SAN DIEGO INSTITUTE FOR POLICY RESEARCH

SAN DIEGO
Economic Ledger

FEBRUARY 2008 WWW.SANDIEGOINSTITUTE.COM VOLUME TWO ISSUE ONE

CEO's Corner

Recent national economic news has been, in a word, gloomy. The sub-prime mortgage mess has caused liquidity to significantly tighten as banks have become both more risk adverse as well as had to increase reserves to balance the bad debt they have taken back onto their balance sheets. Consumer spending was poor during the holiday season and several national retailers have adjusted earnings estimates downward. The dollar has shrunk to historic lows, increasing the prices of imports and putting constraints on the Federal Reserve's ability to use fiscal policy to spark a rebound. Most economists think that we are either in a recession or, if not technically meeting such a definition, growth in 2008 will be, at best, anemic.

A question on the minds of many is how San Diego will fare? Will we see the kind of slow down the region experienced in the early 1990s or will the region weather the downturn in relatively good shape? In this issue of the Leger SDI Senior Fellow and Economist Kelly Cunningham decidedly comes down on the optimistic side of the equation. As he points out, net job growth in the region continues to trend upward. The diversification of our economy since the early 1990s has made us much less vulnerable to a slowdown in any particular sector. Moreover, some of the key drivers of our region's growth are not directly tied to consumer spending. The growth of industries such as biotechnology, defense and, to an extent, wireless communications depend much more on federal and corporate expenditures for innovation and research and development than on consumer confidence and their willingness to spend.

There are still challenges ahead to overcome. The weakness of the housing market has

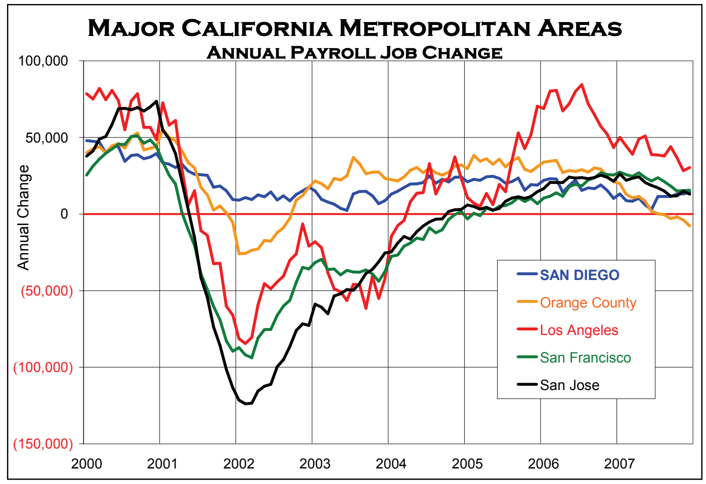
(Continued on page 2)

San Diego's Economic Resiliency Evident from Payroll Job Growth

Over the past decade, San Diego's economy endured two significant slowdowns that many feared would lead to full-blown recessions. However, as shown by the chart (see page 2) showing year-over-year changes, San Diego has consistently added jobs since the severe three-year recession of the early 1990s, the worst endured by the region in the 60 years since the Great Depression. The continued increase of jobs since that time is a significant indicator that San Diego has not had a recession since than or about to have one soon.

"San Diego leads the rest of the state and nation in economic activity. We have already had our slowdown in 2007, before the state and nation, and will see a slight acceleration of economic activity and job gains in 2008, even as the rest of the state and nation slow.

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



Job growth rebounded strongly following the early 1990s recession. At the time of the recession, job losses in the aerospace industry, which was San Diego's largest economic driver, and included the single largest private employer, resulted in the significant downturn of the regional economy. Sectors dependent upon the spending and related activities lost employment as well. The early 1990s also suffered from a fall out after the late 1980s over-building and collapse of the savings and loan industry.

Despite all these factors coming together and causing the San Diego economy to undergo a massive restructuring, at the depths of the recession the annual net loss of jobs barely exceeded 20,000. During the course of the entire downturn (from May 1991 to July 1993), San Diego experienced only a net loss of 44,000 jobs. This represented 4.2 percent of the total 988,000 jobs existing at the end of 1990.

Thereafter, San Diego saw strong job gains across nearly all sectors of the economy, including manufacturing. This resurgence was led by the relatively new formed sector of the economy labeled "high-technology driven research and development". This includes biotechnology, telecommunications, and computer/software companies as key sub-sectors for this entrepreneurially-driven business segment. During this period, San Diego was nationally recognized as developing the "most-diversified high-tech economy in the nation."

Overcomes dot-com and post 9-11 slowdowns

Annual San Diego job growth exceeded 50,000 during the final years of the '90s. The County was caught up in the so-called "dot-com" investment frenzy at the end of the '90s, as well as the subsequent meltdown in 2000. However, unlike northern California and other technology-driven metropolitan areas that soon hemorrhaged thousands upon thousands of job losses, San Diego slowed but never quite showed a year-over-year net decrease in jobs. This was largely due to San Diego's much more diversified portfolio of technology industries. The extent to which San Diego "missed" the bust of the dot-com era can be readily seen on the table above.

Even after the 9-11 terrorist attacks on the nation in 2001, in which the national economy was further jolted, San Diego continued adding jobs throughout 2002. A low point was reached mid-year 2003, but San Diego still never fell into an annual net loss for overall jobs, unlike California's other large employment metropolitan areas.

(Continued on page 2)

Resilient Employment

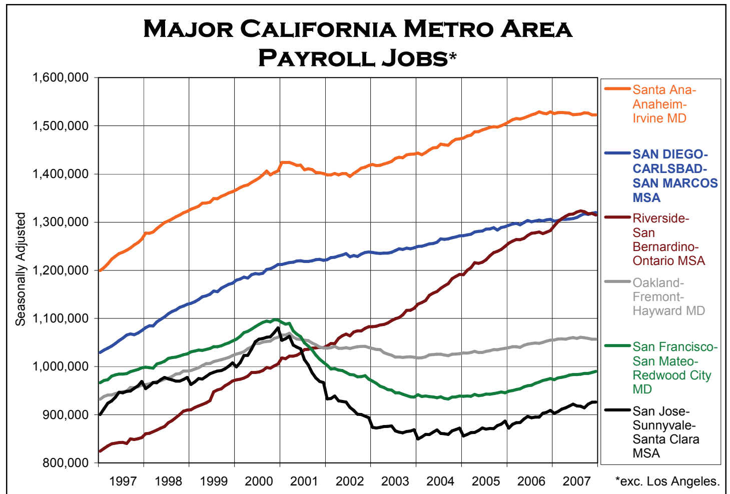
(Continued from page 1)

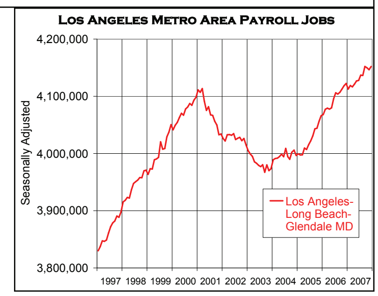
During this time, northern California's larger metro areas, San Francisco, San Jose and Oakland, all suffered thousands upon thousands of job losses. Although adding jobs in more recent years, these metro areas have still not recovered to the point they were at before the massive job losses began in 2001.

Los Angeles also suffered a significant number of job losses in 2001, '02, and '03, before beginning to add jobs again. Only as of 2007 has Los Angeles recovered enough to surpass the previous high point for total jobs. Even San Diego's nearby and similarly sized neighbor (if San Diego's more than 100,000 military jobs were included), Orange County also lost jobs in the 2000s, before rebounding, but now falling again in 2007.

It is interesting to note that jobs in the two-county Riverside-San Bernardino metro area grew exceptionally fast over the past decade, enough to overtake four formerly larger metro area civilian job markets, including slightly exceeding San Diego in 2007 (without considering military payrolls). Job gains in this metro area, known as the Inland Empire, are largely due to businesses and residents moving away from the more congested and expensive coastal counties of Los Angeles, Orange, and San Diego and the development of a logistics and warehouse industry, critical to the movement of goods flowing through the ports of Long Beach and Los Angeles. However, as the housing market slowed, Riverside-San Bernardino has begun losing jobs the past several months.

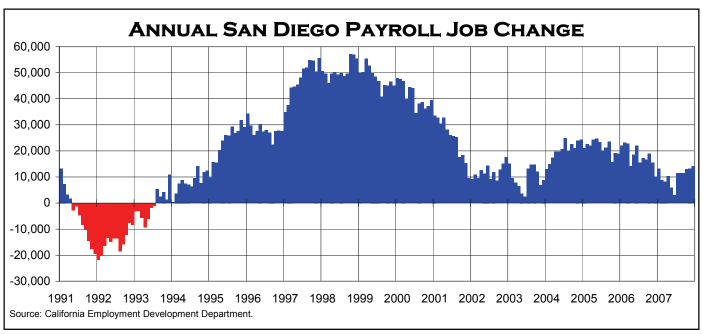
As previously noted, San Diego reached low points for annual job growth in 2003 and again in 2007, but has never fallen to a point of year-over-year total job loss. As a matter of fact, since a summer time low during 2007, annual job growth in San Diego accelerated to 14,100 as of the December 2007 report. San Diego's job growth not only continues to be positive, but appears to be gaining momentum going into 2008.





Is a recession imminent or currently under way?

These employment numbers are critical in helping make sense of prognostications that our region is slipping into recession. Economists from the California-based Beacon Economics already proclaim that California, as well as San Diego, are already well into recession. Local blogs and electronic news sites daily point to the softened real estate market as a sign that the sky is falling and that we can brace for a significant downturn.



We take a contrarian view. While the nation and state may be in or going into recession, San Diego's employment numbers do not suggest the local region has or soon will go into recession.

Economic independence

Local economic fortunes are increasingly independent not only from California, but Los Angeles and the rest of Southern California, than ever before. San Diego can no longer be thought of as an extension or suburb to the Los Angeles mega-economy and should be recognized as an independent and separate economy acting on its own momentum and strengths. While ties to Los Angeles certainly remain, particularly within certain sectors of finance and real estate development, the drivers for San Diego's economy are more independent than ever before.

San Diego's economy historically was said to be balanced upon a three-legged stool of aerospace/transportation manufacturing, defense-related expenditures, and tourism. Further in San Diego's past, fishing and agriculture were dominant industries as well, but their influence waned as population and other industries grew.

Over the past two decades, the fourth leg of local economic prosperity has become prominent in San Diego's fortunes, as previously noted, "high-technology research and development", including biotechnology, telecommunications, and computer/software. This fourth major pillar of the San Diego economy gives the region greater economic prowess with the dynamic power to sustain and stabilize the region's overall economic fortunes independent of the rest of California.

San Diego's technology driven industries are largely research driven endeavors based upon scientific discovery, innovation, and development. Massive funding is necessary for these industries to thrive and investment dollars flow here from around the world. As the industries are driven by business and government investment spending, the economy is less dependent upon the vagaries of consumer spending.

Similarly, the defense industry is another factor helping to create a certain autonomy for San Diego from the rest of the state's economic fortunes. Historically, the concentration of the defense industry in San Diego County made the region much more vulnerable to federal decisions about military expenditures and especially spending on specific weapon systems. More recently, however, the local defense industry has also become more diversified among technology-driven R&D sectors in communications, surveillance and weaponry.

The rise of Tijuana and Baja California manufacturing adds another pillar of economic strength for the bi-national regional economy. While the Mexican industries are subject to and driven by consumer-driven production, with significant ties to the rest of Southern California and the U.S., the presence and prominence of these bi-national industries provide the local region with another important source of eco-

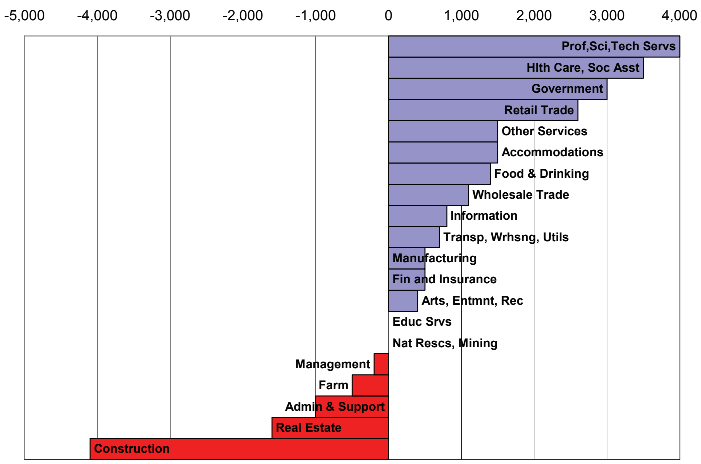
CEO's Corner

(Continued from page 1)

slowed, and in some cases reduced property tax receipts. As we have commented elsewhere, the state's economic slowing has serious implications for a tax system that over relies on taxing wealthy Californians. But overall we are bullish on San Diego and any regional slowdown will be relatively mild and short.

- W. Erik Bruvold, President and CEO, San Diego Institute for Policy Research

Annual Change in San Diego Payroll Jobs
by Sector, Change: Dec '06-Dec '07



Source: California Employment Development Department.

nomic prosperity.

Rebuff to a local recession

The technical definition of a recession is defined by a year-to-year decline in number of jobs and retraction of economic growth. Because regional economic growth below a "national level" is only defined on an annual basis, it is difficult to see negative economic growth for any one or two quarters. A quarter or two of negative growth balanced by higher growth in other quarters may be apparent when the average for the year is 2.0 percent or lower. San Diego has not had annual economic growth below 2.0 percent since the early 90s when the region suffered the severe multi-year recession. The San Diego economy is estimated to have 2.1 percent "real" or inflation-adjusted growth in 2007 and the outlook for 2008 is 2.5 percent. (See the November 2007 San Diego Economic Ledger report on "San Diego's 2008 Economic Outlook", http://www.sandiego institute.com/economic_ledger/) While the San Diego economy has clearly slowed as shown by these relatively low rates, it does not necessarily indicate the economy was or is in recession.

The other major indicator for a regional economic recession is annual losses of jobs. San Diego's annual job growth has remained consistently positive since the recession in the early 1990s. In 2007, annual growth slowed to a low of only 2,900 over the year in July 2007, but since that month job growth in San Diego accelerated to 14,100 annually by the end of 2007.

Continuing job growth

As of December 2007, the largest gain of jobs in San Diego has been among the category of "professional, scientific and technical services", which includes many highly-educated, skilled, and well-compensated technical, legal, and professional workers. Health care shows the second most growth, with the medical field steadily expanding locally. Government, retail, and jobs associated with the hospitality industry also saw significant gains during 2007.

San Diego job losses were primarily in construction and real estate. If not for these losses, total job growth in San Diego during 2007 would have been much more than 20,000. We believe that in San Diego, which was among the first areas to be impacted by the weakening real estate market, the impacts have already largely occurred. Job losses among both of these sectors in San Diego are starting to taper off, and the worst of the cutbacks may have already occurred. As noted in the Dashboard (see back page), residential building permits saw an up-tick in the last part of 2007, suggesting a bottoming of the severe slowdown in local building.

San Diego has led the rest of the state and nation in economic activity. We have already had our slowdown in 2007, ahead of the state and nation, and already seeing slight acceleration of economic activity and job gains even while the rest of the state and nation may slip into recession.

The decidedly net positive increase in jobs is a significant indicator for San Diego's continued economic growth. Furthermore, the acceleration of job growth in more recent months indicates job gains are actually picking up, not slowing down. This suggests San Diego's economic momentum is moving forward, ahead of whatever slowdown the rest of California and the nation may be currently undergoing.

San Diego's economy on track to expand

Some might compare San Diego at the beginning of 2008 to the beginning of the '90s as the region was falling into the severe recession. Similar to that time, San Diego is coming off an overly speculative real estate bubble and seeing some job losses.

However, there are several key differences. First, the housing real estate bubble now is largely due to too easily accessed mortgage loans. This led to unrealistic and unsustainable housing price bubble that is now deflating, particularly as variable mortgage loans reset. Unlike the '90s, there has not been significant speculative overbuilding in residential or commercial real estate. If anything, the market remains under-built to consumer demand and is largely the reason the price bubble developed from not matching this demand. This has led to San Diego workers moving to distant housing markets in Riverside, Imperial County, and Mexico to find affordable housing, only because home prices in San Diego are unaffordable.

Second, as previously noted San Diego is not losing jobs overall. Although construction, real estate, and some financial jobs decreased as the market corrects from the excessive activity in the housing market, those losses are already starting to ease off. Otherwise, San Diego is not only adding jobs across almost all other job sectors, but the biggest gain of jobs is impressively continuing to be among high-paid tech sectors, with a strong ripple effect for income and jobs in other sectors.

Third, in spite of the weakness shown by the real estate market, all of the primary drivers of San Diego's economy are relatively healthy, particularly the technology-driven business sectors, military and defense spending, manufacturing—both south and north of the border, and the visitor industry. ■

San Diego-Carlsbad-San Marcos MSA
Labor Force and Industry (Payroll) Employment

Employment Sector	Dec-06	Dec-07	Change
Civilian Labor Force	**1,530,900**	**1,549,400**	**18,500**
Civilian Employment	1,473,700	1,472,800	-900
Civilian Unemployment	57,200	76,600	19,400
Civilian Unemployment Rate	**3.7%**	**4.9%**	**1.2%**
(CA Unemployment Rate)	4.6%	5.9%	1.3%
(U.S. Unemployment Rate)	4.3%	4.8%	0.5%
Total, All Industries	**1,324,600**	**1,338,700**	**14,100**
Farm	10,900	10,400	-500
Total Nonfarm	**1,313,700**	**1,328,300**	**14,600**
Private	**1,091,200**	**1,102,800**	**11,600**
Goods Producing	192,600	189,000	-3,600
Natural Resources and Mining	500	500	0
Construction	89,200	85,100	-4,100
Manufacturing	102,900	103,400	500
Durable Goods	77,400	78,300	900
Nondurable Goods	25,500	25,100	-400
Service Providing	**1,121,100**	**1,139,300**	**18,200**
Private Service Producing	**898,600**	**913,800**	**15,200**
Trade, Transportation and Utilities	227,800	232,200	4,400
Wholesale Trade	45,200	46,300	1,100
Retail Trade	153,800	156,400	2,600
Transportation, Warehousing and Utilities	28,800	29,500	700
Information	37,400	38,200	800
Financial Activities	52,600	53,100	500
Real Estate and Rental and Leasing	29,400	27,800	-1,600
Professional, Scientific and Technical Services	113,300	117,300	4,000
Management of Companies and Enterprises	17,100	16,900	-200
Administrative and Support and Waste Services	86,900	85,900	-1,000
Educational Services	21,400	21,400	0
Health Care and Social Assistance	105,100	108,600	3,500
Leisure and Hospitality	157,900	161,200	3,300
Arts, Entertainment, and Recreation	23,500	23,900	400
Accommodation	29,700	31,200	1,500
Food Services and Drinking Places	104,700	106,100	1,400
Other Services	49,700	51,200	1,500
Government	**222,500**	**225,500**	**3,000**
Federal Government	40,600	41,000	400
State Government	40,200	41,800	1,600
Local Government	141,700	142,700	1,000

Source: California Employment Development Department. Note: Totals are rounded.

Dashboard Observations

By Kelly Cunningham, Economist, Sr. Fellow

San Diego economic indicators are showing mixed activity at the end of 2007

New business licenses issued by the City of San Diego declined a seasonally adjusted 3.7 percent between November and December 2007. Compared to December 2006, the number has fallen 25.3 percent. The annual number for all of 2007, however, shows a record number at 16,981, not only 8.5 percent more than in 2006, but the highest number since at least 1990.

This clearly reflects San Diego's dynamic entrepreneurial economy indicating new business activity in the area. However, it may also partially reflect workers laid off from regular salaried positions deciding to start their own business. These new business owners are usually not earning as high of income, particularly in the initial start-up phase of their self-owned venture. The year 2003 recorded a large increase of business licenses issued, followed by a further increase in 2004 with more than 16,000 licenses issued. After standing for 3 years, the record set that year has now been broken in 2007.

After an unprecedented fifth consecutive month at 4.8 percent, San Diego's **unemployment rate** not only did not decrease as normal during the holiday shopping season, but slightly rose to 4.9 percent in December 2007. The seasonal adjustment shows the rate jumping 0.6 percent in December. It is very rare for the end of the year unemployment rate to be higher than the normally high point in summer. The only previous times the unemployment rate rose following the summer was in 1990, when San Diego fell into a severe three-year recession, and in 2001, coming after the 9-11 terrorist attacks on the nation. Even in those years, the unemployment rate decreased in the last month of the year. Only December 2007 (according to records back to 1983) shows the unemployment rate increasing from November.

Weak consumer spending left retail stores not needing to hire as much extra help for the normal seasonal holiday sales rush. This does not portend well for the final tally of retail sales during the holidays.

San Diego's stalled unemployment rate is 1.2 percentage points higher than the previous year December and at 4.9 percent is the highest for the County since July 2004. Although still a relatively healthy rate, falling within a range still suggesting full employment, this portends a higher level of unemployment by the summer of 2008. The local unemployment rate has been above the rest of the nation since August 2007, something that has not happened in seven years, nonetheless remains a full percentage point lower than the rest of California.

The number of new **residential units** authorized for construction in December 2007 increased a seasonally adjusted 27.9 percent, and was 8.4 percent higher than the year ago December. The annual number for all of 2007, however, remains significantly down, dropping 31.3 percent from 2006, which was already down 29.8 percent from 2005.

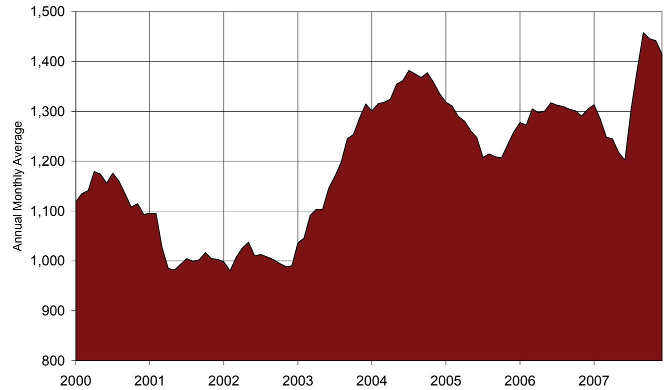
This Ledger sees a slight uptick in new residential units approved for construction with the end of 2007, which may indicate housing construction beginning to find a bottom, with the last months of 2007 actually showing a slight up-tick in activity. Upcoming months when new building usually picks up will determine if a bottoming was indeed reached during the closing months of 2007.

The **San Diego stock index** has shown extreme volatility over the past two years, ending the year slightly down 1.8 percent from November 2007, and off 1.0 percent since December 2006. Similar to national stock indexes, it is difficult to see a general trend for the index, and volatility may be anticipated with shifting national and international business activity.

The San Diego stock index is led by Fortune 500 powerhouses, Qualcomm, Sempra Energy, and SAIC. The next companies on the list are major biotech/lifesciences based firms, including Invitrogen, Amylin Pharmaceuticals, Resmed, Illumina, Gen-Probe, plus Biomed Realty-Trust, Nuvasive, and Isis Pharmaceuticals among the top 14.

Note: The Competitive Edge Research and Communication, Inc. and San Diego Institute for Policy Research *Consumer Confidence Index* is not available for December 2007, but expected to resume later in the year.

New Business Licenses Issued
City of San Diego



Indicator	Dec 2007	Month Change (Sea. Adj.)	Annual Change
Unemployment Rate[1] San Diego County	4.9%	0.6% ▼	1.2% ▼
Residential Building[2] Units Authorized for Constr. San Diego County	581	27.9% ▲	8.4% ▲
New Business Licenses[3] Issued by City of San Diego	943	-3.7% ▼	-25.3% ▼
San Diego Stock Index[4] San Diego based public cos. 2nd Thursday of month	134.1	-1.8% ▲	-1.0% ▲

[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.

San Diego Institute for Policy Research

P.O. Box 504083
San Diego, CA 92150-4083
Phone: 619-209-6034
Email: kcunningham@sandiegoinstitute.com

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.