

AZB ARIZONA BUSINESS

ARIZONA STATE UNIVERSITY'S MONTHLY NEWSLETTER ON THE ARIZONA ECONOMY

Economic growth remains moderate in third quarter

Economic growth continued into the third quarter of 2004 at a moderate pace both nationally and in Arizona. A strengthening of the national job market has not been registered in Arizona, but the Arizona data remain subject to revision. Economic growth typically is faster at this stage of the economic cycle than is being reported in 2004.

EMPLOYMENT AND UNEMPLOYMENT

Though the labor market began to improve in 2002 from the 2001 recession, job losses continued nationally in most months until September 2003. In Arizona, job growth resumed in 2002 but it was weak until July 2003. Monthly employment and unemployment figures are produced by the U.S. Bureau of Labor Statistics (stats.bls.gov), working in Arizona with the Arizona Department of Economic Security (www.workforce.az.gov). Employment estimates for the prior two years are revised early each year; revisions sometimes are significant in Arizona.

Though highly erratic from month to month, national job growth in the first 11 months of 2004 has averaged 185,000 per month, considerably less than normal for this stage of an economic cycle. However, job gains were substantially higher than the modest number in late 2003. In contrast, Arizona job growth has experienced no further acceleration in 2004, though data revisions early in 2005 may boost the figures. Year-over-year job growth in Arizona is running a little more than

50,000, compared to gains of 80,000 to 108,000 in each year from 1994 through 2000. Arizona's growth rate of 2.5 percent exceeds the national average of 1.6 percent by a smaller margin than normal.

The pace of job growth in the Tucson area remains slower than in the Phoenix area. In the balance of the state, the growth rate accelerated in August and September to surpass that of the Phoenix area. For comparisons of job growth by state and metropolitan area, see wpcarey.asu.edu/seid.

Nationally, three sectors stand out as having the greatest percentage employment growth: administrative services, construction, and mining, though numeric job growth was small in the mining sector. In Arizona, construction and mining also are among the growth leaders on a percentage basis, along with educational services (private sector education only). Construction is responsible for more than a fourth of the annual numeric job gain in Arizona. While several sectors in Arizona are expanding much faster than their national counterpart, others are doing more poorly, particularly manufacturing, wholesale trade, and information. Electronics manufacturing employment continues to fall in Arizona while the growth rate nationally is near the nation's overall rate.

The state's unemployment rate fell during the second half of 2003, from near 6 percent to 5 percent. It has fluctuated between 4.3 and 5.4 percent during 2004. The national average unemployment rate is holding at

Growth is slow for an expansionary period

AZB/Arizona Business ceases publication

This is the last issue of *AZB/Arizona Business*. The content of this publication will continue to be available as separate articles online at www.wpcarey.asu.edu/seid, the home page of the L. William Seidman Research Institute.

Each of the home pages of the Institute's research centers can be accessed from this page, as well as the research conducted by the Institute. The Institute's research has been divided into three components accessible from its home page: (1) economic and demographic data — the Bank One Arizona Index of Leading Economic Indicators, the Arizona Business Conditions Index, the Arizona Tourism Barometer, and links to other sources of Arizona data; (2) reports — articles previously published in *AZB/Arizona Business* as well as longer reports; (3) publications — issues of *AZB/Arizona Business* from May 2000 through December 2004 and the various subscription publications of the Bank One Economic Outlook Center.

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around 5.5 percent. Unemployment rates are lower at about 4 percent in the state's two large metropolitan areas.

PERSONAL INCOME

The latest personal income data released by the U.S. Bureau of Economic Analysis (www.bea.gov) are for second quarter 2004, with the most recent quarter's data subject to substantial revision. Arizona's personal income rose less than the national average in the second quarter, affected by employment growth, which accelerated nationally but not in Arizona. Given Arizona's much faster population growth than the national average, personal income in Arizona should rise much more than the national average.

Personal income growth in Arizona also was mediocre in the first quarter, less than in the three prior quarters. The first quarter data reflect revisions to wage and salary disbursements that are a significant portion of personal income. The annual growth rate (inflation-adjusted) was 5 percent in Arizona in fourth quarter 2003 and first quarter 2004, but slipped to 4 percent in the second quarter [see Figure I]. The national rate was 3 percent over the last three quarters.

RETAIL SALES

Retail sales growth in Arizona in 2004 has been the strongest since 2000, according to data of the Arizona Department of Revenue. The year-to-date increase through August was 8.5 percent (not adjusting for inflation), up from a gain of 5.3 percent in 2003. Maricopa County leads the state with a 9 percent rise. The advance in Pima County was 7 percent; in the balance of the state the gain was close to 8 percent. As seen in Figure II, retail sales growth has strengthened considerably in 2003 and 2004 from the weak figures experienced during and just after the recession.

TOURISM

Tourism activity continues to fluctuate, mostly due to the overseas visitors component, according to the Bank One Economic Outlook Center (wpcarey.asu.edu/seid). The latest Arizona Tourism Barometer (July 2004) was down 10 points from the February 2004 level, which was the index's highest point since September 2001, when terrorist attacks caused a sharp drop in tourism activity. The index remains far below its peak level, reached just before the start of the 2001 recession.

HOUSING

Housing price appreciation in Arizona,

as measured by the Office of Federal Housing Enterprise Oversight (www.ofheo.gov), jumped to an annual increase of 9.5 percent in second quarter 2004. As recently as third quarter 2003, the appreciation rate had been just 5 percent. Housing appreciation in Arizona is the highest since the early 1980s; gains were in the 5 to 6 percent range from 1994 through mid-2003. The appreciation rate also has accelerated nationally; the Arizona figure is the same as the national average. Appreciation rates are high in each of Arizona's metro areas: 13.5 percent in Flagstaff, 10 percent in Tucson, 8 percent in Phoenix, and 7.5 percent in Yuma.

INFLATION

As measured by the U.S. Consumer Price Index (stats.bls.gov), the year-over-year inflation rate has fluctuated since bottoming out at 1 percent in early 2002, just after the end of the last recession. It reached 3.2 percent in October, in part due to rising oil prices. This

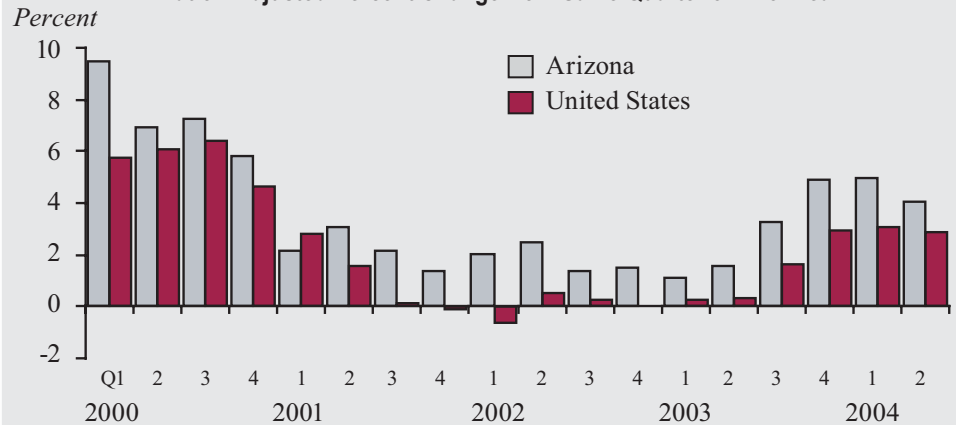
was higher than the 2.5 percent annual average so far in 2004 and the annual 2.3 percent average for 2003.

The U.S. Bureau of Labor Statistics began in 2002 to produce a CPI for the Phoenix metropolitan area twice a year. The latest figure is for the first half of 2004. The area's 2.0 percent inflation rate was a little less than the national average.

National inflation measured by the Gross Domestic Product implicit price deflator (www.bea.gov) has been less volatile than that of the CPI. Inflation dropped to 1.5 percent in mid-2002 and climbed back to 2.2 to 2.3 percent in the second and third quarters of 2004. This quarterly measure is used to deflate the personal income series.

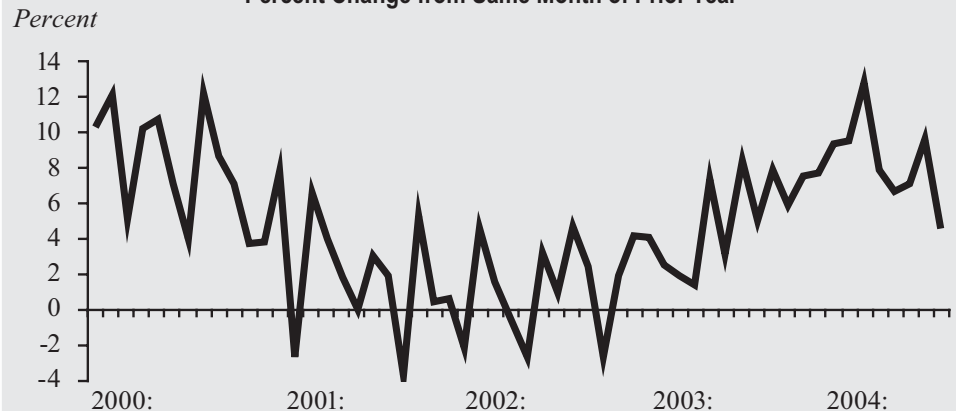
— **Tom R. Rex**
Associate Director
— **Nettie Klingler**
Research Analyst

FIGURE I
PERSONAL INCOME, ARIZONA AND UNITED STATES
Inflation-Adjusted Percent Change from Same Quarter of Prior Year



Source: U.S. Department of Commerce, Bureau of Economic Analysis.

FIGURE II
RETAIL SALES, ARIZONA
Percent Change from Same Month of Prior Year



Source: Arizona Department of Revenue.

Tourism accounts for one-in-20 Arizona jobs

Tourism is a more significant part of the economy in Arizona as a whole and in two-thirds of its counties than the national average. Coconino County has the greatest share of its work force in tourism of any county in the state.

Tourism is an economic activity that imports money into a community. It has been perceived to have a strong presence in Arizona, but measuring its size has been problematic because tourism is not defined in the North American Industry Classification System (NAICS). Tourism consists of a portion of many industries that make sales to residents as well as to tourists.

NATIONAL ESTIMATES

The U.S. Bureau of Economic Analysis (BEA) recently released estimates of travel and tourism nationally for a variety of measures, including output and value added in dollars and employment. The key to making these estimates was to determine tourism's share of each industry, which was estimated from such detailed data as the nation's input-output accounts. The travel and tourism satellite accounts now are a part of the quarterly release of the national income and product accounts.

The BEA defines tourism broadly to include all travel-related expenditures before, during and immediately after each trip by international and domestic leisure, business and government travelers. To be included, domestic trips must be at least 50-to-100 miles from home.

The BEA estimates tourism employment nationally in 2002 to have been 5.4 million, 4 percent of the nation's total employment. The food services and drinking places category had the greatest tourism employment at 1.6 million. Traveler accommodation had tourism employment of 1.3 million; the next highest figure was 0.5 million in air transportation.

The tourism work force receives low hourly wages relative to most other economic activities. Further, a disproportionate number of tourism employees work seasonally and/or part time, further depressing the average wage. Thus, on dollar measures, tourism accounts for a lesser share of the national economy: 2.8 percent of compensation and 2.5 percent of gross domestic product in 2002.

The BEA released consistent tourism data for 1998 through 2003, though the

2003 data are preliminary. Domestic tourism demand rose strongly in 1999 and 2000 but fell considerably in 2001 and barely rose in 2002. A stronger gain occurred in 2003. A similar pattern was experienced in tourism value added. In contrast, tourism employment rose barely more than 1 percent in both 1999 and 2000, then decreased in each of the next three years (-2.5 percent in 2001, -2.0 percent in 2002, and -0.3 percent in 2003).

STATE AND COUNTY ESTIMATES

The Center for Business Research has estimated tourism for Arizona and its counties based on the BEA method, making the assumption that tourism's share of each industry is the same locally as the national average. Data do not exist to test the reason-

ableness of this assumption. Employment is the only sectorally detailed measure available at the state and local levels. The 2001 issue of *County Business Patterns*, produced by the U.S. Census Bureau, was the primary data source used; the figures are as of mid-March, prior to the economic slump and terrorist attack.

A summary of Arizona's tourism employment is presented in Table 1 by industry grouping. Total Arizona employment, tourism's share of the employment (the national shares) and estimated tourism employment is shown for each category of tourism-related industries. Total tourism employment in Arizona was close to 125,000 — 5.2 percent of all employment.

Two categories — traveler accommodation and food services and drinking places

TABLE 1
EMPLOYMENT IN ARIZONA IN 2001

	Total Employment	Tourism Share	Tourism Employment
Traveler Accommodation	44,331	73.2%	32,450
Food Services and Drinking Places.....	161,114	18.6	29,967
Air Transportation	20,548	79.4	16,315
Rail Transportation	1,665	4.5	75
Water Transportation	40	17.2	7
Interurban Bus Transportation	685	92.6	634
Interurban Charter Bus Transportation	396	84.6	335
Urban Transit Systems	4,647	15.0	697
Taxi Service	679	35.7	242
Scenic and Sightseeing Transportation	738	94.7	699
Automobile Rental	5,349	57.1	3,054
Automotive Repair	20,331	6.5	1,322
Parking Lots and Garages.....	879	15.0	132
Toll Highways.....	0	6.7	0
Travel Arrangement and Reservations	11,605	92.5	10,735
Motion Pictures and Performing Arts	4,758	16.5	785
Spectator Sports.....	3,228	27.1	875
Participant Sports	16,541	27.7	4,582
Gambling	5,321	39.6	2,107
Other Recreation and Entertainment.....	8,030	27.6	2,216
Gasoline Stations	17,070	7.2	1,229
Other Retail Trade	248,742	2.6	6,467
Wholesale Trade & Transportation Services	133,691	1.7	2,273
Petroleum Refineries	9	5.3	0
Other Producers	260,206	2.2	5,725
All Other Industries	1,409,597	0.04	564
TOTAL	2,380,200	5.2	123,487

Source: Estimated from U.S. Department of Commerce, Bureau of Economic Analysis and Census Bureau data.

— combined accounted for half of tourism employment. Relative to the national average, the traveler accommodation share was slightly greater (in both the hotel and motel and recreational parks and other camps categories), but the food services and drinking places share was slightly less. Air transportation and travel arrangement and reservations were the next largest sources of tourism employment, each with a share of total tourism employment greater in Arizona than the national average. Car rental and golf courses also had larger shares than the U.S. average.

Tourism employment by county is displayed in Table 2, along with its share of total employment. Tourism's share was greater than the national average in 10 counties, with the share higher than the state average in Coconino, La Paz, Maricopa and Mohave counties. Coconino County had the greatest share of its work force in tourism of any county in the state, in large part due to the Grand Canyon, but with contributions from Page and Lake Powell, Sedona, Flagstaff, summer residents, and traffic on Interstate 40. The high

tourism share in Coconino County largely is reflected in the hotel and motel industry, though the scenic and sightseeing transportation industry share also was higher than the national average. La Paz County had nearly as large a share as Coconino County, due to winter residents and pass-through traffic on Interstate 10. The recreational vehicle and recreational camps industry accounted for most of the high share in La Paz County, with a contribution from the gambling industry.

Nearly 70 percent of the state's tourism work force was located in Maricopa County in 2001. Air transportation and travel arrangement and reservation services were especially important in the Phoenix area. The only counties with shares less than the national average were Cochise, Graham, Greenlee, Navajo and Yuma.

— **Tom R. Rex**
Associate Director

TABLE 2
TOURISM EMPLOYMENT BY
ARIZONA COUNTY IN 2001

	<i>Tourism Employment</i>	<i>Share of Total Employment</i>
Apache	985	5.0%
Cochise	1,510	3.5
Coconino	5,137	9.4
Gila	865	4.8
Graham	289	3.2
Greenlee	95	2.5
La Paz	584	9.0
Maricopa	85,273	5.4
Mohave	2,607	5.9
Navajo	1,103	3.9
Pima	17,772	4.7
Pinal	1,999	4.5
Santa Cruz	701	4.9
Yavapai	2,878	5.0
Yuma	2,037	3.0
ARIZONA	123,487	5.2

Note: The counties do not sum to the state because some employment was not allocated to any county.

Source: Estimated from the U.S. Department of Commerce, Bureau of Economic Analysis and Census Bureau data.

Housing affordability faces uncertain future

Since the beginning of the year, the housing market has sheltered people from the effects of a sluggish economy, uncertain international events and war. With 42,955 recorded sales in third quarter 2004, the Greater Phoenix housing market slowed slightly from the record 44,760 sales for the previous quarter, but remained well ahead of third quarter 2003's recorded sales total of 33,435. Low mortgage rates continued to allow people to fulfill their housing dreams. Additionally, homes are a popular form of investment, both for owner/occupants and investors.

While the current level of activity indicates a market of continuing potential, there is concern that the housing market will begin to slow later this year, when potential homeowners with stagnant incomes are faced with higher home prices and mortgage rates.

RESALE SINGLE-FAMILY HOMES

With 27,580 recorded sales, the Greater Phoenix resale home market was slightly below the 28,760 sales of the previous quarter, but well above last year's 20,560 recorded sales. While July (8,525 sales) and August (11,275 sales) outperformed the same months in 2003, September, with 7,780 sales, was the first month in 2004 to recorded activity below

last year (8,185 sales).

Median resale home prices ranged from \$97,950 (170 sales) in the Sky Harbor area to \$906,000 (165 sales) in Paradise Valley. Active areas were: Mesa with 3,395 sales (\$159,900 median price), Deer Valley with 2,500 (\$220,000), Glendale with 2,055 (\$163,000), and North Scottsdale with 1,690 (\$440,000). The median square footage for a resale home increased from last year's 1,690 to 1,705.

NEW SINGLE-FAMILY HOMES

While the resale market tends to peak in the second quarter and slow throughout the rest of the year, the new home market tends to build to a peak in the fourth quarter. Thus, the movement from 9,845 sales in second quarter to a new record (9,990 sales) is not unexpected. However, like the resale home market, new homes sales in September (2,945 sales) were below a year ago (3,645 sales), while July (2,968 sales) and August (4,077 sales) were ahead of 2003.

As the primary location for affordable homes, the West Valley communities represented 30 percent of the Greater Phoenix new home market. In the East Valley, the median price in Gilbert was \$210,570 for a 2,980-square foot home and in Mesa, \$233,585

for 2,175 square feet. In the West Valley, the median price is \$169,060 for a 1,740 square foot home in Avondale and \$179,900 for 1,850 square feet in Surprise.

With 80 percent of the 180 new home sales priced in excess of \$300,000, North Scottsdale had a median sales price of \$536,180; the lowest was \$138,830 in El Mirage, based on 85 sales. Other active markets were: Deer Valley with 1,070 sales (\$264,550 median price), South Phoenix with 875 (\$155,595) and Superstition Springs with 280 (\$225,340).

The median square footage for a new single-family home recorded sold in third quarter 2004 was 2,050, slightly smaller than the 2,180 square feet reported a year ago.

TOWNHOUSE/CONDOMINIUMS

With low maintenance, amenities and affordable prices, townhouse/condominiums are proving popular with investors, young people and seasonal visitors. The median resale price has increased from \$85,000 in first quarter 2000 to \$113,000 in third quarter 2004. However, even with the rapid increase, the median price represents only 64 percent of that for single-family resale homes. Much like the single-family market, this housing sector declined from a record 5,515 sales in

the second quarter 2004 to 4,725 sales, which is still ahead of last year's 3,745 sales.

In the resale townhouse/condominium sector, the median square footage is 1,140, slightly smaller than the 1,145 reported a year ago. The most active resale areas were North Scottsdale with 605 sales (\$212,500 median price), South Scottsdale with 565 (\$134,000), South Mesa with 360 (\$94,900), and Sun City/Peoria with 260 (\$85,950).

Many of the newer developments are at the high end of the market; the median price of \$183,960 for new units represents

93 percent of the \$198,050 median price for new single-family homes. The primary reason is that 24 percent of the 660 sales were in North Scottsdale, at a median price of \$297,500. Other active areas were Superstition Springs (114 sales, \$133,515), Union Hills (55 sales, \$202,090), and East Mesa (50 sales, \$131,790).

AFFORDABILITY

Even though the Federal Reserve has been raising interest rates, mortgage rates fell from 5.8 percent in the second quarter 2004 to 5.6

percent, but were still above 5.2 percent for the initial quarter of 2004. Because the mortgage market is closely tied to the bond market, increased demand for bonds has driven interest rates down, such as the 10-year treasury bond that has moved from 4.7 percent in June to 4.1 percent in September. The bond market has been popular because it provides some stability in contrast to the volatile stock market in uncertain economic times.

As demand rose, the supply of available homes declined from nearly 25,000 in January to slightly above 10,000. This classical

TABLE 1
HOUSING AFFORDABILITY INDEXES
Greater Phoenix, Single-family Only

Quarter	Resale Homes					New Homes		
	Median Gross Monthly Income	Effective Interest Rate	Median Sales Price	Monthly Housing Payment	Affordability Index	Median Sales Price	Monthly Housing Payment	Affordability Index
First Quarter 2002	\$4,000	6.9	\$139,700	\$920	122	\$158,015	\$1,040	108
Second Quarter 2002	4,020	6.6	144,000	920	122	155,250	995	114
Third Quarter 2002	4,030	6.2	146,000	895	126	159,535	975	115
Fourth Quarter 2002	4,040	6.0	147,000	880	128	164,540	990	115
First Quarter 2003	4,050	5.7	148,750	865	131	163,545	950	119
Second Quarter 2003	4,060	5.4	155,000	870	131	176,085	995	115
Third Quarter 2003	4,060	5.9	159,500	945	120	173,895	1,030	110
Fourth Quarter 2003	4,075	5.7	155,800	905	126	177,820	1,030	111
First Quarter 2004	4,075	5.4	159,705	900	127	180,510	1,015	113
Second Quarter 2004	4,095	6.0	170,000	1,020	112	190,745	1,145	100.
Third Quarter 2004	4,120	5.8	177,500	1,040	111	198,050	1,160	99

TABLE 2
GREATER PHOENIX HOME SALES

Median Sales Price	Single-family			Townhouse/Condominium			Grand Total
	Resale	New	Total	Resale	New	Total	
First Quarter 2003	\$148,750	\$163,545	\$153,610	\$101,000	\$180,000	\$107,000	\$148,380
Second Quarter 2003	155,000	176,805	160,000	103,375	181,835	109,000	154,000
Third Quarter 2003	159,000	173,895	163,785	103,000	188,690	108,620	158,000
Fourth Quarter 2003	155,800	177,820	163,995	105,000	187,775	110,500	158,240
First Quarter 2004	159,705	180,510	165,585	110,000	161,910	115,000	160,000
Second Quarter 2004	170,000	190,745	175,500	113,000	177,250	117,500	168,200
Third Quarter 2004	177,500	198,050	183,900	113,000	183,965	120,000	176,000
<i>Number of Sales</i>							
First Quarter 2003	15,030	7,125	22,155	3,215	355	3,570	25,725
Second Quarter 2003	19,845	7,680	27,525	4,165	470	4,635	32,160
Third Quarter 2003	20,560	8,630	29,190	3,745	500	4,245	33,435
Fourth Quarter 2003	18,350	9,270	27,620	3,565	500	4,065	31,685
First Quarter 2004	19,460	8,135	27,595	3,765	575	4,340	31,935
Second Quarter 2004	28,760	9,845	38,605	5,515	640	6,155	44,760
Third Quarter 2004	27,580	9,990	37,570	4,725	660	5,385	42,995

Source (Tables 1 and 2): Arizona Real Estate Center, Arizona State University East.

struggle of demand and supply resulted in a record median price of \$177,500, up from last year's \$159,000. The new home median price also set a record at \$198,050, up from \$190,745 in second quarter 2004 and \$173,895 a year ago.

While home prices have been soaring, anemic job growth and low inflation have combined to limit growth in the median household income. Thus, the resale affordability index fell from 112 in the second quarter to 111, which is the lowest level since the mid 1980s. The new home affordability index value followed a similar pattern, dropping from 100 to 99, which was last seen in first quarter 2000 with an effective interest rate of 8.0 percent, a median new home price of \$148,075 and a monthly median household income of \$3,850. Although a lower index value indicates less affordable homes, it does not take into account alternative housing forms such as townhouse/condominiums or manufactured housing.

An index value of 100 means the typical home buyer would be able to afford a median-priced resale home at an effective interest rate of 6.8 percent, based on the current median resale price and household income. Since home prices and incomes vary throughout

the Valley, so does the affordability index. For example, in the resale sector, the third quarter 2004 index was 65 in Scottsdale, 117 in the Surprise area, 116 in the Mesa area and 129 in the Avondale area.

LOOKING AHEAD

The desire to own a home, whether for a residence or a rental, seems almost insatiable. During the dot-com maelstrom several years ago, there was concern about the "disconnect" between the companies and the economy and typical investment standards. As the local housing continues to exceed historical norms, the same concerns are now being raised.

Since 1982, the quarterly resale home market has averaged five sales per 1,000 population; currently it is at seven. For the ever-important job market, the quarterly average has been near 90 jobs per resale home, while its currently 60 jobs. This would imply that the housing market is growing faster than the underlying job and income elements of the economy. Historically, it has never been good for the long run when an investment begins to disconnect from the basic economic forces. For the housing market, this occurred in the late 1970s and 1980s with resulting rapid decline

in sales and permit activity and some reduction in prices. The appreciable declines that were so evident then probably will not occur this time around because monthly payments are relatively low, and the economy is recovering rather than entering a decline as it was in both time periods.

Although the dire results from the previous times are not expected to repeat, the resulting high mortgage rates show what can happen to a housing market when a depressed economy significantly lowers a household's income. Even with low rates, increasing foreclosures and bankruptcies show that some households are struggling to maintain their homes.

The investor market also could become subject to economic pressure. If investors are struggling to rent their properties or if appreciation rates slow, they will be more likely to sell their investments. Thus, there is the possibility that the housing market will find itself under significant pressure as people, whether owner-occupants or investors, work to reduce the pressure on their incomes.

— Jay Q. Butler
Director

Arizona Real Estate Center

Arizona Business Conditions Index tumbles in October

The seasonally adjusted Arizona Business Conditions Index fell to 62.0 in October from 67.0 last month, a 7.5 percent decrease. An Arizona Business Conditions Index reading of over 50 indicates that the local economy is growing, while a reading below 50 suggests a slowdown in the overall level of economic activity in the near term.

ANALYSIS

The index continues to hover within the range established a year ago, albeit with higher volatility. Since September 2003, the Index has remained between 62 and 68.2, indicating steady growth in the local economy. What has changed in the last few months is the marked increase in volatility, as the index moves from the high end to the low end of the range from month to month.

This month, the most significant drop in the overall index components occurred in new orders. The new orders subindex fell by 7.6 points, to 60.5 in October. The employment component followed suit by dropping 5.7 points to 62.1. The only index component to rise in October was the purchases subindex, which climbed from 64.1 to 65.6.

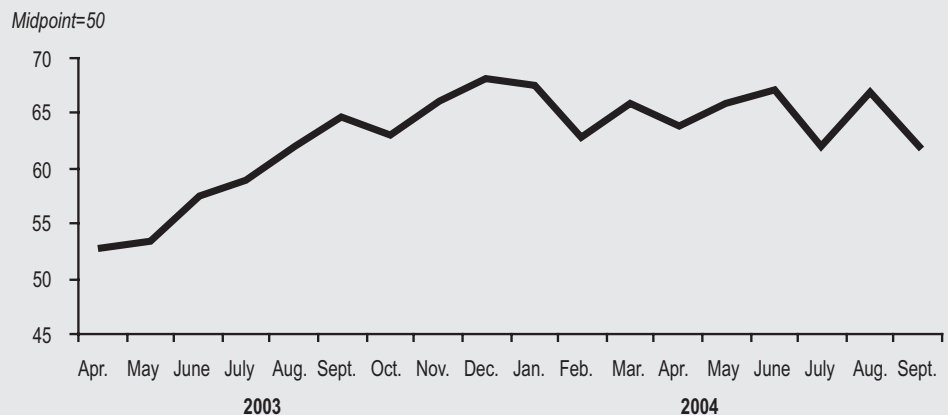
A cause for concern is the continuing high level of the Price Index. In February, the Price Index rose sharply, and it has remained above 70 in six of the last seven months. In October, the index fell slightly to 71.3, indicating that prices for producers will continue to see significant upward pressure in the near term. While fuel prices are a major driver

of this rise in prices, other materials such as aluminum products have also contributed to the continued high level of prices.

— 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 slips in October

The Bank One Arizona Index of Leading Economic Indicators declined in October to 124.5. The number was 0.7 percent below the revised 125.4 for the previous month, and 1.1 percent above the October 2003 level of 123.1 (1987 = 100).

The declines in October hit every indicator that moved at all: employment from the Business Conditions Survey, new orders, delivery times, the inflation-adjusted value of the M2 money supply, the inflation-adjusted value of Maricopa County residential building permits, hours worked in manufacturing, production and materials inventories. Sensitive materials prices were neutral.

The index saw a broad decline in August, followed by a broad recovery in September. The most disturbing aspect of October's broad decline is that it occurs so close to the similar slump in August. It is far from being a trend, but it is clear that the widely anticipated post-election bounce has not yet occurred. The weakness appears to be coming from the national level, rather than being specific to the state. The list of potential negatives at either the national or international level is fairly long, and how Arizona will fare under each influence is not yet apparent.

Oil prices, which had been rising and peaked in October, have since staged a retreat that should help economic activity in November and December. The drama in the oil markets played out in the futures area and, for the most part, represented traders' fears about what might happen to an oil market beset by political unrest in some producing nations and under strain from rising Chinese demand. The demand from China is real and the fears over political unrest were not unreasonable, but forecasting the fears of oil traders is very difficult. The course of oil prices in November and into mid-December suggests that this source of pressure is easing — at least for now.

The weakening dollar is another source of uncertainty, with a significant impact on the economy. The drop in the dollar is, like most things, simultaneously good and bad for the economy. It had to happen sometime, given the serious and worsening trade balance, and the worse the trade balance becomes the longer and farther the dollar will have to fall in order to balance the books again. The falling dollar makes U.S. exports cheaper and our imports more expensive, which does

address the trade imbalance — but how long that will take is not known. American consumers have been happily buying more and more imported goods throughout the 1990s and into the new century, not even slowing down for the recession. American spending has in a real sense been the engine that has kept the world economy chugging along, and if our spending on foreign goods falls, the economic health of our trading partners will suffer and their demand for our exports could decline.

Despite the weakening dollar, uncertainty seems to have peaked early in November with the presidential election and the peaking of oil prices. Uncertainty is bad for the economy, inclining businesses and consumers to be more cautious. It seems likely that the national economic outlook will improve as we move into the New Year, which should

put Arizona back on the growth track.

It is too early in the holiday shopping season to make definitive predictions about retail sales. However, in the annual game of chicken between bargain-hunting consumers and retailers, the retailers have already blinked, and consequently seem to be offering consumers more bargains. Ironically, the two segments doing the best so far this season are luxury goods and those retailers who have offered the best discounts in the middle to low end of the market.

— Tracy Clark

Associate Director

Bank One Economic Outlook Center

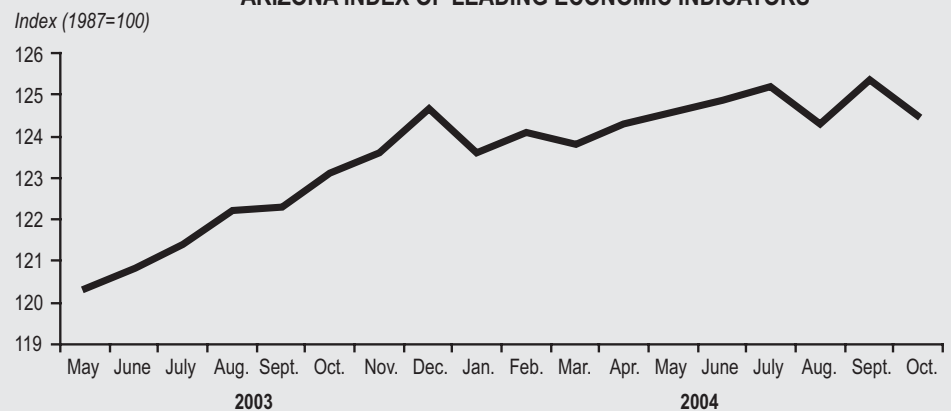
TABLE 1
NET CONTRIBUTION OF INDIVIDUAL COMPONENTS TO THE ARIZONA INDEX OF LEADING ECONOMIC INDICATORS*

	July	August	September	October
Delivery Time*	-0.01	-0.20	0.29	-0.11
Inventory Levels*	-0.03	-0.11	0.08	-0.02
New Orders*	0.02	0.02	0.03	-0.12
Production*	0.05	-0.09	-0.02	-0.04
Employment*	0.02	-0.21	0.21	-0.14
Residential Building Permits	0.29	-0.32	-0.02	-0.07
Average Workweek, Manufacturing	-0.07	0.18	0.07	-0.07
Money Supply	-0.04	0.06	0.20	-0.10
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.

FIGURE I
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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A R I Z O N A E C O N O M I C I N D I C A T O R S

	<i>Month or Quarter</i>	<i>Current Value</i>	<i>Previous Value</i>	<i>Percent Change Previous Period</i>	<i>Percent Change from Year Ago</i>	<i>Year-to-Date Value</i>	<i>Percent Change from Year Ago</i>
LEADING ECONOMIC INDEX (1987 = 100)							
Arizona	October	124.5	125.4 r	-0.7	1.1	NA	NA
BUSINESS CONDITIONS INDEX							
Arizona	October	62.0	67.0	-7.5	-4.1	NA	NA
BUILDING PERMITS (Thousands of \$)							
Maricopa County	Sept.	1,180,077	1,195,424 r	-1.3	23.9	9,927,625	33.4
Pima County	Sept.	180,567	197,964 r	-8.8	13.7	1,572,299	17.9
Balance of State	Sept.	277,116	326,979 r	-15.2	21.1	2,821,746	27.1
Arizona	Sept.	1,637,760	1,720,367 r	-4.8	22.2	14,321,670	30.2
TOTAL HOUSING UNITS AUTHORIZED							
Maricopa County	Sept.	5,231	4,975 r	5.1	21.9	45,131	29.0
Pima County	Sept.	1,012	1,087 r	-6.9	34.9	8,945	19.8
Balance of State	Sept.	2,160	2,560 r	-15.6	3.2	21,221	23.9
Arizona	Sept.	8,403	8,622 r	-2.5	17.8	75,297	26.4
HOME SALES							
Maricopa County – Number.....	Sept.	12,290	17,480	-29.7	-9.4	119,660	31.0
Maricopa County – Median Price(\$).....	Sept.	179,325	175,725	2.0	14.8	169,000	9.7
HOUSING AFFORDABILITY INDEXES							
Metropolitan Phoenix – New Homes	3rd Quarter	99	100	-1.0	-10.0	NA	NA
Metropolitan Phoenix – Resale Homes	3rd Quarter	111	112	-0.9	-7.5	NA	NA
MORTGAGE RATES (30-year Fixed)							
Maricopa County	October	5.5	5.6	-1.8	-1.8	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	August	2,749	2,751	-0.1	5.5	22,796	9.0
Arizona	August	4,098	4,094	0.1	4.8	33,558	8.5

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.