

THE SAN FRANCISCO BAY AREA ECONOMY: ANALYSIS AND OUTLOOK



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The San Francisco Bay Area Economy: Where've We Been, Where Are We Going?

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The San Francisco Bay Area economy was hit especially hard by the recession that began nationally in March 2001. Over the past two years, the San Francisco Bay Area has lost 210,000 jobs (the U.S. economy as a whole lost 372,000 jobs from March 2001 through March 2003). Marin, and the peninsula counties of San Francisco, San Mateo and Santa Clara have borne the brunt of the recession, while the number of jobs grew slightly in the east and north bay counties (Alameda, Contra Costa, Solano, Sonoma and Napa counties). Employment fell in Marin and the San Francisco Peninsula counties from March 2001 to March 2003, by more than 225,000.

The primary cause of the loss of jobs in the Bay Area has been the drop in business investment and falling business profitability. Bay Area job losses have been concentrated in the manufacturing sector (primarily in the computer and peripheral equipment, semiconductor, and electronic instrument industries) and business services. Internet companies' employment also dropped significantly in San Francisco.

Most industries' sales have been hit hard by the layoffs that have occurred. Taxable sales in the nine Bay Area counties increased at an average rate of 10% a year from 1997 through 2000, but then fell 7% in 2001, and 11% during the first half of 2002 (the latest period for which data are available). The steepest sales declines occurred on the San Francisco peninsula, especially Santa Clara county, where first half 2002 taxable sales were 19% below first half 2001 sales levels (see table, above). In stark contrast, Solano county taxable sales continued to grow at a rapid clip, with first half 2002 taxable sales in-

	California Taxable Sales by County		2001		Average Annual Change, 1997-2000
	1st Half 2002	Change from Prior Year	Taxable transactions (millions)	Change from Prior Year	
California	\$ 211,975	-2.1%	\$441,518	-0.1%	9.0%
Alameda	10,295	-9.3%	22,758	-4.2%	8.7%
Contra Costa	5,928	-1.2%	12,257	-0.6%	9.9%
Marin	1,837	-4.9%	3,950	-2.6%	9.3%
Napa	963	1.6%	1,947	2.0%	12.9%
San Francisco	5,573	-12.2%	12,455	-11.6%	8.7%
San Mateo	5,726	-13.5%	12,860	-8.4%	9.4%
Santa Clara	13,636	-18.8%	32,133	-13.9%	11.4%
Solano	2,435	8.9%	4,748	7.3%	10.8%
Sonoma	3,199	-2.8%	6,819	-0.1%	11.0%
SF Bay Area (9 counties):	\$ 49,593	-10.7%	\$109,927	-7.4%	10.0%

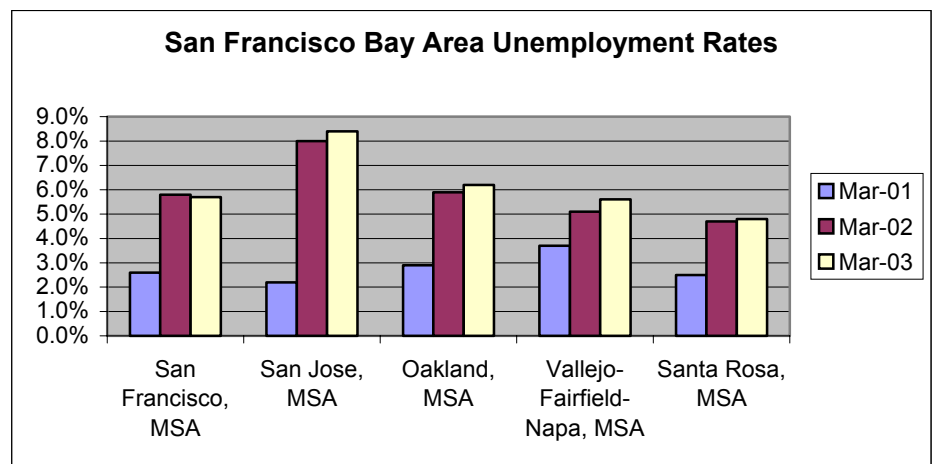
SOURCE: California State Board of Equalization

creasing 9% over year earlier levels. Although taxable sales declined slightly for Contra Costa county as a whole, the California Retail Survey cites east Contra Costa county as one of the fastest growing retail markets in California.

The steep employment downturn in Marin, San Francisco, San Mateo and Santa Clara counties led to an increase in the Bay Area unemployment

rate, from 2.6% in March 2001 to 6.6% in March 2003 (the U.S. unemployment rate, unadjusted for seasonal variations, was 6.2% in March 2003). Unemployment was at a historical low in early 2001, and so the reversal in employment trends appears especially dramatic in the graph below, beginning in 2002.

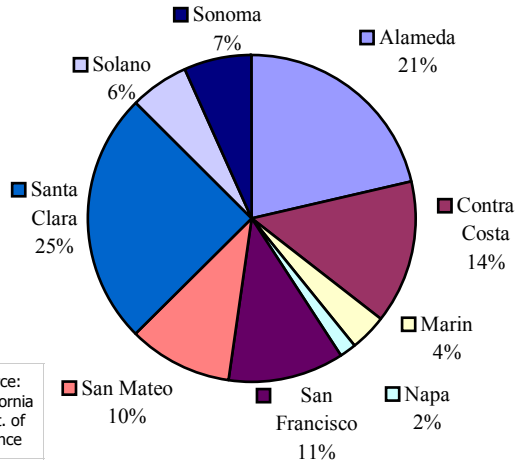
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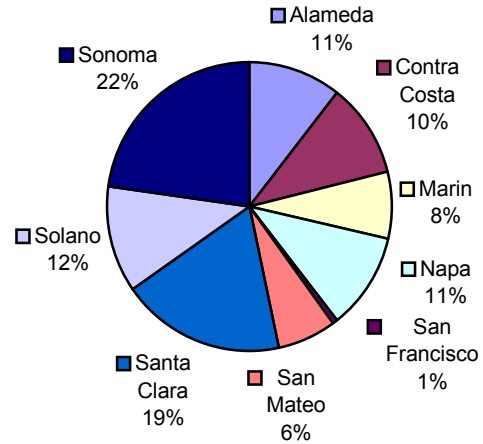
Data are not adjusted for seasonal variations. SOURCE: Calif. Employment Development Department. The San Francisco Metropolitan Statistical Area (MSA) includes Marin, San Francisco and San Mateo counties. The San Jose MSA includes Santa Clara county. The Oakland MSA includes Alameda and Contra Costa counties. The Vallejo-Fairfield-Napa MSA includes Solano and Napa counties. The Santa Rose MSA includes Sonoma county.

The 9-County San Francisco Bay Area Economy At A Glance

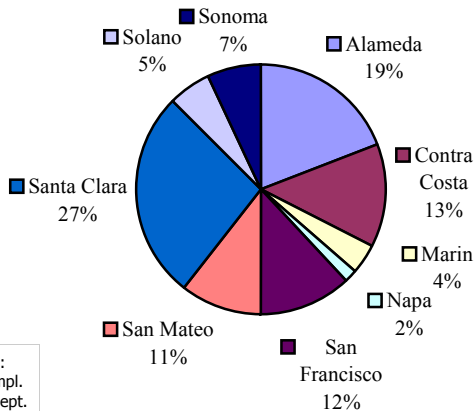
2001 San Francisco Bay Area Population 6.9 Million



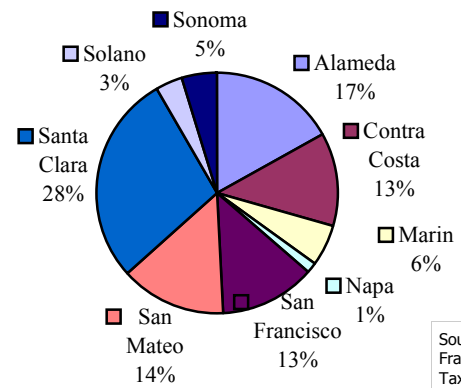
SF Bay Area Land Area - 4.4 Million Acres



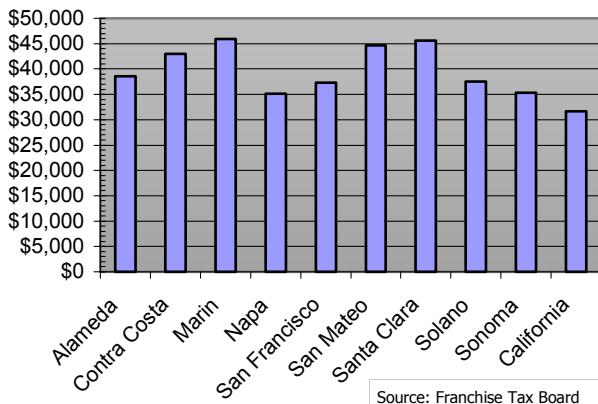
2001 Bay Area Employment: 3.7 Million



2001 Bay Area Personal Income: \$234.1 Billion - 30.8% of CA's Personal Income



2001 Median Personal Income



2001 Median Personal Income* (dollars)

	All Tax Returns	Joint Tax Returns
Alameda	\$38,582	\$74,616
Contra Costa	\$43,012	\$79,989
Marin	\$45,869	\$96,826
Napa	\$35,069	\$61,850
San Francisco	\$37,315	\$60,635
San Mateo	\$44,697	\$84,367
Santa Clara	\$45,585	\$87,781
Solano	\$37,507	\$66,443
Sonoma	\$35,322	\$65,338
California	\$31,666	\$58,341

*Adjusted gross income as reported on California state income tax returns (Source: Franchise Tax Board)

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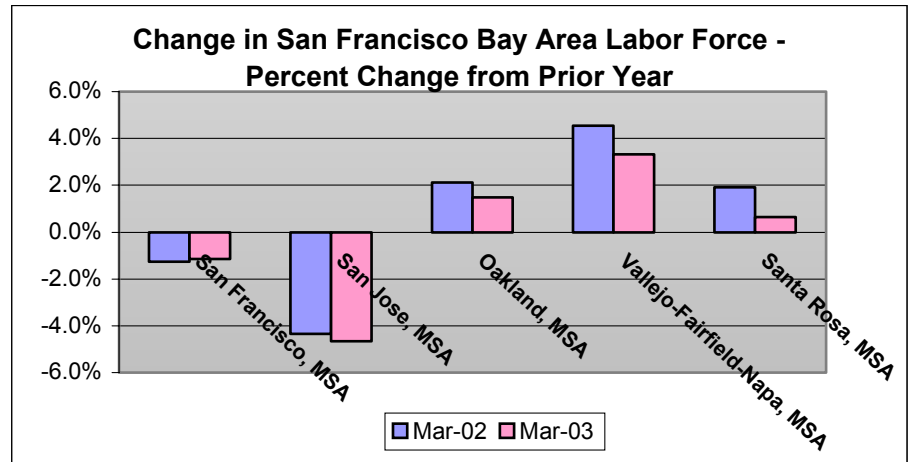
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A decline in the size of the labor force has kept the unemployment rate lower than it otherwise would be. The San Jose metropolitan area labor force grew on average by almost 3% per year from 1996 through 2000, but then fell by more than 4% per year from March 2001 through March 2003. In the San Francisco metropolitan area, the labor force grew 1.8% per year in the late 1990s, but has declined 1.8% per year since March 2001. Many Marin and San Francisco peninsula workers, discouraged by dismal job prospects, decided not to seek employment or returned to school. Others moved out of the area in search of better job opportunities. More than 50,000 residents outmigrated¹ from the Bay Area for the year through July 2002, primarily from Alameda, Marin, San Francisco, San Mateo and Santa Clara counties.

Were it not for the "discouraged" unemployed workers leaving the labor force, the San Francisco, MSA, unemployment rate would be about 10.7% and the San Jose, MSA, unemployment rate would be 16.4%. The remaining employed workers are earning less, on average, too: According to Joint Venture: Silicon Valley Network, average annual salaries in Silicon Valley fell from \$79,800 in 2000 to \$62,500 in 2002.

Although the San Jose metropolitan area has born the brunt of the 2001-2003 Bay Area recession, the recent recovery in companies' sales and profits should make the region the bright spot of the economy by fall 2003. Southern San Mateo and Santa Clara county technology companies should see a moderate recovery as U.S. businesses invest

¹ Net domestic migration for the year through July 2002 (the number of U.S. residents moving into a county minus residents moving out of the county) was -9,581 for Alameda county; -480 for Marin county; -6,424 for San Francisco county; -11,681 for San Mateo county; and -27,382 for Santa Clara county. Net domestic migration was positive for Contra Costa, Napa, Solano and Sonoma counties for the year through July 2002.



SOURCE: California Employment Development Department

in security, wireless networks and software products and services. Several successful south peninsula companies have been reporting large contracts and earnings above expectations. For example, Oracle Corporation has landed a large contract with the Transportation Security Agency, one of 22 federal agencies that compose the newly formed Department of Homeland Security. Symantec (Cupertino, CA), reported increased sales and net earnings as customers spent more on virus detection and network security software. EBay reported revenue up 97% and a doubling of net income for the first quarter of 2003. At Cisco Systems, Inc., net sales for the first 6 months of fiscal year 2003 were up 3% while net earnings tripled over year earlier levels. And at Yahoo! Inc., revenue and earnings per share increased steadily throughout 2002 and in the first quarter of 2003. Layoff announcements continue to offset the good news, however. For example, in early March Agilent Technologies (Palo Alto, CA) announced a layoff of 900 workers, and Palm, Inc. (Milpitas, CA) announced a layoff of 200 workers,

"Were it not for the 'discouraged' unemployed workers leaving the labor force, the San Francisco, MSA, unemployment rate would be about 10.7% ..."

while software firm Siebel Systems recently announced 250 job cuts due to lower than expected sales and earnings.

Airline industry woes will hurt the San Francisco and northern San Mateo county economies, due to lower SFO airport fees collected and layoffs at United Airlines. San Francisco may show employment gains during the second quarter of 2003, however, as companies move in. According to the *San Francisco Business Times*, Colliers International estimates that deals signed during the first quarter of 2003 will bring the South of Market area (SOMA) commercial vacancy rate down to 21%, from 24% at the end of 2002. And lower rents along with greater availability of used restaurant equipment have fueled growth in casual restaurants, with more affordable menus, in San Francisco neighborhoods. Northern San Mateo county has a solid employment base in biotechnology, which will help ease the pain of the United Airlines layoffs pending.

Employment growth in Solano and Napa counties will slow as government agencies grapple with budget cutbacks. Currently, government agencies, including schools, employ 19% of Napa and Solano county workers (compared to

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11% in Santa Clara county). Interest rate increases would further limit the North Bay's employment growth. The residential construction and real estate industries have fueled much of the employment growth in the Vallejo-Fairfield-Napa area, due to historically low interest rates. A recovery in U.S. business investment combined with a rapidly growing federal budget deficit would lead to higher interest rates, which would quickly curtail construction of new homes. Also, the Robert Mondavi Corp., one of Napa county's largest employers, recently announced layoffs of 10% of its workforce (~ 100 workers).

The January 2003 East Bay Economic Outlook, published by the Economic Development Alliance for business, forecasts Alameda and Contra Costa employment growth of 26,000 this year. The East Bay has a strong health care industry: Kaiser Permanente, Kaiser Foundation Hospitals, Brookside Hospital, John Muir Medical Center and Alta Bates-Summit Medical are major Alameda and Contra Costa county employers. East Bay health care employment grew by more than 5% a year from March 2001 through March 2003. Motion picture and sound recording employment growth should continue as Pixar Animation Studios completes its headquarters in Emeryville, which includes 400,000 square feet of office space, a screening theater, animation studios and recreation space.

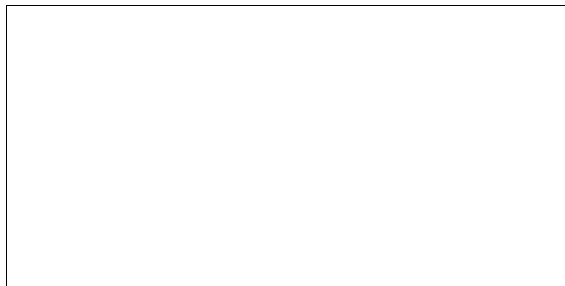
The economic forecast is often self-fulfilling, and so business and consumer sentiment is surveyed regularly.

The Silicon Valley Consumer Confidence Survey released April 11 shows that consumers' confidence in the economy reached a new low during the first quarter of 2003. More than half of the 1002 adults surveyed (52%) foresee bad financial times for the national and regional economy over the next 12 months. More significantly, fewer predict good times for the national economy over the next five years. Only 41% thought "we'll have continuous good times during the next five years," compared to 54% who thought so a year ago. Thirty-six percent of respondents thought we'd have continuous bad times, up from 26% surveyed in March 2002.

Local business owners and managers are not quite as pessimistic as consumers. According to Santa Clara University's Silicon Valley Business Outlook survey respondents, "Business conditions for your company today, relative to 6 months ago" were slightly negative in March. But the survey's respondents expect business conditions 6 months from now to be flat to slightly positive. While 57 of the respondents (37%) think business conditions for their company will improve within the next year, another 33 respondents (21%) think recovery is two to three years out.

For some companies, such as those in the hotel, airline, international travel and convention industries, recovery may indeed be two years out. In the information technology and business services industries, however, many of the companies hit hard by the 2001-2002 recession will begin to see a revival in the second quarter of 2003.

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