

ARIZONA'S ECONOMY

ECONOMIC AND BUSINESS RESEARCH CENTER

The Future is A Lot Like the Present, Only Longer -- Yogi Berra

By Marshall J. Vest, Forecasting Project Director

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Arizona's economy continued enjoying modest improvement during the final quarter of 2011. Preliminary readings for the first quarter are unspectacular, but we expect the pace to quicken as 2012 progresses. However, that doesn't mean that Arizona's economy will overheat any time soon. Imbalances in real estate, depressed population mobility, and severe budget constraints in the public sector will continue to exert a drag on the pace of recovery.

It has been nearly two years since the 2010 Census was conducted, and only now are the results for population growth and changing demographics coming into focus. Analysts have agreed, once again, that population estimates produced by Arizona's state demographer are far superior to those of the U.S. Census Bureau. In deriving the annual estimates between the two decennial census years, the state demographer incorporated results from the mid-decade special census, conducted in many communities across Arizona. The

Census did not. As a result, the state demographer's estimates appropriately show more growth early in the decade and a flatter pattern during the recession.

Using the preferred set, annual population increased statewide, approaching 200,000 during 2005-06, but fell to only 20,500 in 2009 and 12,500 in 2010. Newly-released estimates for 2011 show improvement with a (still depressed) 36,600 gain. We expect a gradual upward climb with the annual gain topping out at 135,000 by 2016 (**Exhibit 1**).

During the recession, natural increase slowed significantly, due to a precipitous decline in births. In 2007, natural increase added 58,400 (births numbered 103,000 while deaths were 44,600). In 2011, the

corresponding numbers were 38,300, 85,500, and 47,200, respectively.

Net migration, by far the largest and most volatile component of population dynamics, dove into deeply negative territory during the recession. From an increase of nearly 150,000 net in 2005, migration flows turned negative in 2009-2010, with annual losses of near 32,000. The 2011 estimate shows recovery of net migration to very near zero. We expect little improvement this year or next, as potential in-migrants from other states remain locked in their homes due to negative equity positions. By 2017, we project net migration to approach 95,000 per year, a level close to long-term averages (**Exhibit 2**).

Exhibit 1: Population Gain by Component, Arizona, 2000 - 2011 (000s)

	Population	Annual Growth Rate (%)	Change	Net Migration	Natural Increase
2000	5,175.6	3.0%	151.8	108.7	43.1
2001	5,287.5	2.2%	111.9	67.2	44.7
2002	5,411.2	2.3%	123.7	79.8	43.8
2003	5,554.2	2.6%	143.0	95.9	47.2
2004	5,725.6	3.1%	171.4	122.6	48.8
2005	5,924.5	3.5%	198.9	147.7	51.2
2006	6,116.4	3.2%	191.9	139.5	52.5
2007	6,275.0	2.6%	158.6	100.1	58.4
2008	6,368.6	1.5%	93.6	37.4	56.3
2009	6,389.1	0.3%	20.5	-31.8	52.2
2010	6,401.6	0.2%	12.5	-31.9	44.3
2011	6,438.2	0.6%	36.6	-1.7	38.3

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“Since bottoming in August 2010, roughly 36,000 net new jobs have been created.”



Recent Evidence

Nonfarm employment statewide continued its slow upward march during the fourth quarter. Since bottoming in August 2010, roughly 36,000 net new jobs have been created. That compares to a (seasonally-adjusted) loss of nearly 310,000 during the recession.

Though recent gains remain small, every industry segment with the exception of “State & Local Government, Excluding Education” is higher than its respective low.

Arizona's unemployment rate finished the year at 8.7%, compared to 8.5% nationwide. One year earlier, unemployment measured nearly a point higher at 9.6%.

Retail sales statewide grew by nearly 9% in 2011, the largest increase since 2005's gain of 13.4%. However, year-on-year increases slowed as 2011 came to an end, with a gain of only 4.9% in November and 3.5% in December. History shows that after a big increase (largely driven by the satisfaction of pent-up demand), gains the following year are significantly lower. We're expecting an increase of roughly 4.5% this year, which is more commensurate with gains in personal income.

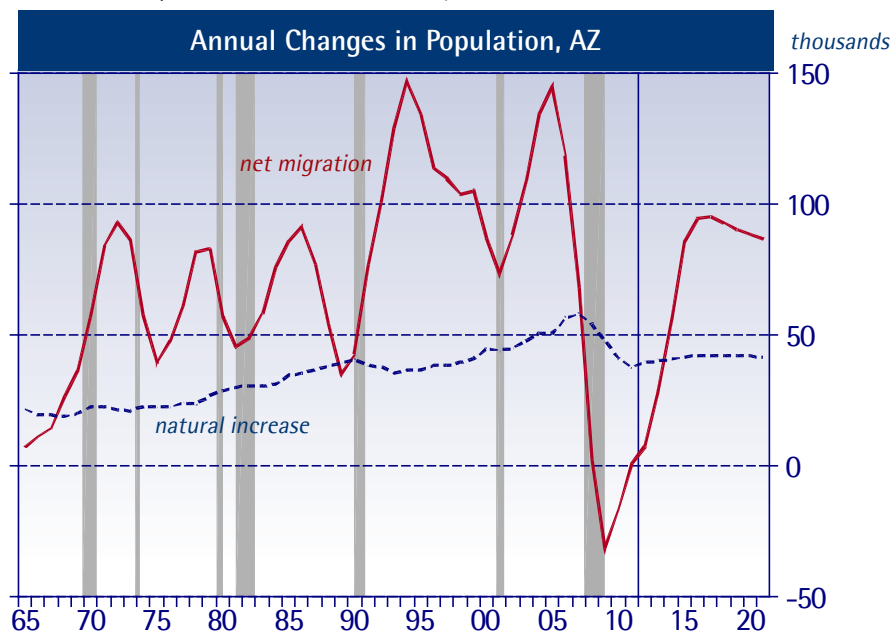
Wages have been trending upward since the recession ended and recent gains are the strongest since 2006. Using QCEW data through 2011Q2, private sector wages have increased 3.0% over the past year. The prior quarter showed an even stronger gain of 5.4%, reflecting a resumption of year-end bonuses in industries such as mining (up 19.1%), air transportation (up 16.5%), finance (up 12.9%), manufacturing (up 11.2%), accommodations (up 8.9%), and utilities (up 6.6%). See **Exhibit 3**.

Arizona's housing markets showed a glimmer of hope with release of the Federal Housing Finance Agency's (FHFA) housing price index for 2011Q4. That index for the metro Phoenix area has now increased for two consecutive quarters in a row, gaining 2.1% in the third and 2.7% in the fourth quarter, quarter-on-quarter. This index includes purchases and refinanced mortgages. The purchases-only portion rose by an outsized 7.01% in the fourth quarter, which was far and away the largest increase among the 25 largest metros (**Exhibit 4**).

Metro Tucson's price index rose 1.1% in the fourth quarter, its first gain since 2007. The Prescott MSA saw a gain of 2.87%, nearly identical to metro Phoenix.

“Arizona's unemployment rate finished the year at 8.7%. One year earlier, unemployment measured nearly a point higher at 9.6%.”

Exhibit 2: Population Growth Will Slowly Return to Normal



Prices in both Flagstaff (-2.07%) and Yuma (-0.54%) continued to decline in the fourth quarter.

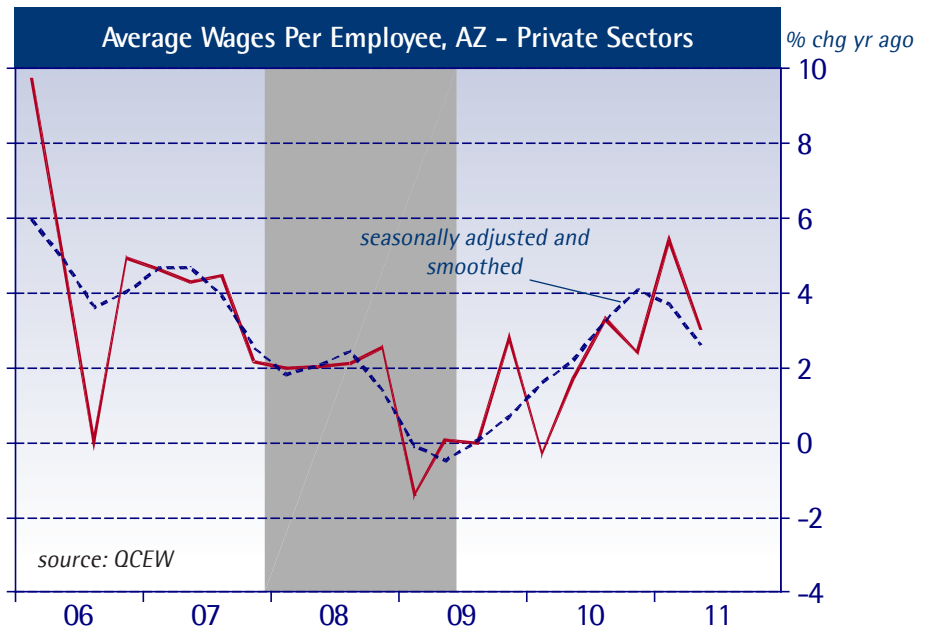
It's still a bit early to call the bottom in housing prices, and a few more quarters will be needed to ensure that the upward trend doesn't reverse direction. Moreover, prices are still declining in Los Angeles, San Diego and Las Vegas. Changes in these areas have historically preceded changes in Arizona housing markets. It is encouraging that prices increased during the 4th quarter in Albuquerque, Austin, Colorado Springs, Dallas, Denver, Santa Fe, Salt Lake City, and Riverside. This provides some assurance that the gains locally are not an anomaly. Once prices convincingly turn upward, market psychology will change for the better and the healing process will accelerate.

The Outlook

The recovery remains in its infancy and it will take years to repair the damage to the Arizona economy suffered during the Great Recession.

Government spending remains a drag on growth and poses huge risks to the economy if policy mistakes are not avoided. Fiscal policy is tightening and will subtract as much

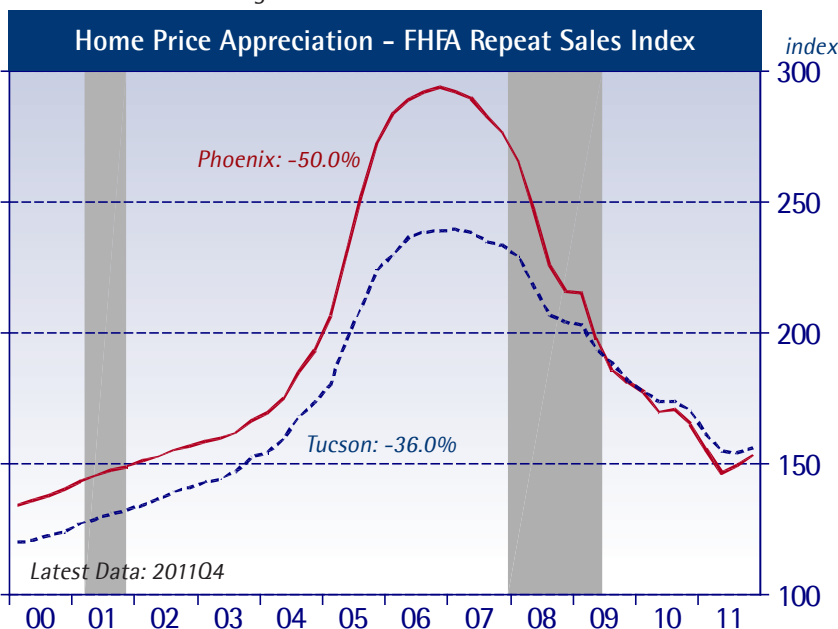
Exhibit 3: Wage Gains are Improving



as 2.5% from GDP growth in 2013 unless Congress addresses automatic spending cuts triggered by failure of the "Budget Super Committee," as well as expiration of the Bush tax cuts, AMT fixes, payroll tax cut, and emergency unemployment insurance. All expire January 1, 2013.

Nationwide, six million homeowners are delinquent and the new program allowing

Exhibit 4: Have Housing Prices Bottomed?



“Wages have been trending upward since the recession ended and private sector wages have increased 3.0% over the past year.”



“The good news is that credit is growing again....Consumer confidence is improving and Europe is making progress on addressing financial distress related to sovereign debt and banking systems”

certain underwater homeowners to refinance provides only \$25 billion, compared to an estimated \$700 billion in negative equity. Although positive, it looks to be too little and too late.

Commercial real estate markets are also distressed. Nationwide, CRE prices are moving sideways and are down 40% from the peak, while half of the \$1.4 trillion CRE loans that need to be refinanced over the next three years are under water.

The good news is that credit is growing once again as measured by bank commercial and industrial loans. Consumer confidence is improving (although still low) and Europe

is making progress on addressing financial distress related to sovereign debt and banking systems. All things considered, the risk of recession for the U.S. now stands at 25%, down considerably from last summer when the odds were even.

We continue to look for another year or two of slow recovery for the Arizona economy. We expect job growth running at less than 2% this year and next, personal income growth of 4% or so annually, and population growth remaining below 1%. By mid-decade, we can expect employment growth to rebound to 4%, population to 2.0% and personal income to 7.0%.

“All things considered, the risk of recession for the U.S. now stands at 25%, down from last summer when the odds were even.”



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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	2013	2014	2015	2016	2017
Personal Income (\$mill)	251,629.3	266,276.4	284,437.2	304,560.1	324,714.3
% change	4.0	5.8	6.8	7.1	6.6
Retail Sales (\$mill)	85,892.8	90,767.0	97,278.5	104,136.8	109,711.9
% change	5.5	5.7	7.2	7.1	5.4
Nonfarm Employment (000s)	2,490.4	2,562.4	2,662.7	2,772.5	2,875.6
% change	2.0	2.9	3.9	4.1	3.7
Population (000s)	6,536.6	6,618.5	6,731.6	6,866.4	7,004.2
% change	0.9	1.3	1.7	2.0	2.0
Residential Permits (units)	23,353.0	34,795.0	48,060.0	56,911.0	58,522.0
% change	35.3	49.0	38.1	18.4	2.8

Phoenix-Mesa MSA	2013	2014	2015	2016	2017
Personal Income (\$mill)	171,284.0	181,328.0	193,926.0	209,050.0	224,791.0
% change	4.0	6.0	7.0	8.0	8.0
Retail Sales (\$mill)	58,806.0	62,927.0	67,496.0	72,740.0	76,709.0
% change	5.0	7.0	7.0	8.0	5.0
Nonfarm Employment (000s)	1,764.0	1,821.0	1,897.0	1,990.0	2,081.0
% change	2.0	3.0	4.0	5.0	5.0
Population (000s)	4,308.0	4,381.0	4,474.0	4,588.0	4,705.0
% change	1.0	2.0	2.0	3.0	3.0
Residential Permits (units)	16,302.0	27,340.0	37,626.0	47,553.0	48,946.0
% change	32.0	68.0	38.0	26.0	3.0

Tucson MSA	2013	2014	2015	2016	2017
Personal Income (\$mill)	39,276.0	41,569.0	44,229.0	47,070.0	49,735.0
% change	4.0	6.0	6.0	6.0	6.0
Retail Sales (\$mill)	12,326.0	12,838.0	13,504.0	14,156.0	14,681.0
% change	4.0	4.0	5.0	5.0	4.0
Nonfarm Employment (000s)	362.0	371.0	383.0	394.0	403.0
% change	1.0	2.0	3.0	3.0	2.0
Population (000s)	1,004.0	1,019.0	1,037.0	1,057.0	1,076.0
% change	1.0	2.0	2.0	2.0	2.0
Residential Permits (units)	4,646.0	6,283.0	7,320.0	7,574.0	7,508.0
% change	36.0	35.0	17.0	3.0	-1.0

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 Economic Indicators

Arizona Monthly Data	% change versus year ago for:							
	AUG	SEP	OCT	NOV	DEC	most	most	
	2011	2011	2011	2011	2011	recent mo.	recent 12-mo.	
Civilian Labor Force (000s) ADES	3,159.8	3,159.9	3,171.4	3,159.7	3,158.8	-0.2	-0.3	
Employment	2,863.1	2,878.7	2,889.4	2,893.4	2,885.6	0.4	0.6	
Unemployment	296.7	281.3	281.9	266.3	273.3	-6.6	-7.8	
Unemployment Rate, Seas. Adj. (%)	9.3	9.1	9.0	8.7	8.7	-9.4	-7.3	
Employees on Non Farm Payrolls (000s) ADES								
Total Non Farm	2,383.7	2,412.6	2,432.0	2,442.7	2,439.7	0.8	0.8	
Natural Resources and Mining	12.4	12.2	12.4	12.4	12.5	9.6	11.3	
Construction	113.1	115.3	117.6	112.1	110.0	0.3	-0.4	
Durable Goods Manufacturing	115.7	115.8	117.3	116.9	116.2	0.4	...	
Fabricated Metal Products	15.0	15.0	15.2	15.1	15.1	6.8	6.3	
Computer and Electronic Products	37.0	36.9	36.9	36.9	36.9	0.7	1.2	
Aerospace Products and Parts	28.3	28.4	28.4	28.5	28.5	-0.6	-2.5	
Non-Durable Goods Manufacturing	32.1	31.9	32.1	32.1	32.3	1.1	1.1	
Wholesale Trade	95.6	95.3	94.6	95.1	96.4	-1.9	-1.0	
Retail Trade	288.9	290.0	293.8	305.4	305.4	0.7	0.3	
Utilities	12.0	11.9	12.0	11.9	11.9	-0.4	-0.6	
Transportation and Warehousing	71.2	71.3	72.1	71.7	70.2	-2.7	4.4	
Information	36.8	36.3	36.4	36.7	37.3	0.9	-0.2	
Finance and Insurance	120.3	119.9	120.1	121.2	122.4	3.0	1.8	
Real Estate, Rental, and Leasing	43.1	42.7	43.1	43.2	44.1	-3.3	-2.9	
Professional and Business Services	338.4	338.9	342.6	345.3	349.3	-0.7	0.4	
Educational Services	52.9	56.5	56.7	56.9	56.2	1.9	...	
Healthcare and Social Assistance	300.4	300.8	303.7	303.9	303.4	2.9	2.8	
Leisure and Hospitality	255.8	257.6	258.7	256.6	259.1	2.2	2.0	
Other Services	92.2	91.4	91.6	91.1	89.8	0.4	3.1	
Federal Government	58.6	58.5	58.1	57.3	57.4	-0.3	-3.5	
State and Local Government	343.1	365.1	367.9	371.7	364.5	0.4	-0.7	
Education	178.8	203.1	206.8	210.5	203.3	1.1	0.5	
Hours Worked Per Week, Mfg, ADES	40.4	40.7	40.4	...	...	0.5	2.4	
Average Hourly Earnings (\$) ADES								
Construction	19.7	19.4	19.4	...	...	0.8	0.5	
Manufacturing	17.5	17.5	18.0	...	...	8.0	1.8	
Trade, Transportation & Utilities	15.8	15.9	16.2	...	...	0.4	-0.9	
Retail Trade	13.2	13.4	13.7	...	...	-1.5	-0.7	
Wholesale Trade	23.2	22.9	23.3	...	...	4.0	-0.6	
Sales (\$000s) ADOR								
Aggregate Retail Sales	6,155,107	6,294,987	6,178,677	6,545,017	...	7.1	9.4	
New Housing Units Authorized, Census C-40								
Total Units	1,439	1,199	943	1,159	1,025	26.7	5.9	
Single Family Units	1,040	984	789	740	811	28.5	-3.1	
2-4 Unit Structures	10	18	19	14	150	...	44.0	
5-plus Unit Structures	389	197	135	405	64	-64.0	66.9	

Arizona Economic Indicators

Phoenix-Mesa MSA Monthly Data	AUG 2011	SEP 2011	OCT 2011	NOV 2011	DEC 2011	% change versus year ago for:	
						most recent mo.	most recent 12-mo.
Civilian Labor Force (000s) ADES	2,115.2	2,119.1	2,128.2	2,123.1	2,127.9	0.1	0.0
Employment	1,936.8	1,948.6	1,956.7	1,960.5	1,960.8	0.9	0.9
Unemployment	178.4	170.5	171.5	162.6	167.1	-7.9	-9.1
Unemployment Rate, Seas. Adj. (%)	8.2	8.0	8.1	7.9	8.0	-8.0	-9.2
Employees on Non Farm Payrolls (000s) ADES							
Total Non Farm	1,695.2	1,716.8	1,731.3	1,738.4	1,739.3	0.8	1.2
Natural Resources and Mining	3.3	3.2	3.3	3.3	3.3	4.2	7.1
Construction	83.7	85.1	87.4	82.5	80.6	-0.4	-0.1
Durable Goods Manufacturing	86.1	86.2	87.3	86.8	86.3	1.2	0.5
Computer and Electronic Products	33.9	33.8	33.8	33.7	33.7	0.2	1.0
Aerospace Products and Parts	16.3	16.4	16.5	16.6	16.6	2.1	-0.7
Non-Durable Goods Manufacturing	25.0	24.8	24.9	24.9	24.9	-0.3	1.1
Wholesale trade	81.2	81.3	80.4	80.4	81.8	-0.9	-0.5
Retail Trade	203.9	204.0	207.7	217.1	217.5	0.6	0.3
Utilities	8.3	8.3	8.4	8.3	8.3	0.4	0.1
Transportation and Warehousing	55.1	55.8	55.9	55.9	55.9	0.1	4.3
Information	27.8	27.6	27.4	27.8	28.0	-0.6	0.3
Finance and Insurance	104.1	104.1	103.7	104.5	106.0	3.7	2.3
Real Estate, Rental, and Leasing	33.7	33.7	34.0	33.9	34.5	-3.8	-2.2
Professional and Business Services	268.3	267.6	270.6	273.0	277.2	-1.2	0.3
Educational Services	43.9	45.5	45.9	46.4	46.1	4.3	5.3
Healthcare and Social Assistance	202.7	205.5	206.7	205.6	205.8	3.4	3.4
Leisure and Hospitality	175.0	176.6	178.2	177.4	178.9	2.3	2.6
Other Services	68.0	67.7	68.1	67.6	65.6	0.0	4.3
Federal Government	22.5	22.4	22.5	22.2	22.3	-0.9	-6.9
State and Local Government	201.4	216.5	217.9	219.8	215.5	0.1	-0.7
Education	102.7	119.0	121.0	123.0	118.7	1.0	-0.5
Sales (\$000s) ADOR							
Aggregate Retail Sales	4,230,639	4,306,423	4,205,337	4,493,048	...	5.9	9.8
New Housing Units Authorized, Census C-40							
Total Units	1,126	912	667	909	573	23.8	14.6
Single Family Units	739	712	538	527	573	45.4	2.2
2-4 Unit Structures	4	14	15	14	0	...	-44.6
5-plus Unit Structures	383	186	114	368	0	-100.0	127.0
Housing Sales and Prices, ARMLS							
Total Sales (millions)	1,318	1,224	1,159	1,147	1,270	NA	NA
Total Units	8,712	7,892	7,563	7,146	7,840	NA	NA
Average Price (\$)	151,240	155,084	153,289	160,564	161,944	NA	NA

Arizona Economic Indicators

Tucson MSA Monthly Data	AUG 2011	SEP 2011	OCT 2011	NOV 2011	DEC 2011	% change versus year ago for:	
						most recent mo.	most recent 12-mo.
Civilian Labor Force (000s) ADES	485.5	487.6	489.6	487.9	486.3	-0.5	-0.7
Employment	444.6	448.7	450.8	450.8	448.0	0.1	0.1
Unemployment	40.9	38.9	38.8	37.1	38.3	-7.1	-8.5
Unemployment Rate, Seas. Adj. (%)	8.2	7.9	8.0	7.9	8.0	-6.7	-7.9
Employees on Non Farm Payrolls (000s) ADES							
Total Non Farm	352.4	358.3	359.6	361.2	358.8	0.0	0.3
Natural Resources and Mining	1.9	2.0	2.0	2.0	2.0	6.0	6.0
Construction	15.3	15.5	15.7	15.4	15.2	1.5	0.2
Manufacturing	23.5	24.2	24.4	24.5	24.3	3.7	-1.4
Aerospace Products and Parts	11.9	12.2	12.1	12.2	12.1	0.8	-2.2
Wholesale Trade	7.8	7.7	7.7	7.7	7.8	-1.6	-3.2
Retail Trade	39.6	39.5	38.7	39.3	39.4	-4.0	-0.7
Transportation, Warehousing, and Utilities	9.4	9.4	9.5	9.4	9.3	0.6	5.3
Information	4.2	4.2	4.1	4.2	4.2	0.0	-3.5
Financial Activities	17.4	17.3	17.4	17.5	17.6	-0.2	-1.3
Professional and Business Services	46.2	46.0	46.0	45.9	45.7	-3.8	0.3
Educational and Health Services	59.5	58.7	59.1	59.6	59.0	0.0	1.6
Leisure and Hospitality	37.6	40.1	40.6	40.4	40.7	6.8	3.3
Accommodation	6.3	6.3	6.4	6.3	6.3	-3.2	1.3
Food Services and Drinking Places	27.1	27.8	27.8	28.0	28.3	3.7	2.6
Other Service Providing	14.4	14.2	14.2	14.2	14.1	0.6	1.4
Federal Government	12.7	12.8	12.8	12.7	12.7	1.6	-1.2
State and Local Government	63.0	66.7	67.3	68.3	66.9	-1.0	-1.2
State and Local Government Education	39.3	43.2	43.7	44.6	43.4	-1.1	0.0
Sales (\$000s) ADOR							
Aggregate Retail Sales	924,884	933,219	925,140	983,457	...	11.2	7.6
New Housing Units Authorized, Census C-40							
Total Units	159	135	146	102	139	-19.2	-12.0
Single Family Units	153	128	125	100	138	1.5	-15.3
2-4 Unit Structures	0	2	0	0	0	...	-84.6
5-plus Unit Structures	6	5	21	2	1	-97.2	7.0
Housing Sales and Prices, TAR							
Total Sales (\$000s)	171,368	160,344	149,079	160,810	155,173	-8.2	-2.2
Total Units	1,106	1,064	982	1,015	961	6.0	13.2
Average Price (\$)	154,944	150,699	151,812	158,434	161,471	-13.4	-13.4

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