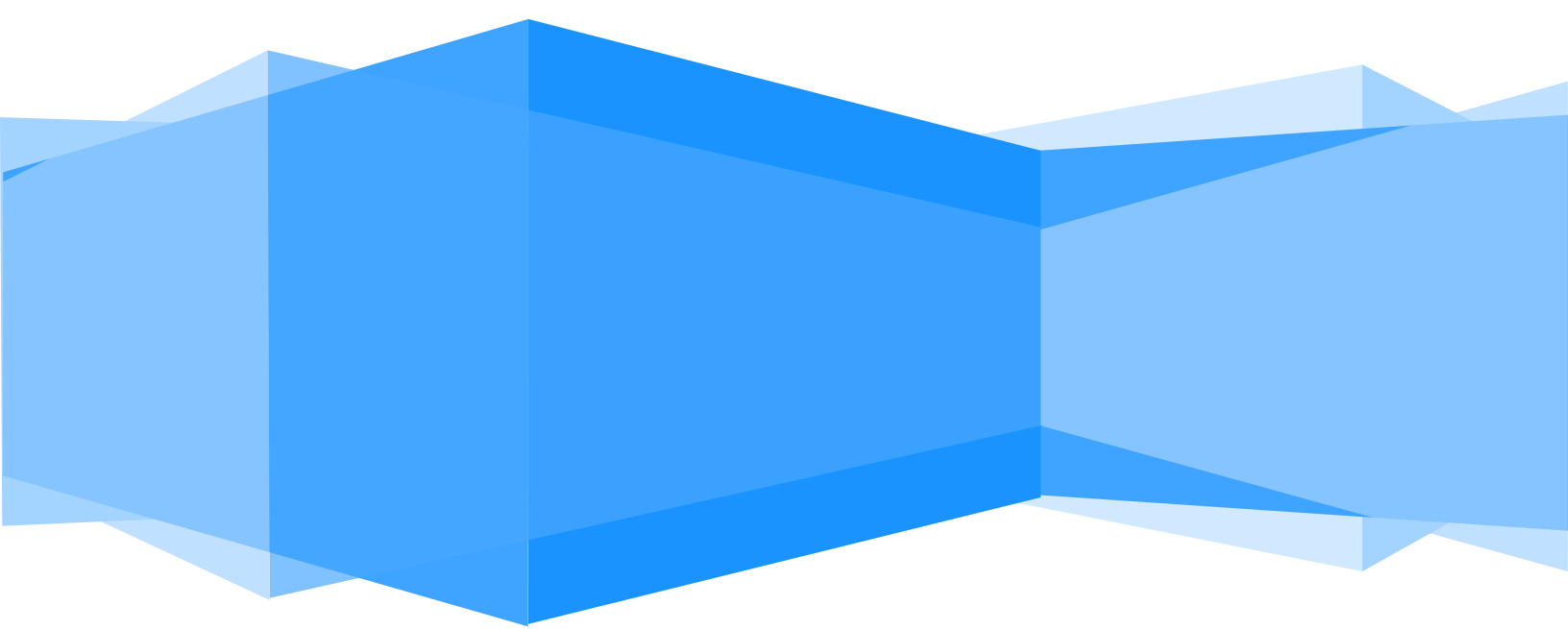




Economic Outlook

4th Quarter 2009 News



Economic Trends

More evidence recession ending

All signs suggest the economic recovery will end the year on firmer footing despite a recent report that the economy grew at a 2.2 percent pace in the third quarter, less than previously thought. The Commerce Department's new reading on gross domestic product for the July-to-September quarter was weaker than the 2.8 percent growth rate estimated recently. Economists had predicted this figure would remain the same in the final estimate of the quarter's GDP - the value of all goods and services produced in the United States.

The main factors behind the downgrade were that consumers didn't spend as much, commercial construction was weaker, business investment in equipment and software was softer and companies cut back more on their stockpiles of goods. Even so, the economy managed to return to growth during the quarter, after a record four straight quarters of decline. That signaled that the deepest and longest recession since the 1930s had ended and the economy had entered a new fragile phase of recovery.

And many analysts still think the economy is on track for a better finish in the current quarter. The economy is probably growing at nearly 4 percent in the October-to-December quarter, analysts say. A few peg it closer to 5 percent. If they're right, that would mark the strongest showing since 5.4 percent growth in the first quarter of 2006 - well before the recession began. The government will release its first estimate of fourth-quarter economic activity on January 29.

Growth in the final quarter is expected to be driven mainly by companies restocking depleted inventories. Stocks of goods were slashed at a record pace during the recession. So even the smallest pickup in customer demand will force factories to step up production and boost overall economic activity in the final quarter.

Stronger sales of exports to foreign customers, as well as spending by U.S. consumers and businesses, also will help underpin fourth-quarter growth. "We expect a better performance in the fourth quarter, but the core problems for the economy - bust banks and a massively overleveraged consumer - have not gone away," said Ian Shepherdson, chief economist at High Frequency Economics.

That's why many economists predict growth will slow to a pace of around 2 or 3 percent in the first three months of 2010. Consumers are likely to stay frugal. And the big lift from inventory restocking isn't expected to last. With unemployment high and credit tight, growth won't likely be as energetic as in the early phases of previous recoveries. The unemployment rate, now at 10 percent, is expected to remain high.

Federal Reserve on the Economy

Bernanke: Too early to declare victory

Federal Reserve Chairman Ben Bernanke warned recently that it's too soon to know whether the economic recovery will last and again pledged to hold rates at record-low levels for an "extended period." The Fed chief's speech to the Economic Club of Washington made clear he thinks the economy will struggle even as it recovers from the recession. He said the economy confronts "formidable headwinds" - including a weak job market, cautious consumers and tight credit.

Those forces "seem likely to keep the pace of expansion moderate," he said. The central bank has leeway to keep rates low because inflation is under control and is expected to stay tame because of the economy's weakness. Some private forecasters even fear that the recovery could fizzle late next year as government stimulus fades.

Asked about prospects for such a "double dip" recession, Bernanke said he could not guarantee it won't happen. He stuck with his forecast for a moderate recovery but said a "vigorous snapback" is less likely. Bernanke said he expects "modest" economic growth next year. That should help push down the nation's unemployment rate - now at 10 percent - "but at a pace slower than we would like," he acknowledged.

Under one Fed forecast released last month, the jobless rate would remain high next year - ranging from 9.3 to 9.7 percent. The Fed has warned that it could take five or six years for the job market to return to normal. To nurture the recovery, the Fed has kept rates at record low near zero for a year.

When asked about rates, Bernanke joked, "Well, they can't go much further down." He went on to repeat the Fed's pledge to keep rates at record lows for an extended period. "That remains where we are, but we're going to have to continue to look at the economy," Bernanke said. Despite all the negative forces, consumers recently have shown their resilience and kept spending.

Home sales have firmed helped by the government's tax buyer credit. Car sales were aided by the government's now-defunct Cash for Clunkers rebates. Business spending on new equipment and software also slowed signs of stabilizing and better economic conditions abroad have boosted U.S. exports. And the heavy pace of lay-offs is slowing.

Employers shed just 11,000 jobs last month, the fewest since the recession began two years ago. That helped push down the unemployment rate to 10 percent, from a 26-year high of 10.2 percent in October. Still, economists took Bernanke's remarks as indicating that he isn't in a rush to raise rates. "Bernanke's main message is that the Fed still remains very committed to policies that will provide further support for a stronger recovery," said Brian Bethune, economist at IHS Global Insight. "There hasn't been dramatic enough improvements in the economy to make any major changes."

Inflation

Rise in wholesale inflation unlikely to last

Evidence that the economic rebound could eventually raise inflationary pressures emerged in a recent report that wholesale prices surged recently. Most economists aren't worried, though. They think the economy remains too weak for the price increases to last.

An eventual Fed rate increase could help defuse inflation and boost the value of the dollar against other currencies. But it carries risks. Higher interest rates would raise borrowing costs and squeeze corporate profits. They could send stock prices falling. And they risk derailing the economic recovery.

The economy is growing steadily but slowly. The latest sign was a recent report that industrial production rose a better-than-expected 0.8 percent in November, and the portion of industrial capacity in use rose to 71.3 percent, from 70.6 percent in October. It shows that factories, mines and utilities are using more of their plants as the recovery takes root.

Still, even with the gain, capacity use remains far below its long-run average of around 80 percent. Analysts said industrial spare capacity remains so large and demand still so soft that inflationary pressures are likely to remain tame. "Despite today's nasty numbers, the chances of run-away inflation remain small," Paul Dales of Capital Economics.

Throughout the economy, few companies have much pricing power in the face of budget-conscious consumers. Kroger Co., for example, posted a lower quarterly profit in part because it's had to cut prices to compete even as its costs have risen.

Stronger activity at mines led last month's increase in industrial production, rising 2.1 percent. The manufacturing sector - the biggest chunk of industrial output - rose 1.1 percent. Utilities fell 1.8 percent, according to the Fed report. Overall wholesale prices jumped 1.8 percent in November, the Labor Department said. That's more than double the 0.8 percent gain analysts had expected. Core inflation, which excludes energy and food, rose 0.5 percent, the sharpest increase in more than a year.

Home sales hit 3-year high

Extraordinary government efforts to stabilize the housing market are paying off. What happens when the help runs out is anyone's guess. Sales of previously occupied homes surged in November to the highest level in nearly three years, spurred by federal subsidies for starter homes and a massive Federal Reserve push to drive down mortgage rates.

The strong figures were driven by a race to take advantage of a tax credit of up to \$8,000 for first-time homebuyers. The credit has been extended to next spring, but the government initially planned to end it November 30. "It was like the end of the world," said real estate agent Stephanie Somers of Re/Max Access in Philadelphia. "All the first-time buyers converged onto that one month."

The pace of home sales is now up 46 percent from its bottom in January and still 10 percent shy of its peak from four years ago, according to data released by the National Association of Realtors. The real estate recovery depends not only on taxpayer dollars but also on the health of the economy at large, which grew at a less robust pace in the third quarter than previously thought.

The economy grew at a 2.2 percent annual pace from July to September, down from an initial reading of 2.8 percent. Experts think the economy is even stronger now than it was last quarter, but they expect it to ebb again early next year. And that's when the tax credit will wind down and the Fed plans to stop buying mortgage-backed securities, which could raise mortgage rates. Whether the real estate rebound can continue without the help remains to be seen.

"The housing market recovery can't continue if the overall recovery in the economy doesn't persist," said Michelle Meyer, an economist with Barclays Capital. While prices for homes in many parts of the country are still falling, analysts said the tax credit clearly helped the volume of sales. "In the short run, it's an effective stimulus," said John Ryding, chief economist at RDQ Economics. "If you give someone money to spend on something, they will spend it."

With April 30 as the new deadline, experts forecast sales will drop during the winter and pick up again in the spring. Without the looming deadline, "buyers have no sense of urgency now," said Gary DeRosa, an agent with ZipRealty Inc, in Seattle. About 2 million homebuyers have taken advantage of the credit so far, the Realtors group said. It expects 2.4 million more to use it by the middle of next year. First-time buyers made up about half of all transactions last month, driving sales up 44 percent above last year's levels, a record.

Overall, sales of existing homes rose 7.4 percent in November to a seasonally adjusted annual rate of 6.54 million, up from 6.09 million in October. That was far stronger than the 6.25 million forecast by economist surveyed by Thomson Reuters. The inventory of unsold homes on the market shrank about 1 percent to 3.5 million. That's a healthy supply of about six and a half months' worth, the smallest in three years.

That home prices are still falling shows one government housing program, an effort to get lenders to prevent foreclosures by lowering monthly payments for hundreds of thousands of borrowers, isn't working as well as the Obama administration would like. Only about 31,000 borrowers have completed the process so far.

In the meantime, high unemployment is causing homeowners to default on their loans in record numbers. Banks are unloading foreclosed homes, driving prices down in many areas, particularly Arizona, California, Florida and Nevada. Nationwide, the median sales price was \$172,600 in November, down 4 percent from a year earlier, but flat from October.

Many experts warn that lenders have millions of properties in the foreclosure pipeline that have yet to come on the market, suggesting prices could fall even further. Plenty of traditional sellers are also keeping their homes off the market.

Bay Area Business Confidence Index

Bay Area CEOs see fewer job cutbacks

The Bay Area economy appears to at last be getting no worse, a new survey shows, but don't cheer just yet: That sliver of hope won't morph into an improved job market any time soon. Business Confidence Index for the Bay Area improved to a mark of 53 out of 100 in November, according to the survey results released recently. That was up from a reading of 47 in August. An index reading that exceeds 50 signals economic growth, while a reading below 50 signals contraction.

"It looks like we have finally hit rock bottom and are now looking up," said Jim Wunderman, president of the Bay Area Council, which commissioned the quarterly survey of area chief executives. Still, a painful job market will afflict Bay Area residents, the survey found.

Over the coming six months, 23 percent of Bay Area companies plan to reduce their staffing levels, while 18 percent anticipate they will add jobs, the November survey found. In the August results, 26 percent of Bay Area companies were planning to cut jobs, while 14 percent intended to expand staffing levels. The East Bay is the region's weakest job market, the survey found. In Contra Costa County/Solano County, 35 percent of the respondents plan to reduce their work force. In Alameda County, 27 percent intend to slash staff. Those were the two worst of outlook marks in the Bay Area.

One strong market: Santa Clara County, where 19 percent of the employers plan to reduce jobs, and 24 percent plan to add jobs. Along those lines, the chief executive of two Silicon Valley chip industry manufacturers is seeing some improvement in one of his companies, Fremont-based Clean Sciences Inc.

"Our business more than doubled in the second half of 2009 compared with the first six months of this year," said Jonathan Kaye, president of Clean Sciences, which makes devices to clean parts for semiconductor equipment. The survey findings track with other assessments from economists with San Francisco-based Wells Fargo.

"The job cutting is diminishing in the Bay Area," said Scott Anderson, a Wells senior economist. "But we are forecasting another three to six months of job losses" for the nine-county region. Employers simply aren't convinced the economy has healed enough to justify a hiring binge - or any hiring.

"Companies will make do with the workers they have," said Ed Del Beccaro, senior managing partner with the Walnut Creek office of realty firm Colliers International. "They will hire part-timers and independent contractors, while they wait and see." Wells Fargo believes the jobless rate in California could hit 13 percent. In October, the statewide jobless rate jumped to a 69-year high of 12.5 percent. "Even when hiring does resume, it will be nothing that gets people very excited," Anderson said.

Holiday Season Retail Sales

Holiday shopping sales rise slightly

Holiday shoppers spent a little more this season, giving merchants reason for cheer. The spending bounce means retailers managed to avoid a repeat of last year's disaster even amid credit and double-digit unemployment rates. Profits should be healthier, too, because stores had a year to plan their inventories to match consumer demand and never needed to resort to fire-sale clearances.

Retail sales rose 3.6 percent from Nov. 1 through Dec. 24, compared with a 2.3 percent drop in the year-ago period, according to figures from MasterCard Advisors' SpendingPulse, which tracks all forms of payment, including cash. Adjusting for an extra shopping day between Thanksgiving and Christmas, the number was closer to a 1 percent gain.

Last year, the economy was in "critical condition," said Michael McNamara, vice president at SpendingPlus. "This year, it's in stable condition." A major winter storm that slammed the Northeast and shut in shoppers on the Saturday before Christmas derailed sales. But consumers appeared to have made up for the loss by shopping in advance of the storm and the days leading up to Christmas. "We had a pretty decent surge," McNamara said.

Online sales were a particular hot spot, fueled by a big increase the weekend before Christmas. They rose 15.5 percent on the season, though they make up less than 10 percent of all retail sales. One worrisome sign: Merchants are facing big hurdles to lure shoppers back in January amid lean inventories and what appear to be weak gift card sales. Gift card sales are recorded only when they are redeemed.

Stores count on a post-Christmas boost because of the growing importance of January on the retail sales calendar. Last year, the week after Christmas accounted for 15 percent of overall holiday sales, according to Shopper-Trak, a research firm. Retail consultant Burt Flickinger describes gift cards as "the lifeblood" of the post-Christmas season, because shoppers typically spend more than the value of the cards.

"Retailers with a disappointing December are going to need January to survive," Flickinger said. "Inventories are even too low for retailers. Karen MacDonald, a spokeswoman at Taubman Centers Inc., said a survey among its centers showed that merchants are on track to generate on average low single-digit sales increases from a year ago. MacDonald noted that the centers had a strong last-minute sales surge and business had been strong.

She added that 85 percent of shoppers are buying, 10 percent are exchanging and about 5 percent are returning items. Gift card redemption rates were discouraging, she said. They averaged 10 percent, based on a sampling of malls. In good years, those rates are anywhere from 30 to 40 percent. That confirms that gift card sales were just "lukewarm," she said. "Shoppers are seeing more value in deeply discounted merchandise" than buying gift cards, MacDonald said.

Auto Trends

Luxury car buyers spending less for holidays

This holiday season, the luxury car buyer is offering a simple phrase: I'm not spending too much. Wealthier shoppers are trickling back into showrooms after staying away much of the year. But there's a catch. Many are pinching pennies, sort of, by choosing smaller BMW and Mercedes models, or they're buying top-of-the-line cars from cheaper brands.

This year, almost 14 percent of luxury buyers replaced old vehicles with brands other than traditional high-end names such as Audi, BMW, Cadillac, Infiniti, Jaguar, Lexus, Lincoln, Mercedes and Porsche. That's up from just 4 percent in 2006 and a reminder that these buyers still don't feel as wealthy as they once did. Home values are still down and portfolios shrunken, despite the stock market's gains this year.

Two potential beneficiaries of the shift are Buick and Hyundai, brands offering luxury models that are much cheaper than Beamers and Audis. Buick for years was known for cushy, boring sedans normally found outside grandma's house. The average Buick buyer is still about 70 years old, and the brand is desperately trying to attract younger drivers and reverse a sales slide, Aaron Bragman, an auto industry analyst with Global Insight in Troy, Michigan. This may be its opportunity.

After years of ho-hum styling, blasé interiors and soft suspensions that made driving a chore, Buick's new LaCrosse luxury sedan is far sportier than its predecessor. It's got crisper handling and sleeker styling designed to appeal to people in their 40s and 50s. It also includes onboard hard drives and other electronic gizmos for younger drivers, all the while costing \$5,000 to \$20,000 less than European and Japanese luxury competitors.

At \$27,000, Buick's German-designed LaCrosse performs as well as its more expensive competitors, yet has everything luxury buyers are seeking, Bragman says. That's important because luxury shoppers are picky, even when they economize. While many are now willing to give up a prestigious name or a bigger car, they still want cutting-edge styling along with reliability and safety. They demand tight handling and a quiet ride. The car must have excellent fit-and-finish inside and out and features such as heated leather seats and navigation systems.

"They may very well be downsizing in terms of the package. They're not downsizing in terms of the features they want," says Art Spinella, president of CNW Marketing Research of Bandon, Oregon. Another winner is Hyundai's Genesis, which has received stellar reviews for its luxury and handling but can cost \$15,000 to \$25,000 less than higher-end cars. Even with a small resurgence for the holidays, luxury car sales are down 27 percent so far this year. But November sales fell just 8 percent, and dealers are reporting increased traffic this month.

Those trends reflect revived confidence among consumers. In the third quarter, net worth - the value of assets such as homes, bank accounts and investments, minus debts like mortgages and credit cards - rose

5 percent, to \$53.4 trillion, the Federal Reserve says. It was the second straight quarterly increase. Personal incomes rose in November at the fastest pace in six months.

Yet even with those gains, Americans' net worth remains far below the peak of \$64.5 trillion reached before the recession. Buying a cheaper car brand is one way to save money. Another is trimming size.

November Auto Sales

Automobile sales still struggling for traction

U.S. auto sales fought to gain ground in November and big improvements aren't expected until people stop worrying about losing their jobs. Sales were mostly stable, but even higher incentives couldn't push the needle much beyond last November's dismal lows, when a credit freeze and the financial meltdown kept car buyers at home. One strength was sales of fuel-efficiency cars and crossovers, which are as roomy as SUVs but are built on lower car frames, bolstering fuel economy.

Last month's big winner, again, was South Korea's Hyundai, which posted double-digit sales growth. Sales at the top three U.S. sellers - General Motors, Ford and Toyota - held steady, while Chrysler struggled for another month. The auto market is recovering from a historic drop in sales that began last year. Sales in October were unchanged from a year ago.

Small monthly auto sales increases are likely as the economy continues its slow improvement, but larger sales gains will not happen until the jobless rate drops substantially, and people feel confident spending money on big-ticket items, said Martin Zimmerman, a former Ford Motor Co. chief economist who now teaches at the University of Michigan. The U.S. jobless rate hit 10.2 percent in October, a 26 year high, and Zimmerman said people are holding onto their vehicles.

Carmakers continued to rely on discounts and other incentive spending to sell cars and trucks last month. Sales incentives rose 2 percent in November to \$2,713 per vehicle, according to the auto Web site Edmunds.com. General Motors said its sales fell 2 percent in November, though sales of its core Buick, Cadillac, Chevrolet and GMC brands rose. Ford's sales were essentially flat compared to last November, at 122,846, although sales of its crossovers rose 26 percent and car sales rose 14 percent. Trucks and SUVs saw double-digit declines.

Ford's hybrid sales increased 73 percent, to 2,361, as buyers gravitated toward gas sippers. At about \$2.65 per gallon, regular gasoline is up around 50 cents over November of last year. The Ford Fusion sedan, which leads the mid-size category in fuel-efficiency at 34 miles per gallon, posted a 54 percent increase from last November, shattering its previous record for full-year sales. "We can see now that a modest economic recovery is under way," Ford senior economist Emily Kolinski Morris said.

Toyota said its U.S. sales rose 2.6 percent to 133,700, led by standbys like the Camry sedan and the RAV4 crossover. Hyundai sales soared 46 percent on the back of its top-selling Sonata sedan. Honda's U.S. sales fell 2.9 percent in November on slower sales of small cars like the Fit and the Civic.

Ford posted a 33% rise in December U.S. car sales, ending a stellar year for the auto maker compared to its rivals. Ford recorded its first full-year market-share gain since 1995.

Meanwhile, Chrysler posted a 3.7% decline and said its full-year sales were the worst the auto maker had seen in 47 years. The largest U.S. auto maker - General Motors - posted a 5.7% decline. Toyota said its U.S. sales rose 32% last month, Honda's December sales rose 24% and Nissan's climbed 18%.

Bay Area Still Shedding Jobs

Job losses mounted by the thousands in the Bay Area during November, and the reductions were so severe that they exceeded the employment cutbacks for the entire state of California. The nine-county Bay Area lost 11,300 jobs during November, according to recent economic reports. California overall lost 10,200 jobs, the Employment Development Department said.

"The Bay Area has yet to begin its recovery," said Jon Haveman, a partner and economist with Beacon Economics. In contrast, "Recovery has set in over much of California," Haveman said. The only hopeful sign was produced by the California jobless rate, which improved to 12.3 percent in November, the state Employment Development Department reported. The October rate was 12.5 percent.

But the jobless rate may have improved partly because the labor force shrank as people gave up looking for work in the face of a feeble economy. Once people give up, they are no longer counted as part of the unemployment rate.

The job losses in the Bay Area's three primary urban centers persisted during November, the EDD reported in a seasonally adjusted survey of payroll jobs:

The East Bay lost 3,100 jobs during the month.

Santa Clara County lost 3,500 jobs.

The San Francisco-San Mateo-Marín region lost 4,700 jobs.

Solano County had no change in its job totals last month, according to Beacon Economics. San Joaquin County lost 600 jobs during November, the EDD reported.

Why is the Bay Area still in a deep slump? Some of the root causes are linked to the nature of this recession, which was unleashed by the collapse of the housing and mortgage sectors and worsened by the meltdown of the financial markets and banking industries. "The East Bay was crushed by the housing downturn," Haveman said. Housing-linked woes rippled through the rest of the Bay Area. San Francisco and Silicon Valley were left a little off the hook for that," Haveman said. "Those areas came into the downturn later."

That means the South Bay and San Francisco-Peninsula area could struggle while other parts of the state start to emerge from the economic quagmire. Still, there were a few signs that the East Bay's job losses could be finally starting to abate, when compared with the rest of California.

Over the most recent 12 months, the East Bay lost 34,700 jobs, a 3.4 percent decline. During the same one-year period that ended in November, California lost 617,600 jobs, a 4.2 percent drop in the statewide job base. Economists also warned of an ominous trend in California's labor pool. The statewide labor force shrank by nearly 20,000 workers in November.

"This is due to people deciding they have better things to do with their time than to look for work, given how bleak the job market is," Haveman said. The labor pool, though, may have dwindled for other reasons, said labor expert Michael Bernick, a former director of EDD. "Discouraged workers is part of it, but people are also dropping out of the labor market for other reasons," Bernick said. "Some are going back to school, some are staying in school, and some are retiring."

Still, the researchers with Beacon Economics said the trends they have found in the EDD reports for October and November suggest the job market may soon halt its free fall and perhaps stabilize. Meanwhile, the bulk of the job gains statewide emerged in Los Angeles County, which added 23,300 positions. The nearby counties of Riverside, San Bernardino, Orange, and San Diego added a total of 10,600 jobs.

UCLA Anderson School Forecast

California's economy won't pick up until at least early 2011, and job losses will continue into next year, according to the latest prediction from the UCLA Anderson Forecast. By the time 2009 ends, the California job base will shrink by 4.3 percent. California will not generate new jobs during 2010, the Anderson economists predicted. Unemployment will only worsen and will rise to 12.7 percent by the end of this year. Yet signs of an economic recovery abound. The prolonged recession of 2008-09 reached a turning point sometime in the early fall of 2009. Although millions remain unemployed and many businesses continue to struggle, it appears that "The Great Recession" that began in December 2007 is technically over.

The primary indicator that suggests a recovery has begun is renewed gross domestic product growth in the third quarter of 2009, up 2.8 percent after four straight quarterly declines. Factory orders, industrial production, consumer spending (retail sales), housing permits, existing home sales, home prices and exports are on the uptick.

Even corporate America is bullish. The Business Roundtable's fourth quarter 2009 CEO Economic Outlook Index showed an impressive gain. Underlying this optimism is a rise in profits - corporate earnings rose by 11 percent in the third quarter of 2009. The best news for unemployed workers is that

there is talk of renewed hiring and increased investments over the next six months in preparation for the projected sales growth in 2010.

There are two clusters of opinion for GDP growth in 2010: one is more optimistic in the 2.0-2.1 percent range. On the optimistic side the National Association for Business Economists consensus forecast recently predicted real GDP growth of 2.9 percent for 2010. Similarly, the most recent Economist magazine forecast for 2010 stood at 2.7 percent and Beacon Economics of San Francisco recently came out with a forecast of 2.6 percent.

On the less optimistic side in the well-known UCLA Anderson forecast with a prediction of 2.0 percent matched by a prediction from Goldman Sachs of 2.1 percent growth next year.

In addition to massive economic stimulus spending and low interest rates, there are two other factors that will add strength to the recovery: increased exports and greater spending on information technology.

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