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❖ U.S. Economic Developments

Economic Indicators Generally Weaken In Third Quarter

Many monthly indicators of economic well-being weakened during the third quarter compared to their second quarter levels. Along with declining stock markets, the slower growing or declining indicators include the purchasing managers' index, industrial production, the leading economic indicators index, retail sales, and both major consumer confidence indices.

Sluggish Growth Expected in Late 2002

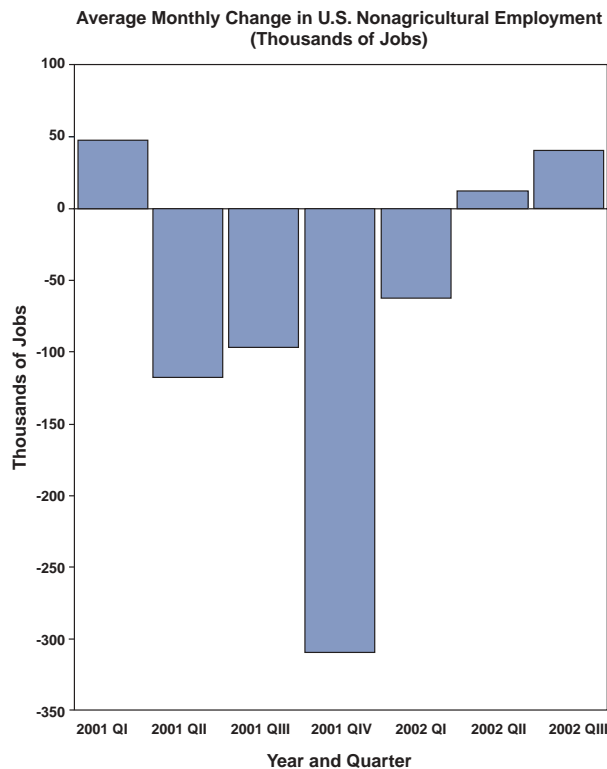
Despite the proliferation of weak monthly indicators, few economists expect any quarters of negative economic growth this year or next. The vast majority of economic forecasters expect modest economic growth for the rest of 2002 and into 2003. The September 2002 UCLA forecast predicts that real GDP will increase 2.3 percent in 2002 and 2.7 percent in 2003. The average forecast of a panel of 35 economists surveyed in August by the Philadelphia Federal Reserve Bank, calls for real GDP to increase 2.3 percent in 2002 and 3.0 percent in 2003. The Philadelphia Federal Reserve Bank 2002 consensus forecast of real GDP is one percent below the ten-year average of 3.3 percent per year. In the quarters ahead, continued increases in consumer spending, stimulative fiscal and monetary policies, low inflation,

high productivity, and export increases are expected to result in economic growth, but at a relatively slow rate.

Jobless Recovery So Far

This appears to be a "jobless" recovery, similar to the 1991-1992 recovery period. While the early 1990s recession ended in March 1991, nonagricultural employment stagnated for about a year afterward. It was not until April 1992 that U.S. nonagricultural employment surpassed the level recorded for March 1991.

In the 1990s expansion, monthly nonagricultural employment reached a peak in March 2001, at 132.5 million jobs. As shown in the chart, there were sharp employment losses



in the last three quarters of 2001 associated with the recession. Average monthly nonagricultural job losses were greatest in the fourth quarter of 2001, at 310,000 jobs per month. Job losses slowed to 63,000 in the first quarter of 2002, and started rising in the second and third quarters. However, job gains have been very weak in the second and third quarters, averaging 12,000 jobs per month in the second quarter and 39,000 jobs per month in the third quarter. According to the Bureau of Labor Statistics, the minimum statistically significant month-to-month change was 76,600 nonfarm jobs in September. Using that criterion, changes in monthly nonfarm jobs were only statistically significant for two of the nine months from January through September of 2002.¹

(Information derived from: U.S. Department of Commerce, STAT-USA website: <http://www.stat-usa.gov>, Federal Reserve Bank of Philadelphia, August 22, 2002, website: <http://www.phil.frb.org/redirect.html>; *The UCLA Anderson Forecast*, September 2002, website: <http://www.anderson.ucla.edu/research/forecast>, U.S. Bureau of Labor Statistics, website: <http://www.bls.gov/>.)

❖ *California Economic Developments*

Little Growth in Jobs so Far in 2002

Similar to the U.S., there has been little job growth in California so far in 2002. From January through September 2002, there has been no net increase in California nonagricultural employment. The California unemployment rate has likewise remained reasonably flat. From January through September the unemployment rate averaged 6.4 percent. Over the same time period the U.S. unemployment rate averaged 5.7 percent, so the California unemployment rate was about 0.7 percent above the U.S. unemployment rate. This is slightly higher than the average gap between the state and national unemployment rates for 2001, which was 0.5 percent.

¹ The August and September 2002 data are preliminary figures, subject to revision.

UCLA Predicts Sluggish California Employment Turnaround

The September UCLA forecast shows small increases in employment starting in late 2002. However, with declines in employment occurring for most of the year, UCLA economists are predicting nonagricultural employment to decline 0.2 percent in 2002, essentially remaining flat. They believe nonagricultural employment will increase 1.5 percent in 2003. This growth rate is only about half of that of the late 1990s. From 1996 through 2000 annual growth in nonagricultural employment averaged 3.1 percent per year. UCLA predicts California unemployment rates of 6.4 percent in 2002 and 6.5 percent in 2003. These rates are only slightly higher than those of recent months.

Extremely Strong Growth in Home Sales and Prices

The only component of the California economy that has been growing significantly in recent months is existing residential real estate activity. According to the California Association of Realtors (CAR) data, existing home sales set quarterly sales records in both the first and second quarters of 2002. Existing home sales were closed at an annual rate of 593,620 units in the first quarter of 2002, followed by an even stronger rate of 599,060 units in the second quarter. While annual sales rates declined in both July and August, sales remain at historically high levels. In their mid-year forecast, the CAR is predicting that existing home sales for 2002 will set a record, exceeding the record of 537,830 homes set in 1999.

In addition to high levels of sales activity, existing home prices are also jumping sharply this year, following rapid increases in 2001. Median home prices increased by 9 percent in 2001. Home prices have generally continued to increase rapidly so far in 2002. In their mid-year forecast, the CAR is

predicting median California home prices to increase 18 percent in 2002, reaching a level of \$313,000.

A major reason for the increase in existing home sales and prices is record-setting low mortgage interest rates. According to the Mortgage Bankers Association of America, the average contract interest rate for 30-year fixed rate mortgages decreased to a record low of 5.85 percent for the week ending September 13, 2002. The low rates have led to additional mortgage applications. Weekly volumes of new home loan mortgages and refinancings reached a record high for the week ending September 6, 2002. Refinancing activity accounted for nearly 75 percent of the mortgage applications.

(Information derived from: California Department of Finance, website: <http://www.dof.ca.gov/>; California Employment Development Department (EDD), *Labor Market Conditions in California*, October 11, 2002, EDD Labor Market Information website: <http://www.calmis.cahwnet.gov/>; *The UCLA Anderson Forecast*, September 2002, website: <http://www.anderson.ucla.edu/research/forecast/>; *Western Blue Chip Economic Forecast*, Bank One Economic Outlook Center, College of Business, Arizona State University, Tempe, Arizona, October 2002, California Association of Realtors, website: <http://www.car.org/>)

❖ *Productivity and the Changing U.S. Retail Trade Industry*

The U.S. retail trade industry has been dramatically transformed over the past decade, reflecting changes in technology, industry structure, and consumer preferences. The U.S. Bureau of Labor Statistics (BLS) published an article last year discussing changes in retailing from 1987 through 1999.² The BLS paper also documents the above-average increase in productivity that the retail industry has experienced resulting from these changes,

particularly in the late 1990s. This article will summarize some of the more important findings from this and other publications.

Changes in technology include widespread adoption of Universal Product Codes (UPCs) and point-of-sale (POS) scanners. According to the BLS, the number of POS terminals used in U.S. retail trade increased from 53,000 in 1990 to 1.7 million by 1998. POS equipment can be used to electronically link cash registers, laser scanning devices, and credit card processing machines with sophisticated software packages. These systems enable retailers to expand service and sales without increasing personnel. POS equipment also allows retailers to more precisely control their inventories, keeping them at lower levels.

Industry structure is typically measured by sales by the largest firms compared to the rest of the firms in an industry. Changes in industry structure are closely linked by applying POS equipment technologies, since their bigger scales of operation enable larger firms to use these technologies more efficiently than smaller firms. According to the BLS, the 50 largest U.S. retail trade firms accounted for 20.3 percent of total retail sales in 1987. This percentage has increased to 25.7 percent by 1997. In 1997 these 50-firm concentration ratios were even higher for certain major industries within retail trade. The top 50 food and beverage companies had 54.1 percent of total U.S. retail food and beverage sales in 1997, while the top 50 general merchandise store companies had 95.8 percent of general merchandise sales. These two categories accounted for 40 percent of U.S. nonauto retail sales in 1997.

Finally, consumer preferences have also shifted during the past decade. Collectively, U.S. consumers now do much more of their shopping at discount department stores than they used to. According to the BLS, in 1987 discount department store sales accounted for 43 percent of all department store sales. By 1997 this proportion had increased to 63 percent. Since discount department stores are dominated by large firms and use POS equipment extensively, this shift in consumer

² "Labor Productivity in the Retail Trade Industry, 1987-99," *Monthly Labor Review*, December 2001, U.S. Bureau of Labor Statistics. Many of the statistics cited in this BLS publication are from the 1997 *Census of Retail Trade*, published by the U.S. Census Bureau. The Census Bureau surveys retailers every five years.

preferences magnifies the productivity benefits of adopting technological improvements and economies of scale.

All of these components have combined to result in tremendous increases in the productivity of the retail trade industry, particularly in the late 1990s.³ According to the BLS, retail labor productivity increased an average of 3.1 percent per year from 1995 through 1999, almost double the 1990-1995 average of 1.6 percent per year. Productivity of department stores increased even more than average retail productivity in the late 1990s. From 1995 to 1999 productivity of department stores increased an average of 6.2 percent per year.

³ A commonly used definition of economic productivity is the amount of goods and services produced per unit of labor. In discussing labor productivity, analysts typically cite nonfarm output per hour statistics, which are available quarterly from the U.S. Bureau of Labor Statistics (<http://www.bls.gov/>).

To put these numbers in perspective, total U.S. nonfarm productivity increased an average of 2.1 percent per year from 1995 through 1999. The retail industry is a large component of the U.S. economy, accounting for about 18 percent of total nonagricultural employment in 1999. Because retailing is such a large part of the economy and because productivity increased so rapidly, many analysts have concluded that retailing is responsible for a large portion of the increases in total U.S. productivity that occurred in the late 1990s.⁴

⁴ One reference is "Economic Trends: Productivity: A Retail Link," *Businessweek*, June 10, 2002. The article states, "According to a McKinsey Global Institute study, retailing was one of six industries that accounted for almost all of the nation's productivity jump in the last half of the 1990s." Another study cited in *Businessweek* ("Economic Trends: Really Grand Openings," September 23, 2002) reaches similar conclusions (*The Link Between Aggregate and Micro Productivity Growth: Evidence From Retail Trade*, Lucia Foster, John Haltiwanger and C.J. Krizan, National Bureau of Economic Research, Working Paper 9120, August 2002). One more interesting conclusion this study reached was to ascribe nearly all the retail productivity growth in the second half of the 1990s to closing old stores and opening new stores.

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