

ARIZONA ECONOMIC ENVIRONMENT

Since the end of recession in July 2009, Arizona's overall economic environment is getting better over time, although on a slower track. There are a number of factors that have helped the U.S. as well as Arizona economy gradually pickup and add jobs this past year.

- Continued improvement in real Gross Domestic Product (GDP), real personal income at the state and national levels, employment, and retail sales.¹
- Continued employment gains in the private sector, increasing private domestic investment, gradual increase in the index of industrial production and rate of capacity utilization, high levels of corporate profit, a gradual resurgence in private residential construction permits.²
- Continued gradual climb in household net worth, a continued decline in the fraction of disposable income used for household debt payments, and U.S. exports.³
- Residential real estate markets in Arizona and Phoenix metropolitan area are showing an improvement as measured by various indicators. These include rising levels of building permits. Also, the home prices in Arizona have been rising.⁴
- Revolving consumer credit levels have remained flat. However, an expansion of non-revolving consumer credit since 2011 has served as an impetus to expanding economic activity. Consumer sentiment and consumer spending have shown signs of improvement, but the rate of growth has been slowing down.⁵

As per the Budget Control Act of 2011, the federal government enacted across-the-board budget cuts also known as sequestration followed by a continuing resolution that went into effect in March 2013. The objective was to reduce the federal government deficit and debt levels. Spending was reduced in both civilian and military programs. In addition, the payroll tax cuts of 2 percent expired in December 2012, bringing the rate back to the default of 6.2 percent as of January 2013.⁶

Although, the economic fundamentals continue to improve, they appear to be dampened by the effects of sequestration and the payroll tax increase. Hence, it is expected that the rate of growth in some of the indicators mentioned above would be lower. With an improving domestic economy and employment growth in the Private sector, consumers are expected to spend more. However, the impact of sequestration and payroll tax increase is expected to be felt through the economy slowing down the rate of economic activity and lowering the demand for goods and services slightly in the short run. Reduced

¹ See FRED graphs and data for the variables: real gross domestic product, 1 decimal (GDPC1); real personal income (RPI); real disposable personal income (DSPIC96); total personal income in Arizona (AZOTOT); per capital personal income in Arizona (AZPCPI); and real retail and food services sales (RRSFS) at the website <http://research.stlouisfed.org/fred2/>.

² See FRED graphs and data for the variables: real gross private domestic investment, 3 decimal (GPDIC96); industrial production index (INDPRO); capacity utilization (TCU); capacity utilization – manufacturing (MCUMFN); corporate profits after tax (CP); new private housing units authorized by building permits - in structures with 1 unit (PERMIT1); privately owned housing starts authorized by building permits, 1-unit structures for Arizona (AZBP1FH); and new private housing units authorized by building permit for Arizona (AZBPPRIV) . at the website <http://research.stlouisfed.org/fred2/>.

³ See FRED graphs and data for the variables: total net worth - balance sheet of households and nonprofit organizations (TNWBHNO); total assets - balance sheet of households and nonprofit organizations (TABSHNO); owners' equity in household real estate - net worth - balance sheet of households and nonprofit organizations (OEHRENWBHNO); total liabilities - balance sheet of households and nonprofit organizations (TLBSHNO); home mortgages - liabilities - balance sheet of households and nonprofit organizations (HMLBSHNO); debt outstanding domestic nonfinancial sectors - household, consumer credit sector (HCCSDODNS); debt outstanding domestic nonfinancial sectors - household, home mortgage sector (HHMSDODNS); household debt service payments as a percent of disposable personal income (TDSP); and real exports of goods & services, 1 decimal (EXPGSC1). at the website <http://research.stlouisfed.org/fred2/>.

⁴ See FRED graphs and data for the variables: all-transactions house price index for the United States (USSTHPI); all-transactions house price index for Arizona (AZSTHPI); home price index for Phoenix, Arizona (PHXRNSA); new private housing units authorized by building permit for Phoenix-Mesa-Scottsdale, AZ (MSA) (PHOE004BPPRIV); privately owned housing starts authorized by building permits: 1-unit structures for Phoenix-Mesa-Scottsdale, AZ (MSA) (PHOE004BP1FHSA); privately owned housing starts authorized by building permits, 1-unit structures for Arizona (AZBP1FH); and new private housing units authorized by building permit for Arizona (AZBPPRIV); total private construction spending: residential (PRRESCONS); private residential fixed investment (PRFI); and real private residential fixed investment, 3 decimal (PRFIC96). at the website <http://research.stlouisfed.org/fred2/>.

⁵ See FRED graphs and data for the variables: total revolving credit owned and securitized, outstanding (REVOLSL); total nonrevolving credit owned and securitized, outstanding (NONREVSL); University of Michigan: consumer sentiment (UMCSENT); and real personal consumption expenditures (PCEC96). at the website <http://research.stlouisfed.org/fred2/>.

⁶ See (a) IHS Global Insight. U.S. Forecast for September and October 2012. [at the website www.ihs.com/products/global-insight/index.aspx](http://www.ihs.com/products/global-insight/index.aspx).
(b) Wells Fargo Economics Group. Monthly Outlook. October 2, 2012. at the website www.wellsfargo.com/com/research/economics
(c) Wells Fargo Economics Group. Special Commentary. U.S. Fiscal Primer: The Deficit and Debt. August 2012. at the website www.wellsfargo.com/com/research/economics
(d) IHS Global Insight. U. S. Economy Article: The Fiscal Cliff: An Update. December 19, 2012. [at the website www.ihs.com/products/global-insight/index.aspx](http://www.ihs.com/products/global-insight/index.aspx).
(e) The Pew Center on the States. Fiscal Federalism Initiative. The Impact of the Fiscal Cliff on the States. November 2012. [at the website www.pewtrusts.org/fiscal-federalism](http://www.pewtrusts.org/fiscal-federalism).

spending and increased taxes are expected to lower the level of aggregate demand in the U.S. and Arizona economies and slow the rate of economic and employment growth. The housing market remains encouraging with continued increase in home prices in Arizona and other states.

Arizona's employment was one of the fastest growing in the nation prior to the recession that started at the end of 2007. For many years, Arizona consistently rated amongst the top 10; however the pattern ended in 2007. The structure of the Arizona economy, highly tied to the construction industry, made Arizona one of the hardest hit states by the economic and financial crises. The ranking had dropped to 36 as of May 2011, after being in the top 2 from CY 2004 to CY 2006, second only to Nevada. For CY 2010, the state's national ranking had tumbled to 49 with Nevada at 50. Arizona's ranking amongst the nation's states had significantly improved in the past year and it now ranks 8th in the Nation.

Table 1: Percentage Change in Program Year Average Employment—Arizona

Industry	PY 2007	PY 2008	PY 2009	PY 2010	PY 2011	PY 2012
Total Nonfarm	0.2%	-5.3%	-5.3%	0.0%	1.7%	2.1%
Manufacturing	-2.8%	-8.3%	-8.6%	-0.3%	2.7%	1.8%
Natural Resources and Mining	18.9%	1.6%	-15.6%	3.7%	8.0%	5.8%
Construction	-10.9%	-25.3%	-25.9%	-4.5%	1.7%	6.4%
Trade, Transportation and Utilities	1.2%	-5.7%	-5.4%	-0.3%	1.5%	1.0%
Leisure and Hospitality	1.0%	-3.8%	-3.8%	1.3%	2.6%	3.1%
Education and Health Services	4.8%	4.2%	3.1%	3.2%	3.3%	2.0%
Professional and Business Services	-0.5%	-8.6%	-7.1%	0.7%	2.1%	2.2%
Financial Activities	-2.9%	-4.7%	-3.4%	0.7%	3.0%	2.9%
Other Services	2.8%	-3.1%	-7.4%	-1.9%	-2.1%	-1.4%
Government	3.9%	0.1%	-2.3%	-2.1%	-0.7%	1.8%
Information	-1.4%	-4.3%	-6.8%	-1.6%	3.9%	2.9%

Notes: Source: BLS Current Employment Statistics

1. Calculated from seasonally unadjusted data;
2. PY 2012 includes May's preliminary estimate.

There was modest growth of 2.1% in Nonfarm employment in 2012. Looking at the performance for the Program Years 2010 and 2011, Nonfarm employment was flat in 2010 and gained by 1.7% in 2011, after posting a loss of 5.4% in 2009 and 5.3% in 2008 (**Table 1**). For PY 2012, all the major industrial sectors posted employment gains with the exception of Other Services which posted over-the-year loss of 1.4%. When over-the-year rate of growth across various sectors are compared in 2012, Construction lead the gains at 6.4% followed by Natural Resources at 5.8% and Leisure and Hospitality at 3.1%. Other gaining sectors were: Financial Activities (2.9%); Information (2.9%); Professional and Business Services (2.2%); Education and Health services (2.0%); Government (1.8%); Manufacturing (1.8%); and Trade, Transportation and Utilities (1.0%);

Although Construction and Natural Resources and Mining sectors had the most over the year percentage gains, these two sectors have a smaller employment base as shown in **Table 2**.

Construction lost over half its workforce during the recession resulting in a smaller base employment. As shown in **Table 2**, Arizona's large industrial sectors in descending order of Magnitude as of PY 2012 are Trade, Transportation and Utilities, Government, Educational and Health Services, Professional and Business Services and Leisure and Hospitality.

Industry	PY 2007	PY 2008	PY 2009	PY 2010	PY 2011	PY 2012
Total Nonfarm	2,670.4	2,528.6	2,393.6	2,393.5	2,434.8	2,485.5
Manufacturing	178.4	163.6	149.5	149.0	153.0	155.7
Natural Resources and Mining	12.6	12.8	10.8	11.2	12.1	12.8
Construction	209.1	156.2	115.8	110.6	112.5	119.7
Trade, Transportation and Utilities	527.4	497.3	470.4	468.9	476.1	481.0
Leisure and Hospitality	273.4	263.1	253.0	256.4	263.1	271.2
Education and Health Services	315.9	329.3	339.4	350.4	362.1	369.3
Professional and Business Services	400.1	365.8	339.8	342.3	349.6	357.3
Financial Activities	182.4	173.9	168.0	169.1	174.1	179.2
Other Services	100.4	97.3	90.1	88.4	86.5	85.3
Government	429.3	429.7	419.9	410.9	408.0	415.2
Information	41.4	39.6	36.9	36.3	37.7	38.8

The Employment and Population Statistics (EPS) unit of the Arizona Department of Administration released a forecast of Arizona's Nonfarm employment on May 9, 2013 as depicted in **Table 3** below.

	2012^(a)	2013^(b)	2014^(b)
Arizona	2.0%	1.9%	2.1%
Phoenix MSA⁽¹⁾	2.4%	2.3%	2.4%
Tucson MSA⁽²⁾	1.5%	0.8%	1.1%
Balance of State⁽³⁾	0.6%	0.8%	1.4%

Notes:

1) Maricopa and Pinal counties

2) Pima County

3) Arizona less Maricopa, Pinal, and Pima counties

a) Historical

b) Forecast

EPS is forecasting a gain of 98,300 Nonfarm jobs, representing a growth rate of 4.0 percent, over the two projected years of 2013 and 2014 for Arizona. An over-the-year gain of 46,500 Nonfarm

jobs is projected in 2013 and 51,800 jobs in 2014. The rate of growth projected for Nonfarm employment in Arizona is 1.9 percent in 2013 and 2.1 percent in 2014. This would suggest a gradual slowdown in the rate of Nonfarm employment gains in 2013 compared to 2012 and a slight improvement in 2014.

Table 3 shows the average annual growth rate in Total Nonfarm employment for Arizona, Phoenix MSA, Tucson MSA, and Balance of State. In 2013, all regions are forecast to have positive annual over-the-year growth rates in Nonfarm employment. Arizona is forecast to grow at 1.9% in 2013. Phoenix is expected to grow faster than the state at 2.3%. However, the projected growth rates for Tucson (0.8%) and the Balance of State (0.8%) are slower than the statewide and Phoenix MSA rates. The expected Nonfarm job gains in 2013 for the Phoenix MSA are 40,800 jobs, for Tucson MSA are 3,000 jobs, and for Balance of State are 2,700 jobs.

Growth rates in 2014 are expected to be higher than 2013 across all regions. Phoenix is forecast to continue growing at a faster pace (2.4%) than Tucson (1.1%), Balance of State (1.4%), and the state overall (2.1%). For 2014 the job gains forecast for Phoenix MSA are 43,200 jobs, Tucson MSA 3,900 jobs, and Balance of State 4,700 jobs.

Although there are positive signs of economic improvement, there are also risks that could add uncertainty to the forecast. Constrained budgets persist for a large majority of households. Despite some job growth and lowering in the unemployment rate, many consumers in the U.S. continue to face employment insecurity, lower wages and high debt. Rising prices for essentials could absorb a greater fraction of household spending, leaving less disposable income. In the domestic economy, constrained federal, state, and local budgets could inhibit growth. Although the residential real estate market has improved, the commercial real estate sector continues to be weak, which could pose additional risk. Continued multi-year recessions in the Euro Monetary Zone economies along with the tightening of the fiscal policy has the potential to depress economic activity further by reducing European demand for exports, thus contributing to a slowing of economic growth in many parts of the world. Economic growth is slowing in Asia and Latin America which could reduce imports from the U.S.

In Arizona, losses continued late into 2010 past the official end of the U.S. recession in June 2009 as declared by National Bureau of Economic Research (NBER). Net positive over-the-year gain started only since January 2011. The overall employment situation in Arizona is improving and expected to be better over the coming years. However, the forecasted rate of growth in Nonfarm employment in 2013 and 2014 is lower than what was observed prior to the recession ('97-'06 average of 3.2%). Although population growth in Arizona is positive (0.60% in '11 and 0.94% in '12), the rate of growth is lower than historically observed (2.8%, '01-'07). The forecasted population growth for 2013 is 1.13% and for 2014 is 1.33%. The current housing situation limits the ability of home owners to sell their properties in other states and relocate to Arizona. However, an initial increase in home prices in Arizona and some other states is a positive sign. The situation is slowly getting better.

The state's seasonally adjusted unemployment rate was 10.6% in May 2010. It dropped to 9.5% in May 2011, dropped to 8.4% in May 2012, and further dropped to 7.8% in May 2013 as shown in **Table 4** below. The decline in unemployment rate is an indication of the economy getting

better. The U.S. unemployment rate has also declined from 9.6% in May 2010 to 9.0% in May 2011, to 8.2% in May 2012 and then to 7.6% in May 2013. The state has a higher unemployment rate compared to the nation as of May 2013.

	May-11	May-12	May-13⁽¹⁾
United States	9.0%	8.2%	7.6%
Arizona	9.5%	8.4%	7.8%
Phoenix - Mesa - Glendale	8.7%	7.4%	6.8%
Tucson Metro	8.5%	7.4%	7.0%
Flagstaff Metro	9.3%	8.2%	7.8%
Lake Havasu City - Kingman - Metro	11.1%	10.0%	9.7%
Prescott Metro	9.9%	8.7%	8.3%
Yuma Metro	26.8%	27.0%	29.9%

1) preliminary

Table 5 shows that the number of claimants receiving unemployment benefits in Arizona steadily increased in tandem with the negative trajectory of the employment environment, but has started a declining trend since 2010. From PY 2007 to PY 2008, the number of claimants increased by 37.7%, and from PY 2008 to PY 2009 the number of claimants was up 99.6%. From PY 2009 to PY 2010, the number of claimants increased further by 33.24%. However, from PY 2010 to PY 2011, the number of claimants decreased by 28% and by 15.4% from PY 2011 to PY 2012. There was a sharper decline of 26.2% from PY 2012 to PY 2013. This reflects a better and improving economic environment. Nonetheless, the average duration jumped from its level of 14.60 weeks in PY 2006 to its highest level of 19.2 weeks in PY 2010. For PYs 2007, 2008, and 2009 average duration stood at 15.0, 15.3, and 18.6 weeks, respectively. Compared to the high level in 2010, the average duration for PY 2011 dropped to 17.6 weeks and further dropped to 17.0 weeks in PY 2012. Number of Persons receiving unemployment claims on average increased with the onset of recession. It was 37,219 in PY 2007; 74,292 in PY 2008; and 98,990 in PY 2009. However, it started declining as the economy started slowly improving and was 71,313 in PY 2010, 60,300 in PY2011 and dropped considerably in PY 2012 to 44,488.

Item	PY 2008	PY 2009	PY 2010	PY 2011	PY 2012
Average Number of Claimants per Month	74,292	98,990	71,313	60,300	44,488
Average Number of Weeks (Duration)	15.3	18.6	19.2	17.6	17.0
Percentage Over-the-Year Change	99.6%	33.2%	-28.0%	-15.4%	-26.2%

Note: Program years begin on July 1 of the given year and end on June 30 of the following year.

Source: Arizona Department of Economic Security