

**Joint Legislative Budget Committee
Staff Memorandum**

1716 West Adams
Phoenix, Arizona 85007

Telephone: (602) 542-5491
Facsimile: (602) 542-1616

DATE: December 16, 2002

TO: Finance Advisory Committee Members

THRU: Richard Stavneak, Director

FROM: Tim Everill, Revenue Section Chief

SUBJECT: DECEMBER 17th FINANCE ADVISORY COMMITTEE MEETING

As you know, the next Finance Advisory Committee meeting will be on December 17th in Senate Hearing Room 1 located at 1700 West Washington. We will be seeking your perspective on the state of the economy for the remainder of FY 2003, as well as a preliminary look at FY 2004.

In our Revenue Outlook tab, you will find a copy of our PowerPoint presentation for the meeting, which will highlight some of the issues related to forecasting state revenues for the remainder of the current fiscal year, as well as next year.

The Revenue Highlights tab contains the October Revenue Highlights and the November Monthly Fiscal Highlights.

The Economic Summary tab contains the November Arizona Blue Chip.

Outlook Questions

The key questions of interest are:

- Do you see signs of a recovery?
- If yes, what are these signs, and what do they suggest about the strength of the recovery?
- What is your current perspective on how the depth and duration of the recession will specifically impact the major revenue categories?

TE:te

JLBC

FINANCE ADVISORY COMMITTEE MEETING

Tuesday, December 17, 2002

AGENDA

9:30 - 9:45	JLBC Staff	Revenue Outlook
9:45 - 10:00	Elliott Pollack Elliott D. Pollack and Company	U. S. Economy
10:00 - 10:15	Tracy Clark Arizona State University – Bank One Economic Outlook Center	Arizona Economy
10:15 - 10:30	Marshall Vest University of Arizona – Eller College of Business and Public Administration	Arizona Employment
10:30 -	Discussion	

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ARIZONA

MONTHLY FISCAL HIGHLIGHTS

November 2002

Based on preliminary data, November General Fund revenues are \$428.2 million. This amount is \$(24.2) million below the budget forecast for the month, bringing the year-to-date deficit to \$(187.8) million. In comparison to FY 2002, this November's collections are \$7.1 million above last year and the year-to-date collections are \$(77.7) million below last year.

Revenue collections in November were mixed. Individual income tax revenues were \$(14.2) million below the forecast, but were 3.4% above last year. This month's withholding performance was the best so far in FY 2003, with a decline of only (0.2)%, which is especially good since there was one less processing day this November compared to the previous November. The 3-month average for withholding is now (2.1)%. The primary reason for the 3.4% growth in income taxes is that refunds in November were (39.8)% lower than last year. It is unclear why this month's refunds were so much less than last year.

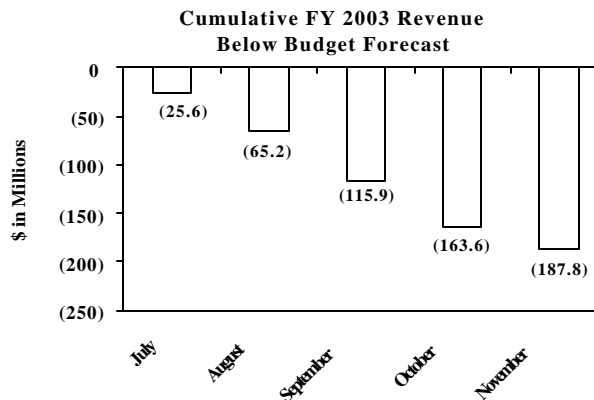
November sales tax collections were down (1.5)% compared to last year and were \$(11.1) million below the forecast. As a caveat, the November sales tax number is preliminary, as it reflects our estimate of state revenues prior to application of the sales tax distribution formulas.

Corporate income tax collections were \$5.8 million above the monthly forecast but are still \$(3.9) million below the year-to-date forecast. Based on estimated collections for the remainder of the fiscal year, we are considering a downward revision to our corporate income tax forecast.

We currently project a FY 2003 shortfall of \$285.1 million after the completion of the 6th Special Session. Prior to the Special Session, the projected deficit was \$500 million. The 6th Special Session legislation reduced the current year shortfall by \$220 million, with \$164 million in spending reductions and \$56 million in fund transfers. The Governor subsequently line item vetoed \$5.1 million out of the Legislature's plan. The remaining \$214.9 million offsets the original projected deficit of \$500 million for a current shortfall estimate of \$285.1 million.

**General Fund Revenues
Compared to Adopted Budget Forecast and FY 2002 Collections**
(\$ in Millions)

	FY 2003 Preliminary	Forecast Difference	Year over Year Difference
November	\$ 428.2	\$ (24.2)	\$ 7.1
Year-to-Date	\$2,311.9	\$(187.8)	\$(77.7)



JLBC

JLBC MEETING

At its November 25th meeting, the Joint Legislative Budget Committee considered the following issues:

Department of Economic Security – The JLBC heard testimony to determine adjustments on the General Assistance (GA) program due to a projected insufficiency of funds in the program for FY 2003. The GA program provides financial assistance to persons who are unemployable because of a physical or mental disability. The options include running the program until it has exhausted all funding, implementing a waiting list, reducing benefits to some clients more than others, and keeping full benefits for the first few months but then phasing out benefits. The JLBC did not take action on this item.

Arizona Learning Systems/Community Colleges – The JLBC heard testimony on the options to direct the disbursement of the state-funded Arizona Learning Systems (ALS) equipment. ALS was a consortium of Arizona's 10 community college districts to promote distance learning across district boundaries using Internet, interactive video-conferencing (ITV), and other technologies. Pursuant to a General Appropriations Act footnote, ALS terminated at the end of August 2002. The state-funded assets include 10 sets of video and telecommunications equipment and hub equipment. The options include allowing the community college districts to retain the equipment, transferring the equipment to the University of Arizona Health Sciences Center for collaborative use by the Arizona University System, and selling the equipment. The JLBC deferred action on this item.

Department of Revenue – The JLBC approved the estimated expenditure plan of \$27.6 million for the 5-year administrative expenses for the Ladewig litigation involving income tax refunds for out-of-state corporate dividends. The Committee also approved \$7.5 million for administrative costs in FY 2003. This fully funds the estimated administrative costs of \$13.5 million in FY 2003 when added to the \$6 million which the Committee approved at October's meeting. A new statutory allocation for administrative and settlement costs will be needed for each ensuing fiscal year beginning with FY 2004. In addition, the Committee will give final approval of DOR's administrative costs related to the Ladewig litigation on an annual basis. Due to pending litigation, the details of the case were discussed in Executive Session.

Other Reports – The JLBC received written reports this month on 1) Arizona Department of Administration's use of alternative fuels and clean burning fuels, 2) State Board of Directors for Community Colleges tuition and fees charged by community college districts, 3) Department of Economic Security Developmental Disabilities Title XIX reimbursement rates, 4) Department of Economic Security cost of care collections in Developmental Disabilities Program 5)

Department of Economic Security annual child care expenditures, 6) Arizona Department of Education/JLBC Staff Technology Assisted Project-Based Instruction Program, 7) Department of Health Services Assurance and Licensure backlogs, 8) Department of Health Services Behavioral Health Title XIX reimbursement rates, 9) Arizona Historical Society expenditures of non-appropriated funds, and 10) Department of Racing Boxing events and revenue.

ARIZONA
REVENUE HIGHLIGHTS
OCTOBER 2002

Final October General Fund revenues were \$439.3 million, which is \$(1.9) million less than estimated in our preliminary report. This amount is \$(48.0) million below the forecast for the month, bringing the year-to-date revenue shortfall to \$(163.6) million. In comparison to last year, October receipts were \$(28.3) million below the previous October and are \$(84.8) million below year-to-date.

The individual income tax was again the primary cause of the revenue shortfall, contributing \$(36.8) million of the month's \$(48.0) million forecast deficit. The sales tax finished \$(8.1) million under the forecast, and the corporate income tax was \$(2.7) million below projections.

The 2 largest revenue categories are the sales tax and income tax withholding. For October, sales tax revenues increased by 1.2%, and withholding decreased by (8.3)% in comparison to the prior year.

Sales Tax collections grew by 1.2% in October and are now 1.4% ahead of last year. Revenues were \$(8.1) million below forecast, bringing the year-to-date forecast difference to \$(15.2) million. The October result is disappointing considering that October sales tax receipts represent September economic activity, and the prior September included the post-September 11th economic shutdown. A brief description of the major sales tax categories follows:

- **Retail Sales Tax** revenues increased by 1.7% for the month, lowering the year-to-date total to 2.8%. Given that the retail sales in the prior October had declined by (3.9)% due to September 11th, this month's modest growth of 1.7% is less than anticipated.
- **Contracting Tax** collections posted an October decline of (1.5)% and have fallen by (3.2)% so far in FY 2003.
- **Restaurants and Bar** receipts increased by 6.6% for the month, bringing the year-to-date figure up to 3.1%. This category performed fairly well in October, as would be expected given the weakness in the base year.

Individual Income Tax revenues declined by (8.0)% in October compared to the same month last year. After the first four months of FY 2003, tax receipts are down by (5.7)% compared to last year. In dollar terms, this translates into a monthly forecast shortfall of \$(36.8) million, and a year-to-date forecast shortfall of \$(130.9) million. Most of the forecast shortfall (85%) is attributable to weaker than expected withholding collections, which

were (8.3)% below last year's collections. In addition, estimated payments for October were (14.8)% below last year.

Corporate Income Tax collections were \$18.3 million in October, which is \$(2.7) million below forecast for the month. Year-to-date collections are (16.9)% below the actual collections during the same period last year after adjusting for a processing error in September 2001.

Recent Economic Indicators are presented in the table at the top of the following page. Highlights from the table are presented below.

Arizona Tourism Industry showed year over year improvement in both airport passenger volumes and hotel nights stayed. September airline passenger volume was 30.0% above a year ago, and hotel nights are 13.0% above. However, these high growth rates are likely due to the low base set in the prior year when terrorist attacks brought civil aviation to a standstill.

The Arizona Business Conditions index improved slightly in October, though it currently remains below the crucial 50-point mark, indicating a stagnant local economy.

U.S. Gross Domestic Product grew at a 3.1% annual rate in the 3rd quarter according to advance estimates.

U.S. Consumer Confidence fell to its lowest level since 1993, as consumers expressed uncertainty about the job market, possible war with Iraq, and the financial markets.

JLBC

RECENT ECONOMIC INDICATORS

Indicator	Time Period	Current Value	Change Over Prior Period	Change Over Prior Year
Arizona				
Unemployment Rate	October	5.7%	0.0%	0.4%
Jobs	October	2.27 million	1.0%	(0.3)%
Personal Income	2 nd Quarter	\$141.1 billion	1.4%	3.4%
Contracting Tax Receipts (3 month moving average)	August-October	\$41.5 million	(2.1)%	(1.9)%
Retail Sales Tax Receipts (3 month moving average)	August-October	\$113.4 million	(3.4)%	2.7%
Hotel Nights Stayed	September	1.5 million	(5.7)%	13.0%
Airport Passenger Volume	September	2.9 million	(17.1)%	30.0%
Leading Indicators Index	September	116.0	(1.0)%	3.2%
Business Conditions Index (>50 signifies expansion)	October	47.5	6.5%	18.8%
U.S.				
Gross Domestic Product	3 rd Quarter	9,465 billion	3.1%	3.0%
Consumer Price Index	3 rd Quarter	180.4	1.8%	
Consumer Confidence	October	79.4	(15.3)%	(6.9)%

* * *

OCTOBER 2002 GENERAL FUND REVENUE COLLECTIONS
(\$ in Millions)

	Current Month					Fiscal 2003 Year-to-Date (Four Months)				
	Actual October 2002	Difference From Last Year		Difference From Forecast		Actual October 2002	Difference From Last Year		Difference From Forecast	
		Amount	Percent	Amount	Percent		Amount	Percent	Amount	Percent
TAX REVENUE										
Sales and Use Income	\$242.5	\$ 2.8	1.2%	\$ (8.1)	-3.3%	\$ 993.7	\$ 13.7	1.4%	\$(15.2)	-1.5%
Individual	181.7	(15.7)	-8.0%	(36.8)	-16.8%	760.8	(45.8)	-5.7%	(130.9)	-14.7%
Corporate	18.3	(10.9)	-37.4%	(2.7)	-13.0%	117.0	(23.7)	-16.9%	(9.7)	-7.7%
Property	4.8	2.7	128.8%	2.1	75.6%	5.2	2.5	89.4%	2.0	59.7%
Other Taxes	15.9	(4.0)	-20.0%	2.6	19.7%	111.6	1.3	1.2%	8.8	8.6%
Urban Revenue Sharing	(35.9)	(0.7)	2.1%	0.0	0.0%	(143.5)	(2.9)	2.1%	0.0	0.0%
Subtotal (Taxes)	427.3	(25.9)	-5.7%	(43.0)	-9.1%	1,844.8	(55.0)	-2.9%	(145.0)	-7.3%
OTHER REVENUE										
Lottery	2.7	0.9	54.6%	-	0.0%	6.5	(6.2)	-48.9%	-	0.0%
Interest	1.5	(2.8)	-65.2%	(2.9)	-65.4%	5.5	(6.0)	-51.8%	(5.9)	-51.6%
Other Miscellaneous	7.8	(0.6)	-7.2%	(2.2)	-22.0%	26.8	(17.7)	-39.8%	(12.7)	-32.1%
Subtotal (Other)	12.0	(2.5)	-17.2%	(5.1)	-29.7%	38.8	(29.9)	-43.5%	(18.6)	-32.4%
TOTAL REVENUE	\$439.3	\$(28.3)	-6.1%	\$(48.0)	-9.9%	\$1,883.7	\$(84.8)	-4.3%	\$(163.6)	-8.0%
Education Sales Tax ^{1/}	36.2	0.9	2.5%	(0.3)	-0.8%	146.6	3.9	2.8%	0.0	0.0%

^{1/} The dedicated 0.6% education sales tax is accounted separately from the General Fund.

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Arizona outlook 2003



Lee McPheters

Between 1990 and 2000, the Arizona economy created more than 750,000 new jobs. The percentage growth of total employment was just over 50 percent. Put differently, one out of three Arizona jobs in 2000 did not exist in 1990.

Starting in 1993, Arizona ranked among the top five states in the rate of employment growth for a total of eight consecutive years, ending with 2000.

2002 Slump

After so many years of sterling economic performance, it is no wonder that economic analysts expected Arizona in 2002 to bounce back from the recession of 2001 with at least moderate growth. Now, looking back, it is evident that the Arizona economy in 2002 was mired in a slump that was both broad and deep.

The depth of the downturn is evidenced by the duration of job losses. Every month in 2002 (through October, the latest available data) nonagricultural employment dipped below the level of the same month of the previous year. For comparison, historical figures show that for all of the recession of 1991, there was only one month with over-the-year job losses.

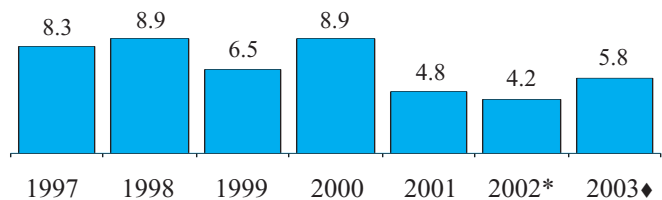
The breadth of the effects can be seen by looking at the performance of each economic sector. Final figures are expected to show job losses for the year in manufacturing, construction, mining, services, trade, finance, and transport.

Unemployment continued to

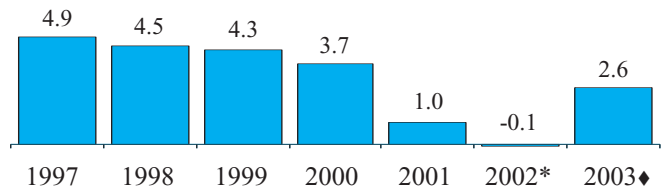
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ARIZONA ECONOMIC FORECAST (Annual Percentage Change)

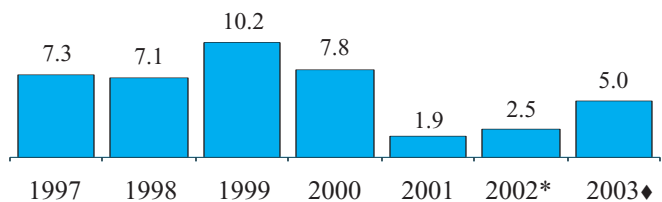
Personal Income



Employment



Retail Sales



* Estimate ♦ Forecast

Sources: U.S. Bureau of Economic Analysis, Arizona Department of Economic Security, Arizona Department of Revenue

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Blue Chip Job Growth Update — monthly rankings of states and metro areas

**Bank One Economic Outlook Center
(480) 965-7858**

2002 ARIZONA BLUE CHIP ECONOMIC FORECAST

SOURCE:	ANNUAL PERCENT CHANGE 2002 FROM 2001									AVERAGE RATE FOR 2002		
	AZ Current \$ Personal Income	U.S. GDP Deflator (Chain)	AZ Real Personal Income	AZ Retail Sales	AZ Wage & Salary Empl.	AZ Mfg. Empl.	AZ Single- family Units	AZ Multi- family Units	AZ Pop. Growth	U.S. 3-Mo. T-Bills	U.S. 10-Yr. Treas. Notes	AZ Unempl. Rate
Arizona Public Service	4.5	1.4	3.1	2.3	0.2	(5.8)	(2.5)	(30.0) L	2.6	1.8	4.7	5.6
ASU – Bank One EOC	4.0	1.3	2.7	2.0	0.1	(5.0)	4.3 H	(30.0) L	2.7	1.7 L	4.7	5.6
CH2M HILL	4.0	1.4	2.6	3.1	(0.2)	(6.2)	(3.5)	(15.0)	2.6	1.8	4.8	5.9
Department of Economic Security	4.9	1.2	3.7	3.6	(0.9)	(5.9)			2.5	1.8	4.9	5.9
ECON-LINC	4.0	1.4	2.6	2.8	(0.6)	(6.0)	(5.0)	(5.0)	2.3 L	1.9	4.8	5.8
Eggert Economic Enterprises Inc.	3.9	1.2	2.7	2.9	0.5	(4.2)	(11.0)	(12.0)	2.3 L	1.8	4.9	5.7
Elliott D. Pollack & Co.	4.1	1.8 H	2.3	2.5	(1.0) L	(7.0) L	(2.0)	(25.0)	2.7	1.8	4.5	5.2
H. C. Reardon Economics	4.1	1.3	2.7	2.7	0.0	(7.0) L	(12.0)	(17.0)	2.7	1.7 L	4.5	5.6
Joint Legislative Budget Committee	4.0	1.3	2.7	1.2	(1.0) L	(6.6)	(10.0)	(15.0)	2.5	1.7 L	4.5	5.8
Lancaster Consulting	4.6	1.4	3.2	3.0	0.5	(2.5)	(10.0)	(12.0)	2.6	1.9	4.8	5.4
The Maguire Company	4.2	1.3	2.9	2.6	0.0	(5.0)	(12.0)	(17.0)	2.7	1.7 L	4.7	5.7
NAU – BBER	4.5	1.3	2.9	3.2	0.0	(4.0)	(15.0)	(15.0)	2.4	1.8	4.8	5.5
Office of the Treasurer	4.5	1.2	3.3	2.9	0.6	(3.8)				1.7 L	4.7	5.7
Protitlement	4.3	1.8 H	2.5	3.0	(0.5)	(6.0)	(12.0)	(15.0)	2.7	1.9	4.7	5.4
Salt River Project	4.5	1.2	3.3	2.0	(0.5)	(7.0) L	(7.0)	(15.0)	2.8 H	1.7 L	4.7	5.7
Stellar Capital Management	4.3	1.1	2.9	2.4	0.0	(6.9)	(10.0)	(20.0)	2.5	1.7 L	4.2 L	6.3 H
Tucson Electric Power Co.	3.0 L	1.8 H	2.0 L	(0.1) L	0.0	(3.0)	(18.0) L	(20.0)	2.4	2.6 H	4.9	5.0 L
UA – Eller College	4.0	1.4	2.6	1.2	(0.1)	(6.0)	(3.0)	(25.6)	2.5	1.9	5.4 H	6.0
VisionEcon	5.4 H	1.0 L	4.4 H	3.7 H	2.0 H	0.0 H	0.0	(3.0)H	2.7	1.8	5.0	5.2
Wells Fargo & Co.	4.0	1.4	2.6	2.9	(0.3)	(4.9)	(1.0)	(30.0) L	2.6	1.7 L	4.7	5.8
Consensus — This Month	4.2	1.4	2.9	2.5	(0.1)	(5.1)	(7.2)	(17.9)	2.6	1.8	4.7	5.6
— Last Month	4.3	1.4	3.0	2.6	0.0	(4.8)	(8.1)	(16.8)	2.6	1.8	4.8	5.6

ARIZONA BLUE CHIP PANEL

<p>Arizona Department of Economic Security Donald Wehbey</p> <p>Arizona Office of the Treasurer Neal Helm</p> <p>Arizona Public Service Pete Ewen and Brian Cary</p> <p>Arizona State University Bank One Economic Outlook Center Tracy Clark</p> <p>CH2M Hill Kent Ennis</p>	<p>ECON-LINC John Lucking</p> <p>Eggert Economic Enterprises Inc. Robert J. Eggert, Sr.</p> <p>Elliott D. Pollack and Co. Elliott Pollack</p> <p>H. C. Reardon Economics H. C. Reardon</p> <p>Joint Legislative Budget Committee Staff</p> <p>Lancaster Consulting Dwight Duncan</p>	<p>The Maguire Company Alan Maguire</p> <p>Northern Arizona University Bureau of Business and Economic Research Dennis Foster, Ronald Gunderson and Max Jerrell</p> <p>Protitlement Steve Pritulsky</p> <p>Salt River Project Arlyn Herrera, Rebecca Holmes and Karen Wolfe</p>	<p>Stellar Capital Management Phoenix, Arizona Stephen Taddie</p> <p>Tucson Electric Power Co. Julia Adams</p> <p>University of Arizona Eller College Marshall Vest</p> <p>VisionEcon Debra J. Roubik</p> <p>Wells Fargo & Co. Scott Anderson and Sung Won Sohn</p>
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ARIZONA HISTORICAL TABLE

	AZ Current \$ Personal Income (millions)	U.S. GDP Deflator	AZ Real Personal Income (millions)	AZ Retail Sales (millions)	AZ Wage & Salary Empl. (thousands)	AZ Mfg. Empl. (thousands)	AZ Single- family Units	AZ Multi- family Units	AZ Pop. (thousands)	AZ Unempl. Rate
2001	\$135,224	109.4	\$123,605	\$44,833	2,265.7	209.6	50,930	10,613	5,324	4.7
Percent Change	4.8	2.2	2.5	2.0	1.0	(2.7)	4.3	(2.8)	3.0	
2000	\$129,069	107.0	\$120,625	\$43,940	2,242.8	215.4	48,846	10,920	5,169	3.9
Percent Change	8.2	2.2	5.8	7.8	3.7	1.7	(5.6)	(9.5)	3.0	
1999	119,339	104.7	113,982	40,769	2,163.1	211.7	51,764	12,067	5,017	4.4
Percent Change	5.7	1.5	4.2	10.0	4.3	(2.0)	1.5	(8.7)	3.1	
1998	112,895	103.2	109,394	37,071	2,074.7	216.0	50,997	13,218	4,864	4.1
Percent Change	8.9	1.3	7.5	7.2	4.5	4.1	18.6	1.3	3.3	

2003 ARIZONA BLUE CHIP ECONOMIC FORECAST

SOURCE:	ANNUAL PERCENT CHANGE 2003 FROM 2002									AVERAGE RATE FOR 2003		
	AZ Current \$ Personal Income	U.S. GDP Deflator (Chain)	AZ Real Personal Income	AZ Retail Sales	AZ Wage & Salary Empl.	AZ Mfg. Empl.	AZ Single- family Units	AZ Multi- family Units	AZ Pop. Growth	U.S. 3-Mo. T-Bills	U.S. 10-Yr. Treas. Notes	AZ Unempl. Rate
Arizona Public Service	5.7	2.0	3.7	4.9	2.3	0.5	(5.0)	(7.5)	2.6	2.2	5.0	5.1
ASU – Bank One EOC	5.3	1.7	3.6	4.0	2.0	1.0	(4.0)	8.0 H	2.3	2.0	4.9	4.9
CH2M HILL	6.1	2.1	4.0	5.6	3.3	1.0	(7.0)	(7.0)	2.5	2.5	5.5	4.9
Department of Economic Security	5.7	2.2	3.4	5.2	1.8	0.0			2.4	2.2	5.3	5.1
ECON-LINC	5.4	1.6	3.8	3.8	2.2	1.0	(10.0)L	(10.0)	2.5	2.6	5.0	5.2
Eggert Economic Enterprises Inc.	5.8	1.9	3.9	5.4	3.1	1.3	(4.0)	(3.0)	2.7	2.4	5.6	5.2
Elliott D. Pollack & Co.	6.5 H	2.3	4.3 H	5.0	2.8	3.0 H	(10.0)L	(10.0)	2.7	2.7	5.5	4.7
H. C. Reardon Economics	6.4	2.4	3.9	5.8	3.4	2.6	(5.0)	(5.0)	2.7	2.0	4.1 L	4.7
Joint Legislative Budget Committee	5.5	2.6 H	2.9	4.0	2.0	(1.0)	(2.0)	(4.0)	2.5	2.0	4.8	4.8
Lancaster Consulting	6.1	2.0	4.0	5.3	2.8	1.5	0.0	(10.0)	2.5	2.7	5.2	4.9
The Maguire Company	5.7	1.8	3.9	5.5	3.0	2.0	(8.0)	(10.0)	2.7	2.9	4.9	4.9
NAU – BBER	5.7	1.5 L	4.2	5.4	3.0	1.3	0.0	0.0	2.5	2.0	4.8	4.5
Office of the Treasurer	5.6	1.8	3.8	5.0	2.4	0.7				2.9	4.9	5.1
Protitlement	6.2	2.2	4.0	5.8	2.7	2.6	(5.0)	(10.0)	2.7	2.6	5.4	5.2
Salt River Project	6.0	2.4	3.6	5.5	2.5	1.5	0.0	0.0	2.8	1.9 L	4.8	4.5
Stellar Capital Management	5.5	1.6	3.6	4.3	2.1	1.4	1.0	2.0	2.3	3.0	5.5	5.3 H
Tucson Electric Power Co.	4.8 L	1.8	2.8 L	3.3 L	1.3 L	(1.5)L	(9.0)	(12.0)L	2.5	3.5	5.0	4.8
UA – Eller College	6.1	2.4	3.7	4.4	2.8	2.3	(7.8)	(0.1)	2.2 L	3.7 H	5.9 H	5.3 H
VisionEcon	5.5	1.5 L	3.9	7.7 H	4.0 H	1.0	11.7 H	3.9	3.1 H	2.8	5.4	4.1 L
Wells Fargo & Co.	5.8	1.9	3.9	5.0	2.6	1.1	0.0	(5.0)	2.6	2.5	5.1	5.3 H
Consensus — This Month	5.8	2.0	3.7	5.0	2.6	1.2	(3.6)	(4.4)	2.6	2.6	5.1	4.9
— Last Month	5.9	2.0	3.8	5.2	2.6	1.3	(3.4)	(4.3)	2.6	2.7	5.2	4.9

Basic data sources:

(1) Arizona personal income in current \$, (2) Gross domestic product price deflator chain type [1992 = 100] and (3) Arizona personal income in 1992 \$, Bureau of Economic Analysis; (4) Arizona retail sales, Arizona Department of Revenue, (5) Arizona total nonagricultural wage and salary employment and (6) Arizona manufacturing employment, DES; (7) Arizona single-family unit authorizations and (8) Arizona multi-family unit authorizations, ASU – AREC; (9) Arizona population, ASU – CBR; (10) 3-month Treasury bills, Federal Reserve Board; (11) 10-year U.S. Treasury notes yield FRB, H15; (12) Arizona unemployment rate, DES.

(Continued from Page 1)

increase through 2002, as job losses mounted. Foreclosures and bankruptcies increased while debt levels rose and consumer confidence declined. Interest rate reductions and continued population growth supported the Arizona housing market during the year, but luxury home sales turned soft as capital gains and executive bonuses evaporated.

Potential state budget deficits grew as the major revenue sources were impacted by recession. Retail sales growth was weak, corporate profits were down, personal income growth slowed, and tourism declined.

2003 Forecast

As the New Year begins, consumer confidence is still very fragile, employers are cautious about hiring and, indeed, layoffs are continuing in some firms.

Analysts have incorporated all of the above into their forecasts for 2003. They know that when recovery does come, Arizona's economy is quite capable of producing growth rates for most indicators at double the national average.

But 2003 does not seem to hold the promise of robust growth, either at the

national level or here in Arizona.

The consensus forecast calls for personal income in 2003 to increase by 5.8 percent. This will be the best performance in the past three years, but short of the 8.9 percent gains posted in 2000 [see figure].

Employment is projected to rise by 2.6 percent in 2003. The number of new jobs created will be 58,000. Coming on the heels of job losses in 2002, the employment increase will be a welcome change. But compared to years in the 1990s when the economy regularly produced 75,000 or more new jobs each year, the job creation machine is operating at a reduced level. Most analysts believe robust job growth will not return until 2004, when the recovery is in full bloom.

Retail sales are forecast to rise, but the increase will be below Arizona's average annual advance in retailing. The consensus forecast calls for an increase of 5 percent in 2003. As can be seen from the figure, sales growth was in the double digits as recently as 1999. High levels of debt and consumer caution are likely to affect spending next year, at least up until the second half, when back-to-school and

holiday sales should show more strength.

Other indicators for 2003 are noted in the forecast table on this page.

The consensus manufacturing forecast from the panelists is an increase in employment of 1.2 percent. If this forecast is realized, it will represent an important turnaround in a sector that has lost jobs in three of the past four years.

Population increases for Arizona (at 2.6 percent) will be among the strongest in the nation. Although housing permits are projected to decline, it must be noted that the reduction in activity is only a slight slowing from a near-record pace.

Risks to the forecast for 2003 abound, including a protracted war, additional terrorist attacks, declines in consumer confidence, or a double dip national recession. In the absence of any significant external shock, analysts believe 2003 should bring moderate growth and set the stage for a stronger recovery to follow.

Lee McPheters is Associate Dean of Executive and Professional Programs with the College of Business at Arizona State University.

SPECIAL QUESTION: FIRST LOOK AT THE PANEL'S 2004 FORECAST

Asked to reveal their first look at 2004, panel members clearly feel the recovery will continue, although the pace will remain moderate. A bright spot in the picture is that the economy will improve for both individuals and firms if the preliminary projections for 2004 are correct.

The biggest uncertainties for the economy actually appear to be in 2003. If business spending does not increase, consumer spending could falter, leading to the dreaded double-dip recession. The Federal Reserve has applied further medicine in the form of a 50-basis-point reduction in the Federal Funds rate, but the impact of this is questionable in light of existing low interest rates. The Fed is hoping consumers and investors will view the move as an indication of decisive action rather than desperation. The real impact will be to further lower the real interest rate, which should encourage spending. This medicine has (so far) worked like a charm on consumers, but there is a legitimate concern about the limits to consumer spending. The Fed is really hoping that the latest cut will encourage more spending by business, but only time will tell.

The table shows what the panel believes will happen and, to some extent, must happen for the economy to continue to improve. Ironically, the first thing that

THREE-YEAR FORECAST INTO 2004			
(Percent Growth)			
	2002	2003	2004
AZ Current \$ Personal Income.....	4.2%	5.8%	6.4%
U.S. GDP Deflator.....	1.4	2.0	2.4
AZ Real Personal Income	2.9	3.7	4.0
AZ Retail Sales.....	2.5	5.0	5.8
AZ Wage & Salary Employment.....	-0.1	2.6	3.7
AZ Manufacturing Employment	-5.1	1.2	3.2
AZ Single Family Units	-7.2	-3.6	2.0
AZ Multifamily Units.....	-17.9	-4.4	5.1
AZ Population Growth	2.6	2.6	2.7
U.S. 3-Month T-Bills.....	1.8	2.6	3.3
U.S. 10-Year Notes.....	4.7	5.1	5.5
U.AZ Unemployment Rate	5.6	4.9	4.6

must happen is a modest pickup in inflation. The biggest deterrent to increased business spending may be the almost non-existent pricing power that many firms face. Many goods-producing firms are facing falling prices at a time when demand is stagnant or declining. These firms must cut costs in order to maintain or improve profits, which means reducing spending and perhaps employment. The overall price level is rising, although slowly, because of increases in housing costs, some goods and services. If consumers cut back significantly on spending in general and invest-

ing in housing in particular, there is some danger that the country could enter a deflationary spiral which could be just as damaging as the inflationary spiral in the '70s and '80s — and much tougher to cure.

The outlook is overall still good but the analysis tends to be somewhat depressing because the risks are on the downside. However, common sense suggests that we must keep an eye on the risks.

— **Tracy Clark**
Associate Director
Bank One Economic Outlook Center

ARIZONA BLUE CHIP ECONOMIC FORECAST

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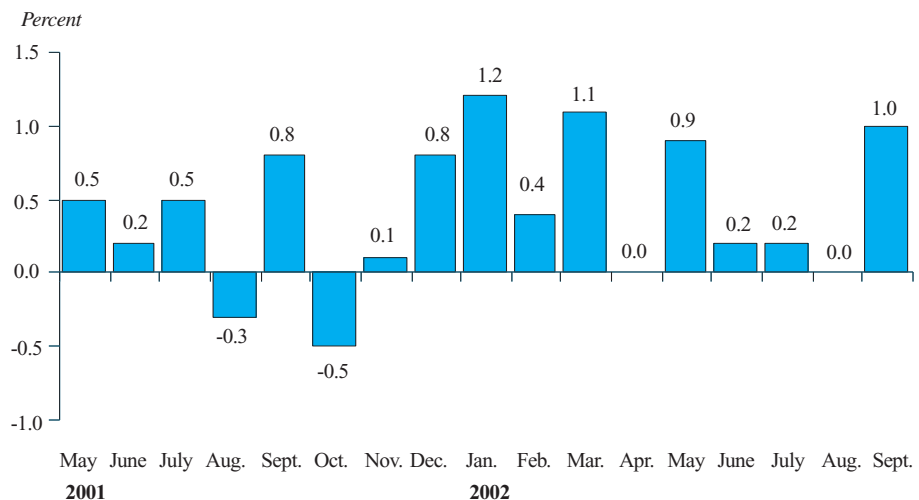
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LEADING INDEX

ARIZONA INDEX OF LEADING ECONOMIC INDICATORS Monthly Percentage Change*



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