STATE BOARD OF EQUALIZATION

ECONOMIC PERSPECTIVE

Summary of Recent Economic Developments *May 2002*

❖ *U.S. Economic Developments*

Turnaround in Real GDP Growth

Real gross domestic product (GDP), increased 5.8 percent in the first quarter of 2002 and 1.7 percent in the fourth quarter of 2001, providing evidence that the recession probably ended sometime late last year. If so, this recession will likely go down as one of the mildest on record, with just one quarter of declining real GDP. (Third quarter 2001 real GDP declined 1.3 percent.) For 2001 as a whole, real GDP rose 1.2 percent, the slowest growth since 1991. To put the weakness of the 2001 figure in perspective, real GDP increased an average of 4.1 percent per year from 1996 through 2000, and 3.4 percent annually for the 10-year period from 1992 through 2001.

Recession Unusual by Some Measures

The recession was unusual, in that consumer spending on durable goods and residential investment held up quite well. These two sectors normally have steep declines during recessions. For example, real durable goods spending declined 6.6 percent in 1991, during the previous recession. However, real durable goods spending *increased* 6.7 percent in 2001. Similarly, real residential investment spending decreased 12.8 percent in 1991, but rose 1.5 percent in 2001. The only negative aspect to the uncommonly strong spending during the recession for these two sectors is that without a steep decline in spending during the recession, there is less likely to be a sharp upturn as the economy recovers, unlike typical early recovery periods from other recessions.

Profits Fall Sharply During Recession

While the recession was mild in many respects, corporate profits declined more than in typical recessions, especially in technology industries. U.S. corporate profits[1] were down 12.5 percent from levels reported in 2000. Profits have not declined as much since 1970, when they decreased by 13 percent. (There was a recession during all of 1970.) To put the 2001 figures in perspective, corporate profits increased 3.3 percent in 1990, during the 1990-1991 recession. Corporate profits increased 5.5 percent in 1991, even though the economy was in recession part of the year and growing slowly during the rest of the year. In other recession years of 1974, 1980, and 1982, annual calendar-year corporate profits declined from 8 to 11 percent.

Profits of large companies fared even worse in 2001. In 2001, earnings for 900 large corporations tracked by *Businessweek* fell 59 percent from 2000. The decline was the steepest since 1973, and far worse than the 19 percent decline in 1991 associated with the last recession.

Fewer Employment Losses in First Quarter

Many economic indicators measuring early 2002 activity show evidence of a turnaround from the recession. One of

[1] Corporate profits with inventory valuation and capital consumption adjustments.

these is nonagricultural employment, which is one of the most comprehensive economic indicators. The number of employees on nonagricultural payrolls reached a peak in March 2001, and has generally declined over the subsequent 12 months. About 1.4 million nonagricultural jobs were lost from March 2001 through March 2002. U.S. nonagricultural employment declined by 848,000 jobs in the fourth quarter of 2001. Preliminary data for the first quarter of 2002 showed a decline of 280,000 jobs, much fewer than the fourth-quarter decrease. (Both of these figures will be revised by the Bureau of Labor Statistics later this year.)

Stable Unemployment Rate In First Quarter

The U.S. unemployment rate averaged 5.6 percent in the first quarter of 2002, identical to the average for the fourth quarter of 2001. (The number of jobs determined from the survey used to calculate the unemployment rate differs from the nonagricultural employment survey estimate, since it polls households rather than employers.) The first-quarter unemployment rate remains well above the 4.8 percent average rate for 2001, and is up even more from the 4.0 percent average for 2000, prior to the onset of the recession.

Continued 2002 Recovery Widely Anticipated

Many economic forecasters believe that economic growth will strengthen throughout the rest of 2002. A Philadelphia Federal Reserve Bank survey of 35 forecasters released in late February calls for real GDP to increase at annual average rates of 2 to 4 percent during the remaining quarters of the year and to grow an average of 1.4 percent for the entire year of 2002. They forecast real GDP to rise 3.5 percent in 2003, a figure close to the most recent 10-year average annual growth rate of 3.4 percent. The March 2002 UCLA economic forecast calls for real GDP to rise 1.5 percent in 2002, similar to the Philadelphia Fed survey average, and to grow 2.6 percent in 2003, much lower than the survey average.

(Information derived from: U.S. Department of Commerce, STAT-USA website: http://www.stat-usa.gov/; *2002 Economic Report of the President;* website: http://w3.access.gpo.gov/eop/index.html; "This is so Not The 90s," *Businessweek,* February 25, 2002; "Survey of Professional Forecasters," Federal Reserve Bank of Philadelphia, February 22, 2002, website: http://www.phil.frb.org/redirect.html;)

❖ *California Economic Developments*

California Recession Performance Mixed Compared to Rest of U.S.

The state as a whole generally mirrored the nation during the 2001 recession. However, the state lost fewer jobs than the nation percentagewise but had a steeper decline in income. California nonagricultural employment declined 0.3 percent from March 2001 (the first month of the U.S. recession) through January 2002. Over the same time period U.S. nonagricultural employment declined 1.1 percent. For 2001 as a whole, California nonagricultural employment increased 1.4 percent, well above U.S. growth of just 0.3 percent. The California unemployment rate increased from 4.7 percent in February 2001 (the lowest rate of the California economic expansion that began in 1994) to 6.4 percent by March 2002 (the high point so far), a 1.7 percent increase. The increase in the unemployment rate for the U.S. over this time period was similar, going from 4.2 percent in February 2001 to 5.7 percent by March 2002, a 1.5 percent increase.

While employment gains were greater, California personal income increased much less than U.S. personal income last year. In 2001, California personal income rose 1.4 percent, but U.S personal income increased much faster, 4.9 percent.

Sharp Regional Differences in Employment Growth in 2001

The statewide nonagricultural employment increase of 1.4 percent masks a distinct regional divergence in economic performance during the recession. High technology industries were affected much more by the recession than "old economy" industries. Consequently, nonagricultural employment in 2001 declined disproportionately in the San Francisco and San Jose metropolitan areas, which have relatively large numbers of employees in high technology industries. While every other major metropolitan area of the state had increases in nonagricultural jobs in 2001, San Francisco nonagricultural employment declined 1.0 percent, and Santa Clara County nonagricultural employment declined 1.3 percent. Of the eight most populous metropolitan areas of the state, Riverside-San Bernardino had the fastest growth in 2001, 4.1 percent, followed by Sacramento at 3.2 percent.

UCLA Predicts Slow California Employment Turnaround

The March UCLA forecast shows relatively small increases in California nonagricultural employment, throughout the rest of 2002, followed by much sharper gains in 2003. On an annual basis, UCLA predicts nonagricultural employment to rise 0.7 percent in 2002 and 2.2 percent in 2003. These growth rates are both much lower than the average annual growth in nonagricultural employment of 3.2 percent from 1996 through 2000.

Steep Declines in Third and Fourth Quarter 2001 Taxable Sales

As a consequence of the state's recession, taxable sales declined sharply in the third and fourth quarters of 2001. The Board of Equalization's preliminary estimates show that taxable sales declined 4.4 percent in the third quarter of 2001 compared to the third quarter of 2000. Preliminary data show a 5.1 percent decline for the fourth quarter of 2001. For 2001 as a whole, taxable sales declined 1.2 percent (again, using preliminary data), the largest decline since 1991. To put the weakness of these figures in perspective, taxable sales increased 11.9 percent in 2000. For the five-year period 1996 through 2000, taxable sales rose an average of 8.0 percent per year.

(Information derived from: California Department of Finance, website: http://www.dof.ca.gov/; California Employment Development Department (EDD), *Labor Market Conditions in California,* April 12, 2002, EDD Labor Market Information website: http://www.calmis.cahwnet.gov/; *The UCLA Anderson Forecast,* March 2002, website: http://www.anderson.ucla.edu/research/forecast/; Board of Equalization, News Release #16, March 27, 2002, *Taxable Sales in California,* website: http://www.boe.ca.gov/.)

❖ *A Long-Term Look at California Taxable Sales and Personal Income Growth*

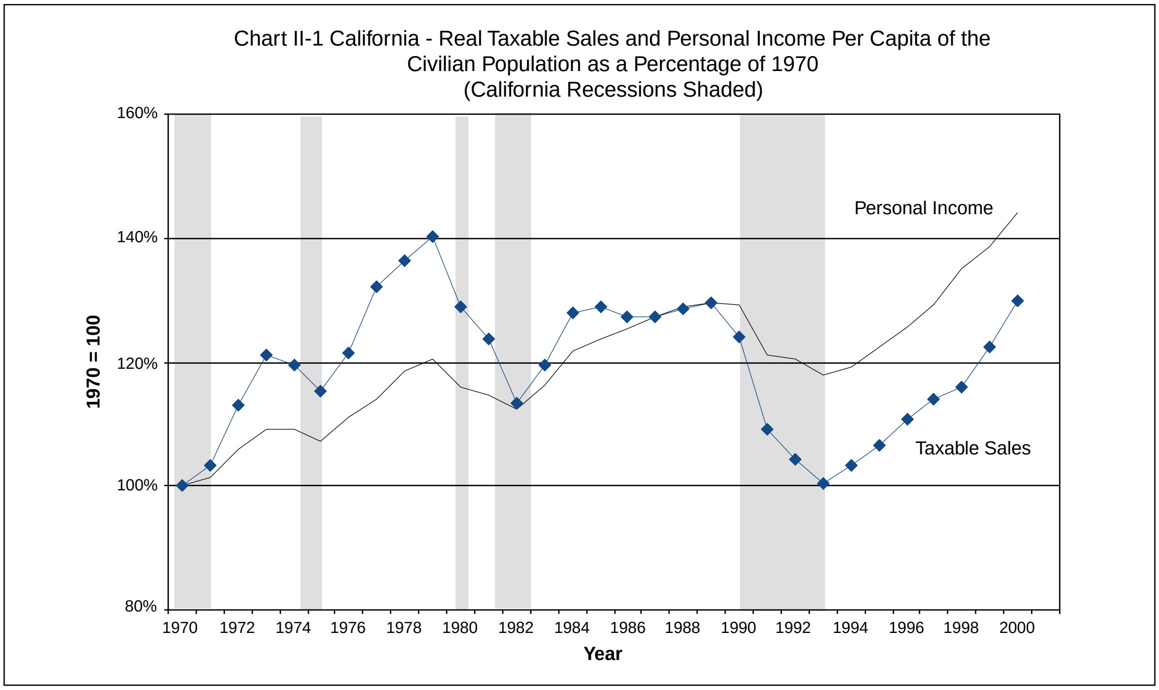
As discussed in our November 2001 newsletter, a well established tenet of economics is that consumption and income are strongly correlated to each other. The accompanying chart shows this relationship for taxable sales, a major component of consumption, for California from 1970 to 2000. (Consumption includes many tax-exempt items, such as food for home consumption and personal services.) To develop the data used to create the chart, we calculated real per capita taxable sales and personal incomes and set them each to equal 100 percent of their respective 1970 values.[2]

The chart clearly shows declines in the recessions of the mid-1970s, the early 1980s and the early 1990s. Real per capita taxable sales declined much more than real per capita personal income during these recessionary periods. Real per capita taxable sales generally rose faster than real per capita personal

[2] We used the California consumer price index to put the taxable sales data in real terms. This differs from the taxable sales deflator we typically use for our quarterly and annual *Taxable Sales in California* reports. The taxable sales deflator would be a more accurate index to use, but it is not readily available to us prior to the mid-1980s.

income throughout the nonrecessionary periods of the 1970s (i.e., all years except 1974 and 1975). During most of the nonrecessionary periods of the 1980s and the 1990s real per capita sales and income increased at similar rates of growth. There was little growth in both real per capita taxable sales and personal income during most of the 1980s, but sharp increases in both during most of the 1990s.

It is interesting to note that real per capita taxable sales peaked more than 20 years ago, in 1979. Part of the reason real per capita taxable sales have declined since 1979 can be explained by changes in the types of purchases consumers now make. Over the past twenty years, consumer preferences have shifted. Consumers are now generally spending a smaller proportion of total spending on goods (many of which are taxable, excluding food for home consumption and prescription drugs) and a larger share on services, most of which are exempt from the sales tax. It is also noteworthy that it took almost the entire remainder of the decade of the 1990s for real per capita taxable sales to recover from the early 1990s recession.



(Information derived from: Board of Equalization, *Taxable Sales in California*, (Annual printed issues, 1970 through 2000); California Department of Finance, website: http://www.dof.ca.gov/.)

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