis the forecast is for the downturn to have hit income, employment, taxable sales and unemployment earlier than expected. The bad news of September resulted in a contraction in each of these measures of economic activity in the 3<sup>rd</sup> quarter of this year. This contraction is expected to continue through the 1<sup>st</sup> quarter of 2009 followed by very slow growth for the balance of the year. The East Bay economy, nearing the end of the housing downturn and with some hope of recovery in the near term, must now wait for the recovery from the national recession to achieve sustained economic growth.

## **The UCLA Anderson Forecast for the CA Economy: 2008 Q3**

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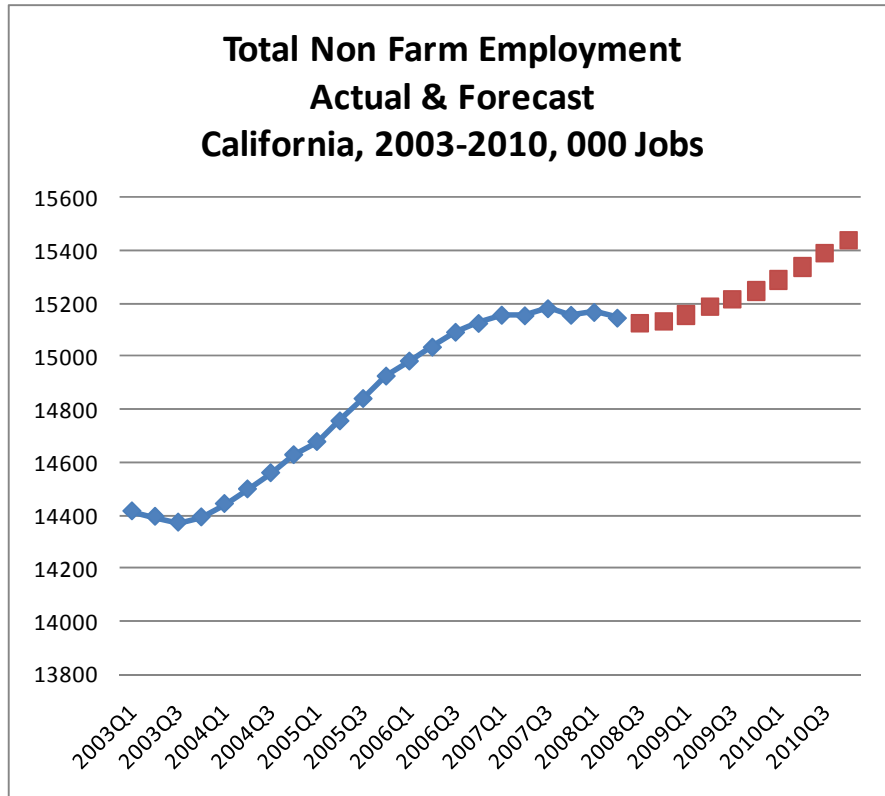
California is once again, and this time unfortunately, a bell weather state. The California economy stalled out a quarter earlier than the U.S. economy and sharply rising unemployment appeared here on the West Coast first. The continuing plunge in housing prices and skyrocketing foreclosures, a slowing of imports through California's major ports, and continued mortgage finance related troubles for the financial industry continue to take their toll. No longer are the traditional engines of growth for California, the services sectors, just barely keeping California employment growth in positive numbers. The good news is that the statistical evidence shows some slowing of the negative inertia in residential construction, and end in sight for the finance industry, and some strength in manufacturing, agriculture, health care and education.

The stalling out of the U.S. economy in the third quarter has serious feedback implications for California's economy. Ultimately, demand from other parts of the U.S. as well as continued strength in exports will bring California out of the doldrums without much decline in payroll employment and real personal income, but this will take some time. Recent events strengthen our view that things will get worse in California before they get better. On an annual basis our September expectation was that total employment growth will be -0.2% in 2008 and 0.4% in 2009 before growing at a 1.1% rate in 2010. The most recent data suggest it will be a bit weaker still. Real personal income growth will slow from 0.8% to 0.4% growth as we move into 2009 and then return to 2.6% growth in 2010. This slowing in the growth rate portends problems in state government finance until the 2010/2011 fiscal year. Taxable sales after adjusting for inflation will decline this year and not recover until 2010. This is a direct result of the weakness in consumer spending in 2008 and 2009. Finally unemployment is going to continue to be ugly. We originally expected it to grow to a high of 7.2% next year and to decline only moderately the following year. Our next revision will show approximately 0.6% higher unemployment for the balance of 2008. The stalled California economy is simply not producing the jobs required for the new entrants to the labor force over the next couple of years to prevent these elevated levels of unemployment from continuing.

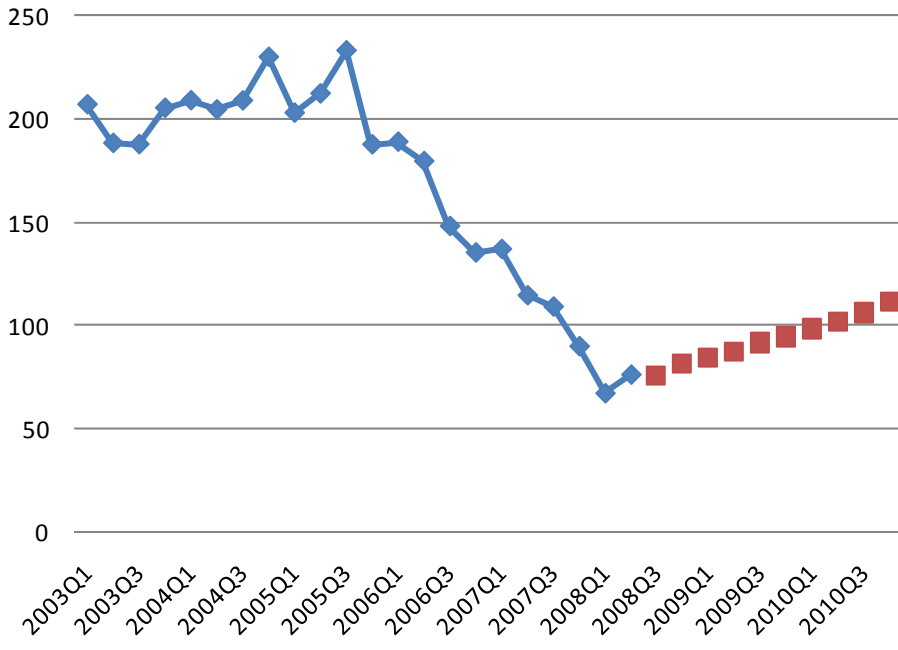
Our near-term quarterly forecast sees a sharp decline in personal income after adjusting for inflation in the 3rd quarter and -0.9% decline in the 4<sup>th</sup> quarter before beginning to recover in Q1 2009. Unemployment will continue to increase through the end of the year and it will stay in the mid 7% neighborhood for each quarter in 2009. The strength in exports of both goods and services in the Bay Area, and Los Angeles and in agriculture in the Central and Salinas Valleys have heretofore been important for keeping California afloat but the stalling of the U.S. and world economies has taken this out of the current employment and income equation.

Manufacturing output should continue to rise as orders for durable goods were up in July and August nationwide. This will eventually translate into greater employment, but thus far productivity gains in manufacturing have continued the slow bleeding of jobs in this sector. So the growth in exports will continue to provide some support for California's personal income, but do little in the way of generating new jobs over the next year. Agriculture, limited by land, weather and capital equipment is unlikely to provide much more stimulus in the near term.

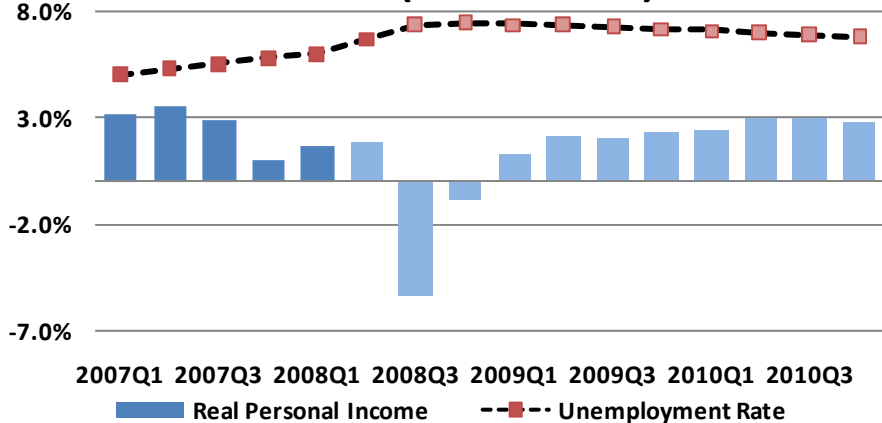
Basically, the California economy will muddle along with little good news the balance of this year and into next year. The turning point for this slowdown in growth depends critically on when bottom will be reached in construction and finance. The ultimate settlement of the budget gridlock in Sacramento does give us pause with respect to the next fiscal year, but the ultimate impact—no growth in government employment—ought to obtain even with an unprecedented timely passage of the 2009/2010 budget.



### Residential Building Permits Actual & Forecast California, 2003-2010, 000



### California Income & Employment Growth (2007 - 2010)



## **The UCLA Anderson Forecast for the U.S. Economy: 2008 Q3**

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**Senior Economist**

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After growing at a surprisingly strong 2.8% in the second quarter, the national economy appeared to have stalled through the end of August. The temporary boost to consumption coming from the \$108 billion economic stabilization package (tax rebates) has been largely spent. It is now important to watch consumer buying habits through the upcoming holiday season as it is going to play a critical role in the course of the U.S. economy. But, the recent, post rebate, pull back of the consumer in reaction to the meltdown on Wall Street may well mean that continued growth in net exports will be insufficient to carry the U.S. economy. As of the time the forecast was constructed (September 2008) we expected real GDP growth to be essentially zero over the next six months (Q4 2008 and Q1 2009). Unemployment, having risen to levels in the low 6% range, would remain elevated through the year as the stalled economy would be unable to generate sufficient job growth to bring it down. What we were describing was an economy bumping along at stall speed where any modest shock could trigger a contraction and full blown recession.

The early evidence from September is that the fear emanating from the implosion of venerable Wall Street firms, fueled by daily pronouncements of dire economic consequences from New York and Washington is just that shock. In the third quarter the financial crisis/bailout has increased uncertainty and caused the consumer to pull back -- so while we were predicting a small positive in GDP growth, this weakness in consumption is going to result in a small negative. This coupled with our first quarter forecast of negative GDP growth and the current employment data will meet the criteria of a recession.

As the financial sector has melted down, government has stepped in with massive intervention. This new, larger role of government represents a shift in government's view of its role in the economy from the recent past. It is not clear how all of this will shake out, but for purposes of our forecast we have made the implicit assumption that the financial markets do not seize up to the extent that they would severely curtail real economic output. The recent infusion of billions of dollars into the financial system by the Fed is consistent with our assumption.

What we are experiencing now is unprecedented. It is not unprecedented in the severity of the sectoral downturns. There have been financial panics before, and many have been more serious than the current one. It is not in terms of the housing downturn either. What is unprecedented this time is that the sectoral corrections that we are seeing are not happening all at once. Rather, like the hiker who doesn't want to take a break to recharge and just keeps plodding along up the mountain, we are experiencing serial adjustments in sectoral imbalances which have slowed growth almost completely and which will not have enough energy to snap back with normal growth anytime soon. And sometimes, the hiker cannot plod along uphill anymore, even if he wants to.

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<sup>i</sup> Allen Matkins UCLA Anderson Forecast Office Space Survey and Analysis, June, 2008

<sup>ii</sup> Michael Crittenden, "Firms Say Bailout Plan Lacks Clarity," Wall Street Journal, November 7, 2008

# East Bay Quarterly Indicators



Q3 2008

GDP & CPI	GDP - % Change from Preceding Period (US)			CPI (San Francisco)			CPI (US All Cities)		
	Q2 06	Q2 07	Q2 08 (adv.)	Aug-07	Aug-08	% Change	Sep-07	Sep-08	% Change
		2.7	4.8	2.8	216.24	225.411	4.24%	208.509	218.813

Source: BEA, BLS

Labor	East Bay			San Jose			San Francisco		
	Sep-07	Sep-08	% Change	Sep-07	Sep-08	% Change	Sep-07	Sep-08	% Change
	Labor Force	1,283,500	1,297,200	1.1%	953,200	975,300	2.3%	881,100	901,900
Employed Residents	1,220,700	1,210,100	-0.9%	836,400	845,800	1.1%	905,200	924,100	2.1%
Unemployment	4.9%	6.7%	36.7%	4.9%	6.5%	32.7%	4.1%	5.0%	22.0%
Payroll Employment	1,050,600	1,029,200	-2.0%	915,600	916,300	0.1%	996,200	1,001,100	0.5%
Goods Producing	169,500	161,700	-4.6%	214,700	213,800	-0.4%	91,300	92,300	1.1%
Service Providing	879,600	866,000	-1.5%	700,700	702,500	0.3%	902,100	906,000	0.4%

Source: California EDD

Non-Residential Vacancies	East Bay			San Jose/Silicon Valley			San Francisco		
	Q2 2008	Q3 2008	Change	Q2 2008	Q3 2008	Change	Q2 2008	Q3 2008	Change
	Industrial	5.6%	3.3%	-2.3%	11.0%	10.4%	-0.6%	n/a	n/a
Office	13.6%	14.4%	0.8%	11.3%	11.7%	0.4%	11.0%	10.50%	-0.5%

Source: Rand Statistics, Grubb & Ellis

Construction Permits (by MSA)	East Bay			San Jose			San Francisco		
	Sep-07	Sep-08	% Change	Sep-07	Sep-08	% Change	Sep-07	Sep-08	% Change
	Residential	\$ 119,915,663	\$ 81,048,061	-32.4%	\$ 102,125,719	\$ 132,308,395	29.6%	\$ 239,119,029	\$ 121,885,645
Non-Residential	\$ 113,479,289	\$ 100,443,425	-11.5%	\$ 168,588,010	\$ 143,046,594	-15.2%	\$ 309,650,139	\$ 101,960,334	-67.1%

Source: Construction Research Industry Board

Tourism & Travel	East Bay/OAK			San Jose/Peninsula/SJC			San Francisco City & SFO (average)		
	Aug-07	Aug-08	% Change	Aug-07	Aug-08	% Change	Aug-07	Aug-08	% Change
	Hotel Occupancy	86.7%	77.00%	-11.19%	79.0%	71.30%	-9.75%	88.2%	93.00%
Hotel Room Rates	\$ 104.59	\$ 110.31	5.47%	\$ 131.43	\$ 129.20	-1.70%	\$ 150.87	\$ 150.83	-0.03%
Airline Traffic (total passengers)	1,465,539	1,069,670	-27.01%	1,036,786	838,701	-19.11%	3,459,915	3,629,829	4.91%

Source: PKF Consulting, OAK, SJC, SFO Airports

Home Prices/Sales	Alameda	Contra Costa	Marin	Napa	San Francisco	San Mateo	Santa Clara	Solano	Sonoma	
	Median Price September 2008	\$ 389,500	\$ 300,000	\$ 680,000	\$ 439,000	\$ 675,000	\$ 603,000	\$ 505,500	\$ 263,500	\$ 347,500
	Annual % Change	-29.90%	-45.60%	-16.00%	-19.30%	-12.70%	-20.70%	-27.40%	-35.70%	-30.50%
Number Sold September 2008	1,410	1,780	231	132	458	462	1,607	646	545	
Annual % Change	48.70%	94.30%	17.30%	94.10%	-2.30%	-4.90%	30.10%	101.20%	45.70%	

Source: Data Quick

Trade	Port of Oakland		The East Bay EDA Quarterly Indicators sheet supplements the Quarterly Economic Forecast and is a compilation of local and national indicators compiled by the East Bay EDA from a number of sources. If you have any questions or suggestions regarding these indicators and/or their sources, please contact Stephanie Brown, Economic Development Analyst, at (510) 272-6843 or visit <a href="http://www.eastbayeda.org">http://www.eastbayeda.org</a>
	Sep-08	Annual % Change	
	Full TEU Containers		
Imports	71,590	-5.70%	
Exports	76,431	4.30%	

Source: Port of Oakland