

BLUE CHIP ECONOMIC FORECAST

PHOENIX

W. P. CAREY
SCHOOL of BUSINESS

The Greater Phoenix Area

ASU ARIZONA STATE
UNIVERSITY

A perspective on measuring competitiveness

The Greater Phoenix economy has displayed impressive growth compared to the U. S. as a whole during the present business cycle as it has during most of the past century. The Greater Phoenix economy historically has grown much more rapidly than the U. S. during periods of expansion. So far this decade, employment growth in Greater Phoenix is outpacing that of the nation by a factor of ten. This is a much stronger relative performance than normal due to a combination of strong growth in the local economy and anemic growth in the nation as a whole. At the present time, one out of every 72 jobs in the country is found in Greater Phoenix, while one out of every 19 jobs created in the U.S. over the past year was created within the local market.

WHERE ARE WE GROWING?

There is more to the story, however. Prior to this business cycle, a more significant portion of our growth relative to the U.S.

was in export or "base" industries. Base sector employment brings dollars into the local economy. Examples of base industry employment include manufacturing, advanced business services, tourism and any other industries that result in dollars being imported into the local economy such as retirement or federal government employment. In fact, the health of the overall economy is a function of these base industries. On average, base industries also tend to provide above average wages (tourism is the notable exception).

During the current expansion, a larger portion of our employment growth has been in the low-to-moderate paying population-based sectors. It is not that our economy is underperforming – it is performing at about the same level in manufacturing, and outperforming the U.S. in most other sectors. But because those other sectors have, in general, lower wages than manufacturing, the total mix shows Greater Phoenix with relatively lower wages. The rapid

population growth is resulting in additional demand for population-based employment. This includes employment in construction, trade, and other service sectors.

In the aggregate, employment growth in Greater Phoenix has actually been broader-based than that of the nation as a whole. For some perspective, over the last 12 months, local construction employment was up 11.7 percent compared to 2.6 percent nationally. Retail trade employment was up 7.6 percent vs. a decline of 0.7 percent nationally. Manufacturing was down 0.1 percent in Greater Phoenix compared to a gain of 0.1 percent in the U.S. as a whole. And, professional and business services gained 8.0 percent locally vs. 2.7 percent nationally.

The local employment pattern is affected by the fact that semiconductor manufacturing, one of the mainstays of the Greater Phoenix manufacturing base, has lagged in this cycle. The weakness in manufacturing is partly due to global competitiveness and
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Local economy slowing, national recession a possibility

It is clear that the panel expects growth in 2006 to be slower than in 2005, and 2007 to be slower than 2006. Both national and local trends are expected to contribute to the slowdown; however, the local economy is still expected to do well relative to the rest of the nation. The pace of the national economy remains the biggest unknown in the effort to forecast the local economy.

The Federal Reserve has been trying to slow the economy by raising the federal funds rate. The second quarter GDP figures are the first evidence that the economy is

slowing, although as usual it is not clear how much of the slowing is due to Fed actions. TV news analysts immediately switched from worrying about the economy expanding too rapidly to worrying that the Fed had gone too far and was going to cause a recession.

National recession is a possibility, particularly since the yield curve has inverted – a signal that has predicted every recession since the 1960s with only one false positive (see chart on page 4). The yield curve is usually expressed as the difference between a long-term and

a short-term interest rate (10-year versus 1-year treasury notes, for example). If the lower long-term rate is primarily the result of low inflation expectations and continued buying of U.S. securities by foreign governments, there is probably little to worry about. However, to the extent that low long rates result from lack of interest in borrowing they are a problem. The drop in mortgage borrowing due to the slowing housing market is the biggest red flag so far. The question is the extent to which mortgage problems and higher gas prices
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GREATER PHOENIX ECONOMIC FORECAST FOR 2006

SOURCE	ANNUAL PERCENT CHANGE 2006 FROM 2005							AVERAGE RATE FOR 2006	
	Popu- lation	Personal Income	Retail Sales	Wage & Salary Empl.	Manu- facturing Empl.	Construc- tion Empl.	Services Empl.	National CPI	Unem- ployment Rate
Arizona Department of Commerce	3.0 L	7.6 L	7.1 L	4.0 L	1.0	3.5	4.3 L	3.1	4.1
Arizona Public Service	3.2	8.5	10.0	4.2	1.5	10.0	5.0	3.5 H	3.9
ASU - Economic Outlook Center	3.1	7.8	7.5	4.5	1.2	3.0	7.0 H	2.8	4.0
Department of Economic Security	3.1	8.1	7.4	5.1	1.5	12.0 H		3.1	4.0
ECON-LINC	3.2	7.8	7.6	4.8	0.2	7.0	5.5	3.2	4.0
EconLit LLC	3.0 L	7.7	7.2	4.0 L	2.5	1.5 L	5.0	2.8	3.9
Elliott D. Pollack and Co.	3.1	8.0	10.0	5.5 H	3.0 H	5.0	5.5	3.5 H	4.0
H.C. Reardon Economics	3.2	8.3	7.6	4.8	0.0 L	10.0	5.3	3.4	3.9
Joint Legislative Budget Committee	3.1	7.9	8.0	4.2	2.0	3.2	5.0	3.2	4.0
The Maguire Company	3.2	8.1	7.5	4.3	3.0 H	4.0	5.5	3.0	4.1
Salt River Project	3.1	9.0 H	8.0	5.1	2.0	10.0	6.0	3.0	3.8 L
U of A - Eller College	3.7 H	8.7	10.2 H	5.0	2.2	4.6	5.3	2.5 L	
VisionEcon	3.6	8.5	8.6	4.5	1.6	6.0	6.0	3.2	4.5 H
Consensus	3.2	8.2	8.2	4.6	1.7	6.1	5.5	3.1	4.0

GREATER PHOENIX ECONOMIC FORECAST FOR 2007

SOURCE	ANNUAL PERCENT CHANGE 2007 FROM 2006							AVERAGE RATE FOR 2007	
	Popu- lation	Personal Income	Retail Sales	Wage & Salary Empl.	Manu- facturing Empl.	Construc- tion Empl.	Services Empl.	National CPI	Unem- ployment Rate
Arizona Department of Commerce	3.0	7.2	6.5	3.2	1.0	-10.0 L	3.6	3.1	4.5
Arizona Public Service	3.1	8.0 H	8.0 H	3.8	1.5	0.0	4.5	3.8	4.3
ASU - Economic Outlook Center	3.0	7.0	7.0	4.2 H	1.1	-5.0	6.0 H	3.1	4.2
Department of Economic Security	3.0	7.3	7.0	4.1	1.3	7.1 H		3.2	4.1
ECON-LINC	3.0	7.8	7.2	4.2 H	2.0	2.0	5.2	3.2	4.2
EconLit LLC	3.0	7.2	6.8	3.8	2.4	1.5	5.0	2.7	4.2
Elliott D. Pollack and Co.	3.1	7.5	7.5	4.0	3.5 H	3.0	5.0	3.2	4.2
H.C. Reardon Economics	2.9 L	7.5	6.4	3.4	0.0 L	0.0	4.0	4.0 H	4.2
Joint Legislative Budget Committee	3.0	7.5	7.0	3.8	2.0	2.0	4.8	2.7	4.1
The Maguire Company	3.1	7.6	7.4	4.0	3.0	4.0	5.0	3.1	4.2
Salt River Project	3.0	8.0 H	7.5	3.2	0.0 L	0.0	3.5 L	2.5	3.8 L
U of A - Eller College	3.3 H	7.8	5.7 L	3.5	0.2	1.0	4.0	1.9 L	
VisionEcon	2.9 L	6.3 L	6.9	3.1 L	1.6	4.0	4.0	3.7	4.8 H
Consensus	3.0	7.4	7.0	3.7	1.5	0.7	4.6	3.1	4.2

Data sources for Maricopa County (Greater Phoenix area): population, U.S. Census Bureau; personal income, Bureau of Economic Analysis; retail sales, Arizona Department of Revenue; wage and salary employment, manufacturing employment, construction employment, service employment and unemployment rate, DES.

GREATER PHOENIX HISTORICAL DATA

SOURCE	Popu- lation (thousands)	Personal Income (millions)	Retail Sales (millions)	Wage & Salary Empl. (thousands)	Manu- facturing Empl. (thousands)	Construc- tion Empl. (thousands)	Services Empl. (thousands)	National CPI	Unem- ployment Rate
2005	3,630	121,521	40,500	1,743.1	132.2	163.1	706.0	195.3	4.1
	3.7%	9.4%	14.2%	6.2%	2.5%	15.8%	6.7%	3.4%	
2004	3,501	111,104	35,466	1,641.2	129.0	140.9	661.6	188.9	4.4
	3.3%	8.6%	9.6%	4.2%	0.5%	9.3%	5.6%	2.7%	
2003	3,389	102,278	32,371	1,575.8	128.3	128.9	626.4	184.0	5.2
	2.9%	5.4%	5.5%	1.2%	-5.0%	2.5%	2.6%	2.3%	

* Estimate

the industry's lifecycle and is not Arizona specific. This does mean, however, that it is important for Greater Phoenix to make itself as attractive as reasonably possible to other base industries that pay above-average wages. Again, this does not mean that the local economy is underperforming in any area. It is simply over-performing in certain areas that are population driven.

There may be limits to what can be done regarding our current employment mix. As noted, the changes in the manufacturing industry are global and are beyond our control. Furthermore, as long as we continue to grow at this rapid pace, population-based industries such as construction, retail trade, and many services will remain in high demand. On the other hand, this also makes it important that we provide a sound economic foundation from which to promote the area. We need to understand which factors truly make an area grow and prosper. Informed and well thought out attempts to broaden our economic base and create more export industry jobs should also be encouraged.

ARE WE GROWING TO OUR POTENTIAL?

Understanding what makes us grow is critical. Indeed, after reviewing hundreds of studies, articles and books on competitiveness over the last 30-plus years, it is evident that there are hundreds of factors that determine why one place grows and another does not. What is important to one individual or one company may be totally irrelevant to another. Thus, the starting point should be determining some basic underlying factors that have caused people and companies to move here.

Some factors are naturally occurring, such as climate and geographic location. Others are products of sound decision making. These include such basics as the provision of a competitive tax structure, limited government regulation, a transportation infrastructure and, generally, leadership with common sense. Yet others are historic "accidents" such as the residual air and army bases from World War II, and the diversification of the U.S. electronics manufacturing base away from the coasts in the 50s and 60s in order to avoid potential air attack in the event of war. Overall, people and companies vote with their feet. Based on that, Greater Phoenix has done quite well. But, there is always room for improvement, especially when it comes to

base industry growth.

HOW USEFUL ARE COMPETITIVENESS STUDIES?

Competitiveness studies are often used to attempt to determine where we stand relative to other communities or states. They attempt to quantify economic development factors, then rank the communities based on scores. Care must be taken in reading too much into these reports.

The difficult questions need to be asked by our decision makers. Are these studies actually indicators of future growth of an area? Have the studies been predictive of that growth in the past? Have the results of these studies been stable (i.e., have the rankings changed significantly over a short time by going, for example, from 15th one year to 26th the next)? Does this indicate that the study's methodology is overly sen-

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sitive and, thus, too unstable to be the basis of any long-term planning? Does the author have a political axe to grind? (Many studies are put out by groups with a specific political agenda and therefore use measurements that are biased to suit their needs.) Are the reports consistent with reality (i.e., is North Dakota's economic performance really matching up with its competitiveness ranking of sixth-best state in one such study, or is Utah's economic performance indicative of its number two ranking)? Exactly how does one quantify "quality of life" factors when, in many cases, beauty is in the eye of the beholder? Can the studies identify if there has been a change in a community's underlying dynamic? Does a study ignore history, without any proof that something has changed? If the studies cannot pass these basic tests, then utilizing the results can be dangerous and costly.

All too often, when a study is released, the media quickly seize upon it as an indicator of the local economy being in trouble, or needing to make changes to policy or law. While this makes for an interesting debate, without the proper background such a debate can lead to erroneous conclusions. This is not to say that there is no place for competitiveness studies. Quite the contrary. If performed in the proper context, they have the potential to be useful tools.

However, there is more to a community than just a study's ranking. There are many other factors that are not quantifiable. Is it a place of hope? Is it a place where people can come and feel like they are making a fresh start, and have an opportunity to make something of themselves? Or, is it a place with an overriding bureaucracy and social infrastructure that prevents that from happening? Is it a place where they can feel good about themselves and create a prosperous futures? Overall, there is no one metric for measuring competitiveness. Many things have to be examined in an attempt to monitor and improve our economic health. It is the job of those who look at this issue to prove – not guess – that what has worked historically will not continue to work. Where is the evidence that shows proven results? This will be the subject of much discussion in the future in many publications, including this one.

How do we make ourselves look pretty? By concentrating on what has worked well in the past and emphasizing those attributes. We can *also* look to the future to see what else can be done. This does not mean, however, that we should go tilting at windmills. That means not accepting the latest trendy pseudo-study that comes along, but instead looking for hard evidence that any new criteria actually provide results instead of "promising results" based only on a point of view rather than any hard evidence.

Before competitiveness studies are used to make important policy decisions, the important questions outlined above must be asked. If the studies pass the basic tests, then they may have a place in the formulation of public policy. However, the onus should be placed on the authors to demonstrate that the factors being reviewed are indeed relevant. Again, many of the underlying economic fundamentals of our community cannot be captured in a single competitiveness study.

— Elliott D. Pollack

will translate into lower consumer spending going forward.

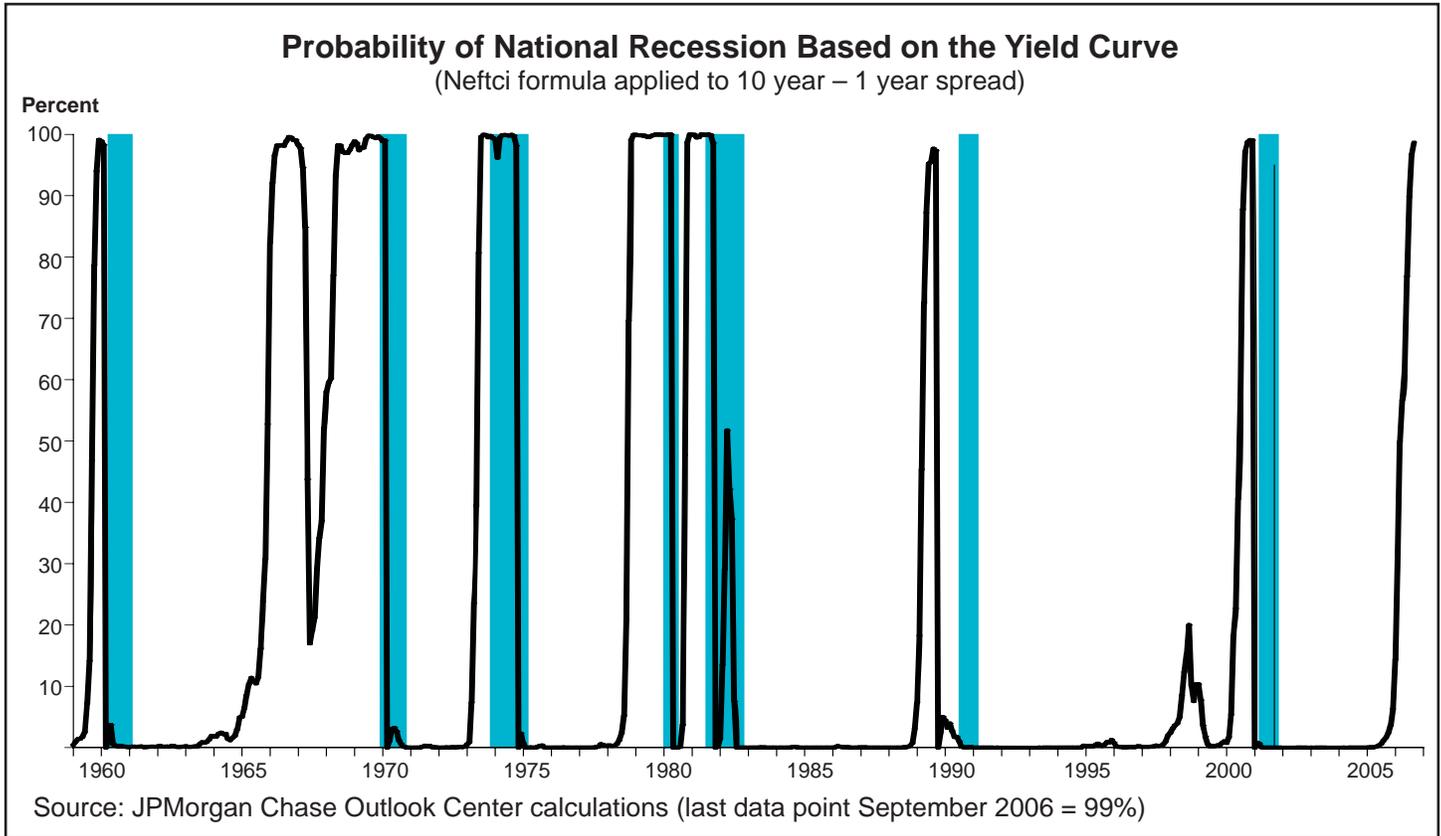
Low interest rates in the '90s and on into the new century contributed to a booming single-family market that was remarkable for the length of its run. However, in marked

contrast to other areas, we had only one – or at most two – quarters where activity tipped over the line from robust to crazy.

The local area is accustomed to a construction sector where residential and non-residential are both up or down at the same

time. We can be thankful that the residential and nonresidential markets are currently out of sync, as nonresidential activity should help buffer the impact from the slowing residential market.

— Tracy Clark



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