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ARIZONA STATE UNIVERSITY'S MONTHLY NEWSLETTER ON THE ARIZONA ECONOMY

Changes occurring at Seidman Research Institute

AZB/Arizona Business to cease publication

A number of changes are occurring at the L. William Seidman Research Institute, part of the W. P. Carey School of Business at Arizona State University. Long-time director Timothy D. Hogan has retired, but will continue to participate in some of the Institute's projects in his emeritus status.


Timothy D. Hogan

Dr. Hogan, with a Ph.D. in Economics from Virginia Polytechnic Institute, joined the faculty of the Economics Department at Arizona State University in 1970 and became associated with the Bureau of Business and Economic Research, a predecessor to the Seidman Research Institute, in 1971. He became a professor of economics in 1983, director of the Center for Business Research at its founding in 1987, and assumed the directorship of the Seidman Research Institute in 1995.


Dennis L. Hoffman

The new director of the Seidman Research Institute is Dennis L. Hoffman, a professor of economics who also is associate dean for research and doctoral programs in the W. P. Carey School of Business. Dr. Hoffman recently served as associate dean of graduate programs. Professor Hoffman has a Ph.D. in Economics from Michigan State University and joined he faculty of the Economics Department at Arizona State University in 1979. Since 1982, he has produced revenue projections for the governor's Office of Strategic Planning and Budgeting and has participated in other applied research projects, such as Arizona Town Hall background reports.

A new director of the Center for Business Research (CBR) will not be named at this time. Tom R. Rex, research manager of the Center, has become its associate director. He has been associated with the CBR since 1980.

The Arizona Real Estate Center, formerly a part of the Seidman Research Institute, has moved from the W. P. Carey School of Business at the Tempe campus of Arizona State University to ASU East. The Center's mission has not changed and it will continue to produce information on construction, home sales, affordability and appreciation, including the Phoenix Metropolitan Housing Study and the Phoenix Metropolitan Commercial Study. Jay Q. Butler remains the director of the Center; Alice Ann Petersen and Karen Faith continue as research technicians. Contact information is Arizona Real Estate Center, East College, Arizona State University East, Sutton 301C, 7001 East Williams Field Road, Mesa, Arizona 85212; (480) 727-1688.

Arizona Business, which began to be published in 1953, primarily has reported the research of the Arizona Real Estate Center, the Bank One Economic Outlook Center and the Center for Business Research since the late 1980s. In 2000, *AZB/Arizona Business* became available online at www.wpcarey.asu.edu/seid/cbr as well as in hard copy. After the December 2004 issue, the content of the publication will continue to be available from the Web site of the university, with the articles available separately rather than aggregated into a publication. More information regarding access to this information will be included in the December issue.

Operations of the other centers in the Seidman Research Institute will undergo little change. In addition to the CBR, the Institute consists of the Bank One Economic Outlook Center, CAPS Research, the Center for the Advancement of Small Business, the Center for Advancing Business through Information Technology, and the Center for Services Leadership.

INSIDE

CENTER FOR BUSINESS RESEARCH

W. P. CAREY SCHOOL of BUSINESS

ASU

Single-family soars in 2nd quarter despite rate increases

Arizona's single-family home sector posted a 23 percent increase in the second quarter, jumping from $2.8 billion in first quarter to $3.5 billion. With this sector representing 70 percent of construction activity, the Arizona construction industry improved from $4 billion to $5 billion. Led by the apartment and retail sectors, the commercial sector grew 34 percent, from $582 to $780 [see Table 3]. However, the biggest area in the commercial sector was tenant improvements at $180 million, mostly due to $124 million in Chandler for the Intel project. The "other" sector (including religious facilities, public projects and health care) improved 22 percent ($438 to $532 million).

Phoenix was the most active area of development, with 19 percent of Arizona's construction market. The 12 communities listed in Table 1 represented 74 percent. Other areas of significant development included Peoria ($98 million), Tempe ($86 million), unincorporated Yavapai County ($61 million), Casa Grande ($58 million), Marana ($52 million), and Lake Havasu City ($47 million).

RESIDENTIAL

Amid a strengthening economy and higher energy prices, there was concern about higher interest rates. Mortgage rates rose from 5.3 percent in April to nearly 6 percent in June. The potential that rates could rise even more has prompted households to take advantage of what could be a disappearing opportunity: to own a home, move up to a better home or acquire an investment home. Based on an increase from 10,622 to 14,080 permits [see Table 2], the leading areas of activity were Phoenix (2,927 permits), Surprise (2,263), Gilbert (1,465), Chandler (1,316), and unincorporated Maricopa County (1,294). The West Valley — including Surprise (2,263), Avondale (811), Buckeye (778), Goodyear (739), and El Mirage (113) — accounts for 33 percent of the new home market.

The single-family housing market in Pima County was fairly stable [see Table 2]. Unincorporated Pima County authorized 979 homes; Tucson, 662; and Marana, 296. The average permit value in Pima County increased from last year's $159,070 to $168,100, while in Maricopa County it rose from $158,940 to $172,295.

Pinal County (2,564 permits) accounted for 12 percent of the state's new home market, while Mohave (805) and Yavapai (831) each had 4 percent. In these counties the unincorporated areas are important markets, with 2,242 permits in unincorporated Pinal County, 370 in Mohave and 328 in Yavapai. Specific communities included Casa Grande (288), Prescott Valley (277), Lake Havasu City (247), and Sierra Vista (239). Paradise Valley had the highest average permit value ($830,140), while it was $217,300 in Prescott, $206,950 in Flagstaff, $119,035 in Casa Grande and $113,915 in Lake Havasu City.

COMMERCIAL

Except for the retail sector, which has followed the ever-expanding area of new-home rooftops, commercial activity has been forestalled by increasing vacancies and limited rent growth. However, with low interest rates and an expanding economy, commercial activity has shown signs of improving. As affordable homeownership draws away tenants, construction of apartments has had an inconsistent pattern as shown in Table 3. Phoenix was the leading area of activity with 950 permitted units, followed by Avondale (247 units) and Chandler (144 units).

Scottsdale led the office building market with $32 million, followed by Phoenix ($18 million). Retail development activity was especially strong in Phoenix ($74 million) and Gilbert ($33 million). The leading area for commercial remodeling was Chandler at $124 million, with most of the activity for the Intel conversion. Other areas included $18 million in Scottsdale and $12 million in Mesa.

Outside Maricopa County, Tucson accounted for most new apartment development with 484 units, followed by 73 units in Eloy. So far this year, the office sector has weakened while the retail sector demonstrated some improvement [see Table 3]. Tucson reported $3.4 million in new retail activity and $7.0 million office development, while unincorporated Pima County had $6.5 million in the office sector and $3.4 million in the retail sector. The primary areas of retail development were in Yuma ($12 million) and Mohave Valley South ($5.1 million). Prescott reported $3.8 million for the office building sector, followed by Lake Havasu City ($2.5 million). Tucson reported strong activity in commercial remodeling ($16 million) followed by unincorporated Cochise County ($10 million). The hotel/motel sector had only three permits valued at $1.8 million.

TABLE 1
REPORTING UNITS WITH GREATEST TOTAL VALUE OF BUILDING PERMITS
Second Quarter 2004

Reporting Unit	*Value (in millions)*
Phoenix	$963
Chandler	405
Surprise	358
Gilbert	321
Unincorporated Pinal County	297
Unincorporated Maricopa County	248
Unincorporated Pima County	220
Mesa	207
Scottsdale	185
Goodyear	179
Avondale	175
Tucson	172

TABLE 2
ARIZONA HOUSING UNITS AUTHORIZED
Second Quarter 2004

	One Family	*Mobile Homes*	*Duplex*	*3-4 Family*	*5 or More*	*Total*
MARICOPA COUNTY	14,080	287	68	306	1,603	16,344
% Change, Previous Year	30	-20	113	524	-14	24
% Change, Previous Quarter	33	10	36	-10	48	32
PIMA COUNTY	2,186	217	38	9	484	2,934
% Change, Previous Year	1	-56	6	-44	4,740	7
% Change, Previous Quarter	2	5	36	200	190	15
REST OF ARIZONA	5862	984	78	38	247	7209
% Change, Previous Year	30	0	15	-44	-62	15
% Change, Previous Quarter	14	2	-29	-54	-4	10
TOTAL, ARIZONA	22,128	1,488	184	353	2,334	26,487
% Change, Previous Year	26	-19	35	165	-7	20
% Change, Previous Quarter	24	4	-2	-17	55	23

Source (Tables 1 and 2): Arizona Real Estate Center, L. William Seidman Research Institute, W. P. Carey School of Business, Arizona State University.

INDUSTRIAL AND OTHER

Although there were no new major industrial developments, activity improved slightly based on two permits valued at $10.9 million in Tolleson. Phoenix issued two permits for new development in the Sky Harbor area valued at $54 million and $23 million. Phoenix issued a permit for $17.5 million for a health care facility and Tempe reported a $37.3 million permit for the arts center.

LOOKING AHEAD

Although inconsistent, the improvement in the commercial and industrial sectors show that the market is getting better and has some potential for strengthening. In most sectors, occupancy has begun to stimulate some rent growth, which could become evident in late 2004 or early 2005. Much of the new commercial development will occur in newer residential areas in the West Valley and Pinal County. This will provide important retail and employment opportunities to fill a market void in what is likely to become an energy-constrained economy.

Although the Federal Reserve has recently raised interest rates, mortgage rates actually have fallen from 5.9 percent in June to 5.6 percent in August. The decrease is due to the inconsistent economic recovery which is limiting growth in the stock market, which in turn is fostering stronger activity in the bond market and lower interest rates. Thus, significant increases in mortgage rates are unlikely. Based on current median home prices and household incomes, 8 percent is the rate that could begin to restrict the housing market. In addition, there are concerns about the motivations of current buyers as to whether the market is being driven by investors or homeowners. Based on market experience, the future direction and strength of the single-family market could well be determined by the strategies and actions of investors.

— Jay Q. Butler
Director
Arizona Real Estate Center

TABLE 3
KEY SECTOR CONSTRUCTION ACTIVITY
Second Quarter 2004, First Quarter 2004 and Second Quarter 2003

	Single-family		COMMERCIAL: Apartments[a]		COMMERCIAL: Office Buildings[b]		COMMERCIAL: Retail Stores[c]		Industrial	
	Number of Permits	*Dollar Value (000)*	*Number of Permits*	*Dollar Value (000)*	*Number of Permits*	*Dollar Value (000)*	*Number of Permits*	*Dollar Value (000)*	*Number of Permits*	*Dollar Value (000)*
MARICOPA COUNTY										
Second Quarter 2004	14,080	$2,425,920	1,603	$98,867	162	$103,888	183	$179,444	35	$34,083
First Quarter 2004	10,622	1,853,692	1,082	69,390	140	83,126	159	117,799	57	33,400
Second Quarter 2003	10,834	1,721,950	1,858	118,587	161	132,452	152	111,643	37	19,593
PIMA COUNTY										
Second Quarter 2004	2,186	367,463	484	35,775	69	13,508	39	8,666	36	6,364
First Quarter 2004	2,146	360,818	167	1,020	65	18,650	24	7,764	5	658
Second Quarter 2003	2,172	345,495	10	430	40	9,074	30	12,069	3	422
REST OF ARIZONA										
Second Quarter 2004	5,862	719,617	247	17,986	49	12,624	54	27,505	27	8,071
First Quarter 2004	5,139	634,860	257	16,655	41	18,603	50	35,266	14	4,420
Second Quarter 2003	4,500	523,503	648	34,328	25	13,377	57	19,821	14	9,647
ARIZONA TOTAL										
Second Quarter 2004	22,128	3,513,000	2,334	152,628	280	130,020	276	215,615	98	48,518
First Quarter 2004	17,907	2,849,370	1,506	87,065	246	120,379	233	160,829	76	38,478
Second Quarter 2003	17,506	2,590,948	2,516	153,345	226	154,903	239	143,533	54	29,662

[a] Five or more housing units [b] Office, bank, medical and professional buildings [c] Shopping centers and other mercantile buildings

TABLE 4
ARIZONA BUILDING PERMITS
Second Quarter 2004

	Residential*		Commercial		Industrial		Other		Total	
	Number of Permits	*Dollar Value (000)*	*Number of Permits*	*Dollar Value (000)*	*Number of Permits*	*Dollar Value (000)*	*Number of Permits*	*Dollar Value (000)*	*Number of Permits*	*Dollar Value (000)*
MARICOPA COUNTY	16,576	$2,501,102	1,411	$597,299	35	$34,083	9,170	$435,911	27,192	$3,568,395
% Change, Previous Year	21	39	38	40	-5	74	-7	9	10	35
% Change, Previous Quarter	26	30	19	46	-39	2	5	19	17	30
PIMA COUNTY	3,542	387,462	458	82,117	36	6,364	1,815	16,217	5,851	492,160
% Change, Previous Year	-8	6	13	48	1,100	1,408	-8	-43	-6	10
% Change, Previous Quarter	0	2	27	38	620	867	1	-24	3	7
REST OF ARIZONA	9,340	794,945	571	100,777	27	8,071	3,012	79,965	12,950	983,758
% Change, Previous Year	16	34	14	1	93	-16	25	-10	18	24
% Change, Previous Quarter	13	12	-7	-11	93	83	7	55	11	12
TOTAL, ARIZONA	29,458	3,683,509	2,440	780,193	98	48,518	13,997	532,093	45,993	5,044,313
% Change, Previous Year	15	34	26	34	81	64	-2	3	10	30
% Change, Previous Quarter	18	22	13	34	29	26	5	22	13	24

* Includes mobile homes

Source (Tables 3 and 4): Arizona Real Estate Center, L. William Seidman Research Institute, W. P. Carey School of Business, Arizona State University.

Economic mix differs considerably by region in Arizona

The economic structure varies widely across the 11 economic regions of Arizona. Some regions are highly dependent on one economic activity — such as agriculture, mining, or tourism — while others have a more diverse mix of driving economic activities, though the mix varies across these regions. Further, the strength of private-sector driving activities differs considerably by region.

A recently completed study of the economy of each incorporated city in Arizona, along with unincorporated areas and regions, was performed by the Center for Business Research under contract to the Arizona Department of Commerce. The 125 reports produced for this project, along with the data-sets, are available from the Department of Commerce's website: www.commerce.state.az.us (click on "Economic Info & Research" then on "Arizona Community Economic Base Studies").

BACKGROUND

An economic base study is a description of an economy's structure and composition. Regional economic theory states that a local economy is driven by economic activities that import money into the local area through the sales of goods and services to customers who do not live in the area. Leading economic activities are identified in the economic base study, which compares economic activity (as measured by employment) in the local area to that in broader areas: Arizona and the nation.

Because of the vast differences in size between a local area, Arizona and the United States, employment is divided by the 2000 census population count for each area. This **"per capita employment"** is expressed as employment per 1,000 residents.

To create a comparative measure, per capita employment in the local area is divided by the national average per capita employment. The result is called a **"location quotient"** — a figure greater than 1 indicates that per capita employment in the local area is greater than the national average. For example, a location quotient of 1.32 indicates that per capita employment in the local area is 32 percent higher than the national average, while a location quotient of 0.68 shows that per capita employment is 32 percent less than the national average. The location quotient calculated relative to the Arizona average typically is similar to the location quotient calculated against the national average, but in some industries it can be considerably different.

When a location quotient is greater than 1, "extra" jobs are present in the local area. This **"excess employment"** is the difference between actual employment and the employment that would exist if employment per capita had equaled the national average. Excess employment is of particular significance in industries that sell their goods and services to companies located outside the region or to individuals who are not residents of the region (nonresidents include tourists and seasonal residents).

"Basic" or "export" activities are those involving sales to nonlocal businesses and individuals. Such activities drive the local economy by bringing money into the community. Basic industries with excess employment are the primary forces driving the local economy. Mining, most types of manufacturing, most agriculture, and tourism are classic examples of basic activities.

In contrast, some economic activities primarily serve local residents. Retail trade and services such as health care, finance, and real estate are examples of largely nonbasic, local-support activities. Similarly, most construction work is purchased by local residents and local businesses. While important components of a local economy, such largely nonbasic activities do not directly bring much money into the community and thus do not drive the local economy.

Excess employment can exist in local-support activities. In some cases, the excess results from local purchasing preferences. For example, per capita sales of air conditioning units are above the national average in much of Arizona because of climatic conditions.

TABLE 1
EXCESS EMPLOYMENT PER 1,000 RESIDENTS BY ARIZONA ECONOMIC REGION
Excess Employment by Private-Sector Industry Summed into Categories, 2001

	Central	*Southern*	*S. River*	*N. River*	*Canyon*	*Mtn.*	*Navajo/Hopi*	*Yavapai*	*Plateau*	*Mining*	*Southeast**
TOTAL	**100.8**	**69.1**	**89.5**	**51.5**	**101.5**	**140.4**	**18.3**	**72.0**	**49.5**	**83.5**	**50.4**
BASIC	**27.8**	**31.5**	**75.7**	**19.5**	**54.5**	**81.6**	**8.5**	**33.1**	**27.5**	**73.5**	**13.9**
Agriculture	0.0	0.0	61.5	0.0	0.0	0.2	0.0	0.0	0.0	1.5	3.6
Mining	0.0	1.8	0.0	0.2	3.6	0.5	5.8	5.3	0.4	65.9	0.4
Logging/Mills	0.0	0.0	0.0	0.0	0.5	1.9	0.0	0.0	4.8	0.3	0.0
Power Generation	1.0	0.9	0.0	0.0	0.0	1.3	0.0	0.6	3.3	0.1	0.0
Export Manufacturing	15.4	19.8	8.7	8.3	6.0	10.6	1.3	9.9	0.8	0.3	3.7
Tourism/Seasonal Residents	11.4	9.0	5.5	11.0	44.4	67.1	1.4	17.3	18.2	5.4	6.2
PARTIALLY BASIC	**39.6**	**18.1**	**5.7**	**16.7**	**22.6**	**17.5**	**0.2**	**25.3**	**10.2**	**3.7**	**23.7**
Local Manufacturing	0.8	0.3	0.2	0.4	0.0	1.6	0.0	0.0	0.1	2.1	0.0
Wholesale Trade	3.2	0.1	0.9	1.3	5.7	1.7	0.0	3.5	0.3	0.0	9.0
Transportation	7.3	0.0	0.1	0.0	0.0	0.3	0.0	0.0	0.0	0.0	2.6
Construction/Real Estate	19.8	9.8	3.3	13.7	15.5	7.3	0.2	19.5	9.8	0.4	2.3
Other	8.5	7.9	1.2	1.3	1.4	6.6	0.0	2.3	0.0	1.2	9.8
NONBASIC	**33.4**	**19.5**	**8.1**	**15.3**	**24.4**	**41.3**	**9.6**	**13.6**	**11.8**	**6.3**	**12.8**

* Because of economic activity along the international border, a greater-than-average proportion of the excess employment in the wholesale trade, transportation, other, and nonbasic categories is basic in the southeast region.

Source: Center for Business Research, L. William Seidman Research Institute, W. P. Carey School of Business, Arizona State University.

In other cases, excess employment exists because some communities function as regional trade and service centers. While sales to residents of neighboring communities might be considered to be basic in a particular community, such sales are not basic in the broader area and are not considered to be a driving economic activity in the same way as mining, for example.

Many economic activities, such as wholesale trade and transportation, are a mixture of basic and nonbasic components. If a community has a substantial number of tourists and/or seasonal residents, even retail trade and such services as health care have a basic component. A portion of the construction industry is basic if purchases are made by companies that sell to an external market and/or by individuals migrating to the area to take a job at a basic employer or to retire. Some federal government activities and certain other government activities can be considered to be basic in a community, but most state and local government employment supports the local community primarily with funds raised locally and thus do not qualify as basic activities.

The focus of this article is a regional comparison of economic structure. As part of the Statewide Economic Study conducted by the Arizona Department of Commerce in 2002, the state was geographically divided into 11 regions, with regional boundaries not necessarily following county boundaries.

Per capita excess employment by industry were summed into several categories, as seen in Table 1. The categorical totals were grouped into three broad classifications: largely basic activities, partially basic activities, and largely nonbasic activities. This analysis was limited to nongovernment activities because of the lack of comparability of some of the national government data to that collected for Arizona.

REGIONAL SUMMARIES

The regions with the highest per capita excess largely basic private-sector employment are heavily dependent on just one activity: agriculture in the South River region, mining in the Mining region, and tourism/seasonal residents in the Mountain and Canyon regions. The figures in these regions are far higher than those in some regions, particularly the Navajo-Hopi region, which has little excess largely basic private-sector activity. Per capita excess partially basic private-sector employment varies less widely across the regions. The highest figure is in the Central region because of the Phoenix area serving the rest of the state in certain activities, such as transportation and wholesale trade. Total per capita excess private-sector employment (including the largely nonbasic classification) varies substantially by region, with the highest figure in the Mountain region and the lowest in the Navajo-Hopi region.

Central. The Central region, which consists of Maricopa County and western Pinal County, by far has the largest population of any region at more than 3 million. Manufacturing is the leading driver of economic activity in the Central region, with high-technology manufacturing of particular importance. Tourists and seasonal residents, transportation, and call centers and back-office operations are other economic drivers.

Per capita excess employment in the partially basic classification is the highest in the state. The transportation and construction/real estate categories have the state's highest figures and the "other" category (particularly telemarketing and back-office operations) is close to highest. The manufacturing category has the second-highest figure, with much of the excess employment in the semiconductors industry, other electronics industries, and the aircraft industry.

Southern. The Southern region, which consists of Pima County, is substantially more populous (approaching 900,000 residents) than any region except the Central region. Manufacturing industries, particularly aerospace, are key drivers of the economy of the Southern region. Davis-Monthan Air Force Base and the University of Arizona are highly significant components of the economy. Tourists and seasonal residents also contribute.

The per capita excess employment figure in the export manufacturing category is the highest in the state. It is dominated by the guided missiles and space vehicles industry, with the aircraft industry also contributing. The telemarketing industry also has considerable excess employment.

South River. Part of La Paz County (excluding the Parker area) and Yuma County make up the South River region. Agriculture and military operations are the primary drivers of the economy of the South River region. Other government activities (such as the Border Patrol and the state prison), some manufacturing industries, seasonal residents, in-migrating retirees, and tourists also contribute.

The dominance of agriculture among the nongovernment activities is clearly seen in Table 1. It is the primary cause of the region having the second-highest per capita excess basic nongovernment employment in the state. Other than farming, the yarn mill industry provides the most excess employment. Though the region is well known for its large number of seasonal residents, their impact on local employment is relatively small. Per capita excess employment in industries making up the tourism/seasonal residents category, the construction/real estate category, and the nonbasic category are relatively small.

North River. Part of Mohave County (excluding the portion north of the Colorado River) and the Parker area of La Paz County comprise the North River region. Manufacturing industries, seasonal residents, in-migrating retirees, and tourists are the primary drivers of the economy of the North River region. The region's economy is partially dependent on gambling in Nevada.

As seen in Table 1, no activity dominates the North River economy. The relatively high figure in the construction/real estate category reflects the region's very fast population growth.

Canyon. The Canyon region, consisting of the portions of Coconino and Mohave counties north of the Colorado River including Page, is by far the least populous region with not even 20,000 residents. Tourism, electrical power generation, and federal government activities are the primary drivers of the economy of the Canyon region. Some manufacturing also contributes.

The small population of the region creates considerable volatility in the measure of per capita excess employment. Several industries have unusually high figures, resulting in one of the highest overall nongovernment figures among the regions. The tourism/seasonal residents category is particularly large.

Mountain. Part of Coconino County (excluding the portion north of the Colorado River, the Hopi and Navajo reservations, and the Sedona area) and the Winslow area of Navajo County comprise the Mountain region. Tourism is the primary driver of the economy of the Mountain region, with some contribution from seasonal residents. Higher education (Northern Arizona University), federal government activities, and some manufacturing industries also are important economic activities.

The importance of tourism and seasonal residents among nongovernment activities is seen in Table 1 and is the primary reason for the region having the highest per capita excess nongovernment employment in the state. Per capita nonbasic nongovernment employment also is the highest.

Per capita excess employment is quite high in the traveler accommodation and full-service restaurants industries. Much of the manufacturing is in the surgical supplies industry.

Navajo/Hopi. The Hopi and Navajo reservations in northern Apache County, northeastern Coconino County, and northern Navajo County make up the navajo/hopi region. Funding from the federal government is the primary driver of the economy of the navajo/hopi region. Coal mining is the other major economic activity.

The region has the lowest per capita excess private-sector employment in the state by a wide margin. The figures are quite low in both the basic and partially basic categories.

Yavapai. The Yavapai region is made up of Yavapai County and the Sedona area of Coconino County. Tourists, seasonal residents, and in-migrating retirees are the primary drivers of the economy of the Yavapai region. The combined effect of a variety of manufacturing industries also is significant.

As seen in Table 1, no activity dominates the region's economy. The strength of the tourism/seasonal residents category particularly results from the full-service restaurants industry. The relatively high figure in the construction/real estate category reflects the region's very fast population growth.

Plateau. Southern Apache County, northern Gila County, and southern Navajo County comprise the Plateau region. Tourists and seasonal residents are the primary drivers of the economy of the Plateau region, with electrical power generation and wood products important activities. Some federal government activities also contribute.

The region has the greatest per capita excess employment in the logging/mills and power generation categories. The sawmills industry has one of the highest figures among the industries, along with the casino hotel industry.

Mining. Southern Gila County, Graham County, Greenlee County, and eastern Pinal County make up the Mining region. Mining is the primary activity driving the economy of the region. Some government activities, particularly state and federal prisons, also are important. The dominance of mining among the nongovernment activities is clearly seen in Table 1. Copper mining and copper smelting have very high per capita excess employment. Mining is the primary cause of the region having the third-highest per capita excess basic nongovernment employment in the state. In contrast, the partially basic and nonbasic measures are near the lowest in the state.

Southeast. The Southeast region consists of Cochise and Santa Cruz counties. Fort Huachuca is the primary driver of the economy of the Southeast region, and stimulates the private sector, particularly the computer design industry. Federal government activity related to the international border also is a strong economic driver, as is international trade. Tourism, agriculture, manufacturing, and telemarketing also contribute.

No activity dominates the region's private-sector economy, as seen in Table 1. The region has the state's highest figures in the wholesale trade and other partially basic categories. Along with the transportation category, a higher proportion of the activity in these categories is basic than in the rest of the state since so much relates to international trade. The wholesaling of fresh fruits and vegetables industry has high per capita excess employment.

— Tom R. Rex
Research Manager

Arizona Business Conditions Index declines in August

The seasonally adjusted Arizona Business Conditions Index fell to 62.0 in August from 67.2 the previous month, a 7.8 percent decrease. An index reading over 50 indicates the local economy is growing; below 50 suggests a slowdown in the overall level of economic activity in the near term.

ANALYSIS

In August, the Arizona Business Conditions Index broke out of its oscillation in the mid-60s where it has remained for almost a year. This is the lowest level that the index has recorded since September 2003. A single month's decline is not a trend. It is worth noting that the overall index remains well over the critical 50-point mark.

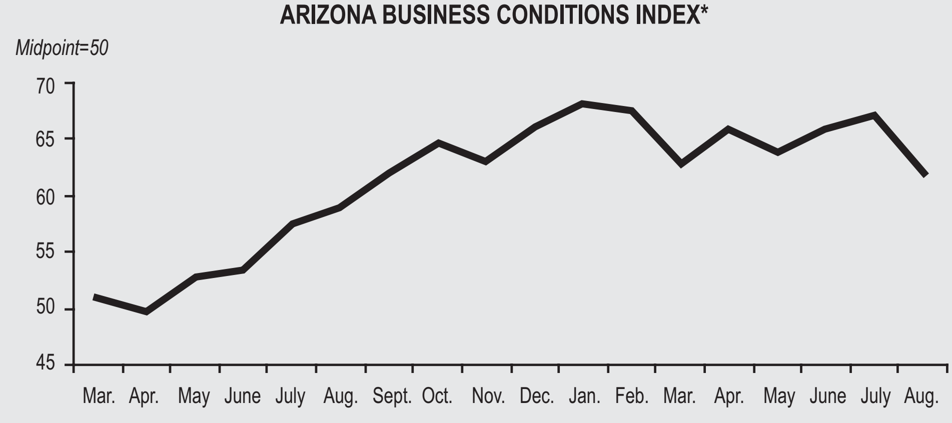
The employment component dropped from 58.4 to 51.7. This component has shown difficulty in recovering. Since the last recession, the employment component has reached beyond the 60-point level only five times compared to the overall index's 12 times. With those five exceptions, the employment component has remained in the low 50s, which is neutral territory.

The Price Index, after reaching the third highest level in the 42-year history of the index, fell by 10.4 points to 63.6 in August. Fuel prices, along with lumber and steel among others, had been a major driver of the previous jump in the Price Index.

Less upward pressure on prices could be the result of a decline in overall demand or a signal that supply has increased enough to meet demand. Given the 8.8 point decline in August of the purchases component of the overall index, the likelihood is that it may be the former.

— Dawn McLaren
Research Economist
Bank One Economic Outlook Center

FIGURE I
ARIZONA BUSINESS CONDITIONS INDEX*



*Excludes Price Index

Source: Bank One Economic Outlook Center, L. William Seidman Research Institute, W. P. Carey School of Business, Arizona State University.

Bank One Arizona Leading Index falls in August

The Bank One Arizona Index of Leading Economic Indicators fell in August to 124.2. The level was 0.7 percent below the revised 125.1 for July and 1.6 percent above the August 2003 level of 122.2 (1987 = 100).

Positive influences on the Leading Index were hours worked in manufacturing, the inflation-adjusted value of the M2 money supply, and new orders. Negative influences were the inflation-adjusted value of Maricopa County residential building permits, employment from the Business Conditions Survey, delivery times, materials inventories, and production. Sensitive materials prices were neutral.

Residential building permits continued a pattern of two “up months” followed by one or sometimes two “down months.” The ups have outnumbered the downs, so the dollar value of permits continues to climb despite the fact that August featured the largest downturn since January. Low interest rates and continued strong population growth have driven the single-family market to record heights. The population growth should continue, and, for the majority of home buyers, mortgage rates of 7 or even 8 percent will not price them out of the market. The concern lies with the estimated 20 percent of the real estate market now being absorbed by investors. Low rates and a lackluster stock market have been the driving force behind investor interest in residential real estate. Mortgage rates of 7 to 8 percent will make rental properties less popular, and a revival of the stock market would have a negative impact as well. It is impossible to tell precisely when investor interest will wane, but it is a significant risk.

The indicators from the Business Conditions Survey are new orders, employment, delivery times, materials inventories and production. The combined influence of these indicators has been negative in four of the last seven months, which suggests that business conditions have begun to plateau at a modest level of growth. Relative to the rest of the country, Arizona’s performance is still good enough to place its state economy in the top 10 in the nation. Unfortunately for Arizona, the lackluster performance of the rest of the economy is preventing the Grand Canyon State’s economy from taking off.

Thus we must look to the national economy, and at job growth in particular, to determine where Arizona will be in the coming months. For the 12 months ending in July, Arizona posted employment growth of 1.9 percent (third in the nation) versus 0.3 percent growth for the nation as a whole. For July, the most recent month for which year-over-year numbers are available, Arizona jobs grew 2.4 percent while the nation as a whole grew 1.3 percent. These numbers are subpar for Arizona at this point in the cycle, and discouraging for the United States, particularly since the national economy has had positive growth only since the first of the year. It appears that the primary problem facing the economy at the national level is weak job creation, despite the excellent GDP growth of 5.0 percent in the first half of the year.

Job growth has been weak nationwide for several reasons. One is the rapid productivity growth of the last 10 years. Simply put, companies can do more with fewer people — at least in the short run. The second reason is that export demand has been soft despite declines in the dollar because of weakness in the economies of our major trading partners. Yet another factor is the international and domestic uncertainty from terrorism, which has made most managers very cautious. However, the economy needs faster employment growth to put economic growth on a firmer footing.

Arizona continues to do better than most states during the current recovery, but our growth seems to have hit a plateau as it awaits signals of expansion in the national economy. The best indicator to watch is employment, for it is in this area that weakness continues to hold the economy back.

— Tracy Clark
Associate Director
Bank One Economic Outlook Center

TABLE 1
NET CONTRIBUTION OF INDIVIDUAL COMPONENTS TO THE ARIZONA INDEX OF LEADING ECONOMIC INDICATORS+

	May	*June*	*July*	*August*
Delivery Time*	-0.08	0.00	-0.01	-0.20
Inventory Levels*	0.03	0.10	-0.03	-0.11
New Orders*	-0.10	0.07	0.02	0.02
Production*	-0.05	0.04	0.05	-0.09
Employment*	0.12	-0.08	0.02	-0.21
Residential Building Permits	-0.08	0.17	0.29	-0.33
Average Workweek, Manufacturing	0.00	-0.07	-0.07	0.14
Money Supply	0.40	-0.05	-0.04	0.06
Change in Sensitive Materials Prices	0.00	0.00	0.00	0.00

+ The net contribution of each component is calculated by multiplying the monthly percent change in its index by its relative importance.

* Based on indicators from the Purchasing Management Association of Arizona, Purchasing Management Association of Southern Arizona and the Northern Arizona Group.

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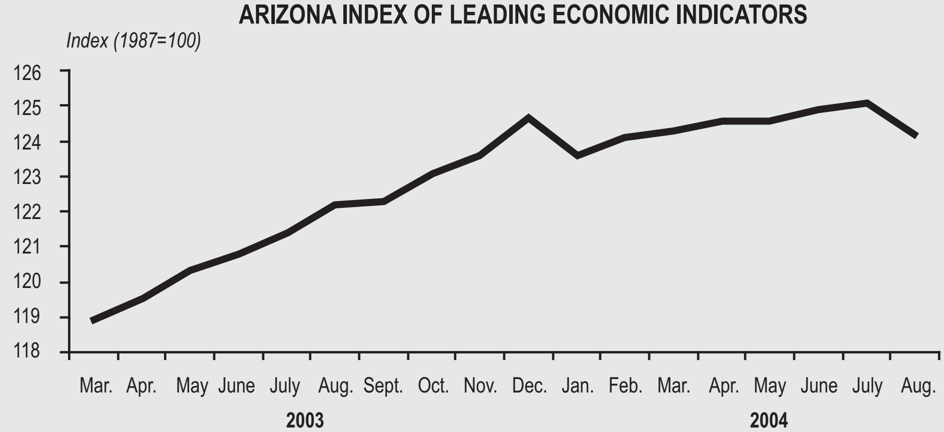
ARIZONA INDEX OF LEADING ECONOMIC INDICATORS



Source: Bank One Economic Outlook Center, L. William Seidman Research Institute, W. P. Carey School of Business, Arizona State University.

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Robert Mittelstaedt , Dean
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Nancy A. Maneely, Editor

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ARIZONA ECONOMIC INDICATORS

	Month or Quarter	Current Value	Previous Value	Percent Change Previous Period	Percent Change from Year Ago	Year-to-Date Value	Year-to-Date Percent Change from Year Ago
LEADING ECONOMIC INDEX (1987 = 100)							
Arizona	August	124.2	125.1 r	-0.7	1.6	NA	NA
BUSINESS CONDITIONS INDEX							
Arizona	August	62.0	67.2	-7.8	5.2	NA	NA
BUILDING PERMITS (Thousands of $)							
Maricopa County	July	1,251,496	1,194,509	4.8	44.6	7,555,246	34.3
Pima County	July	169,679	193,311	-12.2	4.9	1,121,589	12.0
Balance of State	July	302,861	364,964	-17.0	16.8	2,162,990	25.0
Arizona	July	1,724,036	1,752,784	-1.6	34.0	10,839,825	29.7
TOTAL HOUSING UNITS AUTHORIZED							
Maricopa County	July	6,225	5,257	18.4	52.9	34,925	30.7
Pima County	July	858	1,202	-28.6	-13.0	6,342	8.8
Balance of State	July	2,231	2,531	-11.9	14.4	15,995	21.3
Arizona	July	9,314	8,990	3.6	32.9	57,262	25.2
HOME SALES							
Maricopa County – Number	July	13,180	17,730	-25.7	29.2	89,890	32.0
Maricopa County – Median Price($)	July	174,375	173,000	0.8	9.7	166,000	8.8
HOUSING AFFORDABILITY INDEXES							
Metropolitan Phoenix – New Homes	2nd Quarter	100	113	-11.5	-13.0	NA	NA
Metropolitan Phoenix – Resale Homes	2nd Quarter	112	127	-11.8	-14.5	NA	NA
MORTGAGE RATES (30-year Fixed)							
Maricopa County	August	5.6	5.7	-1.8	-5.1	NA	NA
POPULATION ESTIMATES (Thousands)							
Maricopa County	1st Quarter	3,476	3,444	0.9	3.4	NA	NA
Pima County	1st Quarter	918	913	0.6	2.3	NA	NA
Balance of State	1st Quarter	1,365	1,353	0.9	3.2	NA	NA
Arizona	1st Quarter	5,759	5,710	0.9	3.2	NA	NA
RETAIL SALES (Millions of $)							
Maricopa County	June	2,922	2,850	2.5	6.9	17,296	9.4
Arizona	June	4,307	4,300	0.2	7.1	25,366	8.9

Note: The above figures reflect the latest data available as of date of publication and are subject to revision.

NA = Not Applicable r = Revised

Source: Center for Business Research, Arizona Real Estate Center, and Bank One Economic Outlook Center, affiliates of the L. William Seidman Research Institute, W. P. Carey School of Business, Arizona State University. Retail sales data are from the Arizona Department of Revenue.