

THE SAN FRANCISCO BAY AREA ECONOMIC OUTLOOK



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Summer in the Bay Area Economy: Employment Drops, Workers Leave the Labor Force – Will They Ever Return?

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In July 2003, the San Francisco Bay Area unemployment rate fell to 6.7%, down from 6.9% in July 2002 (local employment data are not seasonally adjusted, so only year-to-year comparisons can be made). The drop was not good news for the Bay Area labor market, however: Payroll employment actually dropped 1.8% from year earlier levels (payroll employment excludes sole proprietors and the self-employed). The reduction in the number of unemployed persons was due entirely to workers relocating outside the Bay Area for employment opportunities and a rise in the number of “discouraged workers,” who are no longer actively seeking work.

Payroll employment fell in almost all industries. The exceptions were the health services, mining, and farm industries (farm employment increased in the North and East Bay counties, except in Sonoma County, where farm employment fell 5%). Manufacturing employment fell from 404,000 in July 2002 to 376,000 in July 2003, a 7% drop. The business services industry, the largest industry in the San Francisco Bay Area, with payroll employment of more than 500,000 persons, employed 3% fewer persons in July 2003 than in July 2002.

San Francisco Bay Area payroll construction employment fell 1% in July from year earlier levels, to 184,000 persons, pulled down especially by a construction slowdown in the San Francisco and San Jose metropolitan areas. In the Vallejo-Fairfield-Napa metropolitan area, however, construction employment actually rose 9%, led by a strong

California State Government Budget at a Glance				
	FISCAL YEAR			
	2000-2001	2001-2002	2002-2003e	2003-2004f
Revenue, all funds* (billions of dollars)	\$88.4	\$93.6 [^]	\$95.1 ^{^^}	\$94.2
Expenditures (billions of dollars)	\$96.4	\$102.9	\$99.4	\$99.1
Employment	466,900	478,700	478,800	477,400
Addendum, 9-county San Francisco Bay Area:				
State Government Employees#	96,600	100,600	100,600	100,645
Local Government Employees#	314,700	328,200	322,100	319,153

e = estimated

f = forecast

*General Fund, special fund and bond funds. Special funds made up of sales, highway user and tobacco taxes, motor vehicle fees and other tax and non-tax revenue items.

[^]Includes proceeds from a \$6.2 billion energy bond auction.

^{^^}Includes proceeds expected from an upcoming \$10.7 billion deficit financing bond auction.

#Employment for the month of June, end of fiscal year (July 1st through June 30th). Includes education.

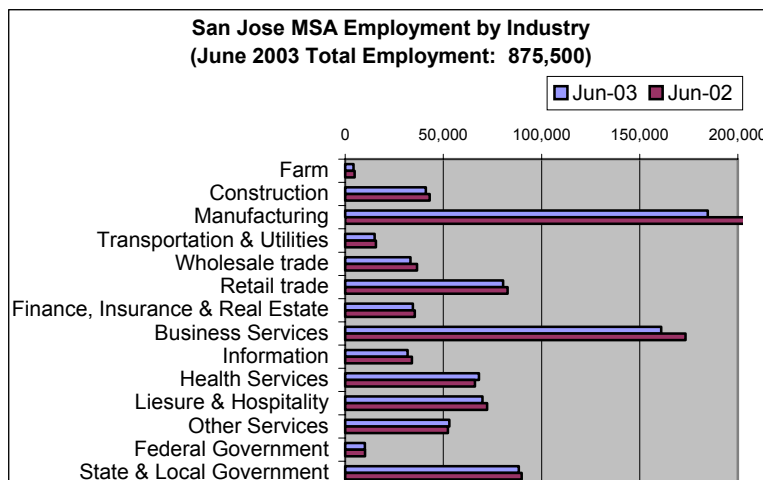
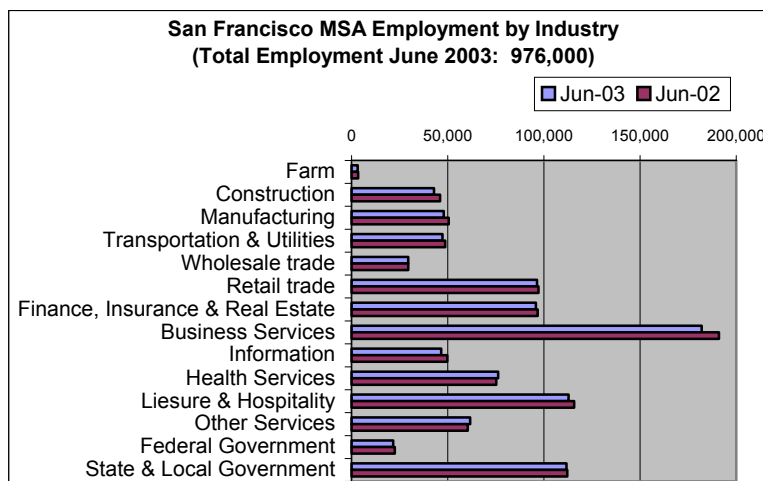
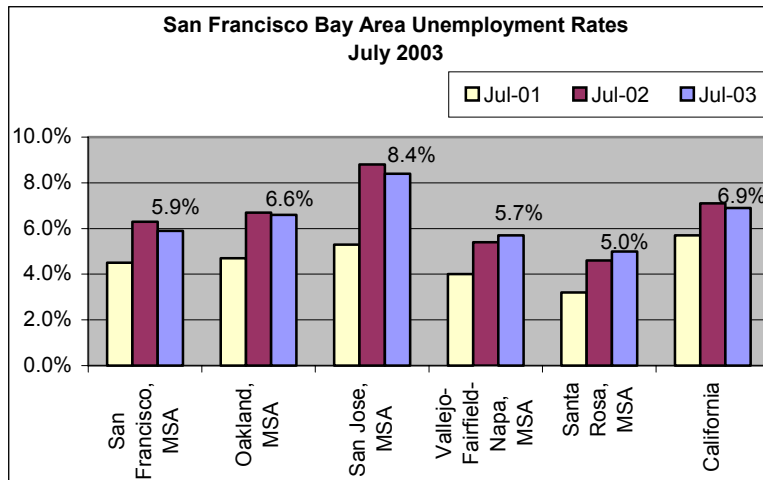
SOURCE: California Department of Finance, Employment Development Department and Econosystems estimates (employment forecasts).

increase in residential construction. Housing prices continue to increase in the Vallejo-Fairfield-Napa area, rising at double-digit rates from 2001 through the first quarter of 2003, according to recent housing price index data from the Office of Federal Housing Enterprise. According to DataQuick Information Systems (www.DQNews.com), the July 2003 median price of homes sold in Solano and Napa counties was up 16% and 18%, respectively, from July 2002 levels, while the median sales price of homes

sold in San Francisco and Santa Clara counties was down by 0.2%.

In the Oakland metropolitan area, a large drop in the heavy construction industry payroll employment was somewhat offset by strong growth in nonresidential building construction: Nonresidential building construction employment increased by one-third in July from year earlier levels, to 6000 persons. Despite the rise in interest rates, which will hit hard in the residential construction industry (continued on page 2)

Summer in the Bay Area Economy: continued



Source for all graphs: Employment Development Department

(continued from page 1) in most of the Bay Area, East Bay non-residential construction industry employment should remain stable through the end of the year. In the second quarter of 2003, Alameda and Contra Costa counties approved more than \$300 million in non-residential building permits each month, about the same as year earlier levels.

State and local employment was previously a welcome source of employment growth in the early stages of the 2001 recession, but budget woes have since kicked in. State and local employment increased 4.2% from June 2001 to June 2002 and then declined (-1.4%) through June 2003. A budget crisis emerged when California capital gains and stock options tax revenue fell from \$17.6 billion in the 2000 - 2001 fiscal year to \$8.6 billion in 2001 - 2002. Money raised via a \$6.2 billion energy bond auction and other stop-gap revenue raising methods (e.g., by issuing revenue anticipation warrants) kept reported revenue from falling that year (see table on page one). As tax revenues continue to come in lower than forecast, state and local government budget cutbacks, along with cuts services and employment (primarily through attrition and hiring freezes), have been implemented. Although the worst of the state and local revenue declines are behind us, past overspending in excess of revenue will continue to strain government finances, leading to a further decline in state and local employment for the fiscal year ending in June 2004 (see the "California State Government Budget at a Glance" table on page one).

Economic recovery remains elusive for the San Francisco Bay Area, despite pockets of success. In Santa Clara County, second quarter 2003 revenue was up 5% at the 12 largest publicly traded companies from year earlier levels, but earnings per share were down by an average of more than 10%. Hewlett-Packard Co., IBM Corp., and Intel Corp. all reported both higher revenue and earnings per share. At Applied Materials, Inc., Solectron Corp. and Sun Microsystems, however, which together employ more than 100,000 persons worldwide, revenue fell at double-digit rates in the second quarter of 2003 (as compared to the second quarter of 2002): earnings per share at the three companies fell even more steeply. Revenue fell 2% at Cisco Systems Inc. during the second quarter of 2003, but earnings per share grew a (continued on page 3)

(continued from page 2) strong 32%. Still, Cisco announced in early August that the company would continue to reduce headcount through attrition as part of their attempt to continue to lower operating costs.

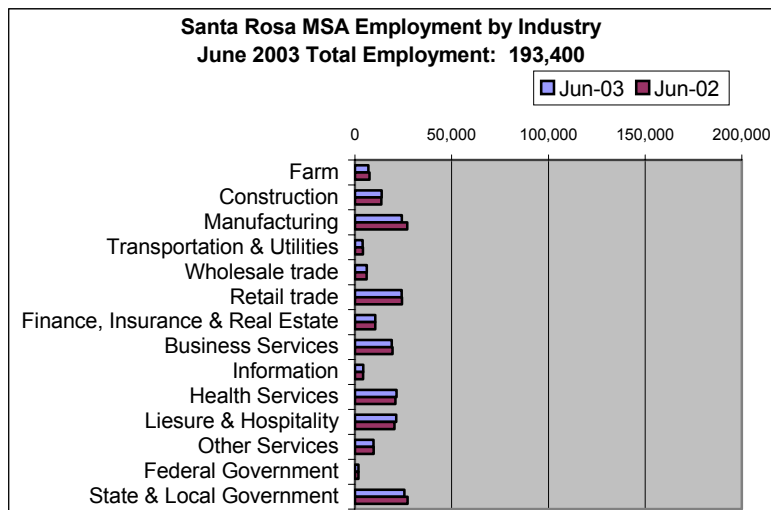
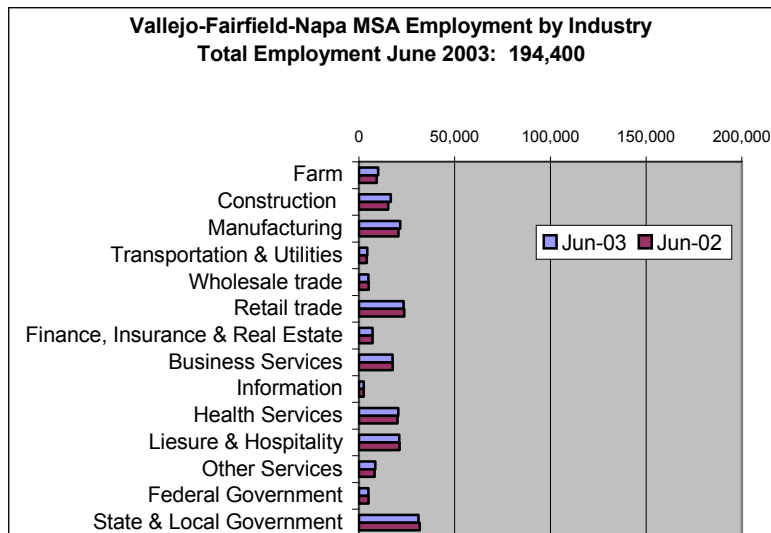
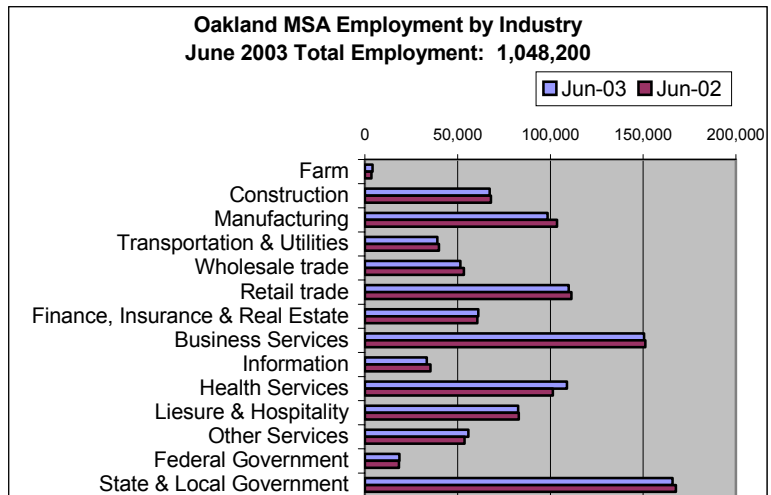
The shaky financial condition of many Bay Area companies is resulting in restrained hiring practices. The majority of respondents to a July 2003 survey conducted for the Bay Area Business Council found that 72% agreed “even if the local economy improves, I do not expect an increase in my company’s workforce.” Results were similar for a survey of 69 Sonoma county businesses in July 2003: 51% of respondents planned to maintain the number of full-time employees at their companies for the next six months. And a survey of 174 Santa Clara University MBA program alumni found that expectations for the number of jobs at their companies were only slightly better six months from now. Total employment in the Bay Area is unlikely to grow until 2004.

“Declining pessimism” characterizes current sentiments about the economy in Silicon Valley. A June 2003 poll conducted by the Survey and Policy Research Institute at San Jose State University shows that the proportion of respondents experiencing worsening financial conditions has fallen to 39% of respondents - down from 43% of respondents in March 2003. And while more than half of respondents (58%) said they thought June 2003 business conditions in the country were worse now than they were a in June 2002, 79% thought so in March.

Bay Area-wide, 51% of the 545 companies surveyed in July 2003 by the Bay Area Economic Forum say there’s been no change in economic conditions in the past six months, but more respondents think the economy is worse now (26%) than better (22%). Fifty percent think the Bay Area economy will get better in the next six months, versus 39% who think the economy will “stay the same.” Only 10% of respondents think the economy will get either moderately (8%) or substantially (2%) worse.

Venture capital funding of emerging companies may eventually lead to increases in production and employment. According to investment activity tracked by VentureWire (<http://venturewire.com/>), funding has increased from less than \$300 million in May to more than \$450 million in July 2003. In May 2003, Visto (Redwood Shores, California), a provider of personal and corporate mobile access applications, received \$30 million in venture capital funding and the drug

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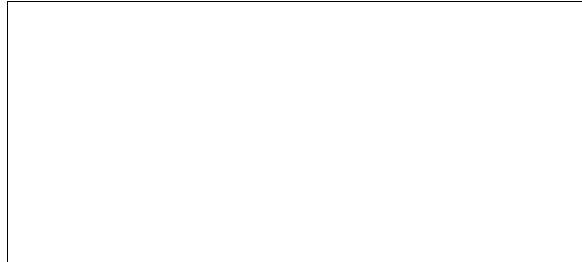
Source for all graphs: Employment Development Department



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(continued from page 3) discovery firm Plexxicon (Berkeley, California) received \$32 million. In June, Trapeze Networks (Pleasanton, California), a provider of wireless data networking products for enterprises, received \$34 million in venture capital funding and wireless switch manufacturer Vivato (San Francisco, California) received \$44 million. July's largest rounds of funding went to pharmaceutical company CellGate of (Sunnyvale, California) (\$44 million) and Sanera Systems (Sunnyvale, California), a provider of datacenter storage switching equipment (\$34 million). Over \$1 billion in venture capital has gone to fund San Francisco Bay Area firms in the second quarter of 2003, and many of these firms will grow and eventually increase hiring.

Many of the software engineering and manufacturing jobs that have been moved overseas will not return anytime soon. But job growth will likely begin in the industries that have received several millions of dollars in funding locally this year: biotechnology and pharmaceuticals; data storage and management; wireless switches, wireless data networking, and mobile messaging software; network security; and digital imaging chips and processors.

There's also just good old-fashioned growth. E-loan has moved to a larger location in Pleasanton, California, and plans to add employees. Investment bank Merriman Curham Ford & Co. is moving to larger facili-

ties in the financial district of San Francisco and is hiring bankers. Bank of America will be adding staff over the next few years as it adds mortgage offices and bank branches in the San Francisco Bay Area. PowerLight of Berkeley, California has landed a \$7.4 million deal with the City of San Francisco (to install a 675-kilowatt solar electrical system atop the Moscone Convention Center) and has added five employees. Sun Microsystems won a \$49.7 million contract to build a super computer for the Defense Advanced Research Projects Agency and plans to expand the team working on the project by 80 full- and part-time employees over the next three years. Trigo Technologies, a product information management software company, recently landed Albertson's stores as a customer and plans to double its workforce in 2003, to approximately 200 employees. The Bay School, a private school to be located in the Presidio of San Francisco, will open in September 2004 with 40 new, full-time equivalent teachers.

The job mix will change in 2004, as companies in the newly funded industries grow. San Francisco Bay Area employment losses should end this fall. After more than two years of almost constant layoff announcements, and with job losses totaling more than 300,000, the "no news" of stabilizing employment will seem almost refreshing. In early 2004 we are likely to be cheered by moderate employment growth in the San Francisco Bay Area. Only then will discouraged workers venture back into the labor force. □