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Sonoma County Economic Forecast for 2009

Sonoma County economy slowing down along with national, state economies

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The last six months of 2008 have seen some of the most tumultuous economic movements in a generation; researchers and our government agreed the economy was in recession as of December 2007. Monetary policy has now aimed itself at quashing the recession by rapidly expanding the money supply and providing incentives to consume and lend. Fiscal stimulus packages have done little to soften the blow yet. Unemployment, especially in the last six months, has risen sharply at the national, state and local levels. For Sonoma County, seasonally-adjusted unemployment stands at 6.7% in November 2008. It has risen almost one percent since July 2008 and two percent since last November; as a result, Sonoma County's Gross County Product likely has fallen by 2% since July and 4% since last November, typical of recessionary times.

The federal bailout packages, coupled with an aggressive monetary policy should begin to show signs of stimulus by May 2009, assuming no other major economic shocks befall our economy. The importance of May 2009 is that new college graduates hit the market, providing low-cost labor to tightening markets. Falling gasoline prices, as a result of petroleum's reduced demand-side speculation, a reduction in current and forecasted worldwide demand, and a slowly reacting supply side all helped reduce inflation pressure that will naturally occur due to the fiscal and monetary stimuli. Consumers, which led the economy into the current recession as a result of purchasing real estate and using their homes as banks for more consumption, may lead us out temporarily. For long-term growth, a supply-side boom is needed; one is likely to take place in environmental technology, which is likely to focus on reduced energy costs for all consumers and businesses. The booms of the 1980s and 1990s were both led by technological changes that reduced the costs of doing business, and drove consumers through higher wages and wealth. The 2000s boom, which lasted approximately 72 months, was led by construction and real estate services, where the main technological enhancement was in lending and financial markets providing liquidity and an enhanced ability to consume. In many ways, we should think of this decade's boom as an extension of the 1990s.

There are weak signs of a turnaround in early 2009. The Toby Tyler Economic Indicators, produced by the Center for Regional Economic Analysis (CREA) at Sonoma State University (SSU) predicted the beginning of mild recessionary activity as early as June 2007. **The indicators are showing a trough reached in April or May of 2009, and a slow turnaround beginning**. Default notices, while still relatively high, are slowing down in their growth rate. Agricultural prices have retreated from their quickening pace in 2008, mainly due to falling petroleum prices in the last few months. The number of employed persons in Sonoma County is rising concurrent with a rising unemployment rate; this county created almost 1,000 more jobs this year on average than 2007 while the unemployment rate rose almost 2%. The labor market is likely to trough (unemployment to peak) by April 2009. Personal income continues to grow, which eventually, especially with the stimuli in place, will trigger some consumption recovery.

The state budget deficit provides a serious conundrum for state and local governments both now and in the coming decade, and a difficult environment for predicting an economic turnaround. With a current approximation of a $42 billion budget deficit, the state of California faces major questions of both operations and politics. Operationally, it must choose one of three fates for itself. First, it can raise taxes through higher sales, capital gains or income tax rates. It is unlikely Prop. 13 would be repealed, so property taxes will not see any changes in tax rates. Second, it can reduce expenses, which means cutting come programs, jobs and asking certain agencies and workers to take salary cuts. This is an issue of political will. Finally, it can borrow. In any event, the state deficit will be partially paid down by borrowing from financial markets, and may have to do so with large tax benefits for investors or relatively high interest rates to attract investors. The politics of any changes may further cause problems in initiating corrections for the fiscal crisis.

The Toby Tyler Leading Economic Indicator for Sonoma County's economy continues to fall since the midyear 2008 report. This indicator provides a forecast of the economy's direction using specific economic statistics that are assumed to be precursors of economic trends. The indicator is an amalgam of county default notices, building permits, new unemployment insurance claims, a national leading indicator, help-wanted ads, and agricultural price indices for the Bay Area. The data are seasonally adjusted for all indices. Default notices slowed down their growth in the latter half of 2008, falling from a peak of 392 per month in April and May 2008 to 212 by November 2008. Building permits continued to fall through 2008, picking up a little at year's end. It is likely that the continued easy monetary policy will lead to growth in building permits in 2009, as compared to 2008, once credit begins to be less constrained. The U.S. Leading Indicator from the Conference Board (www.globalindicators.org) has fallen sharply since June 2008, down over 10%. This is slightly larger to date than reductions experienced during the recession of 1990-91. As discussed below, Sonoma County's coincident indicator is also experiencing similar movements to the 1990-91 recession.

New unemployment insurance claims are rising rapidly since mid-2008, foreshadowing a continued rise of unemployment. The Help-Wanted Index for the Bay Area, also produced by the Conference Board (www.conference-board.org), slipped during July and August 2008, flattening and then rising in the last couple of months of the year. Because these are seasonally-adjusted data, the rise in help-wanted ads may be a sign that the labor market's woes are slowly beginning to end. It will take continued movement upward in labor demand to reveal when this recession will end. Continuing to provide good signs is the agricultural price index. The data show that agricultural prices have remained somewhat stable or fallen since June 2008, due mainly to fuel prices falling. As a signal of deflationary pressure, agricultural prices will remain stable through early 2009. **In sum, the leading indicator is showing that Sonoma County's economy is likely to remain stagnant or fall into further mild recession through May 2009.**

The Tyler Coincident Economic Indicator is also showing similarities to the 1990-91 recession, which lasted about 22 months. Taxable sales have slowed down, a sign of retail weakness and perhaps a sign that consumption is shifting toward food and other non-taxable goods and away from retail otherwise. Non-farm employment, however, has grown since late 2007. Personal income less governmental transfer payments has slowly increased since midyear 2008. There remains weakness in local labor and retail markets; until the credit markets begin to lend again, the potential consumption brewing is less likely to become kinetic. The national coincident indicator from the Conference Board has peaked and started to fall while Sonoma County's indicator has flattened. **In sum, Sonoma's coincident indicator corroborates Sonoma's leading indicator's forecast of continued economic stagnation for Sonoma County, with positive signs for the second-half of 2009.**

The wine industry experienced a slightly smaller harvest than expected, which may mean reduced revenues depending on the initial results of the harvest's quality. There may be some jobs losses in that industry in early 2009. Tourism industries continue to grow, but physical growth has slowed due to tightening credit market conditions. The dollar's international value gained some upward momentum since the midyear 2008 report; however, a worldwide recession is more likely to slow down growth possibilities for local tourism than the dollar's ascension. The dollar remains relatively weak, weakened most recently by both continue bailout packages and the federal funds rate being pushed to its lowest point in decades. New construction will see little growth in 2009 in Sonoma County until signs of a turnaround are more obvious.

Local retail, an industry that has fed off of this decade's income growth, may see more consolidation and consumer shifts toward discount stores. Boutique shopping that is not directly tied to tourism is at risk of not surviving through the current recession. As local real estate markets continue to stagnate, consumption is further pressured downward. The real estate boom naturally led to more retail businesses and breadth in Sonoma County. As real estate markets contracted, retail began to suffer. As the equity markets contracted since the midyear report, consumption was further pressured to fall. A reverse wealth effect puts pressure on high-end retail, home improvement outlets, electronics stores, and other specialized retail businesses.

The local real estate markets show no signs of positive trend in the short term. However, with interest rates being driven down again by monetary policy, it is likely there will be some support in medium-priced markets ($400K to $700K), which will slowly trickle up to luxury home markets. Rising conforming loan limits and falling prices will likely begin to stimulate purchases in this price range. Markets below $400K may continue to suffer as bank regulation and the recession continue to affect home buyers in those markets. The recession is likely to slow down purchases of rental properties also. The larger documentation required by banks to finance loans and the lower interest rates provide conflicting market signals. Until banks become relatively convinced that current interest rates reflect current risks in these markets, real estate see continued downward pressure on prices and jobs.

The local economy remains relatively weak and in recession through mid 2009. CREA has revised some of its long-term forecasts to reflect this continued weakness. Real personal income growth per capita is likely to negative this year in Sonoma County, as will be gross county product in real terms, and 2009 looks only slightly better. The regional inflation rate's rise will be slower than originally expected, but the current, low fuel prices are unlikely to t last through the summer 2009. The fears of stagflation from early 2008 have now given way to fears of deflation. It is unlikely either will be experienced for any extended period. The rapid inflation predicted in the midyear report was saved only by lower gas prices and sharply reduced consumer confidence. There is little in either the Tyler Leading or Coincident indices to signal a reversal of economic fortune anytime soon. Most economists are predicting that 2009 will be a turn-around year, and only the local economic indicators are providing evidence that a turnaround is coming in 2009. National economic policies have provided a lot of stimulus that should slowly come to fruition in the next twelve months. We should think of this recession as coming after a 15-year boom, where the 9/11 recession was short-lived and acts much like the brief and illusory consumer-led boom of 1989-90. As a result, there are similarities to the 1990-91 recession, less mass layoffs in high tech firms due to that phenomenon taking place earlier in the decade. Now the mass "layoffs" are in construction, real estate and finance as these industries saw technological change rather than high tech in this decade. If Sonoma County can become a place where environmental, biomed and other technology firms can incubate and grow, especially while office and commercial space is relatively inexpensive, Sonoma County can be a place of long-term growth in the next decade.