

# EastBay

Q1 09



## ECONOMIC OUTLOOK



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

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

For new quarterly forecasts and monthly updates visit  
[www.eastbayeda.org](http://www.eastbayeda.org)

## East Bay Quarterly Forecast Q1 2009

# Expected Pains of the Recession

Levan Efremidze  
Economist  
UCLA Anderson Forecast

### Summary

The East Bay economy continued its decline in the last quarter. The unemployment rate jumped to 8.1% and more than 11,800 payroll jobs were eliminated.<sup>1</sup> Most of the quarterly losses were concentrated in the retail, construction, employment services (temporary workers), durable goods manufacturing, and information sectors. This is evidence of a further deepening of the recession. Residential construction and financial sector stress, the precursors to this recession, were in place by mid 2007, but the 4<sup>th</sup> quarter employment data show the real force of the recession has expanded to retail, leisure & hospitality, and consumer related sectors. The recession has not yet begun to abate and therefore, we want to look at how much worse the decline will get, and how much longer the decline will last. In this report we contrast the East Bay to the U.S., California, and other Bay Area regions, study the previous two recessions, examine some housing sector fundamentals, and commercial real estate prospects.

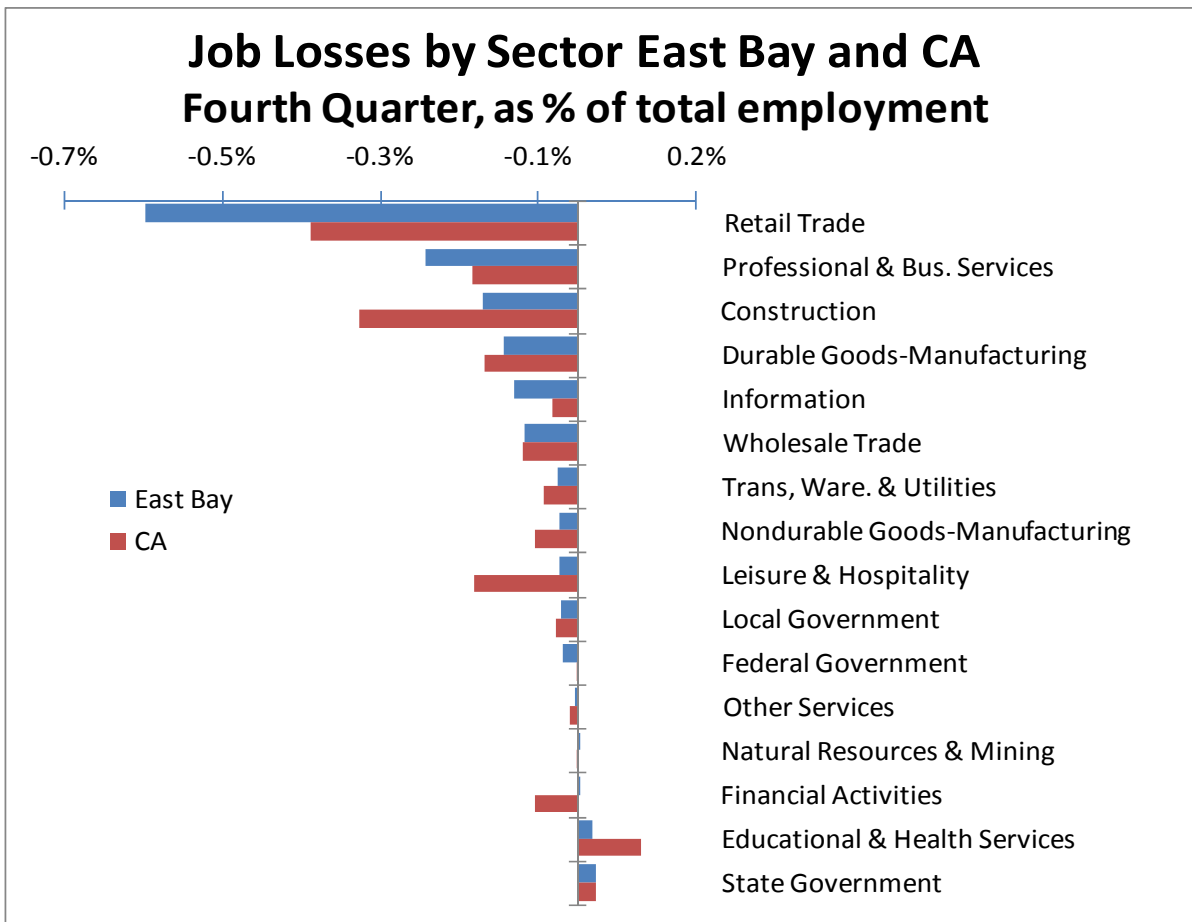
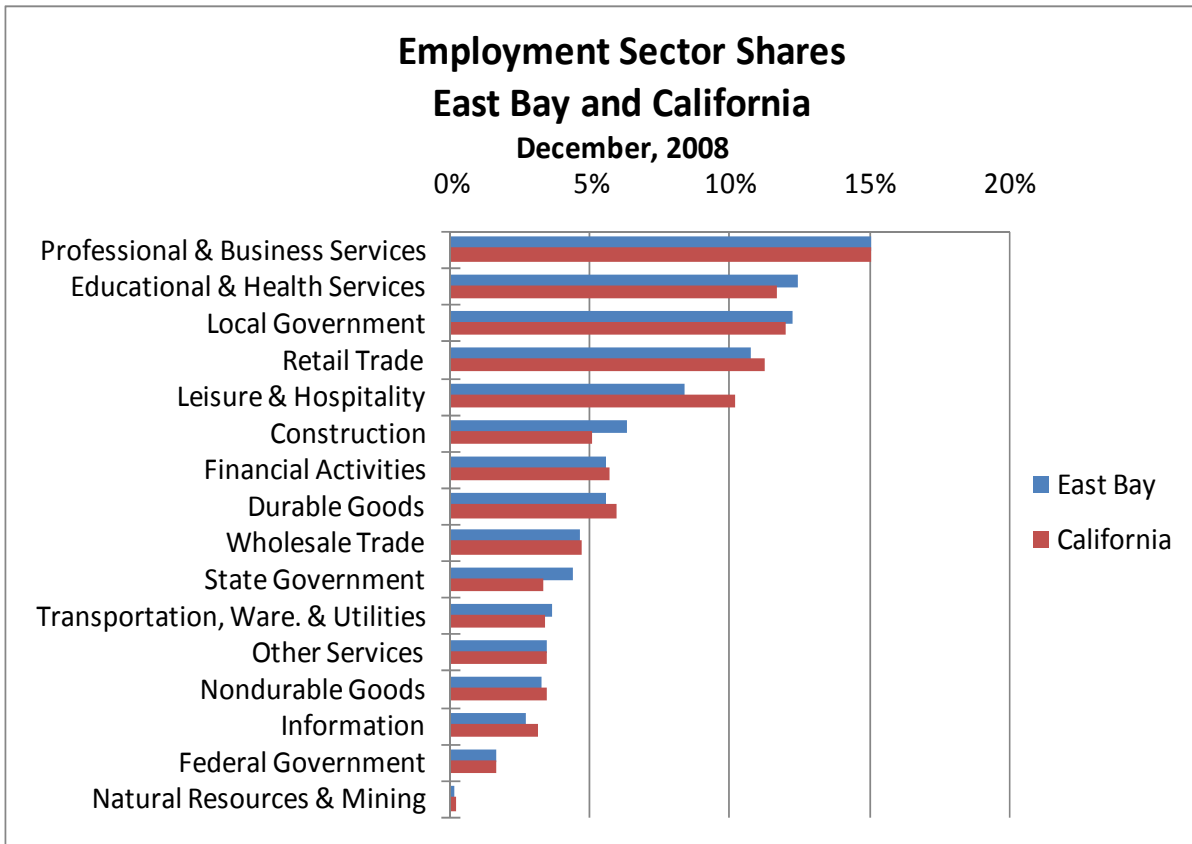
2009 will be a year of increasing unemployment, falling real income and increasing job losses. The East Bay will begin an economic recovery at the end of 2009, coincident with the beginning of the U.S recovery. Though growth will be slow coming out of the recession, the long term prospects for East Bay economic growth, fueled by investments in “green” economy technology, computers and electronics, and export oriented products, are bright.

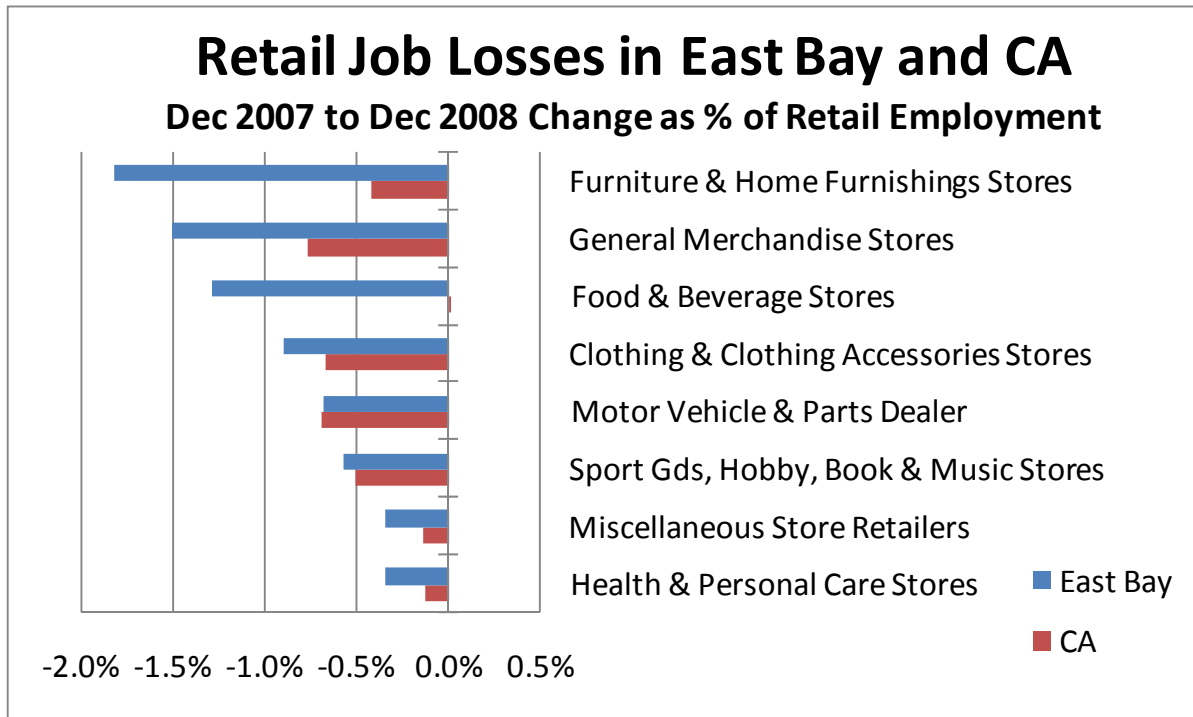
### East Bay and California Employment

The industrial structure of the East Bay economy is similar to that of California, except that the East Bay’s construction, government, and education, health care & human services sectors tend to be somewhat more important and the consumer sectors of retail and leisure & hospitality tend to be somewhat smaller. This explains why East Bay labor markets have been performing less well than California up until September, and why they are much more similar in performance today. Prior to the recession, job loss in residential construction was more heavily concentrated in the East Bay. Now, job loss in consumer related sectors, while larger in percentage terms for the East Bay than for the state, are a smaller component of the total East Bay employment picture.

---

<sup>1</sup> Here we report seasonally adjusted changes in payroll employment from September to December of 2008.





To uncover an explanation for the difference in retail sector losses between the East Bay and California, we examine the retail employment by sub-sector. The clue comes from the fact that furniture and home furnishings retailers were more prevalent and suffered a greater percentage loss in employment in the East Bay than in California. Rapid building of retail establishments, particularly home furnishings is a characteristic of an area which is expanding with new home construction and new housing developments. Retailers chase, and sometimes get ahead of, new development. The growth of the California economy in the first 8 months of 2008, albeit slow, allowed these retailers to hold on. As consumer demand collapsed, this holdover from the expansion in the housing market showed up in a greater than average contraction in retail employment. The more rapid loss of jobs in retail in the 4<sup>th</sup> quarter is evidence that this imbalance is correcting itself rapidly and that future job loss in consumer related sectors should mirror those of California.

#### East Bay and Bay Area Employment

Overall Bay Area employment has been declining since April 2008. In the fourth quarter, the three sub-regions – San Francisco, San Jose/Silicon Valley, and the East Bay – are no longer a mix of positive and negative employment trends as San Francisco joined the rest of the Bay Area and lost jobs in the retail, construction, finance and hospitality sectors. The aggregate Bay Area annual loss amounted to 52,863 jobs, 60% of which were in the East Bay. Until the 4<sup>th</sup> quarter the East Bay, led by a contraction in the construction sector, had the highest quarterly rates of decline. Since the 2006 peak of 74,000 jobs, East Bay construction employment has shrunk to 64,000 jobs. Even after this loss of jobs construction represents 6.3% of total East Bay employment as compared to 4.8% in San Francisco and 4.6% in San Jose. The job market continued to be weak in the East Bay in the 4<sup>th</sup> quarter but the steepest rate of decline in the Bay Area was recorded in San Francisco. The large drop in San Francisco was attributed to the consumer related sectors of trade, transportation & warehousing, and food service & accommodations.

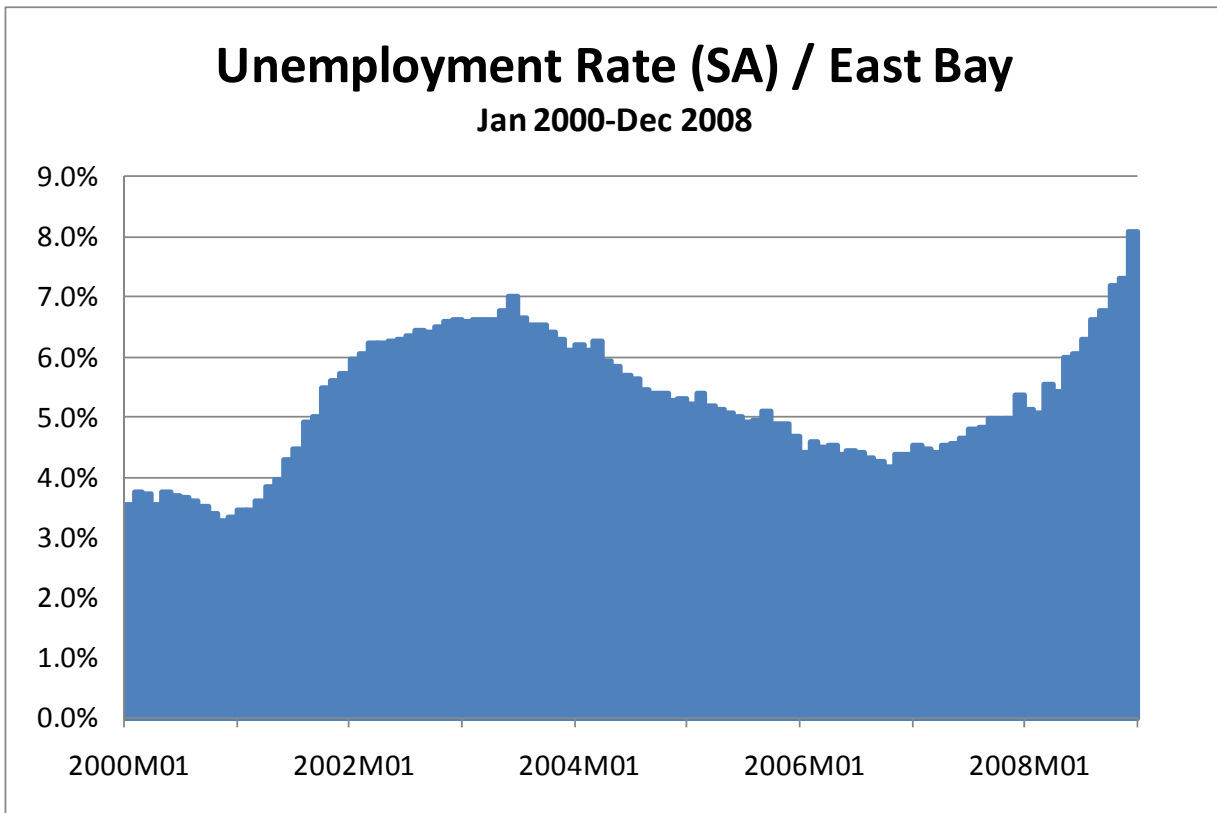
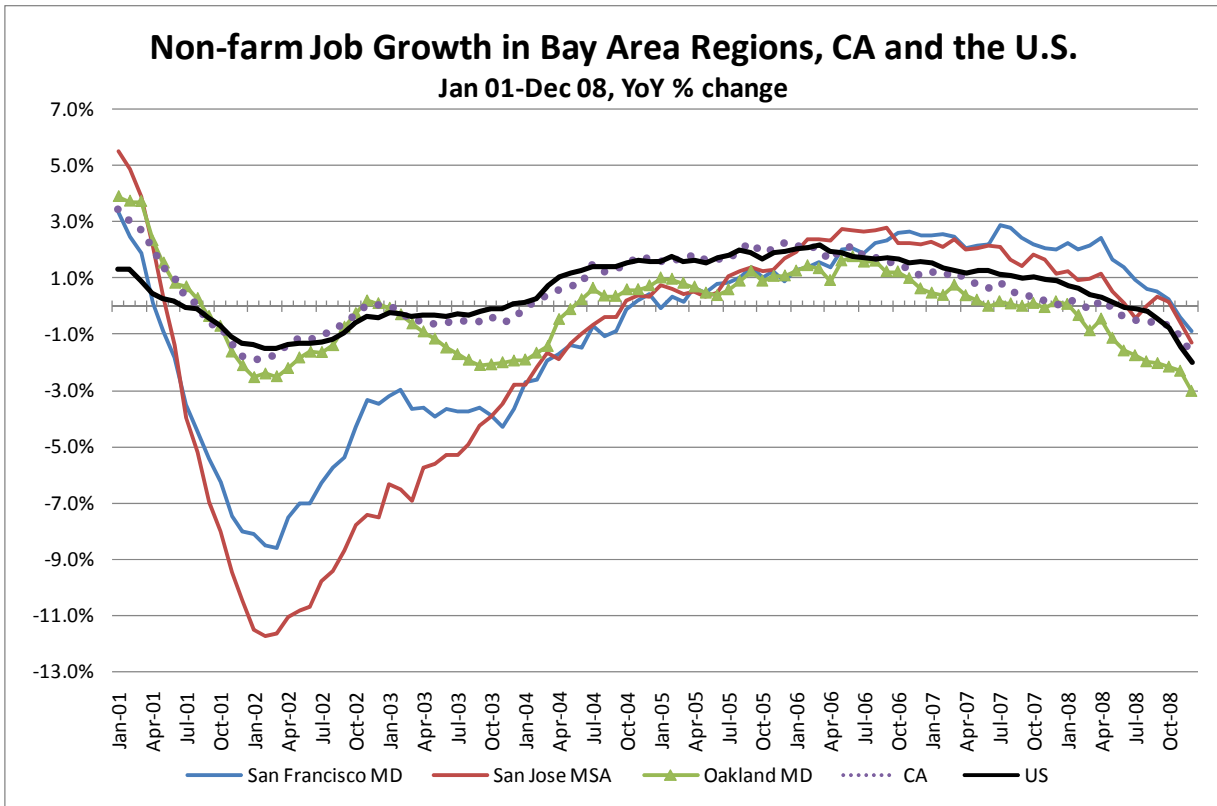
The financial panic on Wall Street and the uncertainty with regard to economic policy in Washington during September and October of 2008 caught forecasters by surprise. Absent this panic and the direct consequence of a collapse in consumption, we had expected a more moderate decline in East

Bay employment in particular and Bay Area employment more generally. Scared households and worried businesses reduced spending and began conserving cash for the uncertain future. Expectations of a disappointing holiday sales season caused retailers to reduce staff, scale back or completely halt hiring in November and December. Consequently in the East Bay, as in the rest of California, the retail sector shed the most jobs of any sector. This represents a dramatic change in the labor market dynamics of the East Bay. Now, as opposed to losses dominated by construction and finance during the first three quarters of 2008, over half of the job loss is in consumer related industries.

## Employment (SA) / East Bay

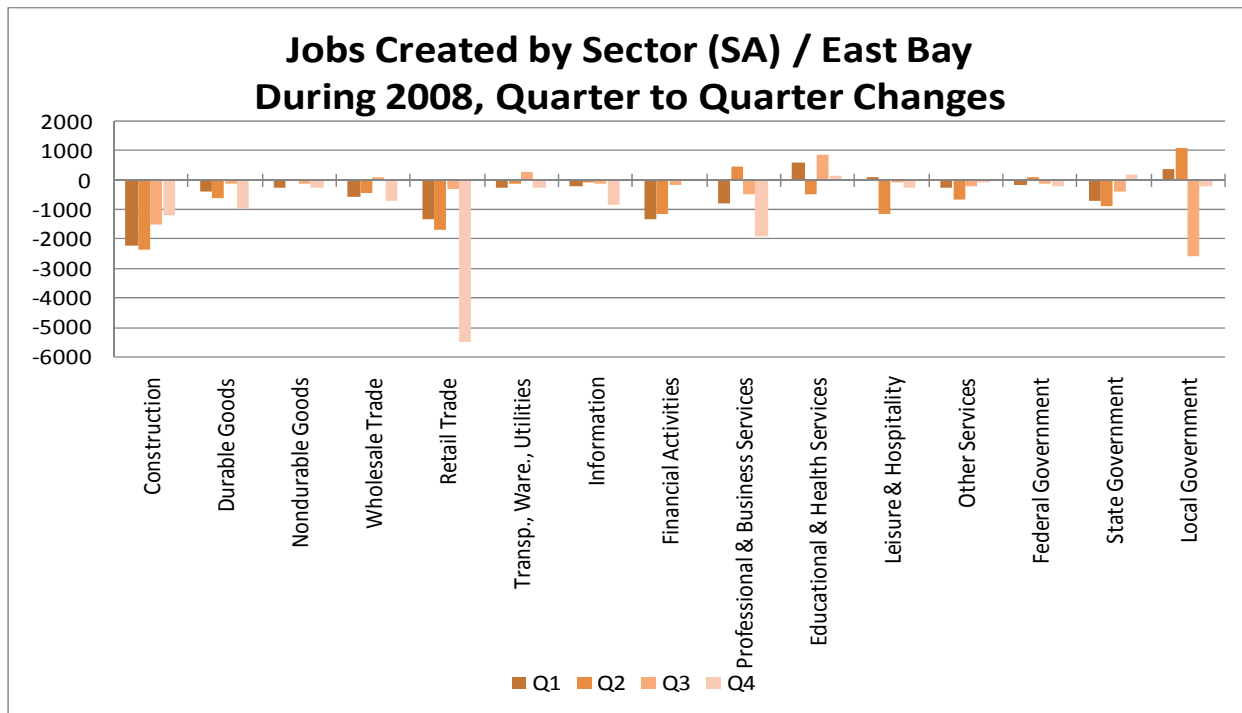
Sector	Dec-08	Last Quarter		Last Year	
		Change	An. %Change	Change	%Change
Natural Resources & Mining	1313	17	5.12%	106	8.7%
Construction	64368	-1199	-7.32%	-7287	-10.2%
Durable Goods-Manufacturing	57055	-954	-6.58%	-2104	-3.6%
Nondurable Goods-Manufacturing	33455	-239	-2.84%	-600	-1.8%
Wholesale Trade	46838	-676	-5.69%	-1588	-3.3%
Retail Trade	104080	-5490	-20.04%	-8833	-7.8%
Transportation, Warehousing & Utilities	36125	-252	-2.77%	-310	-0.9%
Information	27627	-820	-11.53%	-1202	-4.2%
Financial Activities	57434	20	0.14%	-2589	-4.3%
Professional & Business Services	152516	-1931	-5.00%	-2777	-1.8%
Educational & Health Services	126406	172	0.54%	1195	1.0%
Leisure & Hospitality	86256	-237	-1.10%	-1374	-1.6%
Other Services	35448	-33	-0.37%	-1102	-3.0%
Federal Government	16499	-203	-4.86%	-398	-2.4%
State Government	44726	217	1.95%	-1688	-3.6%
Local Government	125207	-211	-0.67%	-1314	-1.0%
<b>Total Nonfarm</b>	<b>1,015,353</b>	<b>-11,820</b>	<b>-4.7%</b>	<b>-31,865</b>	<b>-3.1%</b>

Sources: CA EDD and UCLA Anderson Forecast



Within the East Bay the acceleration in job declines during the last quarter is primarily observed in retail, wholesale trade, durable manufacturing, temporary employment services, and the information sector with the bulk of the job loss coming in retail and employment services. On the other hand, the

previously hard hit finance sector shows slight improvement. But, it is premature to predict the stabilization of the finance sector in light of the on-going financial crisis.



The education and healthcare & social services sector was the only category that added jobs during the last 12 months. The 1,200 additional jobs were not enough to offset losses in other categories during 2008. Overall, though, this sector is not expected to deliver sufficient gains to offset job losses in other sectors in 2009.

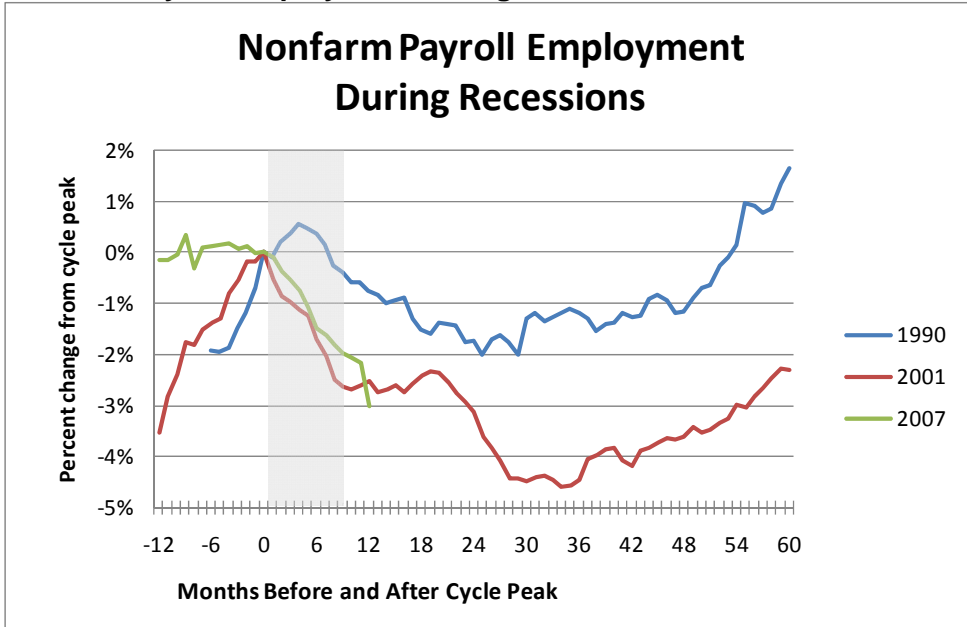
### A Comparison of Recessions

Forecasters generally rely on the past to extrapolate or predict the future. Since the current recession has been underway for a year now, it is time to look at this methodology to see if it will help us understand the future evolution and recovery of the East Bay economy. The depth of this recession as measured by the fall in GDP in Q4 2008 makes it look a bit like the 1981 recession, yet that downturn came on the heels of the 1980 recession. Moreover, for the East Bay economy much has changed since 1981. Consequently we will look for clues in the past data by comparing employment during the more recent 1990 and 2001 recessions to the beginning of this recession to see whether there are any common features, or if not, what might be different this time. Specifically, we will focus on the duration and magnitude of changes in key employment sectors from their peak levels. First we look at the behavior of nonfarm employment, and then construction, manufacturing, retail, finance, information, professional & business service, leisure and hospitality, and government sectors.

The following chart shows non-farm employment changes before and after the start of the recessions. In the 2001 recession the employment peak in the East Bay coincided with the beginning of the national recession, while in 1990 the employment peak was five months after the start of the recession. The duration of the declines varies from 20 months in 1990 to 35 months in 2001. Cumulative non-farm employment declines ranged from -2.5% to -4.6%. The 2001 recession followed the bursting of the Internet Bubble. The East Bay participated in the internet boom and subsequently suffered heavy job losses during the 2001 recession. In the current recession East Bay employment has already declined by -3% and has been declining for 14 months. The current recession in the East

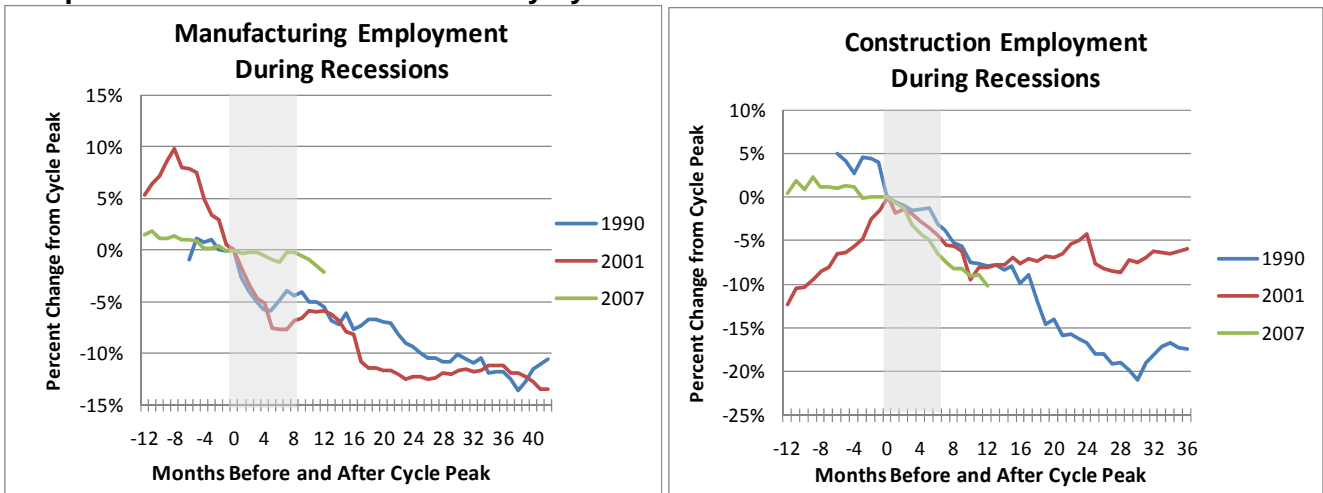
Bay is driven by falling consumer demand, the real estate decline and the financial sector crisis. A cursory examination of the pattern reveals that this recession is different. Were we to have comparable data on the 1973, 1980, and 1981 recessions on a monthly basis the same would be true. What is different this time is that the housing market, which usually turns down simultaneously with the recession, began its decline two years earlier. Thus unlike previous recessions, East Bay employment was not growing leading into the current recession.

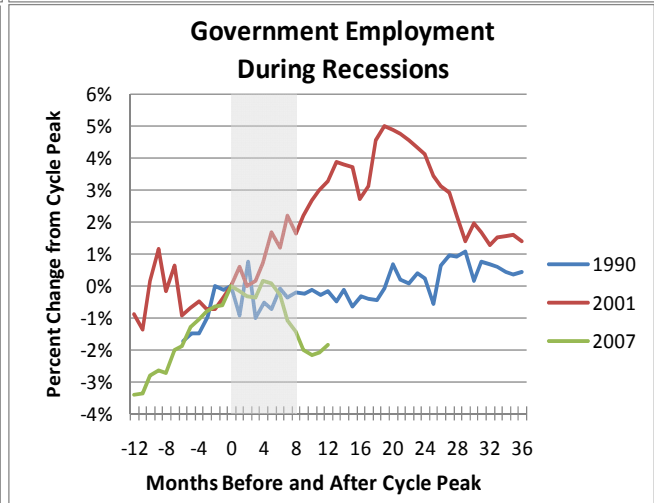
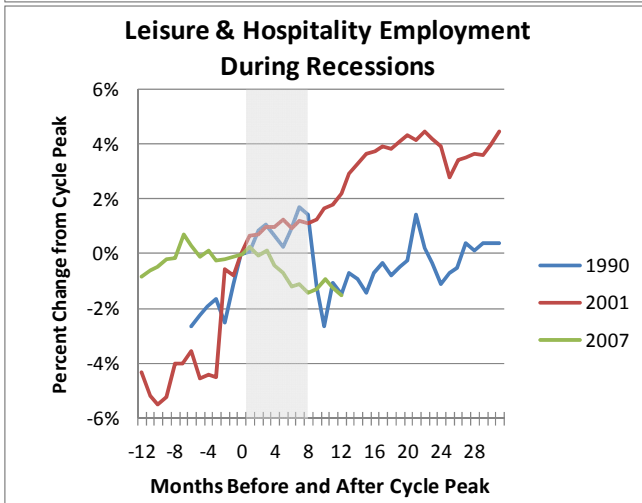
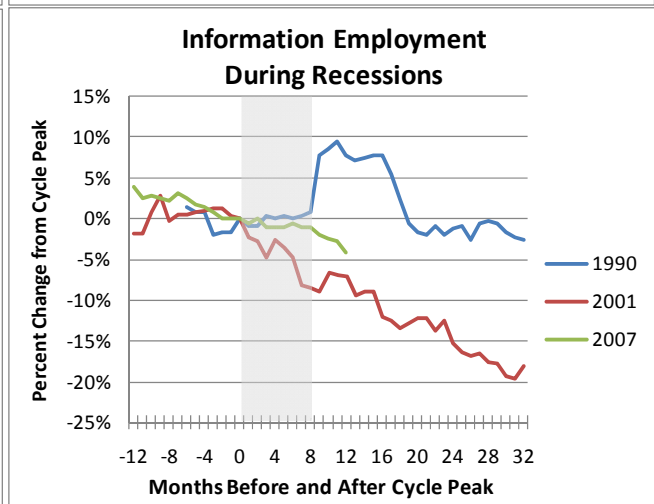
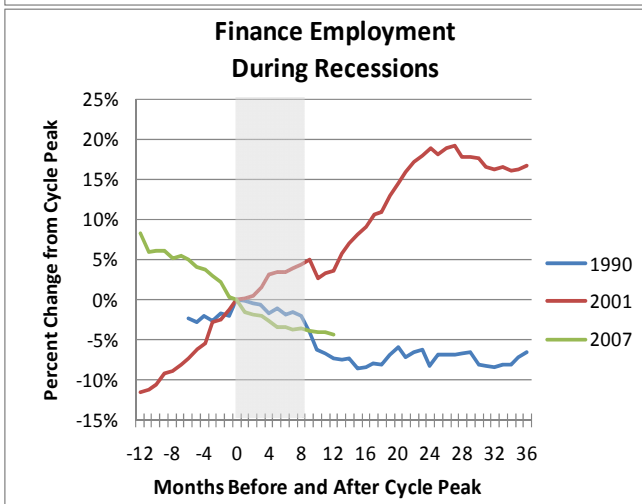
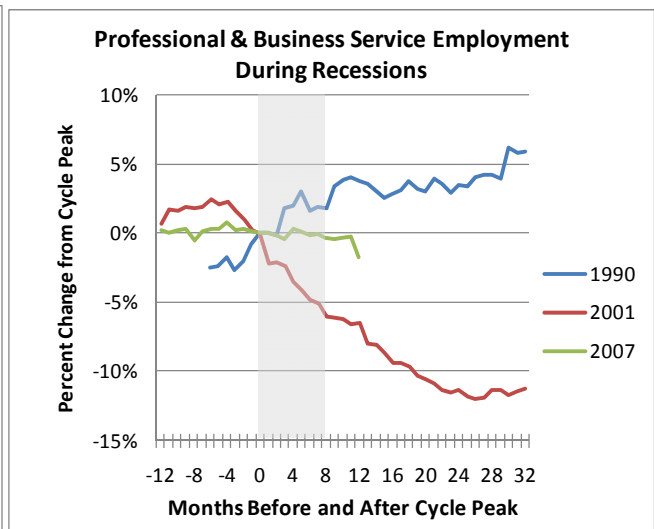
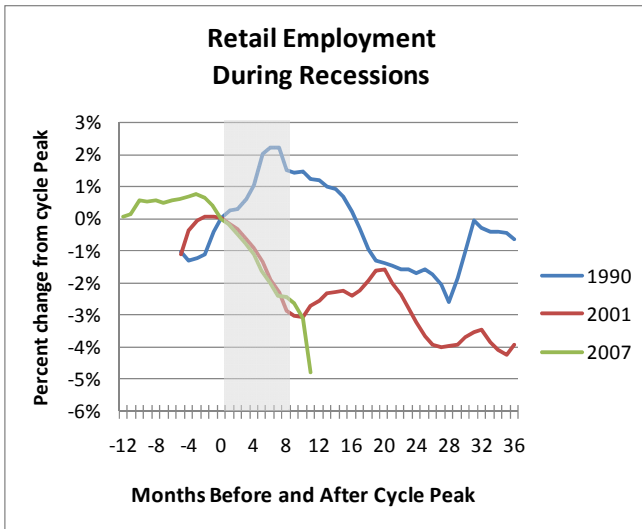
**Nonfarm Payroll Employment During Recessions**



Source: CA EDD and UCLA Anderson Forecast

**Comparison of Recessions in East Bay by Sector**





Source: CA EDD and UCLA Anderson Forecast

Past U.S. and California recessions were characterized with large declines in manufacturing and construction employment, which were then followed by more modest reductions in retail, temporary and hospitality workers. The most volatile sectors were manufacturing (-14% in 1990 and -22% in 2001) and construction (-25% in 1990 and -10% in 2001). The only other sector that consistently showed declines during the past two recessions is retail (-5% in 1990 and -3% in 2001). Other sectors do not show consistent declines in the both recessions, and therefore we are unable to extract any regularity from them.

### Sectors with Largest Job Losses During Recessions

<b>Sector</b>	<b>1990</b>	<b>2001</b>	<b>2007-to date</b>
Manufacturing	-14%	-22%	-2.5%
Construction	-25%	-10%	-12%
Retail	-5%	-3%	-5.6%
Finance	-8%	<i>increase</i>	-18%
Professional and Business Services	<i>increase</i>	-14%	-2%

**Note:** Declines are calculated from sector peak to trough.

So the notion that the past will help us explain the future is a bit wanting here. This recession truly is different. The three important characteristics that differentiate it are the early start to the decline in residential construction and finance, the absence of a sharp drop in manufacturing employment, and the freefall in retail employment. The housing sector will be examined in more detail in the next section. Our forecast for the turning point in aggregate employment will therefore hinge both on what we expect to happen in the housing market and what we expect to happen with respect to consumer spending. The UCLA Anderson Forecast for the U.S. has consumer spending declining through the current quarter (Q1 2009) and then slowly increasing thereafter. There is normally a lag in hiring after demand picks up and that leads us to expect the beginning of a snap back in retail employment later in the year.

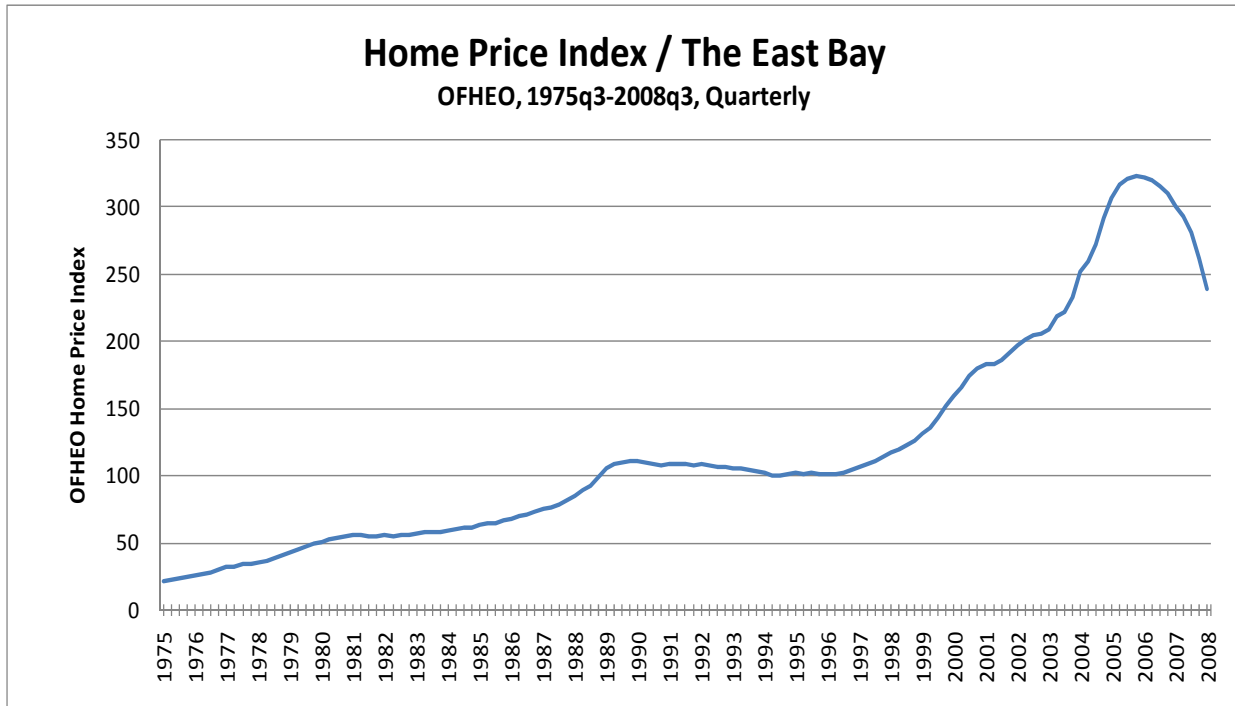
### Housing Sector

Our previous report saw indications that the housing downturn in the East Bay was coming to an end and if so, it would no longer be a drag on East Bay economic growth. We now re-examine this analysis, since the economic environment has changed drastically over the last three months. To ascertain to what extent we should modify our previous forecast, we look at several factors characterizing supply and demand conditions in the East Bay housing market.

On the supply side, the market is in the process of burning off excess inventory. The latest home price estimates using the OFHEO Price Index for the 3<sup>rd</sup> Quarter show East Bay home prices have continued to fall and are down -26% from the peak of June 2006. Even more telling is the fact that the average increase in home prices in the East Bay over the last five years is only 14% percent. After adjusting for inflation, home values have not increased since the 3<sup>rd</sup> Quarter of 2003. Therefore, the excess appreciation of homes in the East Bay has for the most part been burned off and home prices are relatively close to their long run trend. To be sure, these declines are related to the record number of foreclosures in the eastern portion of Contra Costa and Alameda counties and neighborhoods in the western part of the region with less expensive housing, and though foreclosure activity fell sharply in October and November due to SB-1137's increased foreclosure waiting period, they still dominate the supply in the market. Nevertheless, sales in the East Bay are up 65% from last December<sup>2</sup> indicating the pricing mechanism is working to reduce inventory.

<sup>2</sup> <http://www.dqnews.com/News/California/Bay-Area/RRBay090121.aspx>

In addition to foreclosures and owner occupied inventory, builders add inventory to the market by increasing the overall stock of homes. Residential permits have now fallen across the state as home builders are unsure at what price they will be selling their product. Builders are now building a minimum number of homes to stay in business. Or as John Walsh, MDA DataQuick President put it, “builders are in a holding pattern; staying alive until the market recovers<sup>3</sup>.” Large builders such as KB Homes and Ryland are building to a different market. They are taking orders and building to consumer means rather than building on spec<sup>4</sup>. So on the supply side, the only factor on the horizon which might delay the end of the housing downturn in East Bay is the increased inventory due to newly unemployed workers being unable to meet their mortgage payments.



Source: OFHEO, UCLA Anderson Forecast

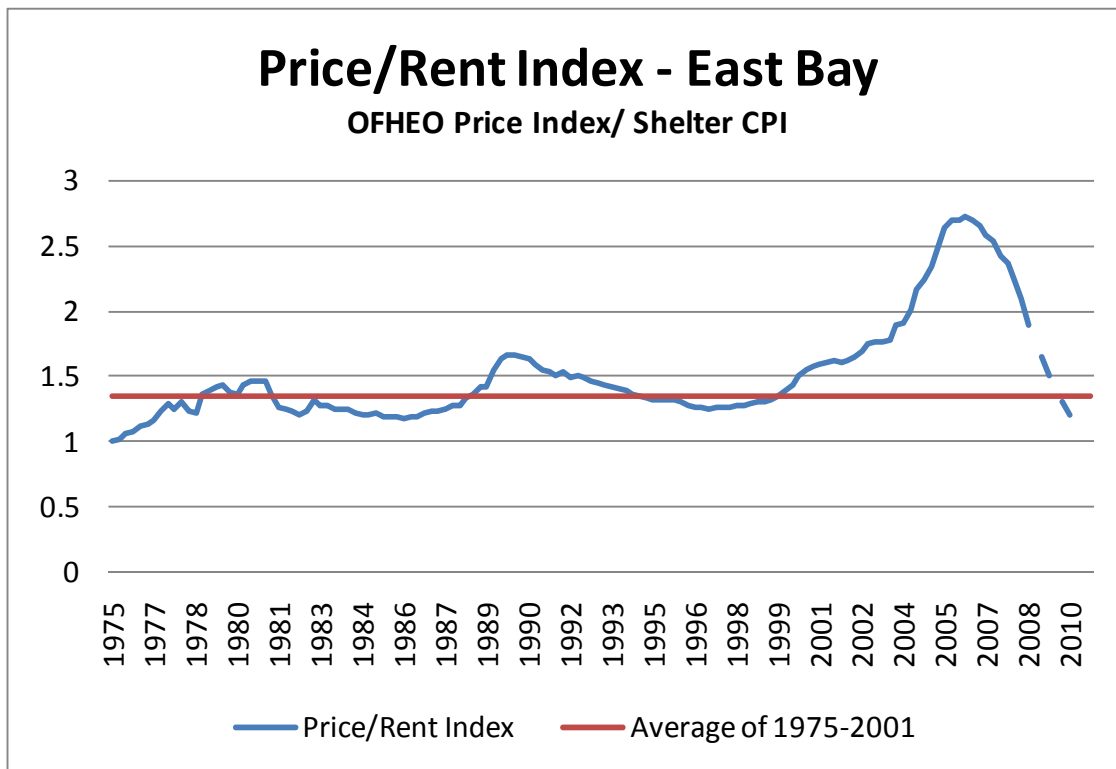
On the demand side are households who are both investing and obtaining housing services and investors who are buying for the return they can earn on their investment. Households are nervous about the economy, and do not want to buy too soon, lest they lose out on the benefits of further price declines. While investors are nervous as well, they look to the rental streams they can earn to support their investment and as home prices fall, their incentive to get into the market increases. This component of demand could stabilize prices in the market in the near term and help induce owner-occupier buyers to come back into the market. The key for both types of buyers is the value they expect to obtain by entering the market.

One measure of the value of a home for investor-buyers is the P/R (Price/Rental) ratio. Rents, of course, 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. If it is expected that rental rates will rise in the future and home appreciation rates 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. While not a perfect measure, when the P/R ratio deviates substantially from their mean there tends to be a correction. For the aggregate of homes in the East Bay an estimate of the P/R ratio is calculated as the ratio of the median price of homes divided by the shelter component of the CPI. Shelter CPI is

<sup>3</sup> <http://www.dqnews.com/News/California/Southern-CA/RRSCA090119.aspx>

<sup>4</sup> Daniel Miller, Still Building, Believe It or Not, Los Angeles Business Journal, January 26, 2009

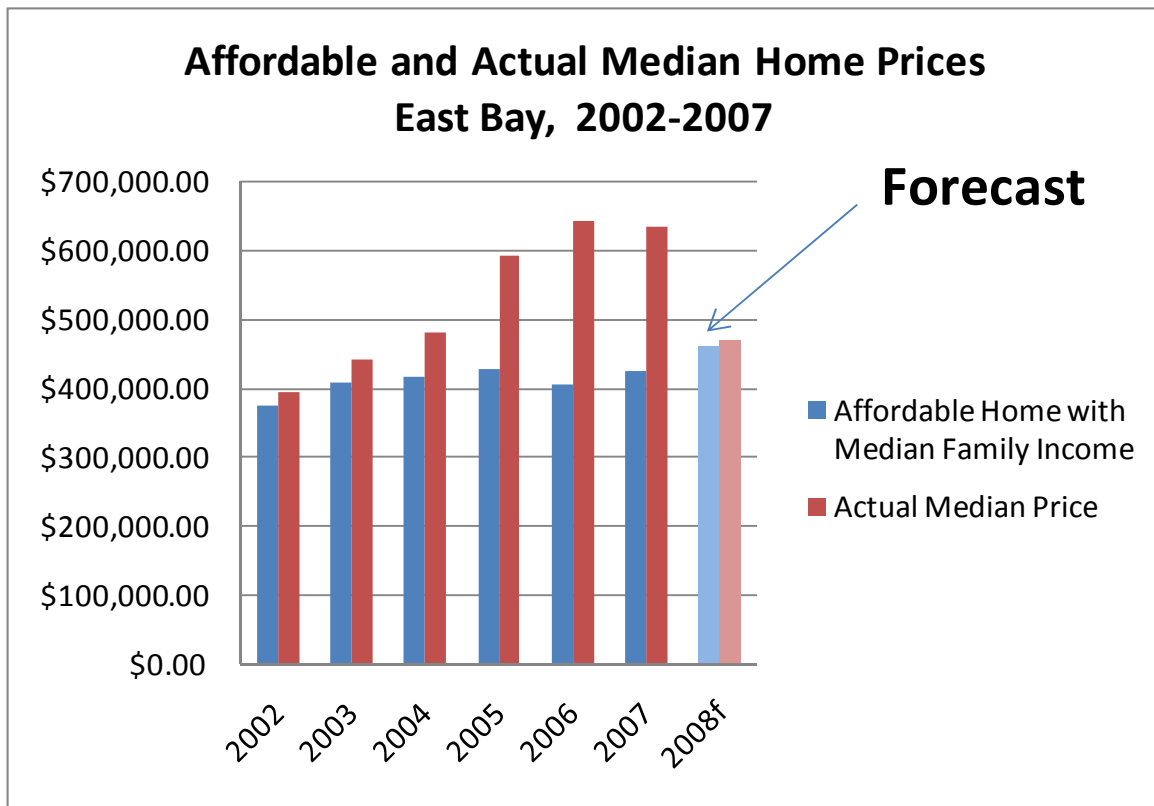
used as a proxy for annual rental values. In the East Bay the P/R ratio began to increase with the easy money, housing bubble period in 2003. After hitting the peak in 2006, the ratio began to decrease. Were the current trend to continue the P/R ratio will be at its 1975-2001 mean in the first quarter of 2009.



Sources: OFHEO, BLS, UCLA Anderson Forecast

For potential owner-occupier buyers the P/R ratio is only one factor. As important is the ability to qualify and carry the mortgage. The graph of “Affordable and Actual Median Home Prices” illustrates a comparison of estimated affordable home prices and actual median home prices in the East Bay for the years 2002-2008. We used median family income from U.S. Census’ American Community Survey<sup>5</sup>, a 30% ratio of mortgage interest and principle payments to income, an 80% loan-to-value ratio (which implies that the family has a 20% down-payment) and a conventional 30 year fixed mortgage rate from Federal Housing Finance Board survey to calculate hypothetical affordable home prices.

<sup>5</sup> <http://factfinder.census.gov>



Sources: U.S. Census, UCLA Anderson Forecast, FHFB

There is a striking difference between the home prices at which median income families could afford to purchase according to our model and actual median home prices for the years of 2004-2007. Why such a difference? Loans such as the ones used to calculate the “affordable home” were not used to purchase the median home in 2004-2006. Rather, stated income, sub-prime credit, 100% finance, adjustable-rate, interest only, or negative amortization loans provided the funds to purchase these homes. So long as homes were appreciating, the appreciation and subsequent re-financing would support the price. The interesting fact is that with lenders reverting to more traditional mortgage loan practices, affordability has improved substantially and median home buyer’s borrowing power is very close to the actual median home prices.

In our re-examination of the forecast of an early 2009 stabilization of the housing market, we have looked at both demand and supply factors. On the supply side the stock of housing is increasing at a low rate and the rate of foreclosures is beginning to fall. The job loss associated with the recession, expected to continue well into 2009, should add additional supply in the coming months and slow the decline in foreclosures. On the demand side, the financial fundamentals for investor-buyer and owner-occupier buyers suggest the market has adjusted from the imbalance of 2006. Again, the fly in the ointment is job loss due to the recession. The UCLA Anderson Forecast for the East Bay economy is for the recovery to begin in the 2<sup>nd</sup> half of the year. This is consistent with a stabilization of the East Bay housing market by the 4<sup>th</sup> quarter of 2009, two quarters later than our previous forecast.

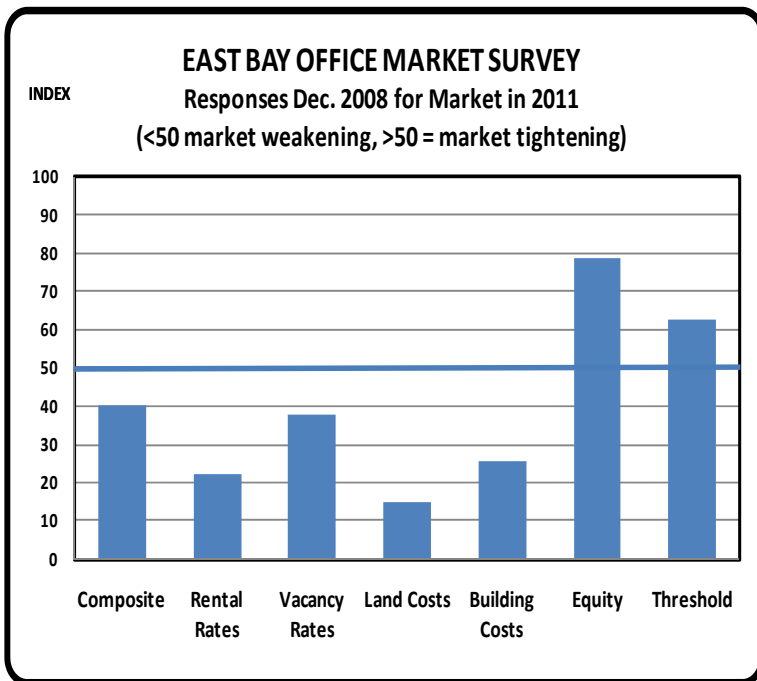
### Commercial Real Estate Survey Results

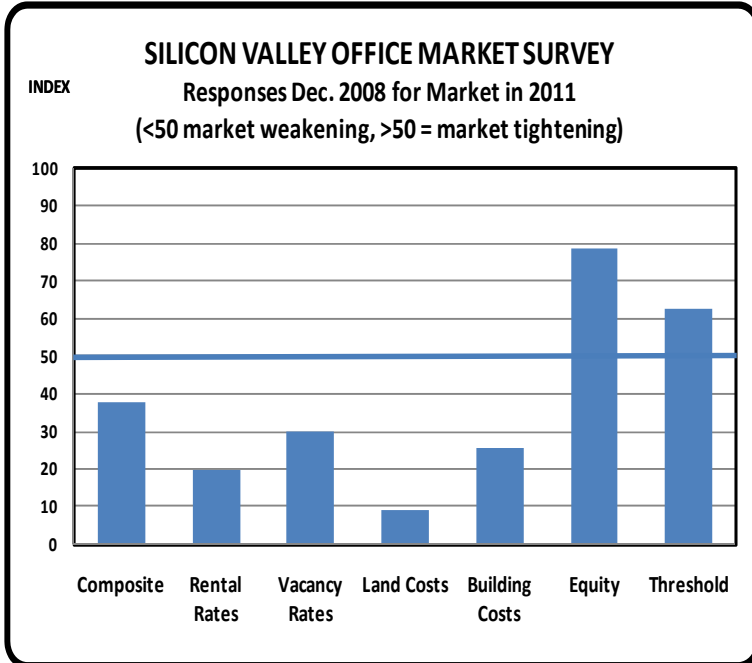
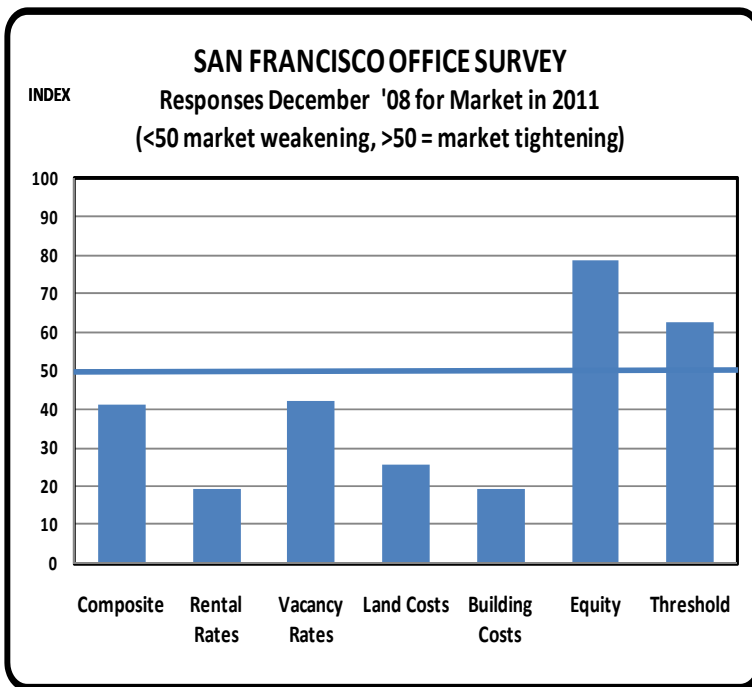
The Allen Matkins/UCLA Anderson Forecast Survey Project now includes a survey panel for each of the three Bay Area markets. The survey is designed to measure panel’s expectations of office market conditions three years from now. The November survey results show a general pessimism on the part

of the panel for occupancy and rental rates in the Bay Area. There were not any stark differences between the panel's view of the East Bay and that of San Francisco and Silicon Valley.

The recent declines in finance and professional business services sectors in East Bay are the sources of the weak demand conditions in office space market. Vacancy rates have reached 18% and inflation adjusted rental rates are falling. These changes are driven by the softening demand, rather than by the supply side developments. Supply additions have been moderate since the 2001 recession and will stay below the historic average for next few years. Our statistical model for the East Bay, which supplements the survey results, forecasts further decreases in occupancy rates, while inflation adjusted rental rates are predicted to stay flat. In this regard our model and the survey panel foresee similar conditions in the near term.

Based on the survey results and the models for all Bay Area districts, the San Francisco market will start a recovery in late 2010, Silicon Valley will be the next in 2011, and the East Bay market will turnaround after 2012. The next survey will be conducted in May 2009 and will give us a glimpse on office market expectations for 2012.





Sources: Allen Matkins/UCLA Anderson Forecast Survey

### Near Term East Bay Forecast

The headwinds of an accelerating U.S. recession during the last quarter did not spare the East Bay economy. The unemployment rate jumped to a seasonally adjusted rate of 8.1% and more than 11,800 payroll jobs were eliminated. A substantial housing downturn has been a drag on East Bay employment since the summer of 2007, but is now beginning to abate. However, the financial crisis of September created an extraordinary uncertainty about the future of the economy and U.S. consumers and businesses reacted with a sharp spending contraction. The financial turmoil and the recession of U.S., the world financial center and largest economy, also spilled over to the rest of the world. The East Bay fully reflects the trends observed in the U.S. and California economies during the fourth quarter.

The comparison of past and current recessions showed that this recession will be unique. The recovery of the East Bay will depend on U.S. consumer spending growth and on the recovery of U.S. trading partners. After several years of zero savings rates, U.S. consumers accumulated a high debt burden that needs to be lowered to a more sustainable level. The national savings rate has already started climbing and it now stands at 3.6%. Our prediction is that the national savings rate will slowly reach 4-5%, thus constraining the growth in consumption and therefore the rapidity of the recovery.

2009 will be a year of increasing unemployment, falling real income and more job losses for the East Bay. The region will lose approximately 26,000 jobs in 2009, the unemployment rate will climb to 8.9% and real personal income will decline by -0.8%. Taxable sales will decline at a -5.8% rate. The East Bay will start the economic recovery at the end of 2009, as the housing market stabilizes and consumption begins to pick up.

## The Balance Sheet Recession

David Shulman, Senior Economist, UCLA Anderson Forecast, December 2008

The news from the economy is bad. The recession that we had previously hoped to avoid is now with us in full gale force. We now expect that real GDP will decline by 4.1% in the current quarter and decline by another 3.4% and 0.8% in the first and second quarters of 2009, respectively. Because Europe and Japan are already in recession and China and India are suffering from a significant slowdown in growth, the export boom of the past few years will wane. Make no mistake the global economy is in its first synchronized recession since the early 1990s. Moreover, with tepid post-recession growth of around 3%, the unemployment rate is forecast to rise from October's 6.5% to 8.5% by late 2009 or early 2010. Concomitant with the rise in the unemployment rate will be the loss of an additional two million jobs over the next year.

Unlike most recessions whose origins arise from the impact of Federal Reserve tightening on consumer and business spending, this downturn has its origins in a severe asset price deflation that has imperiled the balance sheets of consumers, financial institutions and over-leveraged business entities. The asset price deflation was triggered by a collapse in the housing market that triggered increased defaults in the mortgage market which in turn threatened first the liquidity and then the solvency of a financial system that grew increasingly dependent upon the easy flow of mortgage credit. A contributing factor to the mortgage meltdown was Secretary of the Treasury Paulson's remark on November 12th that the Troubled Asset Recovery Program (TARP) would not buy illiquid mortgage securities as originally contemplated. Within eight days the value of a key commercial mortgage derivative dropped by 24% implying a 17% yield for the "super" AAA tranche.<sup>6</sup>

Having never declined since the early 1930s, house prices according to the Case-Shiller Index have fallen by about 22% since their 2006 peak accounting for about a \$4.5 trillion wealth loss. Moreover, as of November 21<sup>st</sup> the S&P 500 was off 45.5%, worse than the 41.9% decline of 1931 and the 38.6% in 1937. In dollar terms stock prices have declined by \$7.4 trillion since their historic high in December 2007. **Thus it should surprise no one that consumer spending under the weight of a \$12 trillion loss in asset values is now in the tank and will likely to remain soft for quite some time to come.** Thus it is no accident that the industries linked to the two most durable and most tied to wealth and credit of consumer assets, houses and cars, are suffering. Housing starts are forecast to drop to below a 700,000 unit annual rate, the lowest in the postwar history and automobile sales are now running at a 25 year low.

To summarize, we are forecasting a nasty recession that will be characterized by four quarters of declining real GDP and unemployment rising to 8.5% by late 2009. Because of the severe stress on consumer balance sheets, the savings rate will have to increase and by definition consumption growth will be sluggish. Although we are not forecasting that the savings rate will return from the 0.6% in 2007 to a more normal 4-7%, we can see a return to a level of 3-4%. As a result trend growth of 3% with very sluggish job growth won't resume until 2010. Remember both the 1990-91 and 2000-02 recessions were partially based on balance sheet issues and both times subsequent job growth as very sluggish. Furthermore it will take quite some time for the financial system to heal and as we have argued a new financial architecture will emerge out of the current crisis.

---

<sup>6</sup> Mulholland Sarah and Jody Shen, "Commercial Mortgage Securities Holders Blame Paulson," Bloomberg News, November 21, 2008.

## **You Haven't Seen THAT Before!**

Edward E. Leamer, Director, UCLA Anderson Forecast, December 2008

Forecasting depends on some reasonable similarity between the current situation and episodes in the historical data. But there is SOOO MUCH over the last several months that we haven't seen before. These abnormalities limit the power of statistical forecasting, forcing us to rely more on hunches. Just so you know, here are some of the features of the data that are so unusual, as well as some that are not that strange.

Housing starts in October were down to 791 thousand at an annual rate, edging out the former record holders: 798 in January 1991 and 843 in January 1982. (These are seasonally adjusted data, by the way.) This looks a lot worse when adjusted for the size of the workforce. The ratio of payroll jobs per housing starts jumped to 173 in October, far surpassing the January 1991 rate of 136 jobs per housing start. Residential investment through 2008q3 has been subtracting from GDP for 11 straight quarters, starting in 2006 Q1. This matches the longest string of negatives since 1947 when these quarterly data commence. The cumulative reduction in GDP from softness in housing is already the greatest ever.

Sales of Autos and Light Trucks plummeted in October to 10.5 million units per year from 12.5 the month earlier. This is the lowest level of sales since 1983. Expressed differently, the ratio of jobs to autos sold jumped to 13 in October, much higher than the previous record of 10.3 jobs per auto in December 1983.

Real retail sales which peaked in May 2007 were declining significantly in the first half of 2008, but after a very bad September and a terrible October were down 5.8%, a number not approached in the 2001 recession, or in any period for which the NAICS data are available commencing in 1992.

The November 20 level of the Dow was 7500, 44% lower than a year earlier. That exceeds the decline in any period in the 20<sup>th</sup> Century except the Great Depression, which had a 72% year-over-year decline in June 1932, and the subsequent recession which had a 55% decline in the year ending March 1936.

The 3-month Treasury yield 0.01 on Oct 21, 2008 tied with January 1940 for the lowest ever, though only because of rounding error. The 10-Year Treasury yield on 3.1% on November 2008 is the lowest since the 1950s.

The annualized rate of decline of the CPI in October 2008 equal to -10.9 percent is the greatest since 1937, but was matched several times in the deflations of the first half of the 20<sup>th</sup> Century. The spread of 5.6 points between the rate on Moody's AAA corporate bonds and the 3-month Treasury is the greatest in the recorded history.

That's a lot of weird stuff, particularly because the real economy is not all that unusual. Here are three items that are not that strange: 1) The October 2008 decline in industrial production by 5.9% from its previous peak falls short of the decline in most previous recessions in the second half of the 20<sup>th</sup> Century and is way short of the catastrophic declines in the recessions of the first half of the 20<sup>th</sup> Century; 2) The October 2008 decline in payroll jobs from the previous peak is only -0.9%, considerably below the recessions since 1947; and 3) The rise in the unemployment rate to 6.5 in October 2008 is very similar to past recessions.

**The California Report:  
Financial Meltdown and Consumer Uncertainty; From Wall Street to El Camino Real**  
Jerry Nickelsburg, Senior Economist, UCLA Anderson Forecast, December, 2008

In the last California report we struck a note of optimism about the coming quarter. What we did not expect was the spectacular Panic of 2008. California consumers reacted in a predictable way; they stopped shopping and began to conserve their resources. Our optimism remains only in tempering our pessimism. California is going to share the national recession with negative economic growth through the middle of next year and high unemployment into 2010. The U.S. recession will be unevenly felt across the state. The Inland Empire, Orange County, the East Bay and the Central Valley will be hit the hardest as the recession provides a double whammy with a generalized downturn in demand and a postponement of a recovery in residential construction. The coastal areas will not be immune as a U.S. downturn means that imports flowing through California's ports will continue to decline, and recessions in Europe and Japan mean that export demand for California manufacturing will be muted. In short, the forecast for the next three quarters is one of contraction in economic activity followed by the beginning of a slow recovery.

Housing has become less of a drag on economic growth, but remains an important part of the current California economic scene. Price declines in the housing sector continue to accelerate. According to the OFHEO Home Price Index, the most conservative of the measure of housing prices, home prices in California dropped 25% from their peak at the beginning of the 3<sup>rd</sup> quarter of 2006. We have been saying that this accelerating rate of decline will burn off the excess appreciation by the early 2009 and that prediction remains true.

Overall our outlook for California is for a very weak first 3 quarters of 2009 and the beginnings of a recovery in the latter part of the year. The keys to California's recovery are the recovery in U.S. consumption improving the demand for imports from Asia and 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. Manufacturing will continue the slow bleed of jobs through the 2<sup>nd</sup> quarter of 2010 primarily due to productivity improvements and leisure and hospitality will remain weak as the recessions in Europe and Japan are expected to be of longer duration than the U.S.

On an annual basis our forecast is that total employment will contract by -0.7% in 2008 and by -1.4% in 2009 before growing at a 0.3% rate in 2010. 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 slow from 0.1% to -0.6% as we move into 2009 and then return positive growth at 0.9%. Personal income growth will not return to its trend level of 2.9% until 2011 at which time we expect it to be growing faster than U.S. personal income. This slowing in the growth rate of personal income portends problems in state government finance until the 2010/2011 fiscal year. Taxable sales will decline this year and not recover until 2010 due to weakness in the demand for consumer durables in 2008 and 2009 and the more general fall off in retail purchases. Finally unemployment is going to continue to be ugly. We expect it to grow to a high of 8.7% next year and to remain at that level the following year.

# East Bay Quarterly Indicators



Q4 2008

GDP & CPI	GDP - % Change from Preceding Period (US)			CPI (San Francisco)			CPI (US All Cities)		
	Q4 06	Q4 07	Q4 08 (adv.)	Dec-07	Dec-08	% Change	Dec-07	Dec-08	% Change
	1.5	-0.2	-3.8	218,485	218,528	0.02%	210,036	210,228	0.09%

Source: BEA, BLS

Labor	East Bay			San Jose			San Francisco		
	Dec-07	Dec-08	% Change	Dec-07	Dec-08	% Change	Dec-07	Dec-08	% Change
Labor Force	1,294,400	1,312,000	1.4%	888,900	913,600	2.8%	961,300	982,500	2.2%
Employed Residents	1,229,900	1,210,900	-1.5%	843,900	842,200	-0.2%	921,900	922,300	0.0%
Unemployment	5.0%	7.7%	54.0%	5.1%	7.8%	52.9%	4.1%	6.1%	48.8%
Payroll Employment	1,058,800	1,026,900	-3.0%	921,600	910,600	-1.2%	1,007,500	998,100	-0.9%
Goods Producing	166,200	156,300	-6.0%	214,700	209,300	-2.5%	90,800	89,000	-2.0%
Service Providing	891,300	869,200	-2.5%	702,100	695,800	-0.9%	914,000	906,400	-0.8%

Source: California EDD

Non-Residential Vacancies	East Bay			San Jose/Silicon Valley			San Francisco		
	Q4 2007	Q4 2008	% Change	Q4 2007	Q4 2008	% Change	Q4 2007	Q4 2008	% Change
Industrial	3.9%	3.3%	-0.6%	11.1%	10.6%	-0.5%	n/a	n/a	n/a
Office	13.3%	14.9%	1.6%	9.7%	12.6%	2.9%	11.20%	12.60%	1.4%

Source: Rand Statistics, Grubb & Ellis

Construction Permits (by MSA)	East Bay			San Jose			San Francisco		
	Dec-07	Dec-08	% Change	Dec-07	Dec-08	% Change	Dec-07	Dec-08	% Change
Residential	\$ 202,737,235	\$ 123,414,114	-39.1%	\$ 78,913,114	\$ 122,905,592	55.7%	\$ 125,781,505	\$ 137,269,409	9.1%
Non-Residential	\$ 95,143,327	\$ 65,169,996	-31.5%	\$ 167,339,001	\$ 83,332,382	-50.2%	\$ 146,771,852	\$ 103,150,655	-29.7%

Source: Construction Research Industry Board

Tourism & Travel	East Bay/OAK			San Jose/Peninsula/SJC			San Francisco City & SFO (average)		
	Nov-07	Nov-08	% Change	Nov-07	Nov-08	% Change	Nov-07	Nov-08	% Change
Hotel Occupancy	63.2%	61.70%	-2.37%	69.5%	56.5%	-18.71%	75.10%	65.9%	-12.25%
Hotel Room Rates	\$ 101.65	\$ 104.70	3.00%	\$ 138.56	\$ 131.10	-5.38%	\$ 166.31	\$ 145.62	-12.44%
Airline Traffic (total passengers)	1,161,746	771,303	-33.61%	861,541	690,578	-19.84%	2,934,334	2,751,947	-6.22%

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 December 2008	\$338,000	\$252,500	\$562,500	\$402,500	\$616,500	\$537,000	\$436,000	\$213,500
Annual % Change from December 2007	-37.4%	-49.9%	-28.2%	-27.7%	-20.5%	-25.6%	-33.6%	-37.6%	-34.0%
Number Sold December 2008	1,492	1,788	165	111	366	435	1,265	733	534
Annual % Change from December 2007	51.8%	61.9%	-24.8%	14.8%	-32.5%	-16.9%	-15.0%	90.4%	23.7%

Source: Data Quick

Trade	Port of Oakland	
	Dec-08	Annual % Change
Full TEU Containers		
Imports	57,207	-15.7%
Exports	63,732	-16.30%

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>