

# EastBay

Q2 09



## ECONOMIC OUTLOOK



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

**Authored by  
Levan Efremidze  
Economist  
UCLA Anderson Forecast**

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## **EAST BAY REPORT, First Quarter 2009**

### **Consumers Might Be Back, but Businesses Are Still Waiting**

Levan Efremidze  
Economist  
UCLA Anderson Forecast

April 2009

The East Bay economy is still in the midst of a recessionary adjustment driven by a multitude of economic forces. During the first half of 2008 the excesses of the preceding economic boom reached a critical point and households, businesses, and banks suddenly reversed their behavior from optimism and risk taking to pessimism and risk aversion. While the federal government is attempting to stimulate the ailing economy and the banking system, the state and local governments are slashing budgets and raising taxes. An enterprise economy like ours is prone to cyclical behavior, but this particular recession is more severe than ten others we have seen since the great depression; it is driven by the household debt defaults, housing decline, banking crises, and it is global. Previously a beneficiary of the economic boom, the East Bay is now bearing its share of adversity.

To ascertain which way the East Bay economy is heading, we assess its last quarter performance by looking at labor market conditions, income growth, tech-sector performance, housing sector, and past recessions within the context of major economic forces relevant to its economy in the near term. In the process of doing this, we compare the East Bay to neighboring regions, California and the U.S. This report is about the local East Bay economy, but when the local data is not available, we will use as proxies relevant national or state indicators to show important transmissions through economic relationships.

The forecast for 2009 is still rather gloomy for the East Bay economy, with the expectation of turnaround at year's end. Employment will continue to shrink throughout 2009, and real income and taxable sales will contract. The unemployment rate will climb above 11.6%. The East Bay will start recuperating at the end of 2009, as the housing market, exports and business sentiment perk up.

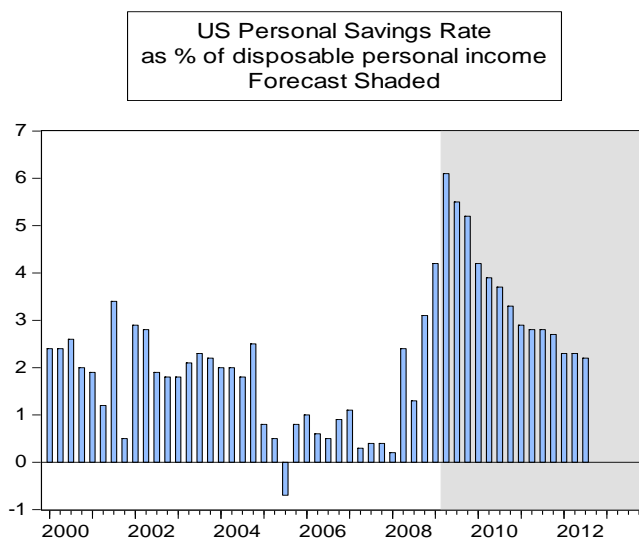
In our research of national, international and California economies, we identified key economic factors driving employment, output and income changes in the East Bay. Among the most important factors are household spending -- presently influenced by the personal balance sheet adjustment and rising personal savings rate, the plummeting business investment due to fear and uncertainty of the economic climate, the ongoing crises in housing and credit markets, plunging international trade, and net effects of rising federal spending but declining state budgets. In aggregate, the relative strengths of these factors produce an outcome that may turn out to be positive or negative. On a quarterly

basis, the aggregate effect at this point is still negative for East Bay and the nation, and is likely to stay so till the end of this year.

### ***Consumers Are Cautious, but Not in Panic***

Households turned cautious last September, largely due to the sharply rising economic uncertainty stemming from the Wall Street-Washington’s juggling of the financial crisis and a real burden of ballooning personal debt. Since then, the personal savings rate at the national level (separate East Bay savings rates are not available) surged to 4.2% in the first quarter of 2009 (Figure 1).

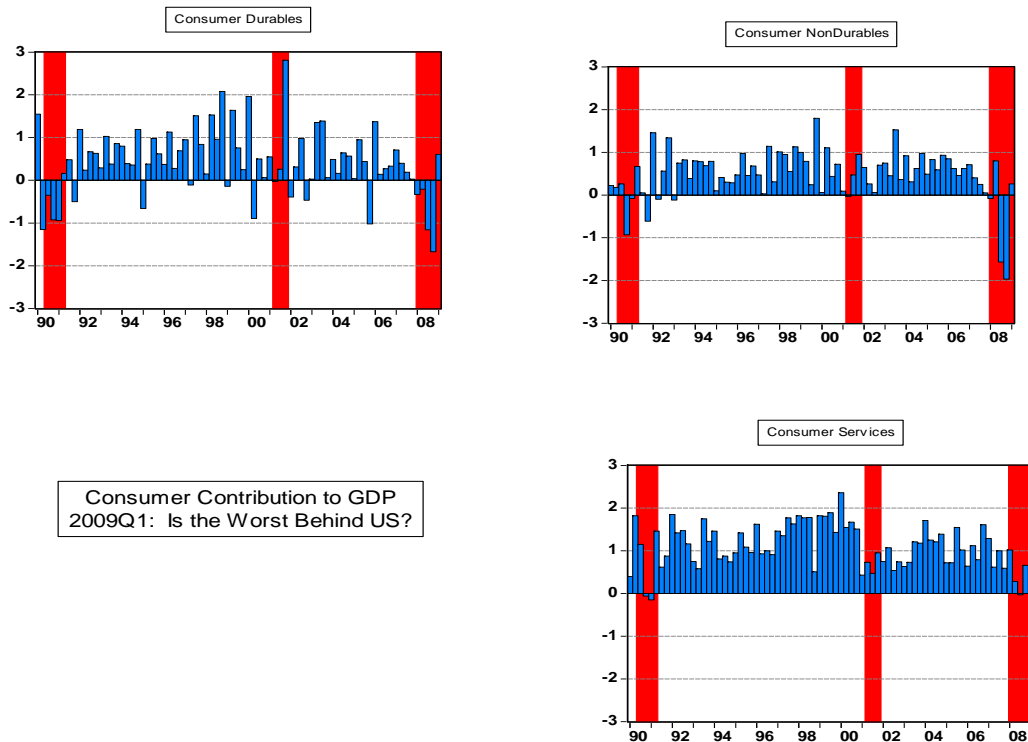
Figure 1.



Sources: BEA, UCLA Anderson Forecast

When consumers face a fear of job loss, they start saving more. While a high savings rate is good for the long-term capital accumulation and consequently for the growth rate of the nation, this sudden rise of the savings rate could cause a phenomenon called “Thrift Paradox,” the term coined and explained by John Keynes during the great depression. If everyone tries to save more, such coordinated action in the short-run will drive down the demand for products and services, thus causing worker layoffs and a fall in overall income, in effect resulting in less savings. But how severe is this problem at present? The local East Bay data on retail employment and the first quarter U.S. GDP data answer this question.

Figure 2. U.S. Consumer Spending

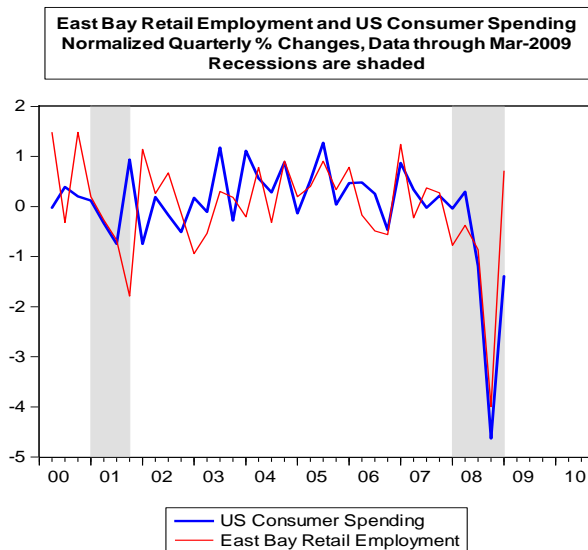


Sources: BEA, UCLA Anderson Forecast

In the first 12 months of this recession, the East Bay retail lost 9,000 payroll jobs, but added about 700 jobs during the first quarter. Another glimpse of the consumer resilience is confirmed by the recent U.S. GDP report (see Figures 2 and 3). Within the overall dismal picture of the economy -- reporting a -6.1% drop in first quarter GDP, we also read some encouraging developments in the category of personal consumer expenditures. The spending here improved by 1.5% as a contribution to the GDP growth from the previous quarter, mostly on durable goods and services, each contributing 0.6%. How hopeful should we be about these healing signs?

The current recession is already longer than the average of the previous ten post-WWII recessions by 5 months. With this measure it should not be a surprise to see consumer spending reviving, but usually housing is the sector that recovers along with durables – a trend we do not see this time around. The housing bust as observed by sliding construction employment and housing starts is still a big drag to the East Bay economy as well as to that of the nation.

Figure 3.



Sources: BEA, UCLA Anderson Forecast

One way to explain how individual consumers are coping with relatively cheaper housing prices and a deflating overall price level could be the reallocation of family budget shares away from housing and more towards consumables, such as durable goods, nondurables and services. In economic terms, relative price changes within the consumer basket of goods produce the so called “income effect,” which means that real purchasing power of the same amount of nominal income rises if some of the goods become cheaper. This income effect could at times overpower the “substitution effect,” a tendency to consume more of the relatively cheaper goods and less of the relatively expensive ones. When income effect dominates, it becomes possible to consume more of all goods. This may also allow room for a higher savings rate. At the aggregate level economic connections become much more complex and this question would require more investigation.

The U.S. economy during the last 20 years has been characterized by rising consumer spending and its share in aggregate spending peaked at 71% of GDP in June 2008. When the economic downturn accelerated in September and consumption started to fall, the logical evaluation called for the eventual adjustment away from consumption and imports towards the restoration of savings, and more exports and manufacturing. Maybe, given the availability of much cheaper housing than before, it will be possible for consumers to maintain spending as well as increase savings. This is an important question for the future of retail and all other consumer driven sectors. The outcome is hard to predict due to the multitude of factors and an unprecedented magnitude of home price declines in many U.S. markets.

## ***Tech Sector Suffers: Business Investment and Exports Plummet***

The East Bay economy is well known for its high tech sector, as an integral part of the overall Bay Area technology cluster. The overall economic recovery in the East Bay will largely be determined by the growth in this sector. Two important elements of this growth have been and will be the U.S. domestic demand for equipment and software, and exports.

Domestic equipment and software spending in the U.S. plummeted by 34% during the first quarter of 2009, in real terms, and this downturn is reflected in East Bay employment numbers. The East Bay's durable goods manufacturing, nondurables, information, and professional and technical support services sectors are under pressure and continue to slash payrolls. In addition to these direct costs, the downturn also causes indirect losses in many other sectors that depend upon growth in the high tech sector. Spending by information technology workers by some estimates equals one third of the overall local expenditures (in the Bay Area) and a fall in earnings in such a large part of the economy will spillover to other sectors.

For hints on the timing of the recovery of the high tech sector, we can look at East Bay computer and electronic goods employment as it relates to U.S. business spending on equipment and software. When demand for these products falls, it takes a few months for manufacturers to respond and adjust payrolls. The peaks and troughs in this employment sector occur 3-4 months later than in the U.S. spending on the equipment and software (Figure 5). Moreover, there may be more employment losses ahead for this sector during the next few months, as business spending is not expected to recover until the end of the year – coincident with the expected economic recovery.

Figure 4. U.S. Equipment and Software Contribution to GDP

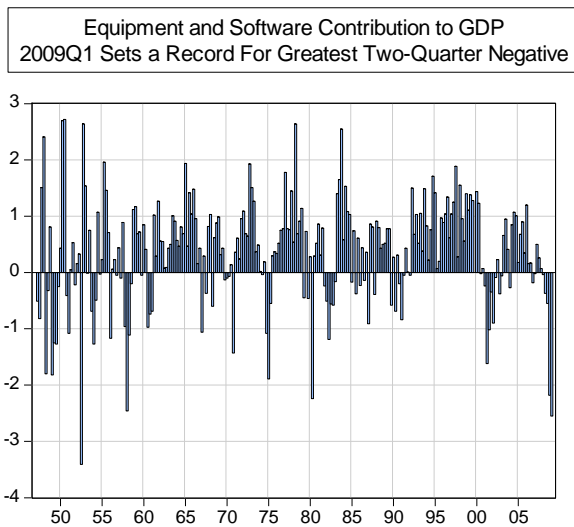
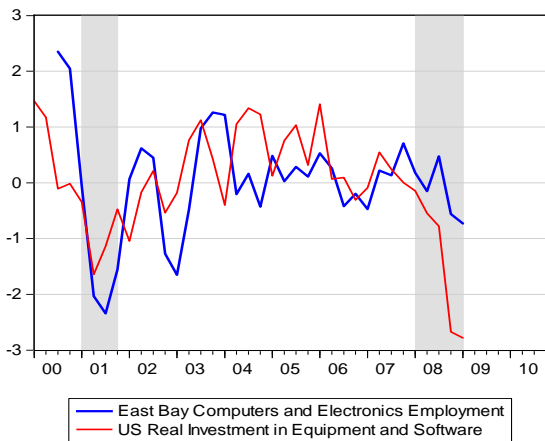


Figure 5.

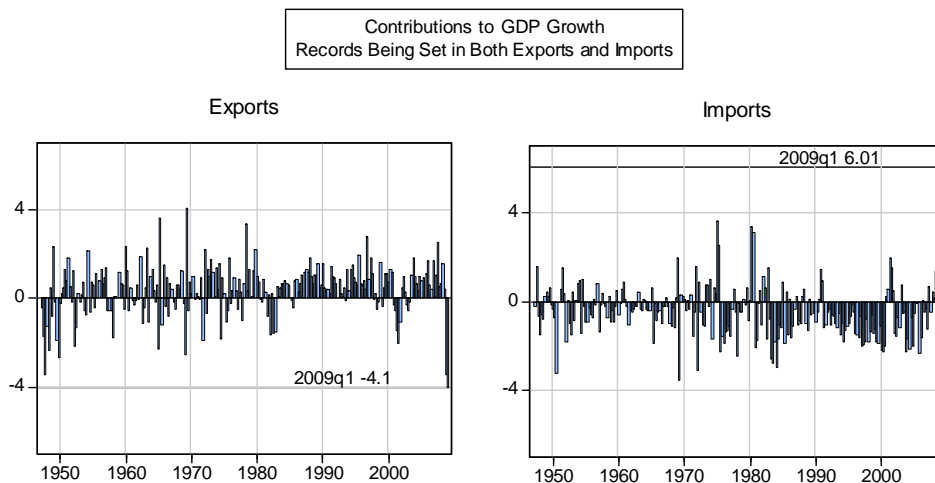
**East Bay Computer and Electronics Manufacturing Employment and US Business Investment in Equipment and Software Normalized Quarterly Changes Through Mar-2009 Recessions Shaded**



Sources: BEA, UCLA Anderson Forecast

The second biggest factor relevant to East Bay manufacturing in general, and to the high tech sector specifically, is the performance of U.S. exports. Here the news is no better. The sales of semiconductors globally are down by 30% in March from a year earlier.<sup>1</sup> The U.S. exports were down 30% in the first quarter of 2009 in annualized real rates, following a 24% drop during the previous quarter (Figure 6). Prospects are slim for a recovery in exports over the next two quarters; as much of the global economy is also experiencing the current recession. According to International Monetary Fund estimates, the European Union and Japan are in bigger economic pain than the U.S. It is unlikely that the U.S. trading partners will recover faster than the U.S., thus exports will not be an engine pulling the East Bay and U.S. economies out of this recession.

Figure 6. U.S. Exports and Imports



<sup>1</sup> <http://online.wsj.com/article/SB124117330343176947.html>

Sources: BEA, UCLA Anderson Forecast

Moreover, for businesses to be able to start investing they need to see an improvement in financial market conditions. East Bay businesses are borrowing money in the same financial markets as others in the U.S. Since the credit crunch started in September, borrowing costs have skyrocketed for large and small businesses alike. The vast majority of the firms in the U.S. would have to pay the rates that are comparable to high-yield bonds. These rates still imply huge risk premiums and they are much higher than in the previous recession (Figure 7). Although rates have come down slightly from the September peak, the spread with U.S. treasury bills is still above 12%. Corporate sales and profits are down, while borrowing costs are high. This is not a good environment in which to expect businesses to spend more money on long-term projects. But as soon as credit markets improve and consumer spending persists, business spending will follow. Moreover, as business investment is a highly volatile component of overall spending, current losses will quickly be reversed by large gains.

Figure 7. High Yield Bond Spread vs. Treasuries, Daily Data



Source: Barclay's Capital

However, despite all the negatives mentioned, the East Bay does have an advantage reflected in large venture capital investments in the emerging technology firms and in its nascent “green” economy which will soon start receiving federal government incentives.<sup>2</sup> These investments will generate jobs in small start-up companies and will supply a much needed boost to local output and income. While new legislation on the carbon cap-and-trade system will not be costless for the overall economy, if implemented sooner rather than later, well positioned regional economies like the East Bay will see a net gain in job creation and income as the new law will induce many businesses to invest in energy efficient equipment and renewable energy innovation in the near-term.

### ***Overall Employment Conditions in East Bay***

Although the East Bay labor conditions continue to sour, the speed of contraction is dropping. In this section we contrast job markets of East Bay, California, San Francisco

<sup>2</sup> [http://vx.thomsonib.com/VxComponent/static/stats/2008q4/metro\\_1300.html](http://vx.thomsonib.com/VxComponent/static/stats/2008q4/metro_1300.html)

Metro District, San Jose MSA and the U.S. We also examine quarterly dynamics of East Bay employment sectors.

Figures 8a and 8b.

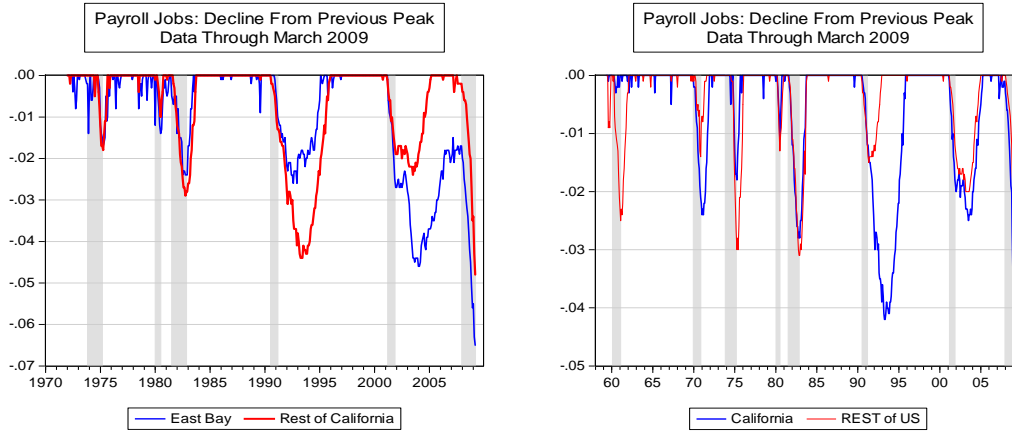
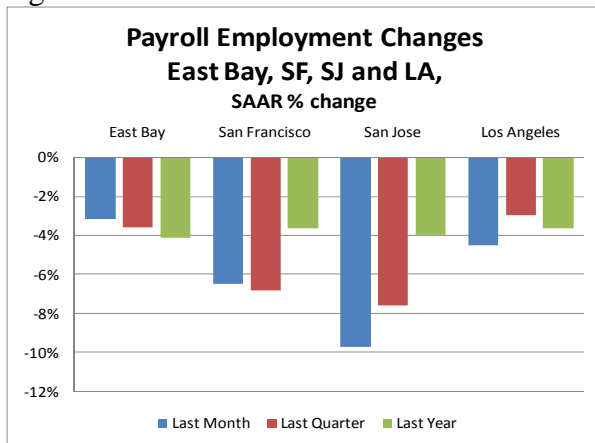


Figure 9.



Sources: BLS, CA EDD, UCLA Anderson Forecast

The East Bay is experiencing the deepest employment recession since 1970. We do not know its duration yet. Figure 8a illustrates that employment has not recovered fully from the 2001 recession as manufacturing employment never returned to the previous peak due to increases in productivity and outsourcing. When the current recession hit in December 2008, payroll employment was still 2% below the previous peak of 2001. The previous recession was much larger in the East Bay than in California and the U.S., the complete opposite of the 1991 downturn. While the Internet and information technology recession in 2001 hit regions that had a high concentration of information technology firms, such as the East Bay, San Jose and San Francisco, the 1991 recession was driven by the defense contraction and the Bay Area was spared but the Los Angeles Area was hit hard. The current recession finds the East Bay and other Bay Area regions mostly tracking with the California and U.S. employment numbers – a large contraction has taken place throughout the nation. The only difference among the three Bay Area regions is that the decline in the East Bay started earlier, due to an industrial structure that exposed the

region to the real estate decline early on. The magnitudes of decline from the previous peak vary in the range of 4-5% in the East Bay as well as the other Bay Area regions (Figure 9).

The East Bay's retail sector was the only private sector with quarterly gains in the first quarter (Table 1 and Figure 10). With the exception of the Federal government sector which also posted a small quarterly gain, all other sectors shed jobs. The typical timing dynamics of different GDP sectors have been well documented in the previous national, state and East Bay reports. As a reminder, the sequence of declines in typical consumer recessions goes this way: homes, durables, equipment and structures. The recovery sequence has the same order. While employment dynamics lag the output cycles, the sequencing would still apply. With this in mind, in the East Bay, we see that construction and professional services job losses have declined from the previous quarter, retail has made small gains, and durable and nondurable goods manufacturing, education and health services, and hospitality are still shedding an increasing number of jobs. It seems that the East Bay will continue cutting payrolls, but at a slower pace throughout this year, as it is typical to see continued job losses beyond the output cycle trough.

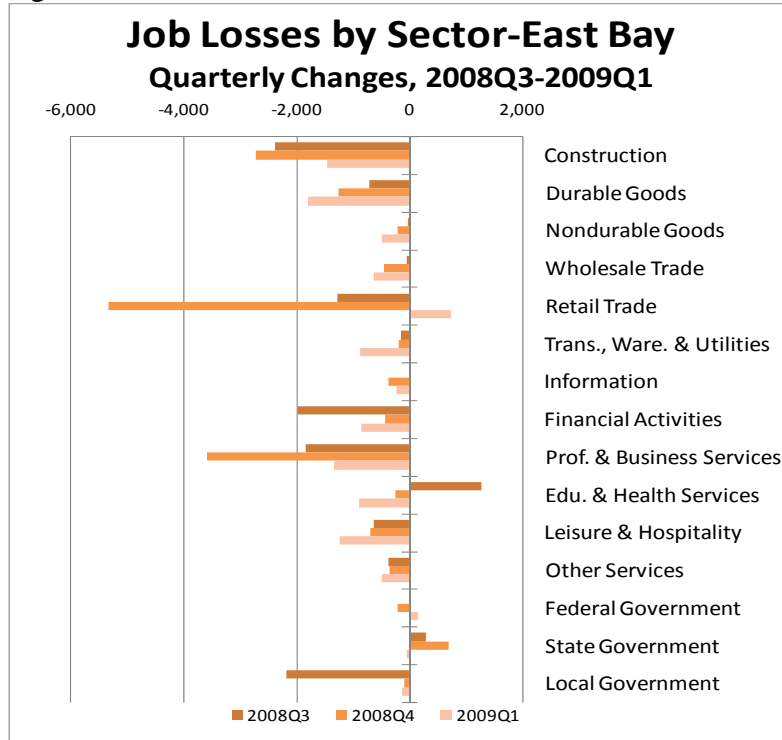
Table 1.

### Employment (SA) / East Bay

Sector	Last Quarter		Last Year		Last Month		
	Change	Change	Change	Change	Change	%	
	from 2008Q4 to 2009Q1	from 2008Q4 to 2009Q1	from 2008Q1 to 2009Q1	from 2008Q4 to 2009Q4	from Feb- 2009 to Mar-2009	from Feb- 2009 to Mar-2010	
	Mar-09	2009Q1	2009Q1	2009Q1	2009Q4	Mar-2009	Mar-2010
Civilian Employment	1,181,685	-17,627	-1.5%	-36,220	-3.0%	-4,380	-0.4%
Civilian Unemployment Rate	10.2%	2.1%	26.1%	4.8%	89.1%	0.6%	5.9%
<b>Total Nonfarm</b>	<b>997,819</b>	<b>-9,116</b>	<b>-0.9%</b>	<b>-42,927</b>	<b>-4.1%</b>	<b>-2,631</b>	<b>-0.3%</b>
Natural Resources & Mining	1,210	10	0.8%	-2	-0.2%	2	0.2%
Construction	58,341	-1,465	-2.5%	-9,690	-14.2%	-903	-1.5%
Durable Goods	54,725	-1,797	-3.2%	-4,298	-7.3%	-502	-0.9%
Nondurable Goods	34,281	-492	-1.4%	-896	-2.5%	-45	-0.1%
Wholesale Trade	46,745	-628	-1.3%	-1,713	-3.5%	-251	-0.5%
Retail Trade	105,754	730	0.7%	-6,543	-5.8%	-531	-0.5%
Trans., Warehousing & Utilities	35,133	-871	-2.4%	-1,786	-4.8%	-11	0.0%
Information	27,084	-231	-0.8%	-903	-3.2%	107	0.4%
Financial Activities	54,010	-847	-1.5%	-4,168	-7.2%	-129	-0.2%
Professional & Business Services	155,341	-1,336	-0.9%	-7,565	-4.6%	-382	-0.2%
Educational & Health Services	126,921	-889	-0.7%	-671	-0.5%	29	0.0%
Leisure & Hospitality	86,973	-1,228	-1.4%	-2,108	-2.4%	242	0.3%
Other Services	34,921	-501	-1.4%	-1,501	-4.1%	-257	-0.7%
Federal Government	17,049	154	0.9%	10	0.1%	-38	-0.2%
State Government	40,215	-41	-0.1%	1,121	2.9%	-114	-0.3%
Local Government	118,671	-128	-0.1%	-2,198	-1.8%	-87	-0.1%

Source: CA EDD, BLS, UCLA Anderson Forecast

Figure 10.

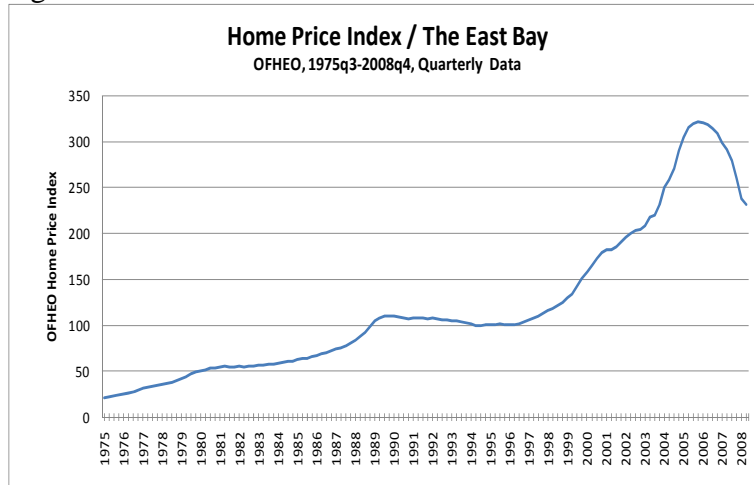


Sources: CA EDD, UCLA Anderson Forecast

### ***The Housing Market Stabilization is Near***

Housing is finally showing green shoots in the East Bay. While the prices have now dropped by more than 28% through December 2008 since the peak of June 2006, according to the fairly conservative OFHEO price index of comparable home sales, California Association of Realtors reported monthly price increases in some California markets for the month of March. The rise for the Bay Area was 1.2%. There were more regions with positive monthly change in California than with negative. DataQuick Services, another real estate research firm, reports a 1.6% increase in Contra Costa County and a -3.4% fall in Alameda County median home prices from February to March 2009. Is housing ready to bottom out? In our previous report we examined affordability of the housing in East Bay and found that a median income family could afford a median home with the current interest rates, assuming that they could come up with the down payment. We also found the supply side of the market was still putting pressure on the prices, with a high inventory of homes for sale and rising foreclosures. In this section we re-examine some of the fundamentals of housing and assess whether the housing recovery is close to a reality.

Figure 11.



Sources: FHFA, UCLA Anderson Forecast

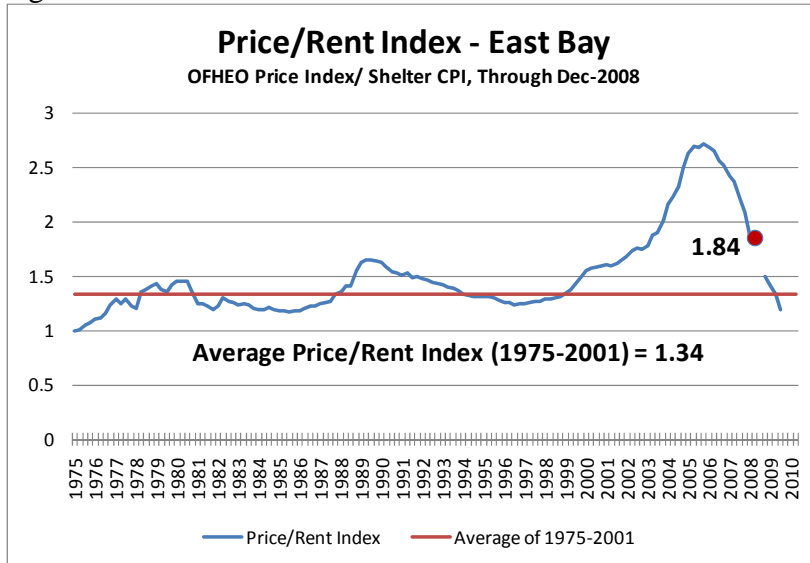
When we look at home buyers – households, they act as both investors and as owner-occupiers. Some individuals are buying homes as pure investors so they can earn a return on their investment through the rental income stream and future price appreciation. Other buyers are occupiers as well as investors. At present, declining home prices produce conflicting incentives for buyers. Lower prices make housing more attractive and affordable on the one hand, while on the other hand a fear of further price falls keeps some buyers on the side lines. Moreover, the first time home buyer federal tax credit in the amount of \$8,000 is creating the urgency in the market as it will expire on December 1, 2009. As we see it in the market at present, home sales are rising and could soon overpower downward price pressures.

Let's look at the Price/Rental ratio to see how attractive the home prices are from the historical investment perspective. The assumption here is that the same incentives that generated the interest in home buying historically will work again when this indicator hits the historical average. The P/R (Price/Rent) ratio is a simplified measure of the value of a home for investor-buyers. Rents are correlated with earnings and therefore the higher the P/R ratio the lower the rate of return to be earned from purchasing the home. Growth rate of rents and market interest rates don't enter the measure directly, but are kept in mind during the analysis. If it is expected that rental rates will rise in the future, home appreciation rates will remain the same or increase, and costs of ownership are unchanged - investors today would be willing to pay more for the higher expected stream of rental income. Rents normally rise as you come out of a recession.

The East Bay P/R ratio is calculated as the ratio of the median price of homes (OFHEO Index) divided by the shelter component of the CPI. Shelter CPI is used as a proxy for annual rental values. In the East Bay the P/R ratio began an explosive rise during the easy money period of 2003-2006, but after hitting the peak of 2.7 in 2006, the ratio plummeted to the level of 1.84, and is getting close to the 1975-2001 historical average of 1.34. With

the current rate of decline it will soon reach the historical average, if prices fall a little more. Also, judging from Figure 12 the P/R ratio fell slightly below the average during the previous two recessions before bottoming out.

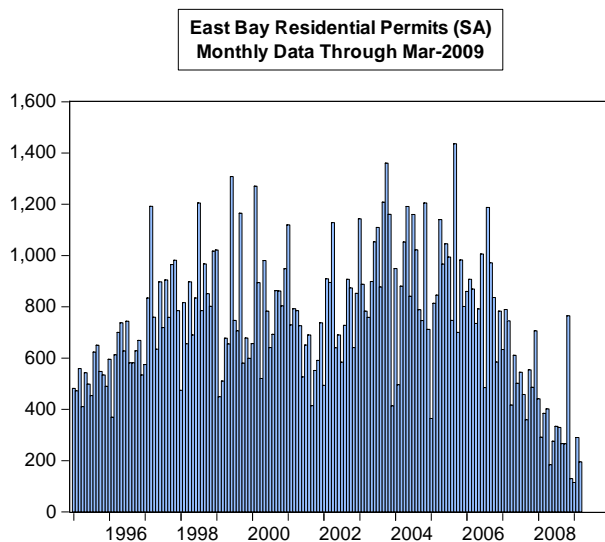
Figure 12.



Sources: OFHEO, BLS, UCLA Anderson Forecast

On the supply side, the market is slowly but surely absorbing excess inventory. The inventory of the unsold homes, measured in how many months would it take to sell them at a current pace of monthly sales, has been declining slowly for several months due to record price declines. Inventory now stands at 5 months for the whole of California. Considering that it was above 12 a year ago, it is a huge improvement.

Figure 13.



Sources: UCLA Anderson Forecast.

Monthly residential permits, another supply side factor which predicts the future supply of homes, are still very low from an historical perspective, even when compared to the “pre-housing bubble,” 1990s average. The February and March improvement from the record low January can not be interpreted as a trend yet. Developers are very likely waiting to see the price stability for a few months.

Given the glimpses of the price improvements in some markets of California, including Contra Costa County, substantial gains in housing affordability and the reversion of the other housing fundamentals to their typical values, we confirm that housing is on track with our previous forecast and is likely to start a recovery in the fall of this year. Commercial real estate is not covered in this report, but we will examine it in the next report when we have the results of our next commercial real estate survey in May.

### ***The Near-Term East Bay Forecast***

The East Bay is battered by the same cruel economic forces as the U.S. Although abnormal when compared to historical evidence, to a large extent the depth of the current recession is similar in for East Bay, California and the U.S. Before the recession, the East Bay was one of the biggest beneficiaries of the housing construction boom. But as the U.S. economy started to suffer with the balance sheet recession, the East Bay was not spared. The region continues to lose jobs; the unemployment rate is climbing and incomes are shrinking. In this report we examined the East Bay’s quarterly performance and its near term outlook within the context of salient economic factors, such as guarded consumer spending, plummeting business investment, shrinking global trade and a near-stabilizing housing sector.

East Bay retail is the only private sector showing signs of a turnaround. Construction losses are receding and housing prices are close to finding a bottom. As businesses are still carefully watching consumers, housing, financial conditions and the global trade, business investment continues to plummet. As a result, high-tech manufacturing and service sector incomes and payrolls are under pressure in the East Bay.

Our 2009 predictions are still quite gloomy for the East Bay economy, with encouraging signs of a turnaround towards the end of the year. Employment will continue to shrink throughout 2009, and real income and taxable sales will contract. The East Bay will lose approximately 20,000 jobs in the next three quarters of 2009, the unemployment rate will reach 11.6% and real personal income will decline by -1.4% during the year. Taxable sales will shrink by -5.6%. The East Bay will start the economic recovery at the end of 2009, as the housing market stabilizes and business investment returns.

## The Global Slump

David Shulman, Senior Economist, UCLA Anderson Forecast, March 2009

From New York on the Hudson to Tokyo on the Pacific a global economic slump has engulfed the industrialized world. The ancient financial markets of London, Paris and Frankfurt along with the emerging ones of Shanghai, Singapore, Dubai and Mumbai are suffering under the weight of bad loans and a free fall in stock prices with 50+% declines being the order of the day.<sup>3</sup> **With economic output falling virtually everywhere, the mid-decade global boom has given way to the worst global bust since the 1930s.**

Most troubling about the global decline in economic activity has been the collapse in international trade. For example in the fourth quarter real imports to the United States declined at an annual rate of 16%, while real exports declined by an even greater 24%. **These 20+% or so declines in the *real* trade accounts are reminiscent of the 27% compounded rate of decline in *nominal* global trade that occurred from 1929-32.**<sup>4</sup>

The economy is being weighed down by the biggest decline in stock and home prices since the early 1930s, a wounded financial system and record high credit spreads. **Simply put consumers have lost a total of \$14.5 trillion in wealth, \$9 trillion in stocks and about \$5.5 trillion in home values.** This hit to consumer net worth along with a severe decline in employment has caused consumption to seize up and the savings rate to soar from near zero to over 5%. Indeed against this backdrop, the \$787 billion stimulus package, although helpful, looks like a drop in the bucket. Thus the recovery we are forecasting will be tepid. It will take time for consumer balance sheets to heal.

The national economic outlook remains bleak. After declining at a revised 6.1% annual rate in the fourth quarter of 2008, we forecast real GDP to decline a further 6.8%, 4.5% and 1.7% in the first, second and third quarters, respectively. Thus, if our forecast is close to the mark, the current recession will last between 19-24 months exceeding the 16 month 1981-82 recession, the longest of the postwar era until now. Nevertheless we do forecast that by the end of 2009 most of the contractionary forces will have been spent and the fiscal and monetary policies discussed below will begin to work -- leading to average quarterly growth in 2010 on the order of 2.7% and a more robust 4.1% in 2011.

We now forecast that the unemployment rate will peak at 10.5% in mid-2010 versus the 8.1% rate recorded in February. Unfortunately, just as the initial recoveries from the 1990-91 and 2000-01 recessions were “jobless”, the employment recovery from the 2007-09 recession will be long and arduous. **By the end of 2011 total nonfarm employment will likely be four million below the 2007 peak and the unemployment rate will remain above 9% at that time.**

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<sup>3</sup> With apologies to Winston Churchill.

<sup>4</sup> Calculated from Kindleberger, Charles P., “The World in Depression,” (Berkeley: University of California Press, 1973) p. 172.

**Edging Backward Into the Future**  
**Please, Please, Uncle Sam, Turn Us Around**  
Edward E. Leamer, Director, UCLA Anderson Forecast

We collectively turned around in October and November of 2008. Instead of marching forward with confidence, we began tip-heeling backward. For years we made our journey into the future with such confidence we felt no need for the safety line of savings. Once the tip-heeling began, we did something that has been entirely forgotten – we started saving again and the personal savings rate went from nothing to 3.6% in December and then to 5.0% in January.

Regardless of what we do over the next few months, the job ahead is to turn our malls into factories, meaning less shopping and more manufacturing. We need to save more and reduce our dependence on foreign lenders. We need to produce more of what we buy right here, and we need to sell more exports to pay for our imports. We need to invest in the factories of America. And we need to retrain our investment bankers so they can get productive work as gardeners.

To keep the economy healthy during the transition, this adjustment has to be done slowly. If we try to do this rapidly, we will simply idle the malls without compensating production and jobs in our factories. If we try to do this all at once, we will idle the factories too. That, unfortunately, is where we are. That's why we need a stimulus.

Too bad the stimulus is poorly designed. It should have been timely, temporary and targeted, as promised by Nancy Pelosi. It is none of the above. To get a stimulus, we need to put idle workers and idle capital back to work, and we need to concentrate spending where the job loss has been greatest. That's what I would call targeted. Tax cuts are not targeted at all since they offer little promise of spending where we need it. And the budgeted spending misses the target by a wide margin, with the exception of the tiny amount of help for homes and cars and a larger amount of help for state governments in their time of need.

So how much stimulus do we need? Nominal GDP over this two-quarter period declined by \$94 billion. The average two-quarter change in GDP from 2004q2 to 2008q2 was \$428, creating a spending shortfall of \$518b, 3.6%. The driver of the economy is personal consumption spending and residential investment. That's where we need to medicine applied. If we can repair that spending, business spending will improve as well, though that is dependent on a healthy credit market. By this calculation, personal consumption expenditure is short by \$526 billion dollars, \$129 for durables (think autos), \$291 for nondurables (think retail and restaurants) and \$106 for services. Residential investment is estimated to be short \$42b but that is based off an abnormal normal period with a -\$24. In a healthy economy, that would be more like a +10 over two quarters. Thus housing had a spending shortfall over this period of \$76 billion. In other words, we have a \$600 billion problem here, which is growing larger as you read these words. \$8 billion of stimulus is a hopelessly inadequate remedy.

**The California Economy: Running Out Of Gas**

Jerry Nickelsburg, Senior Economist, UCLA Anderson Forecast, March, 2009

As the recession deepens, the diverse engines of California's economy find themselves running on fumes. The consumer related retail, wholesale, manufacturing and trade sectors contracted sharply with the collapse in consumer demand in September; the housing, finance, and home related retail and manufacturing sectors entered their 11<sup>th</sup> quarter of contraction; non-residential construction was slammed by frozen credit markets; budget constraints resulted in furloughs and layoffs at the state and local government levels; exports and imports fell and the logistics industry contracted; and even the so called recession proof entertainment industry saw a restructuring to the new media sped up by the downturn.

It is clear that California is experiencing economic symptoms not unlike the 1980/81 or 1973/75 recessions and that this could well be the worst post-WWII downturn yet. And the help from Washington is like the Pony Express, it is going to arrive in California, it will be welcome when it comes, but it will be slow getting here. The rapid infusion of demand contemplated in Stimulus II will be muted as local government budgets are forced to contract.

If there is any good news in the picture it is that the correction in the housing market is almost complete and the downturn in the retail sector is nearing the end of its run. But, there does not appear to be anything uniquely Californian to bring us out of the recession.

The keys to California's recovery are the recovery in U.S. consumption improving the demand for imports from Asia and the demand for products from California's factories, the resumption of non-residential, public works and multi-family residential construction growth, and the return of growth to the retail sector.

The downward pressure on income and employment from housing will carry over into the second quarter, but will have abated before the recovery begins. With new opportunities in alternative energy and propulsion, and new investment in medical technology, software and research, we expect California's personal income to grow more rapidly than average coming out of the recession in 2010.

On an annual basis our expectation is that total employment will contract by -2.6% in 2009 and will continue to decline at an -0.6% rate in 2010. Once growth returns in 2011 employment will begin to grow at a 1.8% rate. Employment growth will not exceed labor force growth until the full force of the recovery is in place in 2011. Real personal income growth will be -0.8% in 2009 and then return positive growth at 0.7% and 3.8% in 2010 and 2011 respectively. This slowing in the growth rate of personal income portends continued problems in state government finance until the 2010/2011 fiscal year.

# East Bay Quarterly Indicators



Q1 2009

GDP & CPI	GDP - % Change from Preceding Period (US)			CPI (San Francisco)			CPI (US All Cities)		
	Q1 07	Q1 08	Q1 09 (adv.)	Mar-08	Mar-09	% Change	Mar-08	Mar-09	% Change
	1.3	2.5	-2.6	219.612	222.166	1.16%	213.667	212.714	-0.45%

Source: BEA, BLS

Labor	East Bay			San Jose			San Francisco		
	Mar-08	Mar-09	% Change	Mar-08	Mar-09	% Change	Mar-08	Mar-09	% Change
Labor Force	1,285,200	1,314,100	2.2%	895,300	924,200	3.2%	961,400	979,700	1.9%
Employed Residents	1,216,200	1,180,000	-3.0%	847,600	822,700	-2.9%	919,800	896,700	-2.5%
Unemployment	5.4%	10.2%	88.9%	5.3%	11.0%	107.5%	4.3%	8.5%	97.7%
Payroll Employment	1,038,000	995,000	-4.1%	922,300	886,100	-3.9%	998,600	961,900	-3.7%
<i>Goods Producing</i>	160,800	145,900	-9.3%	211,800	198,800	-6.1%	87,900	78,800	-10.4%
<i>Service Providing</i>	875,800	847,700	-3.2%	706,000	682,300	-3.4%	908,100	880,600	-3.0%

Source: California EDD

Non-Residential Vacancies	East Bay			San Jose/Silicon Valley			San Francisco		
	Q1 2008	Q1 2009	% Change	Q1 2008	Q1 2009	% Change	Q1 2008	Q1 2009	% Change
Industrial	4.2%	3.1%	-1.1%	11.3%	11.8%	0.5%	n/a	n/a	n/a
Office	13.6%	15.9%	2.3%	10.1%	16.3%	6.2%	11.2%	13.80%	2.6%

Source: Rand Statistics, Grubb & Ellis

Construction Permits (by MSA)	East Bay			San Jose			San Francisco		
	Mar-08	Mar-09	% Change	Mar-08	Mar-09	% Change	Mar-08	Mar-09	% Change
Residential	\$ 121,492,252	\$ 89,038,605	-26.7%	\$ 73,330,809	\$ 36,795,676	-49.8%	\$ 202,437,736	\$ 107,300,099	-47.0%
Non-Residential	\$ 92,862,201	\$ 70,049,652	-24.6%	\$ 186,214,586	\$ 159,311,264	-14.4%	\$ 151,293,292	\$ 49,585,117	-67.2%

Source: Construction Research Industry Board

Tourism & Travel	East Bay/OAK			San Jose/Peninsula/SJC			San Francisco City & SFO (average)		
	Dec-07	Dec-08	% Change	Dec-07	Dec-08	% Change	Dec-07	Dec-08	% Change
Hotel Occupancy	60.1	52.3	-12.98%	54.0%	47.4%	-12.22%	64.00%	69.1%	7.97%
Hotel Room Rates	\$ 104.10	\$ 98.32	-5.55%	\$ 122.87	\$ 116.71	-5.01%	\$ 156.01	\$ 167.39	7.29%
	Feb-08	Feb-09	% Change	Mar-08	Mar-09	% Change	Mar-08	Mar-09	% Change
Airline Traffic	953,677	654,010	-31.42%	855,287	661,237	-22.69%	3,146,970	2,936,292	-6.69%

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 March 2009	\$280,000	\$220,000	\$585,000	\$339,000	\$608,000	\$506,000	\$390,000	\$180,000
Annual % Change from March 2008	-42.60%	-47.70%	-25.80%	-27.70%	-19.50%	-30.00%	-37.10%	-45.50%	-25.70%
Number Sold March 2009	1,216	1,639	161	124	332	380	1,288	722	463
Annual % Change from March 2008	25.20%	68.40%	8.80%	72.20%	-34.60%	-13.20%	16.60%	102.80%	41.60%

Source: Data Quick

Trade	Port of Oakland	
	Mar-09	Annual % Change
Full TEU Containers	152,409	-19.3%
Imports	210,331	-11.1%
Exports		

Source: 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 <http://www.eastbayeda.org>