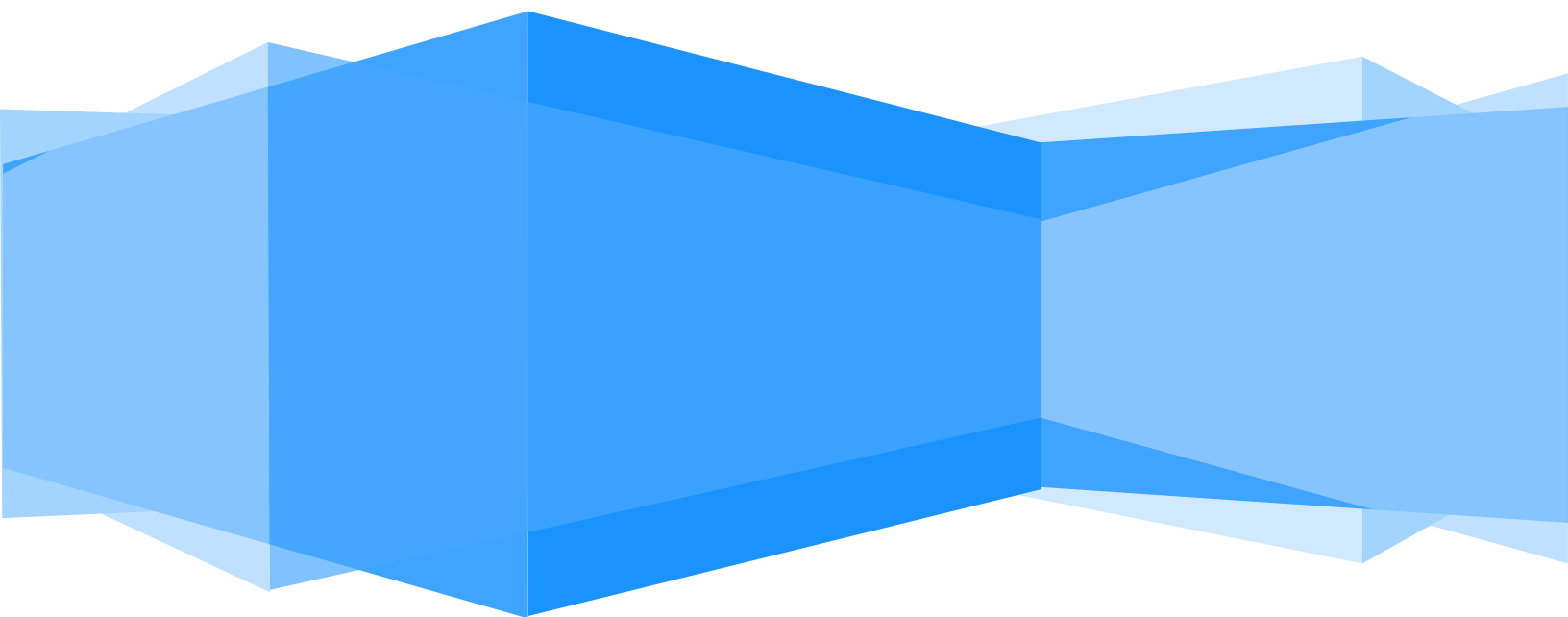




Economic Outlook

1st Quarter 2010 News



Economic Trends

Fed unconvinced recovery under way

Federal Reserve officials signaled the recovery isn't strong enough to stoke inflation, reduce unemployment quickly or justify an end to record-low interest rates. Recently central bankers retained a pledge to keep their benchmark rate "exceptionally low" for an "extended period," one year after first using the phrase. While the economy is improving, employers are still reluctant to hire, homebuilding is "depressed" and inflation will be "subdued for some time," the Federal Open Market Committee said in a statement after meeting in Washington.

Chairman Ben Bernanke and his colleagues are waiting for sustained increases in employment before starting to exit a record expansion of credit, said Charles Lieberman, chief investment officer at Advisors Capital Management in Hasbrouck Heights, N.J., and a former head of the monetary analysis staff at the New York Fed. "It's very difficult to make a strong case that the economy is in a self-sustaining recovery until we have job growth," said Lieberman.

The FOMC left the federal funds rate target for overnight loans between banks in a range of zero to 0.25 percent, where it's been since December 2008. Officials confirmed that their program to buy \$1.43 trillion of mortgage-related debt will be completed by the end of March. The Fed has repeated the "extended period" language at each meeting since March 2009.

Chicago Fed President Charles Evans said last week the phrase means to him three or four more FOMC meetings. The Fed has eight scheduled meetings a year. Recently, Fed officials added language to the statement saying, "housing starts have been flat at a depressed level." A Commerce Department report showed housing starts fell 5.9 percent in February, in part because of winter storms in the Northeast and South.

The end of Fed mortgage-debt purchases risks driving up mortgage rates, worsening the housing crisis, said Joseph Stiglitz, the Columbia University economist and Nobel laureate. "The withdrawal of the support risks increasing the interest rate, increasing the number of foreclosures and exacerbating the strain, the stress that American families are already facing," Stiglitz said in an interview on Tokyo. He said officials "misjudged things," and predicted foreclosures and bank failures this year will exceed the 2009 and 2008 totals.

The economy has lost 8.4 million jobs since the recession began in December 2007. Payroll declines have slowed to an average 27,000 a month from November through February, compared with an average 252,000 from July through October. The job market is "stabilizing," the Fed said, an upgrade from its January statement that the "deterioration in the labor market is abating" Unemployment in February was 9.7 percent, down from a 26-year high of 10.1 percent in October.

"The Fed is right to be cautious at this point," said former Fed Governor Lyle Gramley, now senior economic advisor at Potomac Research Group in Washington. Some analysts pushed back forecasts for an interest-rate increase. The median estimate of analysts surveyed by Bloomberg News this month is for an increase in November.

Existing home sales down by 0.6 percent

Sales of existing homes fell for a third straight month in February, pushing sales down to the lowest level since last July. There is concern the fragile housing rebound is faltering, making it harder for the overall economy to recover. The National Association of Realtors said that sales of previously occupied homes dropped 0.6 percent in February to a seasonally adjusted annual rate of 5.02 million.

The weakness in sales depressed prices with the median home price dropping almost 2 percent from a year ago to \$165,100. Sales activity varied across the country. In the Midwest, sales jumped almost 3 percent, and were up more than 2 percent in the Northeast. In the South, sales fell about 1 percent, and were down almost 5 percent in the West.

"A number of housing markets may be stabilizing or starting to rebound, though we do not yet see, in many respects, a sustained nationwide recovery," said Jeffrey Mezger, president and chief executive officer of KB Home, which builds homes in 10 states. In fact, sales nationally have been declining since November, eroding gains made over the summer. The downward direction troubled economists because the government has taken unprecedented steps to support the housing sector.

To keep mortgage rates low, the Federal Reserve has spent almost \$1.25 trillion. In addition, Congress extended a deadline for homebuyers to qualify for tax credits. Both programs are set to end soon. High unemployment and tough lending standards appear to be holding buyers back. That could derail housing as it tries to emerge from the worst downturn in decades and harm the overall economy.

"Until job growth resumes, housing demand will remain weak and susceptible to another lurch down when the homebuyer tax credit expires in April," said Sal Guatieri, an economist at BMO Capital Markets. Last month, the inventory of unsold homes jumped by 312,000 to 3.59 million, an unusually large increase that pushed the supply of unsold homes to 8.6 months.

Industrial production inches out gain

Industrial production edged up 0.1 percent in February, beating expectations and marking the eighth straight monthly increase. But the key manufacturing sector - for months a rare bright spot - produced less, muting hopes for a speedy recovery. The Federal Reserve reported that manufacturing, the index's largest component, fell 0.2 percent; while mining and utilities increased by 2.0 percent and 0.5 percent, respectively.

Manufacturing took a hit from winter storms that shut down most of the Northeast in February, decreasing hours worked at factories and restraining workers' earnings. However, the storms increased demand for heating energy, boosting mining and utility production. It was a return to more measured gains after January's 0.9 percent increase. The index's consistent upward trend suggests that economic improvement is durable, if modest.

After three months of winter weather dampening manufacturing and boosting energy output, some economists expected to see a manufacturing rebound in March, reflecting the sector's overall upward trend. With inventories razor thin, businesses will need to place more orders to meet even a small uptick in demand. Once businesses have replenished their inventories, though, economists said the recovery will gain momentum only if consumer demand increases.

Production of consumer goods fell in February as factories built fewer cars, appliances and other durable goods. When production of consumer products rises, it will indicate that Americans are spending again - a necessary condition for robust economic growth. High unemployment and stagnant wages have so far prevented a consumer-driven rebound.

Despite a strong outlook for the manufacturing sector in the coming months, "it will be up to (consumer) demand to carry the baton," said Joshua Shapiro, chief I.S. economist at MFR Inc. "We believe the recovery process will be subdued and uneven as the household sector continues to struggle with ravaged balance sheets and lingering labor market weakness," Shapiro said in a written analysis. American industry was operating at 72.7 percent of its full capacity. The eighth straight monthly gain, it was a 0.2 percent increase from January - though still 7.9 percentage points below its average from 1972 to 2009.

Retail Sales

Retail sales heat up in February

Retail sales posted a surprising increase in February as consumers did not let major snowstorms stop them from racking up purchases. The advance, the biggest since November, provided hope that the recovery from the Great Recession is gaining momentum. Some economists cautioned, though, that spending increases will remain modest as long as wages stay flat and job creation weak. They also noted that the government revised down the increase in retail sales for January.

But the February sales gain followed a scant rise in January and a slight decline for December. The increase for January was revised down from 0.5 percent to 0.1 percent. "Weak jobs growth, low wages growth and tight credit mean that any further acceleration in consumption growth is unlikely," Paul Dales, an economist at Capital Economics, wrote in a research note.

Still, the February gain suggested that consumers are spending more freely than they were a few months ago. The increases were widespread. Sales surged at department stores, furniture stores, appliance shops and hardware stores. Restaurants and bars enjoyed a 0.9 percent advance, their biggest gain in nearly two years. That suggested that snowbound Americans headed out to eat and get a break from their homes.

Economists have been worried that the economic recovery could falter if spending begins to lag. The better-than-expected February gain could ease those concerns. Economists are hoping that businesses, which have shed 8.4 million jobs since the recession began in December 2007, will start rehiring laid off workers. That would give households the incomes they need to support spending growth. Some analysts had suspected that the February retail sales report could offer a positive surprise, given encouraging news last week from the nation's big retail chains. The International Council of Shopping Centers had reported that sales jumped 3.7 percent in February compares with a year ago. That marked the third straight increase.

Shoppers shrugged off major snowstorms to visit a broad array of merchants from luxury retailer Nordstrom Inc. to middlebrow Macy's Inc. to discounter Target Corp. All three chains reported solid sales increases that beat analysts' expectations. In a separate report, Commerce said business inventories were

basically unchanged in January. Total business sales rose 0.6 percent, the eighth straight monthly increase.

Economists are hoping that the increases in sales will drive businesses to restock their depleted store shelves. The restocking would boost production and provide increased support for the recovery. The recent retail sales report showed merchandise stores, the category that includes department stores and big discounters such as Wal-Mart Stores Inc., rose by 1 percent in February after a 1.3 percent rise in January.

Manufacturing

Factory orders rise but at a slower rate

Factory orders rose in February, bolstered by strong demand for industrial machinery and commercial aircraft. Still, there were signs in the report that the lift manufacturing has provided to the economy may be fading.

The Commerce Department said recently that new orders rose 0.6 percent last month, just ahead of analysts' estimates of a 0.5 percent increase, according to Thomson Reuters. But that's below January's upwardly revised increase of 2.5 percent and the smallest uptick since August 2009, the department said. A healthy rise in inventories would also give a strong boost to the economic recovery.

In January, factory inventories rose by only 0.3 percent, a disappointing pace. Orders for big-ticket manufactured items, known as durable goods, also rose 0.6 percent, slightly higher than a preliminary estimate released last week. Machinery orders jumped 5.1 percent, driven by higher demand for heating and air conditioning equipment and turbines and other power generation gear.

Orders for commercial aircraft, meanwhile, a volatile category, jumped nearly 33 percent last month. But the auto industry continued to struggle, with orders for motor vehicles and parts falling by 1.7 percent, the second consecutive drop.

Nondurable goods, such as chemicals, food products and apparel, rose 0.3 percent, a healthier showing than many economists expected. Chemical orders, particularly pesticides and fertilizers, as well as food products, led the increase.

January Auto Sales

Most U.S. auto sales rise

Toyota's auto sales fell 16 percent in January, a month when it recalled millions of vehicles and halted sales of several models. Most other automakers reported higher sales and looked for opportunities to snatch sales from the troubled Japanese automaker. January is typically a weak month for U.S. auto sales, but automakers expected sales to improve over last January, when they dipped to a 26-year low because of the tough economy.

General Motors Co. said its January sales rose 14 percent due to higher fleet and crossover vehicle sales. Crossovers are SUV-like in size but sit on a car instead of a truck frame. Rival Ford Motor Co.,

meanwhile, also saw sales rise 25 percent on higher fleet sales, while Nissan Motor Co.'s rose 16 percent thanks to higher demand for sedans like the Versa, Sentra and Maxima. Hyundai Motor Co.'s sales rose 24 percent as sales of the newly redesigned Tucson SUV doubled. Chrysler fell 8 percent on declining sales of Ram trucks and Jeeps, while Honda Motor Co. sales slipped 5 percent on weaker SUV and crossover demand.

Shifting loyalties favor Ford

A daily drumbeat of Toyota recalls, quality worries, lawsuits and investigations, coupled with rebates dangled by hungry rivals, have prompted some Toyota owners to defect from the Japanese automaker. Ford appears to be a prime beneficiary of the difficulties that Toyota has encountered lately, according to a survey by Edmunds.com. Yet it appears that Toyota may have shored up some of the erosion it suffered due to the fallout from its mounting woes.

"Our statistics show Ford as taking advantage of this," said Jessica Caldwell, a senior analyst with Edmunds.com, which tracks auto sales. "Ford appears to have made long-term gains." Before Toyota's woes, Edmunds.com had estimated 8 percent of those planning to buy a vehicle wanted a Ford.

After the recalls began, that number rose to 8.5 percent, or a 6.3 percent gain. At some point during the worst of the Toyota recall setbacks, Ford's intent-to-buy numbers spiked to 10 percent. In recent days, Ford has held steady at the 8.5 percent level, Caldwell said. What about Toyota? The Japanese-based automaker is beset on multiple fronts and is struggling to regain its reputation for quality vehicles. Regulators have launched probes of the Toyota quality issues.

Yet maybe Toyota has managed to stanch its bleeding and begin to heal its largely self-inflicted wounds. "This has hurt Toyota, but the damage may be short-term," Caldwell said. "Their sales had gone down. But they have swung back to pre-recall levels."

Before the recall woes, about 14 percent of consumers were planning to buy a Toyota. That dipped to 10 percent during the worst of the problems for Toyota, Caldwell said. Now, 12 to 14 percent plan to buy a Toyota. "Considering the beating Toyota has been taking, the data shows it's not that bad," Caldwell said. "You have to think the worst is over."

Yet it's more than a flight to quality or American brands that have driven some into the arms of other dealers. Toyota's rivals have harvested sales with rebates when people trade in a Toyota or selected other imports. "They know there's extra money for them from the rebates," said Pete Imsand, general sales manager with Diablo Ford in Pittsburg.

"We have sold some Toyota and Honda customers a Focus, Escape, or a truck. It's the rebates for sure." Caldwell, the analyst, also says the rebates have helped. "Ford, GM and Hyundai have been aggressive in offering incentives targeted to Toyota owners," Caldwell said. "The rebates got them thinking about Ford or GM. They might not have done so otherwise."

February Auto Sales

Toyota's pain is rivals' gain

Toyota's pain is its rivals' gain. All major automakers but Toyota reported higher U.S. sales in February, and most took customers from their powerful Japanese competitor, which has been struggling with a series of massive safety recalls. Toyota Motor Corp. said its U.S. sales fell 9 percent last month, while Ford, GM, Nissan, Honda and Hyundai all reported double-digit growth compared with February of 2009, at the depth of the recession. The gains may have been even higher without the blizzards that paralyzed the East Coast.

Other winners included Kia Motors Corp. and Subaru. Even struggling Chrysler Group LLC saw improvement. Toyota, by contrast, suspended sales of eight popular models in late January. "We feel we're getting our fair share of the Toyota business," said Susan Docherty, vice president of marketing at GM, whose sales rose nearly 12 percent. February was the first full month since Toyota's Jan. 26 decision to halt sales of some of its vehicles in the U.S. because of safety concerns. Those vehicles went on sale again as dealers repaired them, but Toyota's image suffered from the recall of millions of vehicles and congressional hearings on its safety record.

Recently, Toyota unveiled a host of new deals to lure back buyers and reassure existing customers. Existing Toyota owners who buy another vehicle from the company will receive two years of free maintenance, Toyota said. The automaker will also offer zero-percent financing and low-priced leases to customers who buy or lease several of the recalled vehicles, including Corollas, Camry's and Avalon's.

The offers will last through April 5, Toyota said. They also will be part of an ad blitz featuring real customers who recently bought Toyota vehicles. "This will be our most far reaching program we've ever conducted at Toyota," said Bob Carter, a Toyota group vice president, during a conference call with reporters.

Ford Motor Co. posted a 48 percent jump in February U.S. auto sales and outsold General Motors Co. for the first time in nearly a dozen years as it grabbed customers from struggling Toyota. Ford sold 334 more cars than GM in the U.S. for the first time since August 1998, when GM was in the midst of a strike.

Most big automakers reported that sales to rental car companies and other fleet buyers also were strong as companies began buying again after cutbacks last year. Fleet sales generally mean lower profits to automakers than retail sales to individuals. Chrysler, for example, said its February sales rose half a percent, its first year-over-year monthly increase since December of 2007. The company credited strong fleet sales, but it would not release a number. Car sales rose 38 percent, but truck sales dived 28 percent.

Hyundai Motor Co. said its sales rose 11 percent, driven by sales of the new Tucson small SUV, which more than doubled. The company's redesigned Sonata mid-size car saw sales rise 58 percent. Docherty said GM won over some Toyota buyers who left the Japanese carmaker due to the recalls. Chevrolet car sales to individuals rose 10 percent in February, an indication that GM is taking some of Toyota's core market, she said.

Mike DiGiovanni, GM's top sales analyst, said he expected that trend to continue into the spring. Most carmakers offered deals to Toyota customers for trading in their vehicles. According to the automotive

Web site Edmunds.com, incentive spending rose 11 percent from January to \$2,588 per vehicle. Toyota's incentive spending rose 26 percent, to \$1,833 per vehicle.

GM's sales of its Buick, Chevrolet, Cadillac and GMC brands climbed 32 percent. GM plans to keep those four brands and is phasing out Pontiac, Saturn and Hummer. It has sold Saab.

March Auto Sales

Incentive wars fuel auto sales

Car shoppers flocked to showrooms last month, lured by big promotions from Toyota and other automakers that could persist into the spring. Toyota's unprecedented incentives, including low-interest financing, cheap leases and free maintenance for return customers, pushed up its U.S. sales 41 percent in March and helped it recover from a dismal February. They also touched off an incentive war that drew in buyers to rival dealers.

General Motors Co. reported a 21 percent jump in new vehicles sales on Thursday, while Ford's climbed nearly 40 percent and Honda Motor Co. rose 23 percent over March last year. The sales point to one conclusion: March was a good time to buy a new car. Automakers ramped up promotions, with incentive spending up \$100, or 4 percent from February to \$2,742 per vehicle, according to Edmunds.com. That's still down from a record high of \$3,165 last March, when dealers scrambled to lure customers worried about rising layoffs and bankruptcies at GM and Chrysler.

Toyota rolled out the incentives in early March to counter safety recalls that have tarnished its image of quality and reliability. The recalls, which began in October and grew in later months, include more than 8 million cars and trucks around the world due mainly to reports of unintended acceleration.

Company sales fell 9 percent in February, before it launched its aggressive promotions. The broader industry's sales climbed 13 percent that month. Toyota's deals are scheduled to end April 5 but the Japanese automaker says some of them may continue beyond that date.

GM's sales from its four core brands - Buick, Chevrolet and Cadillac - rose 43 percent to 188,546. Redesigned vehicles like the Chevrolet Equinox mid-size crossover and Buick LaCrosse luxury sedan saw strong demand. Sales fell sharply for Saturn, Pontiac and Hummer, the brands it is shedding. Industry analysis firms TrueCar and Edmunds.com predicted that GM's March incentive spending would lead major automakers at more than \$3,500 per vehicle, well above the industry average of roughly \$2,800.

March auto sales shouldn't be viewed as a sign of economic recovery because automakers had to shell out a lot of money to draw in customers, said Jessica Caldwell, analyst for Edmunds. "I still don't see a huge, steady demand," she said.

Other sales results include:

- Chrysler Group LLC continued to struggle, with sales down 8 percent.

- Hyundai's sales rose 15 percent, propelled by sharply higher demand for its newly released Sonata sedan and its Tucson small SUV.
- Nissan Motor Co. sales were up just over 43 percent, while Subaru sales climbed 46 percent.

Consumer Confidence

Consumer confidence stumbles in February

Americans' confidence in the economy has suffered a sudden relapse, dimming hopes that they will start spending - and spurring job growth - any time soon. The Consumer Confidence Index figures were much worse than analysts had expected and showed that Americans are morose about the job market and their economic prospects. That bodes ill for the sort of uptick in consumer spending that normally powers job growth.

The index fell almost 11 points to 46 in February, down from a revised 56.5 in January and the lowest level since a 40.8 reading in April 2009. It erased three consecutive months of improvement, according to The Conference Board, the research group that releases the monthly index. Analysts were expecting only a slight decrease to 55. Economists watch the confidence number closely because consumer spending accounts for about 70 percent of U.S. economic activity.

Outside of the Great Recession, the index hasn't been this low since December 1974. "It still feels like a recession," said Lynn Franco, director of The Conference Board Consumer Research Center. Confidence has been recovering fitfully since hitting a historic low of 25.3 in February 2009. Many economists believe it will remain well below healthy levels for at least another year or two. A reading above 90 indicates an economy is on solid footing. Above 100 signals strong growth.

Some economists say Americans won't start to feel better and spend more until they see clear evidence of sizable job growth. In past recessions, however, the employment picture didn't improve dramatically until after a recovery in consumer spending and confidence. Many economists say business investments and exports can help drive the nascent turnaround in the short term, but a rise in consumer spending is essential to keep it going.

Consumer confidence rebounds in March

Americans' confidence in the economy rebounded in March after a February plunge but remains relatively weak amid a tough job market, according to a private research group's monthly survey released recently. The Conference Board's Consumer confidence Index rose to 52.5 in March, recovering only about half of the nearly 11 points it lost in February. Analysts expected a reading of 50 in March. February's 46.4 marked the lowest level since April 2009 and also erased three consecutive months of improvement. In January, the reading was 56.5.

One of the index's barometers, which measures how shoppers feel now about their economic situation rose to 26.0 from 21.7 in February. The other measurements, which gauge how shoppers feel about the economy over the next six months, ticked up to 70.2 from 62.9. Economists watch the figures closely because health care and other major items, accounts for about 70 percent of U.S. economic activity.

Real Estate

Home building activity in California reached its lowest point in more than 50 years, according to a report released recently by the California Building Industry Association. In 2009, there were 36,209 housing starts statewide, down 44 percent from 2008 and a huge 83 percent drop from a peak of 176,751 starts in 2004. The previous record for low building activity was set in 2008. The CBIA is projecting that 52,000 building permits will be pulled statewide in 2010. The association's records go back to 1954.

UCLA Anderson School Forecast

Report: State jobless rate peaks

The unemployment rate in California, currently at record levels, has peaked, but don't expect jobs to blossom any time soon. The California job market will remain feeble for the rest of this year and probably all of 2011, according to one of the economists who prepared this quarter's UCLA Anderson Forecast.

"The current 12.5 percent unemployment rate looks like the worst of it," said Jerry Nickelsburg, senior economist with the Anderson Forecast. "The jobless rate should start declining. But the rate of decline will be fairly slow." California's jobless rate rose to 12.5 percent in January, the worst unemployment rate since the Great Depression ended with the onset of World War II.

"We will not get enough economic growth in California in 2010 or 2011 to drive the unemployment rate below double digits," Nickelsburg said. "But in 2012, we will get below 10 percent." Yet it's also possible the jobless rate could worsen beyond the current record levels, warned Jeffrey Michael, director of the Stockton-based Business Forecasting Center at the University of the Pacific.

"We could see jobless rate ticking up a few tenths possibly," Michael said. "We are into a range of 12-point-something for the rest of this year." The jobless rate was originally thought to have peaked in October. But annual revisions to the statewide and regional employment statistics in California determined that the jobless rate actually continued to climb after October before reaching January's record-high level.

"This is troubling," Nickelsburg wrote in his forecast about California. The revisions also determined that California lost 836,000 jobs during 2009 - a loss of about 257,000 more jobs than first estimated by the state Employment Development Department. And over a longer term, the job losses in California have been nothing short of disastrous, the Anderson Forecast found. Over the two years from December 2007 through January 2010, California lost 1.3 million payroll jobs. The number of unemployed residents in California during the same period rose by 1.2 million jobs.

And people have dropped out of the statewide labor force during the same two-year period. The labor pool shrank for 94,000 workers. Some jobs won't come back, the economists warned. Construction and manufacturing are cases in point. California also shouldn't depend on green industries to spark a major job boom. "There is a lot of hype about green technologies and all the jobs that industry will create, but when

you dig into it, the numbers will not be there," Nickelsburg said. "Green jobs will not reach the level during the Internet and high-tech expansion, or the electronics and defense expansion of the 1980s."

The researchers did find some areas of encouragement. The Bay Area is not expected to lag California during an economic recovery. Technology and exports will be an important part of this recovery, and that favors the entire Bay Area," Nickelsburg said. "The Bay Area and the Los Angeles-Orange-Ventura area, will be leaders in the recovery. The Inland Empire, the Central Valley and San Diego will be a little slower coming out."

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