



Bank of Marin Breakfast: **The North Bay and our National Economy**

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Introduction

- Recession finally admitted
 - Began Dec. 2007 at national level
 - California probably started Sept. 2007 when full trend in housing downturn began
 - Housing, financial markets disconnect on pricing risk correctly
 - Slowdown becoming global: reactions in earnest
- FED has done almost all it can
 - Now rely on banking to provide funding
 - Bank bailout needs to become lending
 - Local and regional banks are lending (including B of M)

Intro (cont.)

- North Bay effects beginning to show
 - Leading and coincident indicators weakening
 - Employment and income continue to support local economy
 - Though job losses are rising, job growth in 2008!
 - Cost of living to rise further: an unsolvable problem
 - Thinking regionally may solve the problem
- North Bay issues
 - SMART rail provides construction stimulus
 - State budget affects all counties, connected to federal
 - Water remains an issue: AB 811 could help
 - Need to see opportunities

Global Economic Issues

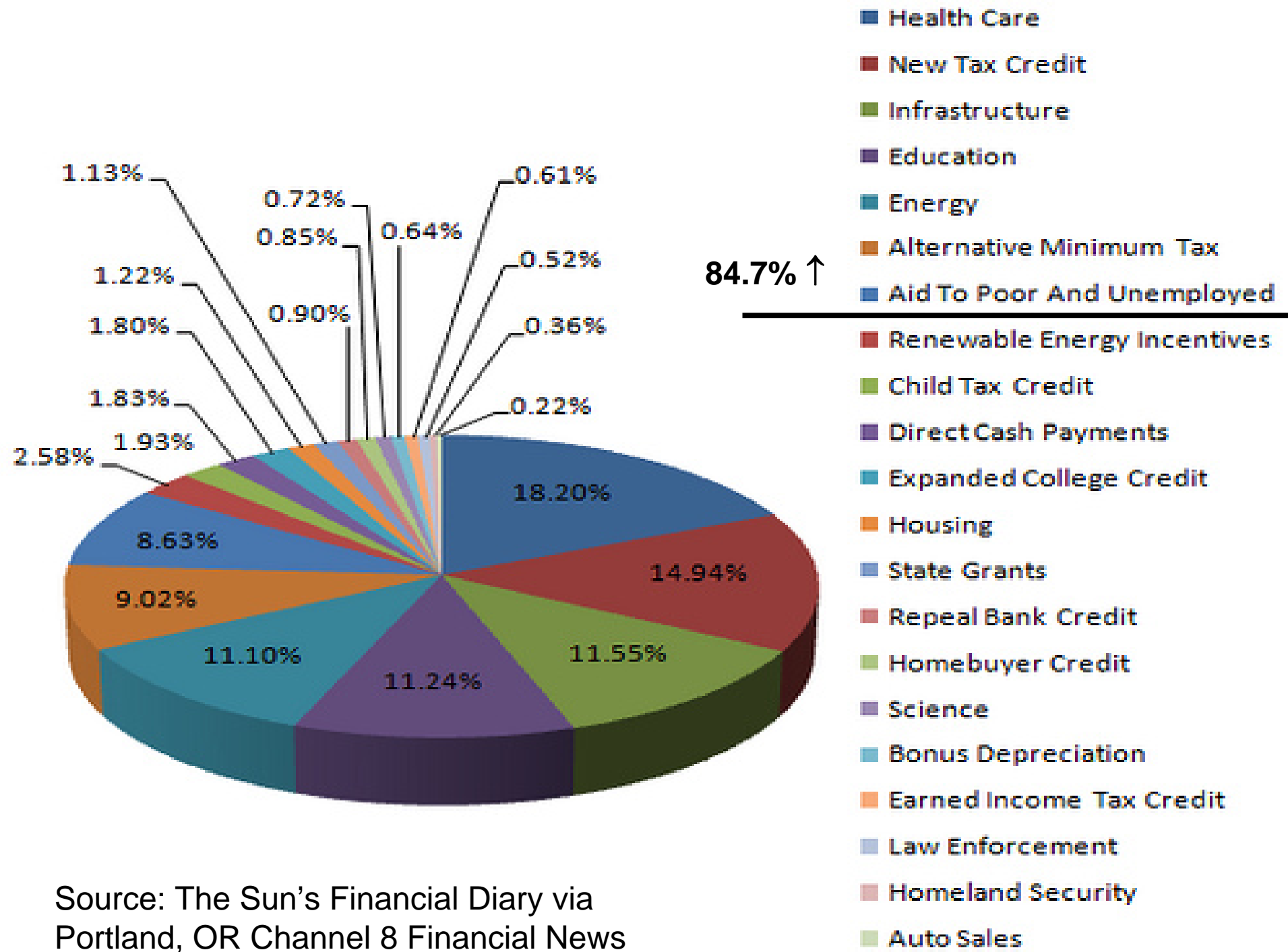
- “Decoupling” being tested
 - Emerging market exports falling
 - Interest rates falling worldwide
 - European Central Bank, Bank of England, Reserve bank of Australia
 - Following American bailout model also
- Does this matter to the North Bay?
 - Real Estate demand
 - Export demand for services
 - Tourism
 - Export demand for goods
 - Strong mix of products sold elsewhere in North Bay (not just wine)

Domestic Macroeconomy

- Expanded fiscal stimulus
 - Already have stimulus in place
 - Defense spending expansion since 2002
 - Bailouts are fiscal policy funded by monetary policy
 - Tax rebates and corporate bonus depreciation
- Monetary policy at a policy endpoint
 - What else could possibly be done?
 - Why have banks not started lending again?
- Need supply-side movements in trend
 - Job creation through innovation, not through consumption

The Stimulus Plan

- Five major sectoral targets as of Feb 19
 - **Health Care:** \$141.3 billion
 - **New Tax Credit:** \$116 billion
 - **Infrastructure:** \$90 billion
 - **Education:** \$87 billion
 - **Energy:** \$86 billion
 - Rough total of \$787 billion



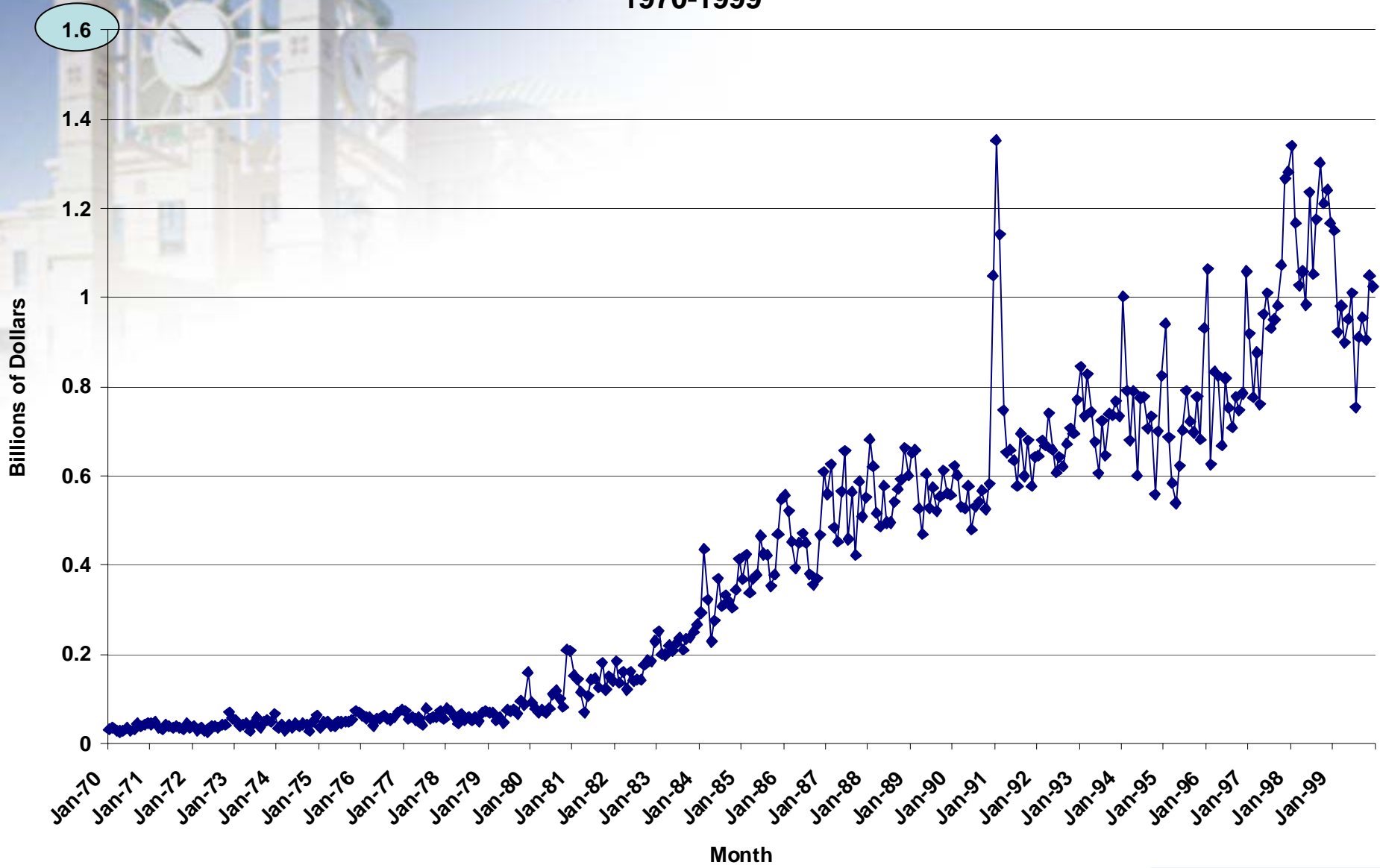
North Bay and Federal Stimulus

- Health Care
 - May see demand for health care supported through Medicare support
 - Increase in medical visits
 - Increase in dental visits
 - Decrease in residential care vacancies
- AB 811, Energy and new start-ups
 - May see retrofit demand rise for water and energy conservation
 - May see green/clean tech businesses incubate here
- Education
 - Will local schools, COM and Dominican see any new demand from stimulus
 - Capital building projects
 - Student loan supports
 - Education cut in state budget

Bank Bailout and Two Perspectives

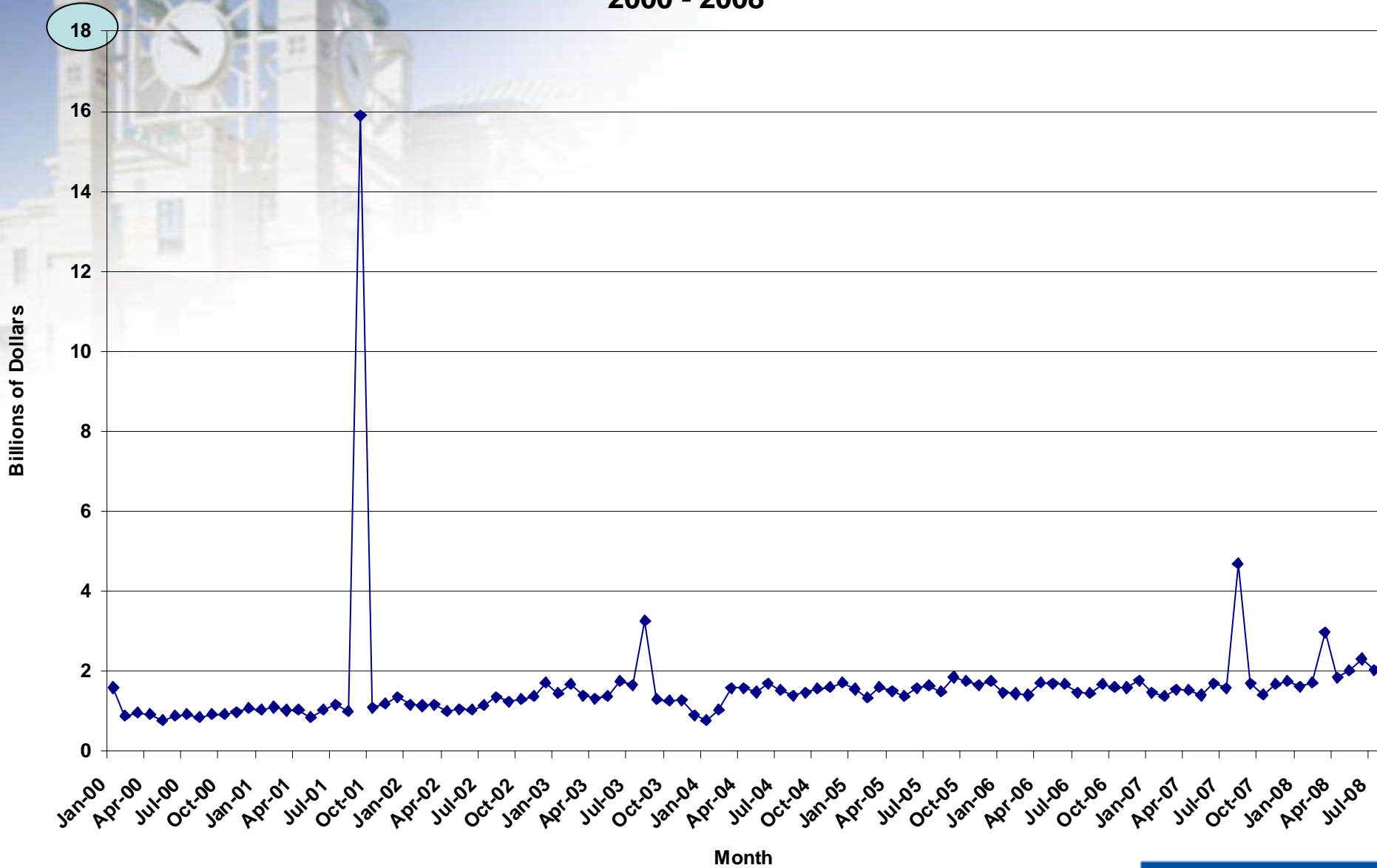
- Stress Test for larger banks
- \$500 billion investment fund
- Term Asset Loan Facility expansion
- Does it matter?
 - Banks need to have an incentive to lend this money
- Banks are lending, data dominated by large banks.
 - Bank of Marin as an example of regional bank that is lending
 - No participation in toxic securities
 - Money is available

Excess Reserves at U.S. Banks (Loanable Funds Not Lent), 2008\$ 1970-1999



Source: Federal Reserve Board

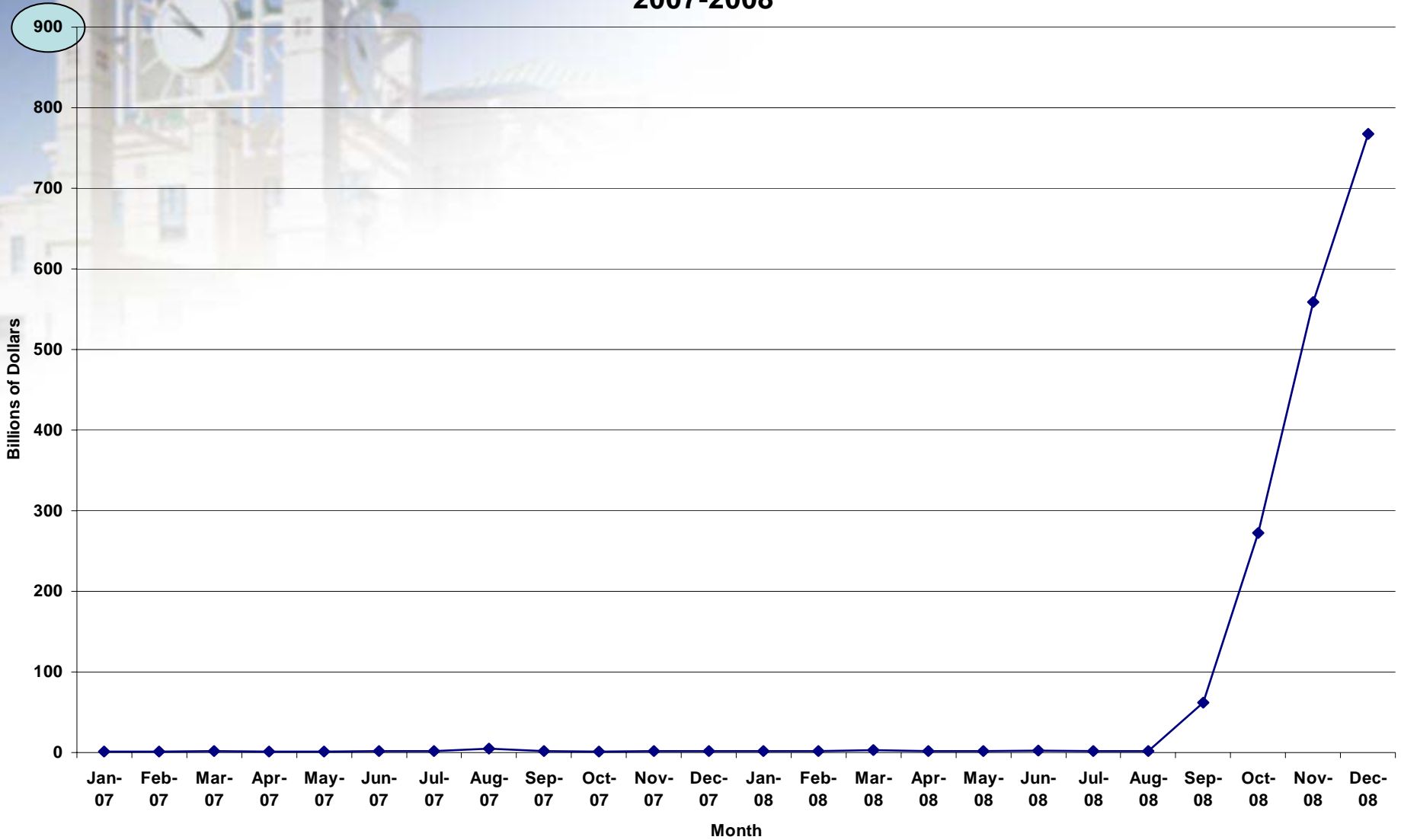
Excess Reserves at U.S. Banks (Loanable Funds Not Lent), 2008\$ 2000 - 2008



Source: Federal Reserve Board



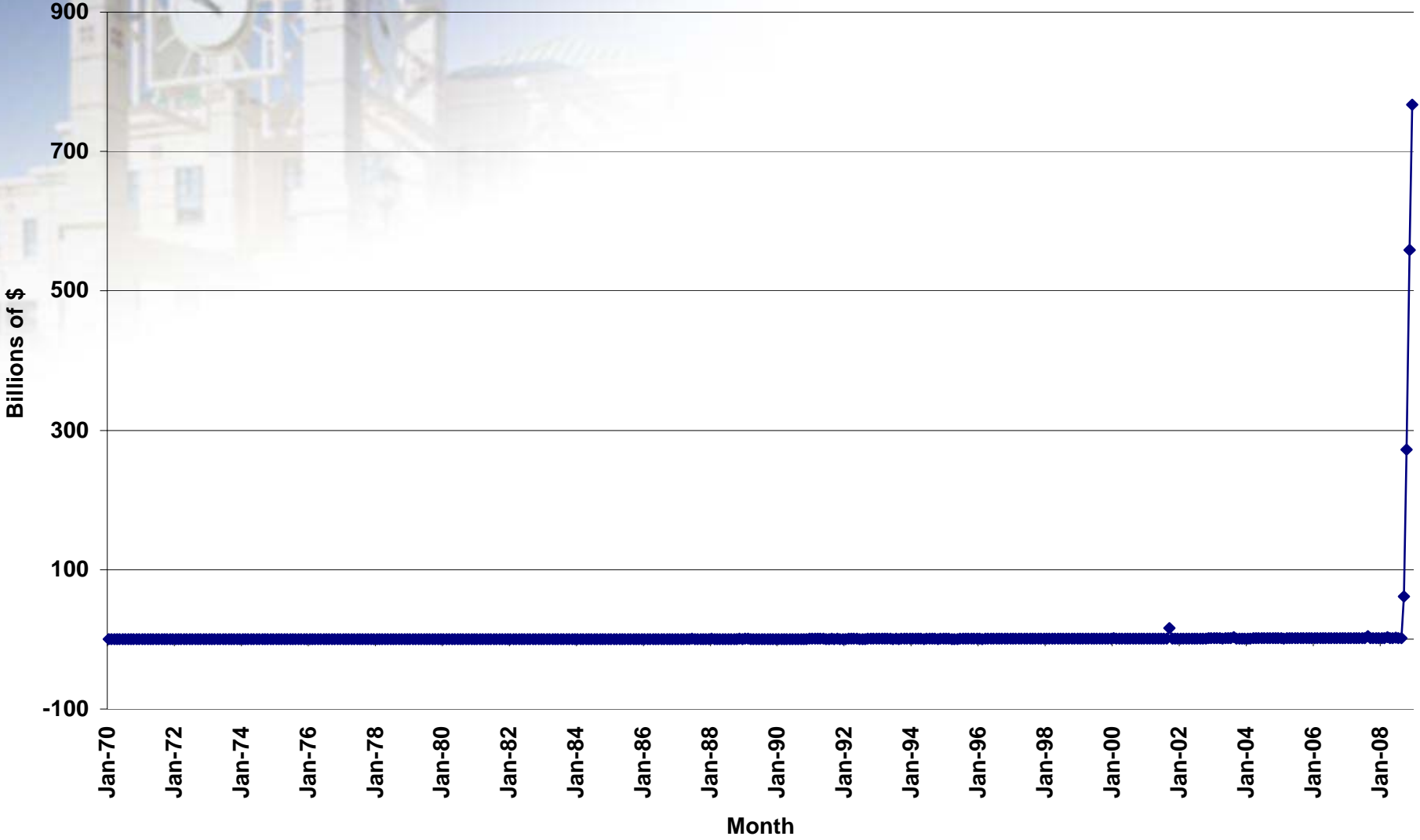
Excess Reserves at U.S. Banks (Loanable Funds Not Lent), 2008\$ 2007-2008



Source: Federal Reserve Board



Excess Reserves at U.S. Banks (Loanable Funds Not Lent), 2008\$ Jan 1970 - Nov 2008



Source: Federal Reserve Board



Stimulus and Bailouts: Long-Term

- A decade of fiscal stimulus has made national debt soar
- **Inflation on the way, interest rates rise to follow**
- Ricardian Equivalence: taxes to come
 - Permanent cuts have larger short-term effects than temporary
 - Temporary cuts or spending provide better long-term signal of discipline
- Social security issues
 - Also global (China the big one)

California as Microcosm

- 2002 saw use of fiscal surplus from capital gains taxes spent on **permanent** spending
 - We are now paying for that in current deficit of > \$40 billion through 2009-10
 - Federal spending may stimulate state economies
 - May be direct bailouts
 - Lag structure here between federal and state budgets affects speed of growth
 - Cannot rely on this model
 - Pension system to be stretched soon
 - School spending in CA now 50th in nation (≈\$18K per pupil)
 - **Opportunity: public-private partnerships in education**

The California Budget: to 2010

- Tax Hikes
 - VLF to 1.15% of estimated car value
 - Sales tax to rise 1%, Gas tax up \$0.12/gal
 - Income taxes up, dependent care credit down by \$200
 - **No change in property taxes**
- Spending cuts: Total about
 - Education hammered: almost \$9 billion
 - Disabled and blind also hurt: \$750 million
 - State employees salaries (job cuts, O/T): \$1.4 billion
- Tax breaks:
 - \$100 million for credits for those that buy new homes
 - \$200 million for credits for small business hiring new workers
 - \$790 million for larger firms to subsidize innovation

What California Likely to Do

- Budget gap closed through borrowing
 - **Approx \$10 billion**
 - Depends on ability to sell debt
 - Depends on amount of fiscal stimulus to state government
 - **Reform is needed**
 - A consumer-led expansion may provide an ephemeral, illusory boost to state coffers
 - Tax reform: What about Prop 13?
 - Budget reform: need a change to 2/3 vote and term limits?
 - How can one vote hold up this process?

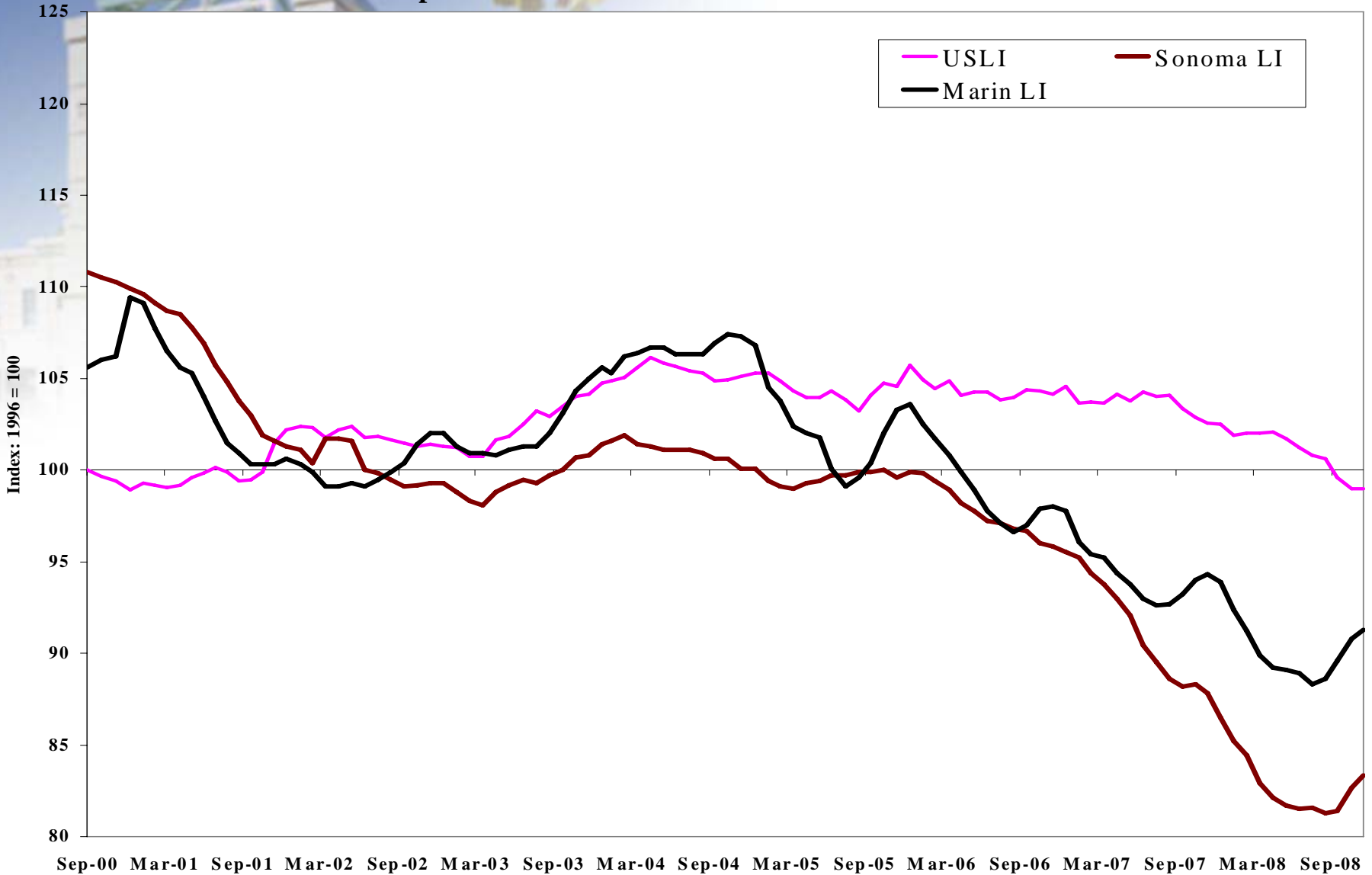
North Bay Economic Indicators

- Leading and Coincident Indicators for North Bay
 - Toby Tyler from PG&E created this.
 - Leading: where we are going.
 - Coincident: where we are.
- The two together shape the “business cycle” as a forecast
 - North Bay indicators volatile in the leading, rising in the coincident
 - Sonoma and Marin closely following each other
 - Interdependence a key issue going forward

Tyler Leading Indicator

- Weighted average of macroeconomic variables for Marin and Sonoma.
- Leading variables tell us where we are headed
 - Default Notices: As defaults ↑, economy ↓
 - Building Permits: As permits ↑, economy ↑
 - New UI Claims: As new claims ↑, economy ↓
 - US Leading Index: As USLI ↑, economy ↑
 - Help-Wanted Ads: As ads ↑, economy ↑
 - Ag Price Index **** : As ag prices ↑, economy ↑
 - Assumes demand not costs causing the price increase

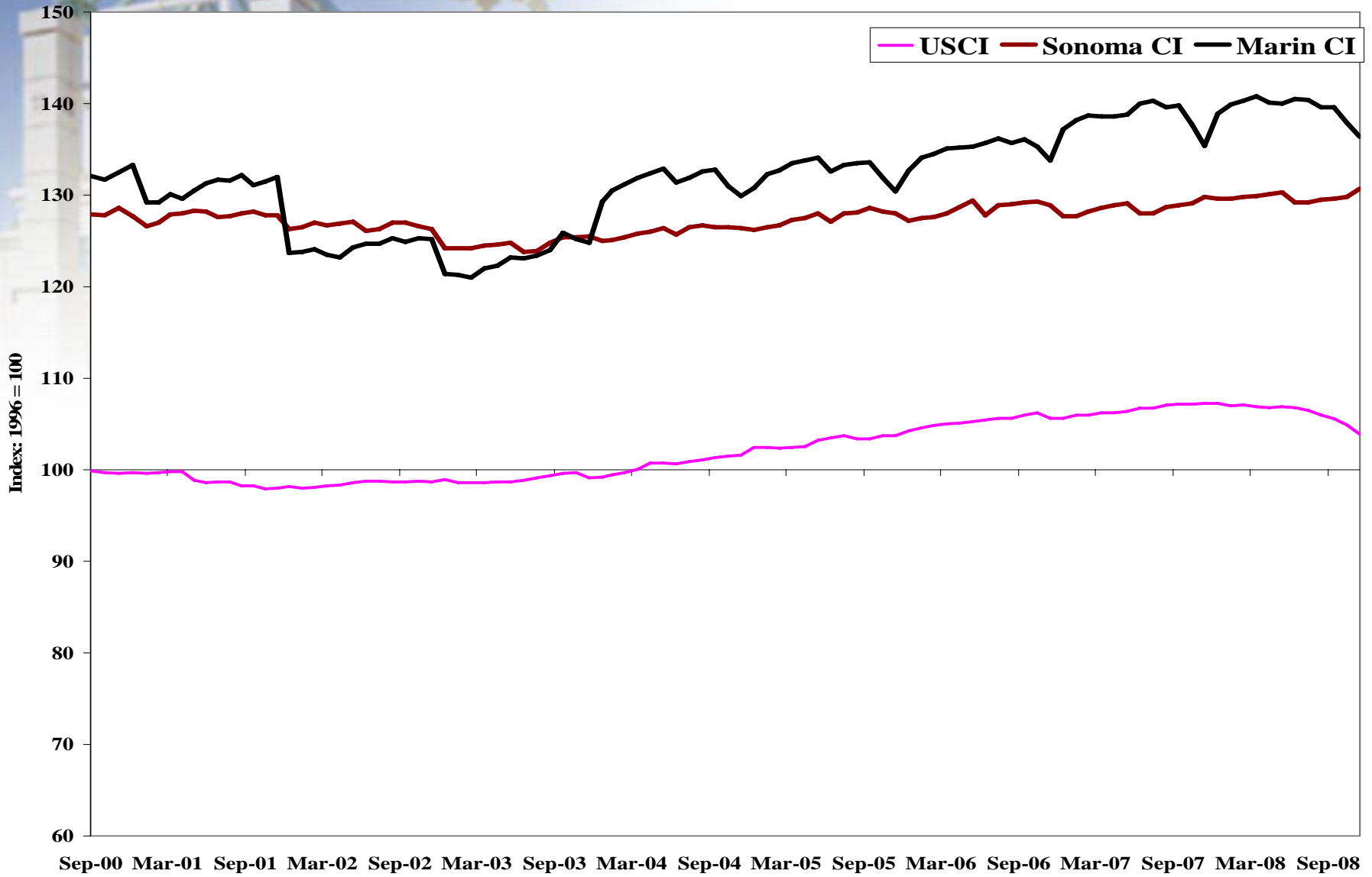
Comparison of Sonoma and Marin LI and USLI



Tyler Coincident Indicator

- Coincident Indicator tell us where we are (all components positively related with economy):
 - **Non-agricultural employment**
 - **Retail Sales**
 - **Personal Income**
- The leading indicator drives the coincident.
 - Marin outlook showing signs of hitting bottom in 2009
 - Sonoma County outlook similar

Comparison of Sonoma and Marin CI to USCI



Housing Market

- As of Dec. 2008,
 - Marin down 27% from Dec. 2007 (\$562,500 median, with caveats)
 - Sonoma County prices 27% down from a year ago also (\$300K)
- Some regional perspective
 - Sonoma County (Sept. 2005, \$580K)
 - Stockton (Sept. 2005, \$385K, now \$129K)
 - SF (Dec. 2007, \$808K, now \$625K)
- Interdependence: 95.3% correlation between Sonoma and Marin median home price since 1995
 - 98% correlation with SF and Marin
 - Regional market for commercial space as well
 - Marin better than Sonoma, which are both worse than Napa
- Much now depends on banking and stimulus

Jobs Fluctuations in Marin

- Employment grew in 2008 in Marin and Sonoma!
 - Likely to slightly fall in 2009
 - Unemployment surge alongside (labor force overall grew mainly from unemployment)
- Gains for Marin
 - Software Development
 - Chemical Manufacture
 - Leasing agents for real estate
- Losses for Marin
 - Construction
 - Utilities
 - Accommodations and higher-end restaurants

Sonoma County Jobs

- Growth of +0.2% over 2008 non-farm employment
- Losses
 - Finance (-5%)
 - State-funded education (-12%)
 - Construction (-7%)
- Gains
 - Manufacturing (+2%)
 - Retail (+3%)

Economic Vision

- Three Es to be the focus, as in other counties
- Economic development
 - Regional economy: should North Bay worry about housing its workers?
 - Is the Disney cluster a microcosm of a “new” Marin?
 - Use of Latino workforce is key to North Bay’s job future: Sonoma more than Marin
- Social equity
 - Aging demography an opportunity: Marin more than Sonoma
 - Cost of living still an issue: no great solutions
 - Non-profit support: public-private partnerships
- Environmental Protection
 - Marin can also be an incubator for green/clean tech
 - Sonoma Mountain Business Cluster in Rohnert Park a model
 - Look at AB 811 and AB 32 to generate jobs

North Bay Economic Outlook

- Recession for both Marin and Sonoma through 2009
 - Mild compared to both California and U.S. overall
 - Reduced exposure to major employers over last 10 years
 - Napa County doing better than North Bay otherwise
 - Exposed to risks in tourism and associated construction
 - Able to use tourism and wine to advantage for now
 - Sonoma County hit hardest
 - Large exposure to residential real estate issues
 - Commercial real estate vacancies rising
 - Lack of common vision and public-private partnerships reducing future growth

NB Outlook (cont.)

- Housing should be seen as a follower not leader
 - Exposure of North Bay to real estate markets is a microcosm of local economy
 - Services and population-serving first
- Think regionally for markets and workers
- Consider how to utilize public and private sectors working together
 - AB 32 as a springboard for new businesses
 - In the trades, training in new tech and installations key
 - AB 811 a way to generate jobs and use property taxes to do it directly
- Recognize regional connections
 - All counties are going to scramble for firms
 - Housing markets should react not drive