San Diego Institute for Policy Research

San Diego Economic Ledger

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CEO's Corner

One of the most important and enduring strengths of San Diego's post-Cold War economy is its diversification. Over the past decade, coming out of the worst recession endured in sixty years, San Diego has seen four key sectors of the economy—tourism, defense, manufacturing and biotech/high-tech—emerge as pillars of economic strength and dynamism in the region. For the nation's 18th largest Metropolitan Statistic Area, it is remarkable that San Diego has four industries that are this dynamic and it is in large part the reason economic growth in the region has outpaced both the nation and the state.

As SDI Senior Fellow and Economist Kelly Cunningham outlines in this edition of the SDI *Economic Ledger,* he is forecasting that while the region's growth rate will slow in 2008, it will still outpace California's and the nation.

While this forecast should be welcome news to San Diegans, the region still faces significant challenges to its prosperity. SDI's bi-monthly survey has shown that the major slowdown in the residential real estate market has weakened consumer confidence and discouraged San Diegans from making major purchases. As noted in a major study SDI carried out on the region's hospitality industry, San Diego will see a major increase in the number of hotel rooms coming on-line in the next 24 months, just at a time that the nation's growth is slowing. In such a situation, policy makers and pundits alike need to continually focus on how to keep San Diego competitive and prosperous.

Despite these challenges, as we examine the local state of the economy in this issue, we anticipate San Diego will continue leading California and the nation in economic growth for 2008 and beyond. As always, we hope you find the information herein helpful and we welcome your feedback and suggestions.

—Erik Bruvold, President and CEO, San Diego Institute for Policy Research

Dashboard Observations

by Kelly Cunningham, Economist, Sr. Fellow

San Diego's economic indicators drop significantly in August 2007, as consumer confidence continues to erode.

Every indicator in the San Diego Ledger decreased in August 2007, and only the stock index shows a slight gain over the past year. The continued erosion of these economic indicators reflect the region's slowest economy in the past four years.

Consumer confidence has sunk to the lowest level of the year. The consumer confidence index for San Diego reflects four impressions of economic activity, including both current and near future expectations, and personal and general perceived views of activity. All four areas have sunk since the beginning of the year, although San Diego residents optimistically indicate higher expectations for their own personal situation in the next six months.

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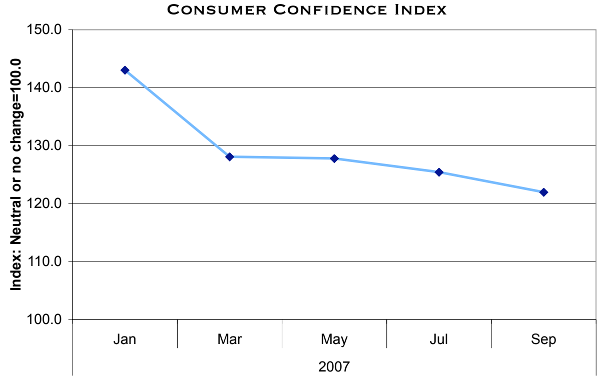
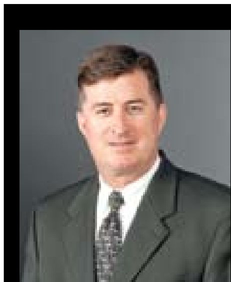
City of San Diego Economic Consumer Confidence Index



Indicator	August 2007	Month Change	Annual Change
Unemployment Rate[1] San Diego County	4.8%	0.2% ▼	0.7% ▼
Residential Building[2] Units Authorized for Construction San Diego County	449	-45.6% ▼	-19.4% ▼
New Business Licenses[3] Issued by City of San Diego	1,111	-10.4% ▼	-15.5% ▼
San Diego Stock Index[4] San Diego based public companies. 2nd Thursday of month	130.6	-11.7% ▼	3.3% ▲
Economic Consumer Confidence Index[5]	122.0	-2.8% ▼	

[1]California Employment Development Department.
[2]Construction Industry Research Board
[3]Business Tax Program, City of San Diego
[4]Second Thursday of month, Bloomberg News, San Diego Daily Transcript
[5]Survey by Competitive Edge Research and Communications, conducted the first week of September 2007.
For detail of data, see website: *www.sandiegoinstitute.com*

San Diego's 2008 Economic Outlook



"Similar to many recent home buyers, the U.S. economy is approaching a point of not being able to generate the necessary income to meet debt repayment requirements."

—Kelly Cunningham, Economist and Senior Fellow, San Diego Institute for Policy Research

Since 2000, San Diego enjoyed stronger economic growth than the rest of California and the U.S., setting the pace of expansion for the rest of the state and nation to follow.

While the rest of California fell into recession and struggled to rebound in 2001, San Diego was slowed but continued growing. The U.S. endured a slight recession and slowdown following the 9-11 terrorist attacks. From 2001 to 2004 San Diego's economic expansion was significantly stronger than the rest of the state and nation, as shown by the annual percent increase of gross production.

San Diego's economy continued to modestly grow in both 2005 and 2006, while the rest of California rebounded and began expanding. Coming from a slower pace, California's economic expansion overtook San Diego's growth rate in 2005. The County was the first to experience slower growth in 2007, followed by California beginning to moderate as well.

Going forward San Diego remains a step ahead and will see a slight acceleration of growth in 2008, as California and the U.S. continue to languish

(Continued on page 2)

Inside this Issue

Forecast of 2008 San Diego Economic Activity

- San Diego's 2008 gross metropolitan product to reach $170.4 billion.
- Housing to continue being a drag on the economy.
- Although slowed, positive job growth continues.
- Slower population growth as residents move away.
- Inflation concerns in future.

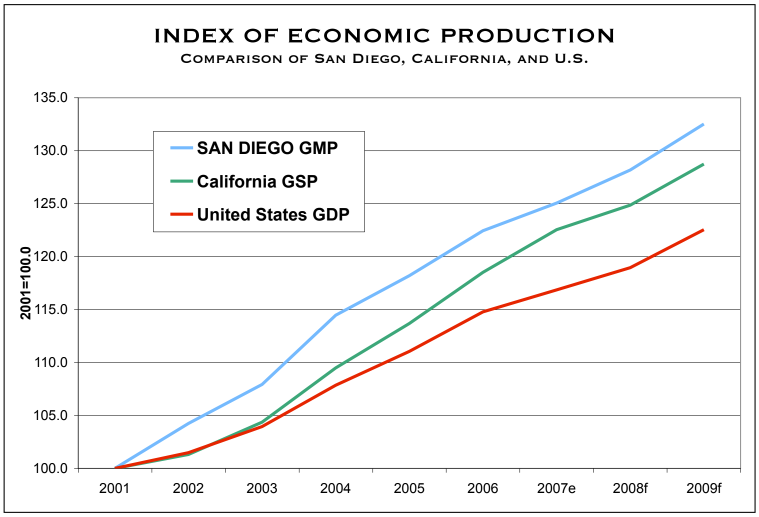
(See Economic Outlook, page 2)

2008 Economic Outlook

continued from page 1

into what the *UCLA Anderson Forecast* projects as a "near-recession."[1] The forecast for U.S. economic activity in both 2007 and 2008 is inflation-adjusted "real" growth of only 1.8 percent, while California is forecast to perform slightly better. Moderately faster growth is anticipated for California and the U.S. in 2009, while San Diego continues to lead with somewhat faster growth.

The main reason for San Diego's stronger economic activity is the development of diversified industries, particularly over the past



SAN DIEGO GROSS METROPOLITAN PRODUCT

	San Diego			Annual Percent Change					
	GRP	Percentage of:		Current Dollars			Constant Dollars*		
Year	(Billions)	CA	U.S.	S.D.	CA	U.S.	S.D.	CA	U.S.
2001	$112.435	8.64%	1.12%	NA	1.1%	3.2%	NA	-0.4%	0.9%
2002	$120.165	8.96%	1.16%	6.9%	3.0%	3.4%	4.3%	1.3%	1.5%
2003	$126.838	9.02%	1.17%	5.6%	4.9%	4.7%	3.5%	3.0%	2.4%
2004	$138.153	9.12%	1.19%	8.9%	7.7%	6.9%	6.1%	4.9%	3.7%
2005	$146.341	9.05%	1.18%	5.9%	6.7%	6.4%	3.3%	3.8%	3.0%
2006e	$155.414	9.00%	1.18%	6.2%	6.9%	6.3%	3.6%	4.2%	3.4%
2007e	$162.874	8.89%	1.19%	4.8%	6.1%	4.4%	2.1%	3.4%	1.8%
2008f	$170.366	8.94%	1.20%	4.6%	4.0%	3.8%	2.5%	1.9%	1.8%
2009f	$179.566	8.96%	1.20%	5.4%	5.1%	4.9%	3.4%	3.1%	3.0%

*Adjusted by GMP/GSP/GDP implicit price deflator. NA: Not Available e: estimate f: forecast

Source: Bureau of Economic Analysis, U.S.Department of Commerce; UCLA Anderson Forecast; San Diego Institute for Policy Research

decade. Community and business leader efforts, the region's strategic positioning, and as always the highly desirable quality of life and climate make San Diego the economic power leading the state and nation. Named as the nation's best performing city among nearly 300 metro areas ranked according to wage and salary growth, job growth and high-tech output growth, the *Milken Institute* aptly states San Diego has "the most diversified high-tech economy in the U.S., with hundreds of biotech, communication, software and information technology outfits."[2] This diversity gave San Diego the ability to better withstand the 2000 "dot-com" fall-out from overly speculative technology driven investment that plagued Silicon Valley and northern California.

San Diego's bi-national economy, partnered with Tijuana and Baja California, provides many advantages for both sides of the border to capitalize on the huge expansion of international trade between the U.S. and Mexico, as well as burgeoning trade with Pacific Rim nations of Asia, the South Pacific, and Central and South America.

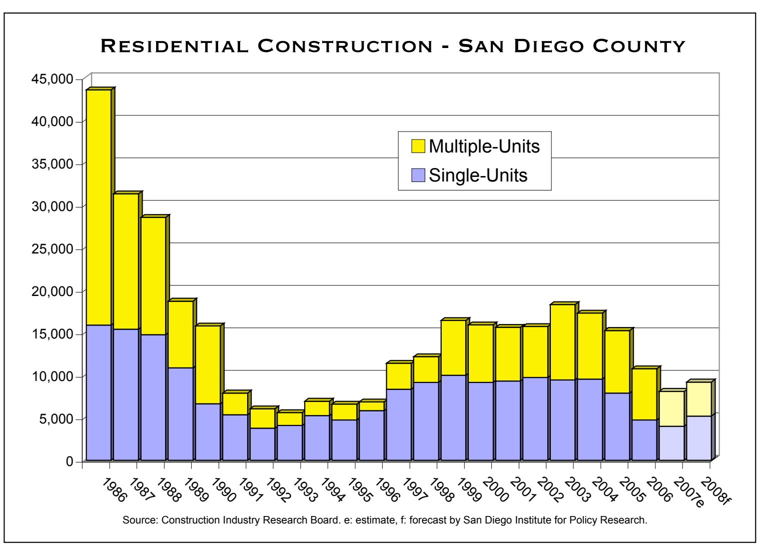
Not as all-encompassing to the local economy as it once was, military and defense expenditures nonetheless continue to provide a significant boost to San Diego's economic activities. Expenditures for homeland defense and toward military campaigns in Afghanistan and Iraq led to significant increases of spending for San Diego's extensive military base operations and military contractors.

Despite significant challenges to business and recreational travel experienced nationwide following the 9/11 terrorist attacks, San Diego's visitor industry managed to rebound and record significant growth. With many visitors not wanting to travel long distances, San Diego benefited as visitors still vacationed by driving in from nearby southern California counties and other western states. Marketing efforts by local visitor industry leaders and businesses were successful in drawing expanded business and recreational travel from these markets. San Diego has enjoyed one of the nation's strongest hotel markets during this period, while newly built hotel properties were added to the local market.

Housing Drag on the Economy

San Diego's housing industry has become a drag on the local economy. San Diego initially saw significant price gains in the local housing market, while housing activity continued to languish for much of the rest of California. Following the anemic years of the first half of the '90s, home construction increased and prices started to escalate.

As other counties also began seeing home price gains, San Diego prices started to moderate and eventually turn downward with sales slowing in 2006. Exceptionally high prices were the primary reason for the slowing sales, not a significant glut of new homes coming onto the market or a lessening of demand from job losses, as was the case in the previous housing slump recorded during the first half of the 1990s.



The imbalance of home prices to population, job, and income levels was largely a result of too easily granted home loans. With the regional mortgage market flush with credit, home buyers flooded the housing market and drove prices to far out-of-balance levels. A market correction was becoming evident in 2006 when prices started to level before faltering in 2007. As entry level, variable mortgage rates and zero-interest loans adjusted higher, many homebuyers were unable to make the higher loan payments, forcing significant numbers into bankruptcy and foreclosure. With sales slowing at the same time as foreclosure rates increased, the housing market greatly softened in 2007. The slower housing market is expected to continue throughout 2008 and into 2009 before returning to more normal levels of activity.

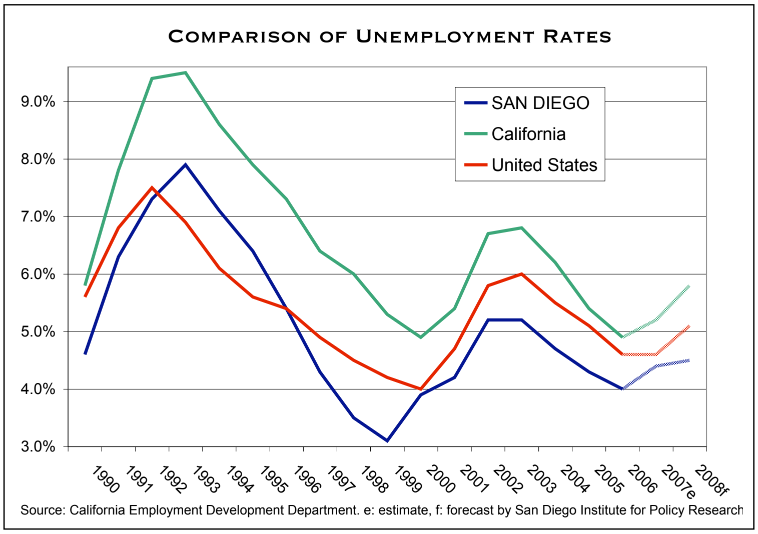
Construction of new homes increased in the 2000s, but by historical standards, did not exceed demand created by population and job growth. Construction of multi-unit housing particularly increased, especially with large numbers of high-rise apartments and condominiums being built in downtown San Diego. With the market slowing down in 2007, the inventory of unsold homes has now significantly risen.

Averaging between 6,000 to 8,000 multi-units built each year between 1999 and 2006, the numbers are not out of line to San Diego's economic and population growth, especially compared with the 20,000 or more such units built in a single year in previous eras.

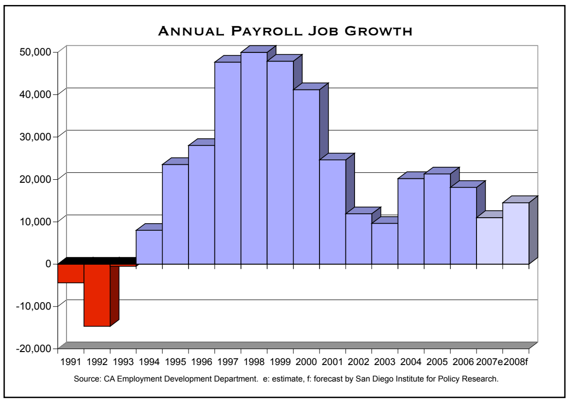
Both single and multi-unit home construction dropped significantly in 2007 to just over 8,000 total units. Projections for 2008 are to continue at this lowered level until the market absorbs the defaulted homes returning to the market and prices adjust to the economic realities for area income levels. The fires impacting San Diego in October and destroying some 1000+ homes will actually boost the number of single-unit homes to be built in 2008.

Population Growth Slowing

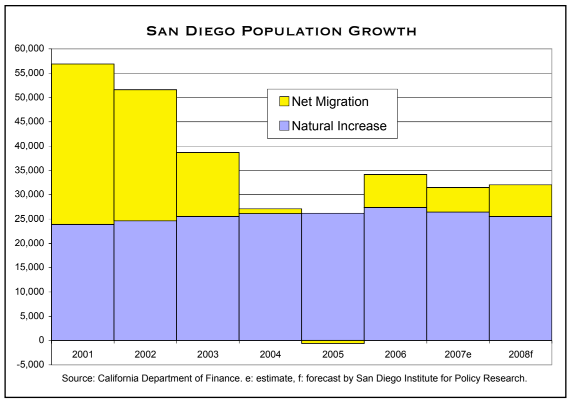
Although San Diego's population continues to expand, the rate of growth diminished considerably in more recent years. Falling from



Source: California Employment Development Department. e: estimate, f: forecast by San Diego Institute for Policy Research



Source: CA Employment Development Department. e: estimate, f: forecast by San Diego Institute for Policy Research.



Source: California Department of Finance. e: estimate, f: forecast by San Diego Institute for Policy Research.

annual growth of 1.8 to 2.1 percent per year, growth fell to 0.8 percent in 2005 and 1.1 percent in 2006.

Natural increase, the number of babies born exceeding deaths of residents, continues at a steady pace. International migration to San Diego, primarily from Mexico, continues at a steady level as well.

The slowdown of population growth is primarily due to an exodus of residents moving away from San Diego. For the first time since 1996, San Diego's domestic migration turned negative again in 2005, and continued to languish in 2005 and 2006.

This out-migration softened total population growth for San Diego from between 50,000 and 60,000 per year, to just more than 26,000 the past few years. In contrast to the early 1990s, when thousands of jobs were lost, there has not been a large increase of unemployment. Job growth slowed but continues to rise in San Diego, and the unemployment rate remains within a reasonable 4.0-4.8 percent range.

The out-migration of San Diego residents is largely attributed to the high cost of housing, forcing many low and mid-level income residents to go elsewhere to find affordable housing. Some workers found more affordable housing in southern Riverside County while retaining their job in San Diego and making long, two-hour commutes each way. Others find housing in Mexico, and Imperial County to the east, but the commute is increasingly difficult for crossing the border, or made more expensive by higher gas prices.

Many are moving away to lower cost areas in Phoenix, Denver, and Austin, not so much in search of better jobs, but undoubtedly where they can afford to purchase a home.

Modest Employment Changes

San Diego's unemployment rate rose from an annual low of 4.0 percent in 2006 to an estimated 4.4 percent in 2007. The forecast for 4.5 percent in 2008 remains a relatively reasonable and healthy rate of unemployment for the region, especially considering much higher levels of previous eras. San Diego's unemployment rate is approaching but still compares favorably with the U.S. unemployment rate at 4.6 percent in 2007, and remains much lower than the rest of California at 5.2 percent. San Diego's unemployment rate is not forecast to increase as much as California or the U.S. during 2008, before moderating in 2009.

Payroll job growth moderated the past few years, but remains positive. Several sectors are losing jobs in 2007, led by construction, manufacturing, real estate, finance, and retail trade. On the other hand, many sectors continue to add jobs, including professional, technical, and business services, accommodations and food services, health care, and government, and are thus maintaining San Diego's overall positive job growth for the region. The job losses being recorded in several sectors, primarily construction and real estate, are anticipated to moderate in 2008, and San Diego should see slightly stronger overall job gains.

Inflation Worries

With slower economic activity, the prices of consumer goods tend to fall and inflation moderates. Due to slower economic growth, particularly with home prices no longer rising, lower increases in San Diego's cost of living resulted. However, pressures to increase rents on San Diego's significantly large rental housing market are rising.

The Federal Reserve's recent actions to lower the federal funds rate and ease credit restrictions may re-stimulate inflationary price rises, as well, including home price increases. This will lead to an escalation in the overall cost of living for San Diego in 2008.

San Diego's inflation rate consistently exceeded California's and U.S. inflation rates from 1998 until 2005, because of the faster economic growth. California's inflation rate exceeded San Diego's in 2006 and 2007, and the U.S. remained lower although at a closer level. San Diego's inflation rate or increase in cost of living should again exceed the rest of the state and nation in 2008 due to the region's faster economic growth.

1 David Shulman, "A Near Recession Experience," UCLA Anderson Forecast, September 12, 2007.

2 Ross DeVol, "Best Performing Cities," Milken Institute, June 2002.

SAN DIEGO COUNTY ECONOMIC INDICATORS

Indicator	Actual 2004	Actual 2005	Actual 2006	Estimate 2007	Forecast 2008	Annual Change '05/'04	'06/'05	'07/'06	'08/'07
Gross Regional Product									
(billions)	$138.153	$146.341	$155.414	$162.874	$170.366	5.9%	6.2%	4.8%	4.6%
Real Change+						3.3%	3.6%	2.1%	2.5%
Population*	3,038,579	3,064,113	3,098,269	3,129,714	3,161,714	0.8%	1.1%	1.0%	1.0%
Change	27,053	25,534	34,156	31,500	32,000	-5.6%	33.8%	-7.8%	1.6%
Net Migration	996	-640	6,780	5,000	6,500	-164%	-1159%	-26.3%	30.0%
Natural Increase	26,057	26,174	27,376	26,500	25,500	0.4%	4.6%	-3.2%	-3.8%
Employment									
Unemployment Rate	4.7%	4.3%	4.0%	4.4%	4.5%	-0.4%	-0.3%	0.4%	0.1%
Industry Payroll Employment	1,271,500	1,292,500	1,310,700	1,321,700	1,336,200	1.7%	1.4%	0.8%	1.1%
Change	20,200	21,000	18,200	11,000	14,500				
Construction									
Housing Permits	17,306	15,258	10,767	8,100	9,200	-11.8%	-29.4%	-24.8%	13.6%
Single Units	9,555	7,904	4,727	4,000	5,200	-17.3%	-40.2%	-15.4%	30.0%
Multiple Units	7,751	7,354	6,040	4,100	4,000	-5.1%	-17.9%	-32.1%	-2.4%
Inflation									
San Diego Consumer Price Index - All Urban Consumers (CPI-U: 1982-84 = 100)	212.8	220.6	228.2	234.5	241.5	3.7%	3.4%	2.8%	3.0%

+Adjusted for inflation with Implicit Price Deflator for California. *Population is year-ending.

Source: San Diego Institute for Policy Research.

Dashboard Observations
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The San Diego Institute for Policy Research and Competitive Edge Research & Communications' (CERC) bi-monthly Opinion Barometer includes a survey of San Diegan's attitude towards the local economy and their own personal financial situation. Beginning in January 2007, a survey of 500 residents randomly selected in the City of San Diego is conducted every other month.

City of San Diego resident's outlook for "now being a good time to purchase an expensive household item" plummeted to 85.3, the first time and the only indicator to show more consumers having a negative outlook (14.7 percent below a neutral outlook at 100.0).

Judgment on the current state of the local economy was next lowest, but still slightly on the positive side at 106.5. Expectations for general business conditions to improve over the next six months are much higher with the index at 124.4. Both of these sentiments were slightly down in September, following slight gains posted in July.

San Diego consumers remain most optimistic about their future personal financial situation, with the average outlook for the next six months being 71.6 percent on the positive side (index of 171.6).

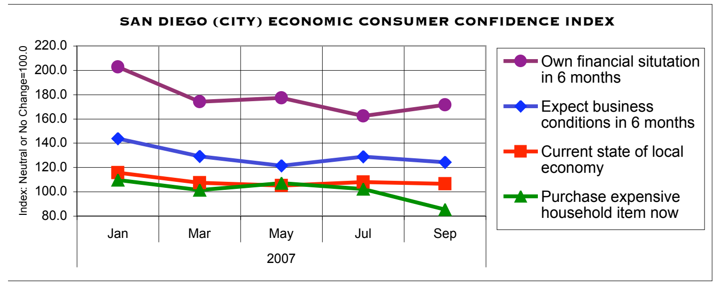
As with national indexes, the **San Diego stock index** continues to show significant volatility. The index was down 11.7 percent in the month of August, but stood 3.3 percent higher than a year ago, the one positive Barometer indicator observed. The Fed slashing in August of the rate it charges at the "discount window" from 6.25 percent to 5.75 percent clearly provided a boost for Wall Street. We believe, however, that this prolongs the problem of too-easily-given-credit and could fuel inflation and weakens the U.S. dollar. Expect higher prices for oil, gasoline and goods imported from Europe, Canada and/or China. The spreading fallout in financial markets is yet to be fully felt and will likely drag both the national and local economy. Like many recent home buyers, the U.S. economy is approaching a point of not being able to generate the necessary income to meet debt-repayment requirements.

New business licenses issued by the City of San Diego indicate another 10.4 percent seasonally adjusted decline in August. Over the past year, business licenses are off 15.5 percent. New licenses issued in 2007 are about equal to the number issued in 2003, the big difference being the numbers were rising that year, while in 2007 they are decreasing.

San Diego's unemployment rate remained at 4.8 percent in both July and August, the highest the rate has been locally since July 2004. The unemployment rate normally decreases in September as the school year starts up (and students exit the workforce) and further decreases as workers are added for the holiday shopping season. San Diego's unemployment rate is therefore not anticipated to increase above 4.8 percent for the rest of the year. Unemployment has clearly risen in San Diego, however, and will probably end the year at the highest level since 2004 when the average for the year was 4.7 percent.

San Diego's unemployment rate remains well below California's (5.2 percent) but has approached the U.S. rate. In fact, San Diego's unemployment rate exceeded the U.S. unemployment rate of 4.6 percent in August for the first time since the year 2000.

New residential units authorized for construction fell precipitously to 449 in August, a seasonally adjusted decline of 45.6 percent. The change over the past year shows a 15.5 percent decrease as well. Housing units under construction in San Diego County have fallen by more than one-half over the past two years. As a result of the cratering of the residential market, construction employment, as well as real estate, finance, and even retail jobs, have all decreased in San Diego.



SAN DIEGO ECONOMIC CONSUMER CONFIDENCE INDEX

	Jan	Mar	May	Jul	Sep	Jan-Mar	Mar-May	May-Jul	Jul Sep
Index*			**2007**						
Overall	143.1	128.1	127.8	125.4	122.0	-10.5%	-0.2%	-1.8%	-2.8%
Current:									
State of local economy	115.6	107.6	105.2	108.0	106.5	-7.0%	-2.2%	2.7%	-1.4%
Purchase expensive household item	109.9	101.4	107.3	102.3	85.3	-7.7%	5.9%	-4.6%	-16.6%
Six Months in Future:									
Expect business conditions	143.8	129.1	121.4	129.1	124.4	-10.2%	-6.0%	6.3%	-3.6%
Own financial situation	202.9	174.2	177.2	162.3	171.6	-14.1%	1.7%	-8.4%	5.7%

*Index: 100.0=neutral or remain same.

Source: Competitive Edge Research & Communication, Inc.; San Diego Institute for Policy Research.

The San Diego Institute for Policy Research (SDI) is a non-partisan organization that formulates and promotes high quality economic, policy, and public-opinion research so as to improve the efficiency and effectiveness of local governments in San Diego County.

San Diego Institute for Policy Research

New address and phone number:

P.O. Box 504083
San Diego, CA 92150-4083
Phone: 858-546-4879
Email: kcunningham@
sandiegoinstitute.com