

DATE: NOVEMBER 5, 2001

TO: CITY COUNCIL

FROM: CYNTHIA J. KURTZ, CITY MANAGER

SUBJECT: ECONOMIC OVERVIEW

Both national and regional economic conditions have changed significantly in the last year. At the City Council's request, we invited Jack Kyser to present a summary of county-wide information that might be useful to City Council.

Jack Kyser is the Chief Economist with the Los Angeles Economic Development Corporation. Mr. Kyser will provide a 10-minute economic overview presentation and then make himself available to questions. Attached, please find a biography of Mr. Kyser and a summary of county-wide economic data. Mr. Kyser will apply this data to Pasadena during his presentation on November 5.

Bio - Jack Kyser

Called the "guru of the Los Angeles economy" by the Los Angeles Business Journal, Mr. Kyser is responsible for interpreting and forecasting economic trends in the Los Angeles five-county area (Los Angeles, Orange, Riverside, San Bernardino and Ventura counties), and for analyzing the major industries of the area. Utilizing this information, he helps develop job retention and creation strategies for Los Angeles County. Mr. Kyser's advice is frequently sought by business, government and the media.

The Los Angeles County Economic Development Corporation is a private, not-for-profit membership organization whose mission is leadership in the retention and creation of jobs and economic base in the Los Angeles area.

A native of California, Mr. Kyser was born in Huntington Park, and currently resides in Downey. He holds a B.S. in industrial design, and an M.B.A. from the University of Southern California. Mr. Kyser has also pursued additional course work at U.C.L.A.

Prior to joining the LAEDC, Mr. Kyser was chief economist for the Los Angeles Area Chamber of Commerce. Mr. Kyser has worked for Security Pacific National Bank and First Interstate Bank of California in their economics departments, and for Union Pacific Railroad in Omaha, Nebraska, where he was transportation economist. Mr. Kyser has taught economics at the University of Nebraska -- Omaha, and served as a business reporter and commentator for radio station KVNO-FM, also in Omaha.

Mr. Kyser serves on the Economic Policy Council of the California Institute, the research and policy arm of the California congressional delegation. Mr. Kyser also serves on the economic advisors panel for the State Controller. He is also a past president of the Los Angeles Chapter of the National Association of Business Economists; is a member of the Southern California Research Society -- a limited membership organization; is a member of Lambda Alpha -- a land economics fraternity; serves on the advisory board of the Export Small Business Development Center; serves on the Travel & Tourism Advisory Council at UCLA Extension; and is on the board of directors of the Foreign Trade Association of Southern California, the Greater Los Angeles World Trade Center Association, the South Park Economic Development Corporation, and the Building Owners & Managers Association of Greater Los Angeles.

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THE OVERALL ECONOMIC ENVIRONMENT

The U.S. Economy: Prior to September 11th, there was a debate about the direction of the nation's economy, as some favorable signs were beginning to appear. However, the attack has caused billions of dollars in losses, in destroyed commercial real estate, lost jobs, disruptions to both the financial markets and industries, not to mention the personal traumas that have resulted. While the distress is concentrated in New York, the waves have rolled across the country. There are a number of factors that will have to be considered in assessing the future course of the U.S. economy, including:

- 1.) The "fear factor" that has overtaken millions of Americans and has manifested itself in anxiety over flying, working in high rises, or going to places where large crowds are assembled.
- 2.) There is also a "bunker mentality" over the potential for future rounds of terrorist attacks that might follow any U.S. coalition military action against Afghanistan or other countries harboring terrorist groups.
- 3.) There is the return of "big government," a natural reaction to the vulnerability and insecurity that have become pervasive. This will redirect some resources from the private sector.
- 4.) The military and intelligence capability of the U.S. will be raised to a level not seen since the Vietnam War or even World War II, diverting the nation's attention and resources away from the previously front-burner issues of health, education and the environment.

While government bailouts will help in the short term, the industries most seriously hurt by the terrorist attack, some of the problems these sectors face will last longer than a few months.

The U.S. economy has been teetering on the brink of a recession since the Summer of 2000, due to the tech sector crash, problems of over-investment, and declining corporate profits. It is now quite likely that the nation's output contracted in the 3rd quarter of 2001, and this trend will continue in the 4th quarter and the first quarter of 2002, yielding the nation's first recession since the Gulf War. GDP growth in 2001 is placed at 1.0 percent, falling to 0.2 percent in 2002. The Federal Reserve Board has cut short-term interest rates 9 times in 2001, and further cuts are quite likely by the end of the year.

The U.S. economy's slow growth/recession will last approximately 21 months, starting from the middle of 2000 and stretching to the Spring of 2002. Although the contraction itself will not be that long in duration (about 9 months) the fallout in terms of unemployment, business failures, personal bankruptcies, and non-performing loans will cause considerable distress.

The international economic situation: With the U.S. economy tipping into a recession, the shock waves will resonate throughout Latin America, Asia, as well as in the European Union and Canada. The fact that the world's second largest economy, Japan, has fallen back into a recession will compound the hardships of the less developed countries in Asia. Japan's economic problems also have implications for California because it is a major trading partner.

The California economy: The State's economy was slowing visibly at mid-2001, reflecting the tech sector crash, sluggish activity in international trade, lackluster trends in nonresidential real estate, and mixed levels of consumer spending. The Bay Area was also coping with a real estate "bubble" in both the residential and nonresidential sectors. On the positive side of the ledger,

new home construction and tourism were seeing modest growth. One concern is that there has also been some deterioration in the State's business environment. Firms in investor-owned utility service territory were coping with much higher electric rates, while other costs for business such as the employment tax and workmen's compensation insurance were also on the rise.

The September 11th attack has dramatically changed the outlook for the state. The most visible impact has been on the tourism and business travel industries. Airlines are cutting flights and staff, hotels are experiencing very low occupancy rates and are also cutting staff, and there have been multiple cancellations of business shows and conventions. A particularly painful loss is that of international tourists who spend more on average than domestic travelers. The ripple impact of all this is enormous, with the potential for a significant loss of tax revenues for city and county governments. This is distressing, given the parlous condition of the State's finances going into the upcoming budget year.

The Federal Reserve Board has continued to aggressively cut interest rates, while a package of economic stimulus will be forthcoming from the Federal Government. However, the limiting factors on any upswing in the State's economy will be the time it takes for various stimulus programs to kick-in, how long it will be before there is an improvement in consumer confidence (and a willingness to travel by air), the unwinding of the investment "bubble," and the stabilization of the tech sector. It could be mid-2002 before the latter occurs.

As a result, the 2001-02 forecast for the State has been revised downward to "recession" levels -- paralleling the forecast for the nation. Nonfarm employment growth is now estimated at 1.9 percent or 277,600 jobs in 2001, while the forecast for 2002 calls for an increase of 1.4 percent or 213,100. Job losses are expected in the manufacturing and transportation - communications - public utilities sectors in both years. The State's unemployment rate should average 5.2 percent in 2001, moving up to an average of 5.9 percent in 2002. New homebuilding should inch up to a total of 149,000 units in 2001, then drop back to a total of 141,000 in 2002. As to the resale housing market, overall home price appreciation should flatten out, driven by the unwinding of the "bubble" in the Bay Area.

Like the nation, California will be in a recession during the last half of 2001, and into the first quarter of 2002. While there are no "state product" numbers to use as a marker, nonfarm employment is the best proxy to use. There could be year-to-year declines in this measure during the fourth quarter of 2001. The Bay Area should feel the most pain, given the slump in tourism and business travel on top of the tech sector crash.

There will be industries in the State that will see an increase in business as a result of the September event. These include technology (for security, advanced communications, and intelligence gathering applications), and "classic" aerospace. While there will be no return to "Cold War" style assembly lines, the State's research and development capabilities will serve it well in the new environment.

The Los Angeles County economy: The County's economy was also slowing at mid-2001, with the causative forces being declines in international trade, the deflating of the dot-com bubble, and the "de facto" strike in the motion picture production industry. On the plus side, new homebuilding and nonresidential construction were both running ahead of 2000 levels, while there has been modest growth in tourism.

Like the State, the County's economy has been seriously impacted by the September attack. The local travel and tourism industry has been a focal point, with significant workforce reductions being announced. The airline situation has also caused problems for the air cargo industry, in terms of increased security precautions, longer transit times, and resulting higher costs. Increased security at the two local ports has also exacted a cost. In addition, consumer spending has weakened. As a result, many cities are expressing concern over the near-term implications for their budgets.

The 2001-02 forecast for Los Angeles County has been revised downward, again to recessionary levels. Nonfarm employment growth is now estimated at 1.1 percent or 46,800 jobs, while the forecast for 2002 calls for a 0.9 percent gain or 35,200 jobs. Like the State, there will be declines in the manufacturing and transportation - communications - public utilities sectors in both 2001 and 2002. The County's unemployment rate should average 5.5 percent in 2001, moving up to an average of 6.4 percent in 2002. The 2001 forecast for new homebuilding remains unchanged, however, at 18,600 units. For 2002, however, there will be a decline to 16,000 units. Resale home prices increased by 4.8 percent during the first half of 2001, while the unit sales trend has been somewhat erratic. Given the favorable mortgage rate situation and the shortage of housing in the County, there should be continued modest price increases into 2002.

The real estate sectors in the County most at risk would be retailing, and office in some sub-markets. The former will be coping with a continued consumer focus on value, and the relentless push by value retailers such as Wal-Mart and Target to expand in the County.

There will be industries in the County that will see an increase in business into 2002. These include technology and "classic" aerospace. Indeed, the September event has strengthened prospects for some existing defense programs in the County, including the C-17 military cargo plane, the FA-18 fighter (fuselage produced in Los Angeles), and the Global Hawk unmanned aerial vehicle. A selection of the prime contractor for the Joint Strike Fighter is pending, and the program will move into the design/engineering/manufacturing phase. While the planes will probably not be assembled in the County, there will be a significant amount of sub-contracting done locally.

There should also be a higher level of production activity in the motion picture industry in 2002. While the Director's Guild contract expires July 1, the guild has already started contract talks with the Motion Picture Producer's Association to avoid the production disruptions caused by the threat of writers and actors strikes in 2001. In addition, Canada is looking at cutting back on some of the tax incentives that have attracted lower-budget film and TV production activity.