



STATE BOARD OF EQUALIZATION

# ECONOMIC PERSPECTIVE

*Summary of Recent Economic Developments*

*February 2003*

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## ❖ *U.S. Economic Developments*

### **Economic Indicators Mixed in Fourth Quarter**

Monthly indicators of economic well-being showed mixed results during the fourth quarter compared to their third quarter levels. The declining indicators include employment, industrial production, and consumer confidence.

Others — such as personal income and housing starts — were little changed from their third quarter averages.

Retail sales were much stronger in the fourth quarter, despite lackluster

Christmas season sales reported by major retailers. Another widely followed indicator, the purchasing managers' index (a survey of manufacturing conditions published monthly by the Institute for Supply Management), rose sharply in December, to a level of 54.7. This follows readings hovering in a narrow range between 48 and 50 since June 2002. Based on historical averages, an index over 50 indicates that manufacturing output, sales, and employment will expand in the months ahead.

### **Sluggish Growth Expected**

According to the "advance estimate" released by the U.S. Department of Commerce, real GDP rose 0.7 percent in the fourth quarter. (The "final" estimate of real GDP for the fourth quarter of 2002 will be published in March.) The average forecast of a panel of 35 economists surveyed in November by the Philadelphia Federal Reserve Bank called for real GDP to increase 2.6 percent in 2003. The Governor's

Budget forecasts real GDP to rise at about the same rate in 2003, 2.5 percent. Such growth rates of around 2.5 percent, while close to the 2002 gain of 2.4 percent, would be well below the average annual growth rate of 3.3 percent in real GDP per year over the past ten years. While most economists do not anticipate any declining quarters this year, a large minority of those surveyed by the Philadelphia Fed—27 percent—expect a quarter of negative growth before 2004.

### **Jobless Recovery So Far**

This appears to be a "jobless" recovery, much like 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 this economic cycle, the recession began in March 2001. While the National Bureau of Economic Research (NBER) has yet to declare the end of the recession, many economists believe that the economy started expanding again in late 2001. If this assumption is correct, the economy has been expanding for about the past year. As in the 1990s, there was essentially no growth in jobs over this period. U.S. nonagricultural employment in December 2002 was slightly below December 2001. Preliminary data show that U.S. nonagricultural employment declined 0.9 percent in 2002 as a whole. With the decline in jobs, the U.S. unemployment rate averaged 5.8 percent for 2002, up from 4.8 percent in 2001.

(Information derived from: U.S. Department of Commerce, STAT-USA website: <http://www.stat-usa.gov>; Federal Reserve Bank of Philadelphia, November 22, 2002, website: <http://www.phil.frb.org/redirect.html>; U.S. Bureau of Labor Statistics, website: <http://www.bls.gov/>.)

## ❖ *California Economic Developments*

### **Slight Decline in Jobs in 2002**

Similar to the U.S. economy, nonagricultural employment declined in 2002. However, preliminary data show that the decline was not as steep, a 0.3 percent decline in California employment compared to a 0.9 percent decline for the U.S. as a whole. To put California jobs growth in historical perspective, the state's nonagricultural jobs have increased an average of 1.8 percent per year from 1992 through 2001. The 2002 decline in nonagricultural jobs was much milder than in the recession of the early 1990s. Before resuming growth in 1994, California nonagricultural employment declined 2.7 percent in 1991, 1.4 percent in 1992, and 0.9 percent in 1993.

### **Stable Unemployment Rate In 2002**

With much slower growth in the labor force than in recent years, the California unemployment rate has remained reasonably flat throughout 2002. The 2002 California unemployment rate averaged 6.4 percent, with monthly figures within a tight range of 6.2 percent to 6.6 percent. These rates are far above the average 2001 unemployment rate of 5.3 percent. However, the California unemployment rate is not high in relation to historical norms or the last recession. From 1992 through 2001, the California unemployment rate averaged 7.0 percent. In 1997, several years after the state's recession of the 1990s ended (generally considered to be December 1993), the California unemployment rate averaged 6.3 percent, about the same as the 2002 average. The California unemployment rate was 9.3 percent in 1992 and 9.4 percent in 1993, the highest annual rates of the early 1990s recession.

### **UCLA Predicts Sluggish California Employment Turnaround**

In early December 2002, the UCLA Anderson Forecast presented their quarterly economic forecasts for the nation and California. UCLA does not expect the state's jobs to increase near historically normal rates (about 2 percent per year) until late 2003. On an annual basis, they predict California nonagricultural employment will inch up 0.7 percent in 2003 and rise 2.2 percent in 2004. (The Governor's Budget calls for similar growth in nonagricultural employment, 0.7 percent in 2003 and 2.1 percent in 2004.) With the sluggish increase in 2003, UCLA forecasts a 6.7 percent unemployment rate in 2003, up from a 6.4 percent unemployment rate in 2002.

### **Slight Upturn in Third Quarter Taxable Sales**

Consistent with small changes in employment, taxable sales were little changed in the third quarter of 2002. Preliminary Board of Equalization estimates show that third quarter 2002 taxable sales inched up just 0.9 percent compared to those of the third quarter of 2001. While the gain was small, the preliminary data (which are subject to revision) indicate the first increase in four quarters. However, taxable sales remain very weak compared to long term average growth rates. To put these figures in perspective, for the ten-year period 1992 through 2001, taxable sales rose an average of 5.1 percent per year. In 1991, by many measures the worst year of the 1990s recession, taxable sales decreased 3.9 percent. Taxable sales declined 0.1 percent in 2001. Preliminary data for the first three quarters of 2002 indicate that taxable sales have declined 2.6 percent compared to the first three quarters of 2001.

(Information derived from: California Department of Finance, website: <http://www.dof.ca.gov/>; California Employment Development Department (EDD), *Labor Market Conditions in California*, January 17, 2003, EDD Labor Market Information website: <http://www.calmis.cahwnet.gov/>; Board of Equalization, News Release #54, December 13, 2002, *2002 Taxable Sales – Third Quarter*, website: <http://www.boe.ca.gov/>; *The UCLA Anderson Forecast*, December 2002, website: <http://www.anderson.ucla.edu/research/forecast/>.)

## ❖ U.S. Gross Domestic Product by Industry in 2001

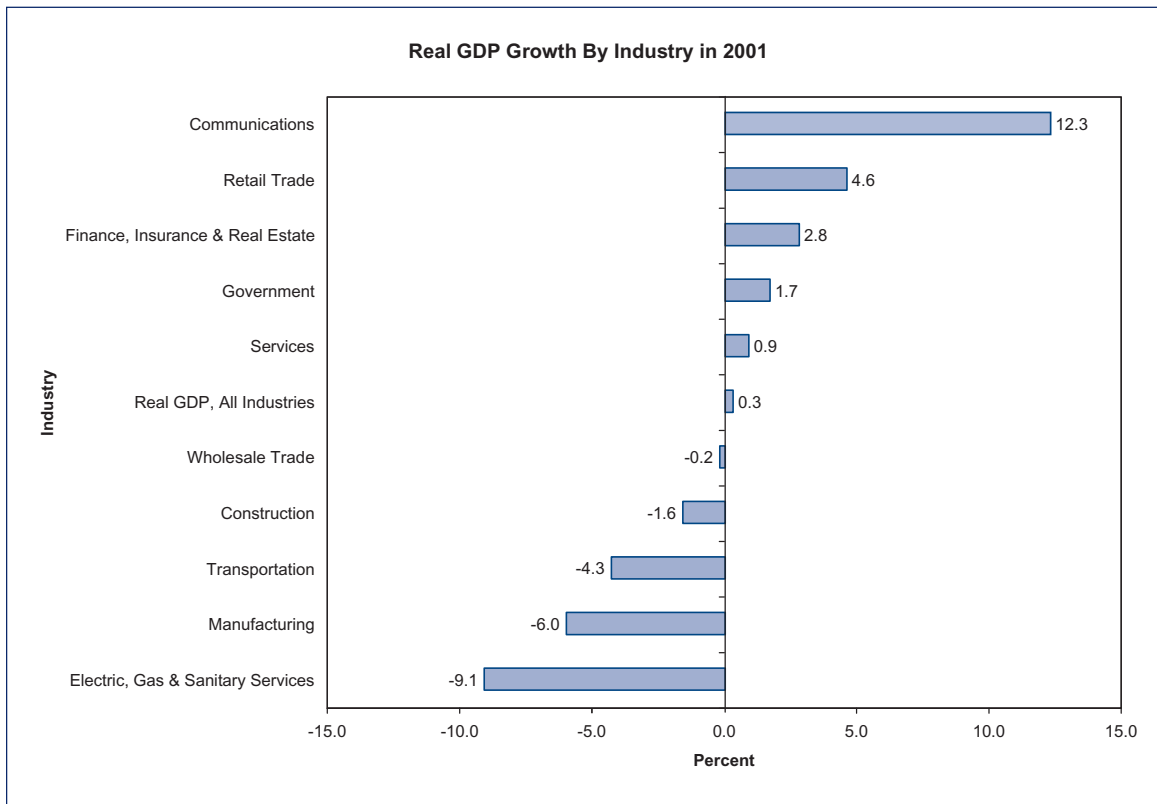
We know that economic growth was very weak in 2001, as real GDP increased just 0.3 percent. What is less well publicized is that there was wide variation in real GDP growth by industry. Recently, the U.S. Bureau of Economic Analysis released data on 2001 real GDP growth by industry. The data were discussed in the November 2002 issue of *Survey of Current Business*.<sup>1</sup> This article summarizes trends in economic growth by industry for 2001.

Changes in real GDP reflect trends in both overall production as well as productivity per worker or per other production input unit. In terms of broad industry groups, in 2001 real GDP in private services-producing industries and government services both increased 1.7 percent, while real GDP in private goods-producing industries declined 4.2 percent.<sup>2</sup> This is a typical pattern for recessions; production of goods tends to be much more affected by economic slowdowns than does production of services.

As for more detailed industries, the accompanying chart shows 2001 real GDP growth for major industries, ranked by their growth rates.

<sup>1</sup> U.S. Department of Commerce, Bureau of Economic Analysis, "Gross Domestic Product by Industry for 1999-2001," *Survey of Current Business*, November 2002.

<sup>2</sup> Services-producing industries include transportation, communications, public utilities, wholesale and retail trade, finance, insurance, and real estate, plus all other services. Goods-producing industries include agriculture, forestry and fishing, mining, construction, and manufacturing.



The chart shows a very wide variation in growth rates, from a high of 12.3 percent growth for communications to a decline of 9.1 percent for electric, gas, and sanitary services. At first glance, it seems surprising that communications — a sector where several major companies experienced well publicized stock market, bankruptcy, accounting, and management problems — would have such rapid economic growth in 2001. However, this situation demonstrates that it is possible to rapidly increase economic production of goods and services, at least in the short run, while simultaneously having these difficulties. The production of communications services, particularly wireless communications services, increased rapidly in 2001. In fact, the overcapacity (over building) problems of the communications industry probably contributed to more rapid growth of output in the industry. Falling prices and more unlimited calling plans resulted in increased market share penetration of cell phones to more households as well as greater use of them. As measured in GDP accounting of services, these developments are considered to be increases in economic production.

The Department of Commerce noted in its article that the performance of information technology related industries was mixed in 2001. As noted, communications output increased sharply. However, output of communications equipment, electronic equipment, and instruments declined sharply in 2001.

After communications, the next fastest growing industry was retail trade, which increased real GDP by 4.6 percent in 2001. While retail spending declined with the overall economy, increasing productivity per worker boosted output in retail. Finance, insurance, and real estate was the third fastest growing industry, with real GDP rising by 2.8 percent. Low interest rates spurred home buying activity and mortgage refinancings in 2001, which caused a large part of the increase. As

mentioned earlier, real GDP in federal, state, and local government services combined rose 1.7 percent in 2001.

Services — which include a wide variety of economic activity ranging from business, professional, and health services to hotel and personal services — increased real GDP by just 0.9 percent in 2001. In contrast to the growth seen in retail trade, wholesale trade had a 0.2 percent decline in real GDP in 2001. Construction output declined 1.6 percent, mostly because of declines in nonresidential building activity. With the overall decline in economic activity, real GDP in transportation services decreased 4.3 percent, reflecting both less travel by persons and decreased shipping of goods. Manufacturing output fell 6.0 percent, as both durable goods and nondurable goods posted sharp declines. Finally, the electric, gas and sanitary services industry saw the steepest decline in output. Real GDP for the industry decreased by 9.1 percent in 2001. Much of the decline was probably related to reduced electricity and fuel use in manufacturing, but some of it may have reflected energy conservation measures, which reduced output.

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