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ARIZONA'S ECONOMY

ECONOMIC AND BUSINESS RESEARCH CENTER

On the (Low) Road to Recovery

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June 1, 2012

Recovery of Arizona's economy from the depths of the Great Recession continues to gain momentum even though progress is slower than normal. Job creation so far compares to the pace that followed the mild 1990-91 recession. The labor force participation rate fell precipitously during the Great Recession; will those workers return? Housing prices are now moving up – at a frenzy-driven pace! Finally, Hispanics account for the unprecedented drop-off recently in births as many presumably left the state.

The national economy appears poised for a summer slowdown and Arizona likely will follow, but the most recent crop of measures for Arizona is encouraging. Recent readings show retail sales increasing at an 8% annual rate in the fourth quarter, and sales were 5.2% higher in 2012Q1 on a year-on-year basis. First quarter restaurant & bars sales were up 7.5% and 8.3% in April, year-on-year. Our forecast calls for gains for all of 2012 of 5.6% and 7.1%, respectively. Both are stronger than personal income, which grew by 4.5% in 2011Q4 and 5.0% for the whole year. Look for a gain in the 4.5%-5.0% range for 2012. Private-sector wages have been trending upward as well, with a year-on-year gain of 4.7% as of 2011Q3, the most recent data available. None of these measures are spectacular, but they are solid.

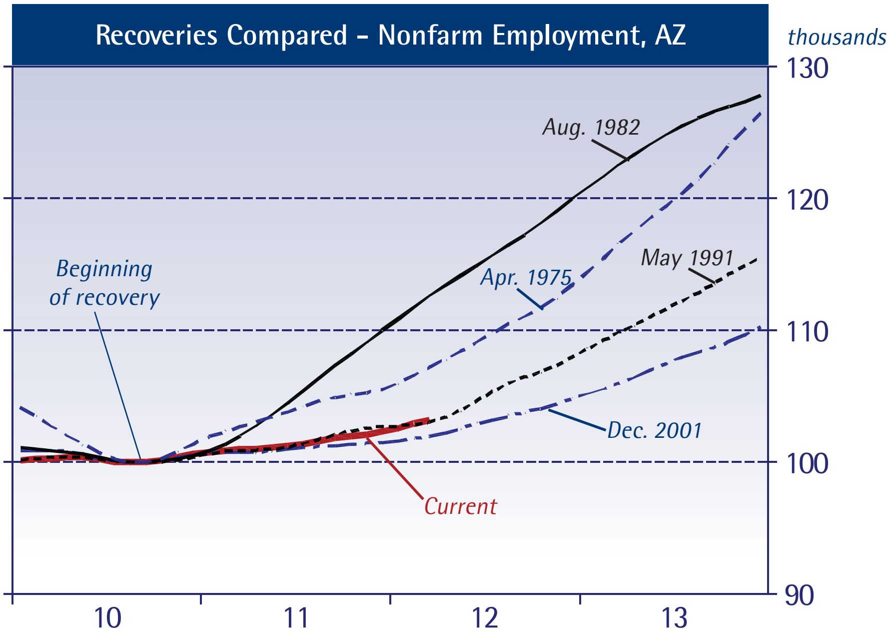
Jobs Recovery Takes the Low Road

Nonfarm employment continues to recover slowly, albeit at a slightly faster pace. Gains for the first three months of 2012 measured 2.1% statewide, year-on-year. Since bottoming in August 2010, a little over 75,000 jobs have been created. That compares to the more than 300,000 jobs lost during the recession. Both numbers are calculated after seasonal patterns were removed.

How does this recovery compare to prior recoveries? The pace of the current recovery matches very closely the path of job creation following the 1990-91 recession. Exhibit 1 superimposes four prior episodes onto the current. Each is labeled with the month that recovery began.

In theory, deep recessions should be followed by rapid recoveries such as we saw in the mid-1970s and early 1980s. Even though the recent recession was much deeper than either of those, we are currently experiencing

Exhibit 1: Job Gains Remain Modest



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"By 2015, nonfarm jobs will once again match the all-time record high set prior to onset of recession at the end of 2007."

growth closely aligned with the shallow and short recessions of the past two decades. The period following the 2001 recession became known as the "jobless recovery."

We expect some 50,000 jobs to be added this year and a like number in 2013. When residential construction resumes in 2014, job growth will accelerate to 70,000 followed by gains approaching 100,000 jobs the following year. By 2015, nonfarm jobs will once again match the all-time record high set prior to onset of recession at the end of 2007.

Where Have All the Workers Gone?

The proportion of the population who are employed has fallen to levels not seen in three decades. **Exhibit 2** shows a crude measure of the labor force participation rate – simply the ratio of the number of employed to total population. In Arizona, that ratio now stands at 0.375, the lowest since the mid-1980s. This ratio peaked in 2000, fell in the aftermath of the 2001 recession, recovered somewhat, and then fell precipitously during the Great Recession. Arizona mirrors the national ratio and consistently runs four to five percent lower.

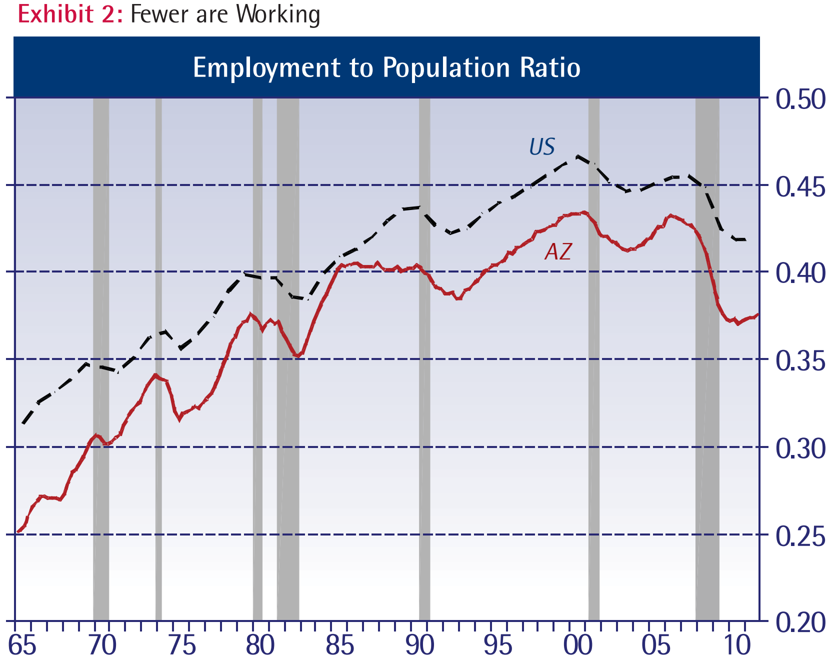
The question is "what happened to the workers?" Is the explanation that baby-boomers are retiring and younger workers are choosing to stay in school? Or have a large number of workers simply dropped out of the labor force, either temporarily or permanently? If temporarily, then as jobs are created going forward, these discouraged workers will reenter the labor force. That's a good thing. Although their reentry will tend to keep the unemployment rate high, it's better than adding to the ranks of the long-term unemployed and disabled roles – workers that are lost for good.

If workers don't return, that will limit the potential for the economy to grow, since labor is an important component (in addition to capital and productivity gains). The unemployment rate is high today, but in the not-to-distant future we could experience labor shortages (especially in many knowledge and skill occupations).

We expect the employment-to-population ratio to move higher but remain well below the peak at the turn of the century.

"The unemployment rate is high today, but in the not-to-distant future we could experience labor shortages"

Exhibit 2: Fewer are Working



Arizona's Housing Market Shows Signs of Life

Housing prices across the state have finally turned the corner and are headed upward. As expected, market psychology has changed dramatically, resulting in a bit of frenzy once again. Some industry analysts warn that home prices are about to explode by noting the shortage of properties available for sale, multiple offers on newly listed properties, and properties selling above asking prices. The frenzy is reportedly driven (largely) by investors who have sensed that prices have bottomed and that now is the time to jump in with both feet before it's too late. Likewise for buyers who intend to occupy their newly-purchased home. Real estate investment trusts (REITs) also are reportedly buying properties for renting.

Housing prices are indeed moving upward at a fast clip, but the magnitude depends on the measure used. Realtor data shows the largest gains. In metro Phoenix, the median value of homes sold on the MLS jumped at a 32% annual rate over the past 9 months! The bottom was reached in June of last year. (In metro Tucson, the increase is 15% over the past six months.) By contrast, the Standard and Poor's Case-Shiller index, which measures repeat sales and thereby controls for the changing mix of properties sold, shows a more modest increase for Phoenix of 9.5% expressed as an annual rate since bottoming 5 months ago. Case-Shiller data is not available for Tucson. Exhibit 3 puts these increases in perspective.

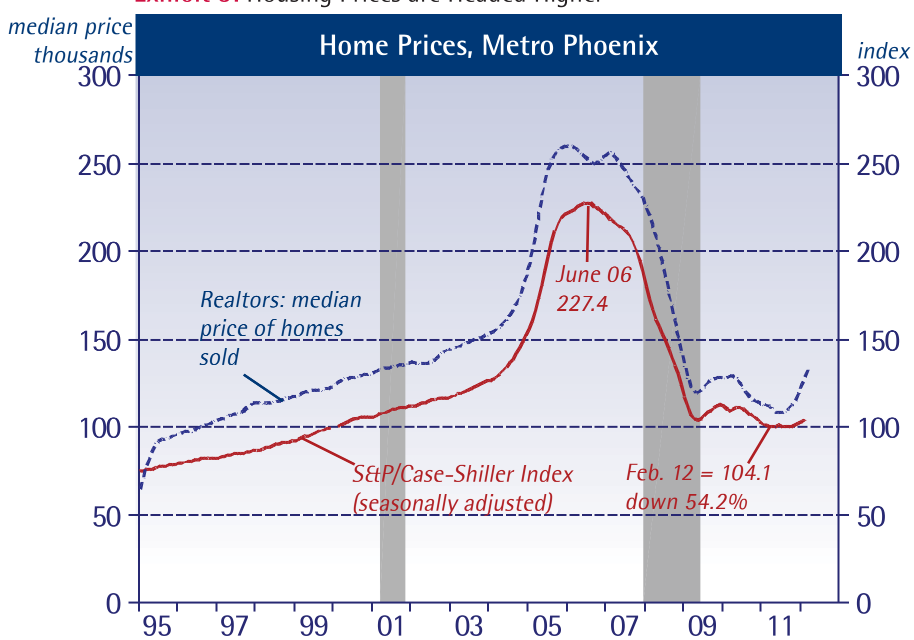
After being cut in half during the past 5 years, prices remain well below trend and have a lot of catching up to do. But numerous questions cloud the outlook. How sustainable is the price support from investors? Given still-tight credit conditions for mortgages and with heated competition from cash buyers, what is the effective demand from potential homeowners? When will population mobility and migration flows resume? On the supply side, how much "shadow inventory" will be marketed as prices increase?

In short, housing markets are still far from "normal." But progress is being made in reducing the inventory of distressed sales, foreclosures are receding, and homeowner equity positions are improving. The upward movement in prices is indeed a welcome development that marks the start of a return to normalcy.

"The upward movement in prices is indeed a welcome development that marks the start of a return to normalcy."

Alamy

Exhibit 3: Housing Prices are Headed Higher



Hispanics Account for the Large Decline in Births

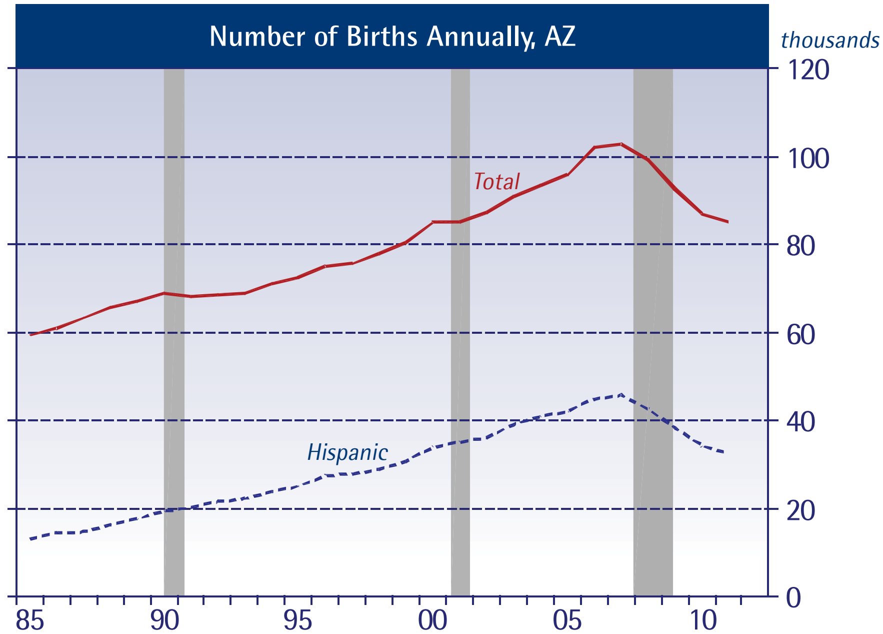
One of the most striking developments during the Great Recession was the unprecedented decline in the number of births in Arizona. After peaking in October 2007, just before the economy began its steep decline, total seasonally-adjusted births fell by 18.1% before bottoming in May 2011. Since then, with data through February, births have increased by almost 1.5%. That's one more indicator that economic conditions are finally improving.

The bad economy was most certainly a factor as families postponed having children. But the decline was much more pronounced than in prior recessions. Another possibility is that women of child-bearing age left the state. Again, the job losses suffered during the recession were no doubt a factor, along with Arizona's crackdown on illegal immigration capped by the infamous SB1070.

This is particularly relevant since Hispanic birth rates are much higher than non-Hispanics. Data from the 2010 Census show that Hispanic women give birth to 2.4 babies on average compared to 1.8 for non-Hispanic whites. Add to that the fact that Hispanic women are younger and still in child-bearing ages. During the middle of the past decade, Hispanics accounted for over 44% of total births statewide, although they comprised only 30% of the total population. In 2011, Hispanics' share of total births fell to 38.1%.

Using annual data, the number of Hispanic births fell 29.2% from 2007 to 2011, while non-Hispanic births fell only 7.7%. All this suggests that many Hispanic families have left the state in recent years (**Exhibit 5**).

Exhibit 4: Hispanics Account for Falling Births



The Outlook

Recent news on the U.S. economy has been disappointing and raises the specter of a summer slowdown, much like last year. Employment gains have been weak, consumer confidence has moved lower, the stock market gave up all its gains for the year during May, and Euro zone troubles worsened. These recent developments are in addition to a long list of factors that are restraining growth. The list includes tight credit, ongoing deleveraging, housing market woes, reduced mobility of the population, and the drag from public sector spending.

Our forecasts for Arizona call for continued slow growth for the remainder of this year and next followed by cautious acceleration as migration flows improve and construction begins to move up. Historically, deep recessions have been followed by rapid recoveries. But recessions involving financial meltdowns take much longer. We still expect it to be mid-decade before all the damage from the Great Recession is repaired.

"Our forecasts for Arizona call for continued slow growth for the remainder of this year and next followed by cautious acceleration ....."

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The Forecasting Project is a community-sponsored research unit within the Economic and Business Research Center producing quarterly economic forecasts for Arizona and its metro areas. These forecasts are recognized as among the most accurate in the Western states.

Forecast Tables

Arizona	2012	2013	2014	2015	2016
Personal Income ($mill)	243,396.8	254,807.4	269,343.7	286,809.8	306,500.9
% change	4.6	4.7	5.7	6.5	6.9
Retail Sales ($mill)	82,908.8	87,026.0	91,927.5	98,217.6	105,149.4
% change	6.7	5.0	5.6	6.8	7.1
Nonfarm Employment (000s)	2,458.2	2,511.0	2,581.4	2,679.2	2,785.5
% change	2.0	2.1	2.8	3.8	4.0
Population (000s)	6,480.6	6,535.3	6,615.0	6,725.0	6,856.9
% change	0.7	0.8	1.2	1.7	2.0
Residential Permits (units)	17,165.0	22,706.0	33,162.0	45,859.0	54,746.0
% change	28.2	32.3	46.1	38.3	19.4

Phoenix-Mesa MSA	2012	2013	2014	2015	2016
Personal Income ($mill)	165,356.0	172,473.0	181,797.0	192,763.0	206,005.0
% change	4.0	4.0	5.0	6.0	7.0
Retail Sales ($mill)	56,761.0	59,485.0	62,995.0	66,745.0	71,327.0
% change	6.0	5.0	6.0	6.0	7.0
Nonfarm Employment (000s)	1,752.0	1,789.0	1,839.0	1,900.0	1,973.0
% change	2.0	2.0	3.0	3.0	4.0
Population (000s)	4,260.0	4,293.0	4,345.0	4,414.0	4,502.0
% change	1.0	1.0	1.0	2.0	2.0
Residential Permits (units)	12,079.0	13,591.0	21,456.0	28,841.0	36,558.0
% change	33.0	13.0	58.0	34.0	27.0

Tucson MSA	2012	2013	2014	2015	2016
Personal Income ($mill)	37,019.0	38,592.0	40,767.0	43,130.0	45,772.0
% change	3.0	4.0	6.0	6.0	6.0
Retail Sales ($mill)	12,146.0	12,598.0	13,024.0	13,527.0	14,137.0
% change	6.0	4.0	3.0	4.0	5.0
Nonfarm Employment (000s)	356.0	361.0	369.0	380.0	390.0
% change	1.0	1.0	2.0	3.0	3.0
Population (000s)	991.0	1,000.0	1,014.0	1,030.0	1,048.0
% change	1.0	1.0	1.0	2.0	2.0
Residential Permits (units)	2,662.0	3,877.0	5,138.0	6,379.0	6,863.0
% change	19.0	46.0	33.0	24.0	8.0

Arizona Economic Indicators

% change versus year ago for:

	NOV 2011	DEC 2011	JAN 2012	FEB 2012	MAR 2012	most recent mo.	most recent 12-mo.
Civilian Labor Force (000s) ADES	3,019.4	3,014.0	2,981.4	3,009.0	3,010.0	-1.2	-2.0
Employment	2,757.7	2,750.1	2,718.3	2,747.2	2,756.1	-0.1	-0.9
Unemployment	261.6	263.9	263.1	261.8	253.9	-11.9	-11.8
Unemployment Rate, Seas. Adj. (%)	9.1	9.0	8.7	8.7	8.6	-14.6	-10.1
Employees on Non Farm Payrolls (000s) ADES							
Total Non Farm	2,455.1	2,456.0	2,420.8	2,447.2	2,466.1	2.3	1.5
Natural Resources and Mining	11.5	11.6	11.3	11.3	11.4	-0.9	3.1
Construction	111.1	110.0	109.8	108.5	112.3	4.1	1.1
Durable Goods Manufacturing	118.5	116.8	116.7	117.3	117.6	0.7	...
Fabricated Metal Products	16.3	16.3	16.3	16.5	16.4	4.8	5.7
Computer and Electronic Products	37.6	37.6	37.5	37.6	38.1	1.6	1.1
Aerospace Products and Parts	26.5	26.5	26.6	26.4	26.5	-0.1	-2.2
Non-Durable Goods Manufacturing	32.4	32.6	32.6	32.8	32.8	2.9	1.7
Wholesale Trade	96.1	97.4	96.4	96.2	96.2	0.6	0.9
Retail Trade	306.3	306.4	297.6	294.7	295.3	1.5	1.4
Utilities	12.0	12.3	12.1	12.0	12.0	-0.3	0.1
Transportation and Warehousing	71.2	71.7	69.5	70.0	71.1	1.0	2.5
Information	36.8	37.7	37.0	36.6	36.8	1.2	1.3
Finance and Insurance	125.5	127.2	124.9	125.1	125.3	3.2	3.5
Real Estate, Rental, and Leasing	44.8	45.8	44.9	45.2	46.6	4.7	0.7
Professional and Business Services	353.7	357.7	352.4	357.4	359.1	4.0	2.5
Educational Services	56.7	56.3	54.3	54.8	54.6	-1.6	...
Healthcare and Social Assistance	305.1	305.9	305.1	306.7	307.5	3.5	2.9
Leisure and Hospitality	258.7	260.4	258.3	265.9	273.6	4.0	2.3
Other Services	87.4	86.2	85.1	86.2	86.9	-2.5	-0.8
Federal Government	56.1	56.2	55.5	55.4	55.9	-1.2	-5.1
State and Local Government	370.7	363.4	356.9	371.4	370.6	1.4	-0.1
Education	209.8	202.3	195.4	209.9	209.6	3.6	1.0
Hours Worked Per Week, Mfg, ADES	...	...	...	...	...	0.5	2.4
Average Hourly Earnings ($) ADES							
Construction	19.7	20.1	20.0	19.9	...	-2.4	0.7
Manufacturing	17.9	18.3	18.2	18.2	...	6.1	4.8
Trade, Transportation & Utilities	15.9	15.4	15.9	16.0	...	-0.9	-1.3
Retail Trade	13.4	13.0	13.4	13.5	...	-2.7	-2.9
Wholesale Trade	23.5	23.0	23.3	23.1	...	1.9	1.0
Sales ($000s) ADOR							
Aggregate Retail Sales	6,548,489	7,786,229	6,348,013	6,753,385	...	7.1	9.0
New Housing Units Authorized, Census C-40							
Total Units	1,159	1,025	1,204	2,184	1,374	10.7	30.9
Single Family Units	740	811	894	1,206	1,237	18.5	17.3
2-4 Unit Structures	14	150	51	10	23	...	144.5
5-plus Unit Structures	405	64	864	968	114	-42.1	144.4

Phoenix-Mesa-Scottsdale MSA Economic Indicators

% change versus year ago for:

	NOV 2011	DEC 2011	JAN 2012	FEB 2012	MAR 2012	most recent mo.	most recent 12-mo.
Civilian Labor Force (000s) ADES	2,123.1	2,127.9	2,007.2	2,046.4	2,027.1	-5.0	-1.3
Employment	1,960.5	1,960.8	1,848.4	1,889.1	1,873.5	-3.9	-0.3
Unemployment	162.6	167.1	158.8	157.4	153.6	-17.2	-11.5
Unemployment Rate, Seas. Adj. (%)	7.9	8.0	7.6	7.6	7.5	-17.1	-11.0
Employees on Non Farm Payrolls (000s) ADES							
Total Non Farm	1,755.3	1,759.4	1,732.5	1,749.8	1,764.5	2.9	2.1
Natural Resources and Mining	3.3	3.3	3.2	3.2	3.2	1.0	5.1
Construction	83.2	82.0	81.7	81.1	84.1	5.0	2.4
Durable Goods Manufacturing	88.3	87.2	87.4	87.8	87.8	1.5	1.6
Computer and Electronic Products	35.0	35.1	34.7	34.8	35.3	2.4	1.8
Aerospace Products and Parts	14.6	14.7	14.7	14.5	14.6	1.2	-0.4
Non-Durable Goods Manufacturing	25.1	25.2	24.8	25.0	25.0	1.0	1.0
Wholesale trade	80.8	82.2	82.0	81.4	81.1	1.3	1.5
Retail Trade	220.2	220.7	212.6	209.9	210.7	2.7	2.3
Utilities	8.2	8.1	8.1	8.1	8.1	-1.0	-0.6
Transportation and Warehousing	54.1	53.9	53.2	53.1	53.7	1.0	2.8
Information	28.0	28.7	28.0	28.2	28.3	1.6	2.1
Finance and Insurance	108.3	109.8	107.6	108.0	108.3	3.3	3.7
Real Estate, Rental, and Leasing	35.5	36.2	35.7	35.9	36.8	5.0	1.9
Professional and Business Services	285.6	289.7	283.1	286.4	288.0	4.5	3.1
Educational Services	46.4	46.8	45.5	46.2	46.2	3.3	3.9
Healthcare and Social Assistance	205.7	207.0	206.2	207.7	208.1	3.7	3.3
Leisure and Hospitality	178.7	180.1	178.9	183.8	190.9	5.0	2.8
Other Services	63.7	62.3	61.9	63.3	63.6	-2.0	-0.4
Federal Government	21.7	21.8	21.6	21.6	21.6	-2.3	-8.2
State and Local Government	217.1	219.0	211.4	...	...	-0.4	-1.1
Education	121.3	123.4	114.8	...	...	0.9	-1.0
Sales ($000s) ADOR							
Aggregate Retail Sales	4,495,341	5,426,385	4,366,247	4,618,591	...	6.7	9.0
New Housing Units Authorized, Census C-40							
Total Units	909	573	676	1,566	997	12.4	50.7
Single Family Units	527	573	673	900	927	29.5	29.7
2-4 Unit Structures	14	0	3	8	15	...	11.6
5-plus Unit Structures	368	0	0	658	55	-67.8	248.4
Housing Sales and Prices, ARMLS							
Total Sales (millions)	1,061	1,176	973	1,207	1,477	2.9	3.2
Total Units	6,381	6,954	5,738	7,249	7,843	-9.6	6.6
Average Price ($)	166,199	169,054	169,648	166,567	188,372	13.8	-2.8

Tucson MSA Economic Indicators

	NOV 2011	DEC 2011	JAN 2012	FEB 2012	MAR 2012	% change versus year ago for: most recent mo.	most recent 12-mo.
Civilian Labor Force (000s) ADES	487.9	486.3	458.5	469.0	462.5	-6.0	-1.8
Employment	450.8	448.0	422.4	432.9	427.1	-5.1	-0.9
Unemployment	37.1	38.3	36.1	36.1	35.4	-15.3	-10.8
Unemployment Rate, Seas. Adj. (%)	7.8	8.1	7.6	7.7	7.7	-14.8	-9.7
Employees on Non Farm Payrolls (000s) ADES							
Total Non Farm	358.0	355.6	351.7	355.1	354.4	-0.7	-0.2
Natural Resources and Mining	1.9	1.9	1.9	1.9	1.9	-2.3	-0.2
Construction	15.0	14.8	14.9	14.7	15.3	3.4	-0.9
Manufacturing	23.2	23.2	23.0	23.1	23.1	-0.8	-1.8
Aerospace Products and Parts	11.6	11.6	11.6	11.5	11.5	-2.5	-3.8
Wholesale Trade	8.0	8.0	7.7	7.7	7.7	-0.9	0.0
Retail Trade	39.1	39.3	38.9	38.9	38.6	-2.1	-1.3
Transportation, Warehousing, and Utilities	9.5	9.4	9.3	9.3	9.3	-0.4	4.4
Information	4.2	4.2	4.1	4.1	4.0	-2.6	-2.0
Financial Activities	17.4	17.5	17.4	17.4	17.5	0.7	-0.8
Professional and Business Services	46.5	46.3	45.8	46.0	45.6	-1.6	0.6
Educational and Health Services	60.4	59.9	59.5	59.2	59.0	0.0	1.6
Leisure and Hospitality	38.5	38.4	38.5	39.2	38.8	-2.2	1.0
Accomodation	6.2	6.0	5.9	6.2	6.2	-6.2	-3.6
Food Services and Drinking Places	27.9	28.1	27.8	28.5	29.2	2.0	2.5
Other Service Providing	14.1	14.1	13.8	14.0	14.1	-3.0	-1.2
Federal Government	12.6	12.6	12.6	12.6	12.6	0.8	-1.9
State and Local Government	67.6	66.1	64.4	67.0	65.3	-2.4	-1.9
State and Local Government Education	43.9	42.6	41.5	43.9	43.9	1.4	-0.6
Sales ($000s) ADOR							
Aggregate Retail Sales	984,009	1,149,403	931,201	1,041,017	...	11.6	8.6
New Housing Units Authorized, Census C-40							
Total Units	102	139	113	173	229	17.4	-25.0
Single Family Units	100	138	113	147	182	7.7	-5.4
2-4 Unit Structures	0	0	0	2	0	...	-20.0
5-plus Unit Structures	2	1	0	24	47	80.8	-76.8
Housing Sales and Prices, TAR							
Total Sales ($000s)	160,810	155,173	143,709	167,639	233,229	22.0	2.8
Total Units	1,015	961	915	1,019	1,387	18.6	15.5
Average Price ($)	158,434	161,471	157,059	164,513	168,153	2.8	-11.1

DATA TABLES: SOURCES AND ABBREVIATIONS

ADHS: Arizona Department of Health Services
ADOD: Arizona Department of Administration, Office of Employment and Population Statistics
ADOR: Arizona Department of Revenue
ADOT: Arizona Department of Transportation
ARMLS: Arizona Regional Multiple Listing Service
ASPB: Arizona State Parks Board
BEA: Bureau of Economic Analysis, U.S. Department of Commerce
BLS: Bureau of Labor Statistics, U.S. Department of Labor
Census C-40: U.S. Census Bureau, U.S. Department of Commerce
EBR: Economic & Business Research Center, The University of Arizona
Micropolitan SA: Micropolitan Statistical Area must have at least one urban cluster of at least 10,000, but less than 50,000 inhabitants.
MSA: Metropolitan Statistical Area must have at least one core urbanized area of 50,000 or more inhabitants.
PSHIA: Phoenix Sky Harbor International Airport
SAAR: Seasonally adjusted at annual rates
TAR: Tucson Association of Realtors
U.S. Bankruptcy Court: District of Arizona
USCBP: U.S. Customs and Border Protection, U.S. Dept. of Homeland Security.

* All Aggregate Retail Sales figures reported by EBR include retail, food, restaurant & bars and gasoline sales.

Source: Economic and Business Research Center, Eller College of Management, The University of Arizona.

ARIZONA'S ECONOMY

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