Professor Steven Hackett, Executive Director
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July 2002

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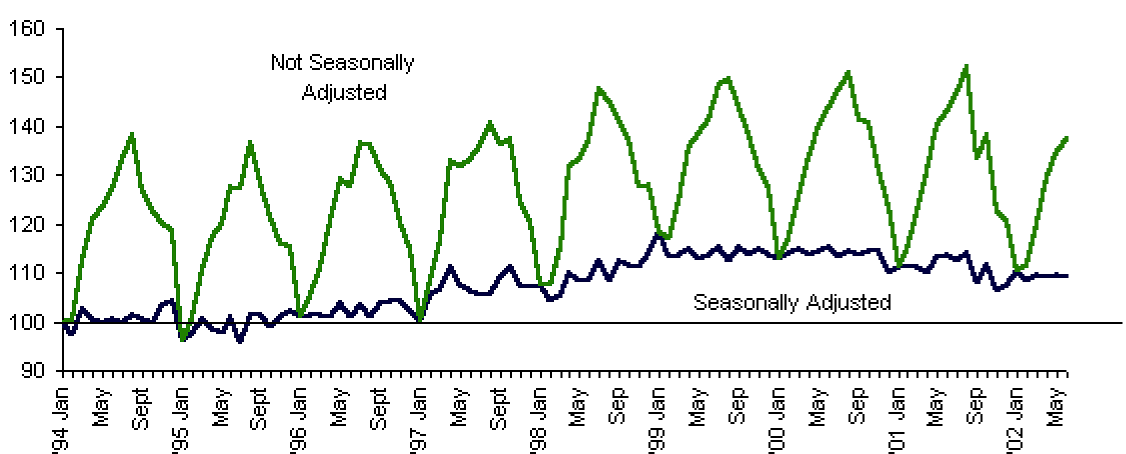
Composite Index



Key Statistics		Leading Indicators	
Humboldt County		***Seasonally Adjusted***	**% Change From Previous Month**
Median Home Price*	$171,500	Help Wanted Advertising	+8.0
30 Yr. Mortgage Rate (7/23)	6.5%	Building Permits	-21.5

Average Hotel Occupancy Rate	67.0%	Unemployment Claims	-1.0
Unemployment Rate**	5.8%	Manufacturing Orders	-3.6

* Home price data are provided by the Humboldt Association of Realtors. MLS is not responsible for accuracy of information. The information published and disseminated by the Service is communicated verbatim, without change by the Service, as filed with the Service by the Participant. The Service does not verify such information provided and disclaims any responsibility for its accuracy. Each Participant agrees to hold the Service harmless against any liability arising from any inaccuracy or inadequacy of the information.

** Preliminary EDD data. See the EDD Website for updates.

Sectoral Performance, *Index of Economic Activity for Humboldt County*

* * *		Percent Change From:					
Sector	**Seasonally Adjusted Sectoral Index Value (1994=100)**	**Previous Month**	**Same Month 2001**	**Same Month 2000**	**Same Month 1999**	**Same Month 1998**	**Same Month 1997**
Home Sales	126.7	-2.3	-4.5	+16.4	+20.8	+30.6	+40.7
Retail Sales	152.4	-3.1	-1.6	+1.6	+12.3	+16.4	+30.2
Hospitality	96.4	+12.4	-4.7	-2.5	-3.1	-6.3	-3.1
Electricity Consumption	97.6	-1.4	-10.1	-26.0	-24.3	--	--
Total County Employment	103.4	-0.2	-0.5	-1.9	-2.4	-0.5	+1.1
Lumber Manufacturing	90.8	-5.3	-12.5	-19.9	-23.0	-21.3	-26.9

Discussion

Composite Index and Overall Performance

The *Index of Economic Activity*'s seasonally adjusted composite value, which now stands at 109.2, remaining essentially unchanged (falling 0.3 percent) from last month's downwardly revised figure.

A look at the graph above shows that the Humboldt County economy remained flat for a fourth consecutive month in June. While this is not necessarily a bad thing--as we reported last month, the modest local recovery appears to be holding on--modest across-the-board sectoral decreases compared to June 2001 activity are cause for concern. Stronger signs of growth would go a long way toward easing the persistent economic uncertainty that remains. National economic news is definitely contributing to the sense of unease, as recent revisions to 2001 GDP growth show that last year's recession, while still relatively mild, actually lasted three quarters rather than the originally reported one quarter. First quarter 2002 GDP growth has been revised downwards and the preliminary data shows second quarter growth to have been sluggish, at best. Despite solid efforts to address levels of corporate malfeasance not seen in the United States since the early 20th century, financial markets continue to lose value. Finally, the likihood of a U.S. invasion of Iraq continues to grow, bringing with it the prospect of further disruption to the economy.

When looking at month-to-month performance, hospitality was the only sector to registered positive growth in June. This sector's *Index* value grew a healthy 12.4 percent from the previous month's level. Retail sales and home sales activity both declined in June, but their respective *Index* values show that these two sectors remain in good shape. The performance of the employment sector is symptomatic of potentially lingering labor market

weakness. Following two months of tepid growth, the lumber manufacturing sector fell by the largest margin based on the preliminary data. Within actually data for second quarter data in hand, the electricity consumption sector also lost ground, however, there is reason to believe that the cause is due more to conservation efforts than reduced economic activity.

The Leading Indicators are tepid, at best, this month. On the positive side, help-wanted advertising regained much of last month's large decrease, but the seasonally adjusted four-month moving average (shown near the end of this report) has levelled off, corroborating other indications of possible labor market weakness. Unemployment insurance claims declined slightly, but once again the four-month moving average here does not suggest any trend. On the negative side, both building permits and manufacturing orders lost ground. The four-month moving averages for these two indicators suggest that while there is continuing weakness in the former, a modest turnaround may be underway in the latter.

Home Sales

The *Index* value of this sector is based on the number of homes sold in Humboldt County each month as recorded by the Humboldt Association of Realtors.

The seasonally adjusted *Index* value for this sector fell for the second consecutive month in June. The figure is also down from June 2001, but is considerably higher than same month activity in years past.

June's median home price jumped 7.5 percent from May's $159,500 to $171,500. This sometimes volatile measure is nearly 20 percent higher than it was in June 2001. The current statewide median sale price of $324,370 for existing homes rose 1.5 percent from May's downwardly revised number. This figure is up a whopping 21.3 percent from June 2001, when it was $267,410 (www.car.org). May's national median price for existing homes climbed 5.8 percent from May's level to $163,500, while the similar figure for new homes rose 3.3 percent to $182,600 (www.realtor.org and www.census.gov).

Retail Sales

Nearly every component of the local retail sector reported declining activity in June, resulting in a fairly large drop in the sector's *Index* value. Nonetheless, the level of that value, as well as most of the year-over-year comparisons, show that retail sales remains the strongest segment of our economy.

Hearings were recently held in Eureka to address that city's concerns over large retail developments and their potential effects on existing businesses. Public input was sought on a proposed ordinance that would require a more detailed review of the impact these projects would have on affected neighborhoods (www.times-standard.com).

National retail sales rose 1.1 percent in June, erasing the revised 1.1 percent decline seen in May. Sales at electronics and appliance stores and general merchandise stores led the advance, while sales at gasoline stations were once again down. Overall retail sales were 3.0 percent higher that in June 2001 (www.census.gov).

The July release of the Conference Board's Consumer Confidence Index plummetted 8.7 percent to 97.1 from June's revised 106.3. This is the Index's lowest level since last February when it hit 95.0. The business research organization cited "[t]he continued decline in the value of stock market portfolios, coupled with ongoing reports of corporate scandals..." as the reasons causing the erosion in consumer confidence. The report went on to say that a "continued slide could very well jepardize the economic recovery." Most analysts question the long-term impact of the current findings. They point to figures showing that the number of consumers planning to buy durable goods such as cars and houses is actually increasing (www.sfgate.com).

Hospitality

Our preliminary seasonally adjusted figure for average occupancy at the participating hotels, motels and inns jumped over 11 percentage points in June. As a result, the seasonally adjusted *Index* value for this sector rose a welcome 12.4 percent from May's level. This seems to validate the notion that an increased number of contacts with the Humboldt County Visitor and Convention Bureau's website may be leading to additional travel to our area. Unfortunately, the local sector is down in all of the year-over-year comparisons. The performance of this sector, as well as reports from industry members, seem to indicate that local lodging establishments may be affected by the national downturn in this industry.

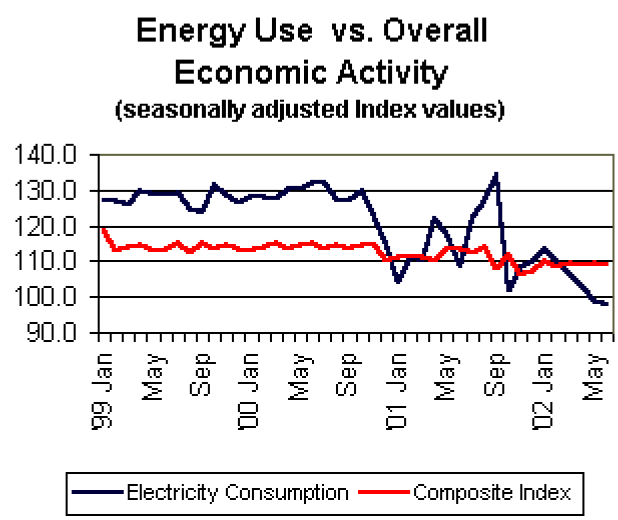
Electricity Consumption

We use kilowatts of electricity consumed as our indicator of the energy sector of the Humboldt county economy. Electricity consumption is a somewhat mixed or ambiguous indicator that usually correlates with economic activity. However, beneficial increases in energy efficiency and conservation reduces the sector's *Index* value.

With the actual second quarter consumption data in hand, our previous estimations, which were based on prior years's consumption, have been revised significantly downwards:

- **April's *Index* level was 102.9, down from an estimated 127.5.**
- **May's *Index* level was 99.0, down from an estimated 125.8.**

Seasonally adjusted June consumption fell 1.4 percent from the revised May number and and the current *Index* level is at its lowest level in seven years. While it's difficult to ascertain how much of the drop is due to reduced activity (such as the closures of energy intesive lumber mills) versus other factors like conservation, the graph below shows that electricity consumption was fairly consistent until the latter part of 2000 when California's energy crisis began. Since then, economic activity has fallen off a bit, but power use has been somewhat erratic. This suggests that retail consumer behavior is playing the larger role.



An PG&E official recently met with a group of local business representatives, telling them that the outlook for energy availability in the near future is better than it was a year ago when California began to emerge from crisis conditions. David Rubin, director of PG&E's service analysis department, explained that more generating capacity and lower demand resulting from conservation and improved efficiency have reduced the probability of power shortages this summer. Rubin stated that the utility's ability to meet long-term demand depends on a number of factors including the number of new power plants yet to be built, the state's ability to import power, statewide economic growth, continued conservation, and the weather (www.times-standard.com).

One factor that will undoubtably play an important role in both the future availability and price of electricity is the extent to which California depends on natuaral gas for electricity generation. Due to concerns about air quality over the past 20 years, relatively clean gas-fired power plants now make up 45 percent of the the state's

generating capacity. A recent study done by RAND, a non-partisan reasearch organization based in Santa Monica, claims that because only 15 percent of the California's natural gas needs are produced instate, consumers are vulnerable to the vagaries of the natural gas market. The study claims that natural gas consumption in California will rise between 18 percent and 50 percent by 2010 depending primarily on how many new gas-fired plants are brought online. Unless current pipeline capacity is increased, supply shortages will become more likely and skyrocketing prices, like those seen during the winter of 2000-2001, will probably result. RAND recommends streamling the the permit process for new pipelines, increasing the availability of renewable energy sources and expanding incentives for conservation (www.times-standard.com).

The Federal Energy Regulatory Commission raised the price cap on wholesale electricity from $91.87 per megawatt hour to $250 per megawatt hour. The original cap, which is widely believed to have ended the energy crisis, was set in June 2001 and would have expired in September 2002. California officials, including the governor and both senators, had pressured FERC to make the price limit permanent. The government agency complied, but raised the maximum amount allowed. Critics of the move claim that even though the new level is only one-fourth as high as the limit currently in place in most other regions of the country, it could still allow the return of unreasonably high prices. They cite average wholesale prices of between $30 and $40 per megawatt hour as evidence that the increase is unnecessary. The FERC order includes a provision that the commission claims will detect and prevent the exercise of market power whenever bids go above $91.87 (www.sfgate.com).

The financial fallout currently underway in the electricity trading industry is beginning to have potentially beneficial effects for Californians. Williams Energy of Tulsa, OK recently agreed with state officials to restructure the firm's 10-year contract to provide 1,400 megawatts of electricity. In return, the state will drop investigations into whether the company unfairly manipulated California's energy market during 2000-2001. Details of the deal have not been released. This is the third such arrangement made between the state and energy producers. In April, contracts with Calpine Corp. of San Jose and Constellation Energy Corp. of Baltimore, MD were shortened and both companies made large payments to the state to drop pending lawsuits against them (www.sfgate.com).

Total County Employment

In their preliminary report for June, the Employment Development Department (EDD) reported that 56,900 people were employed in Humboldt County. This is unchanged from May's revised figure. Preliminary EDD data indicate the following changes in Humboldt county employment:

- **Total county employment in the various service industries increased 0.5 percent from a revised 43,300 in the month of May to a preliminary 43,500 for the month of June. This sector is up 1.4 percent over last year's figure. The preliminary figure for the retail subsector shows 11,300 jobs, an increase of 0.9 percent from June's revised figure. This number is 4.6 percent higher than it was in June 2001.**
- **Total county manufacturing employment came in at 5,100. This is down 1.9 percent from May's revised figure. Total manufacturing employment is down 5.6 percent from June 2001.**

The unemployment rate for Humboldt County rose from May's revised 5.6 percent to the current 5.8 percent according to the preliminary EDD report. The increase is due to growth in the local labor force. Meanwhile, the national rate climbed one-tenth of a percentage point to 5.9 percent and the state rate rose four-tenths of a percentage point 6.4 percent.

Lumber Manufacturing

We use a combination of payroll employment and board feet of lumber production at major county lumber companies as our indicator of the manufacturing sector for the Humboldt county economy. Lumber-based manufacturing generates about two-thirds of total county manufacturing employment.

After experiencing two straight months of modest growth, the preliminary *Index* value for this sector fell once

again in June.

A proposal was recently announced to transform an abandoned Samoa mill site, often characterized as a "brownfield," into a new industrial park. Developers and county officials hope to attract light industrial and high-tech firms to the location. In addition to applying for funds to conduct a feasibility study, the county has begun a permitting process that is expected to take around 18 months to complete. Those involved in the project say it could provide as many as 500 well-paying jobs (www.times-standard.com).

Two local lumber producing firms that hope to prevent their mills from becoming brownfields are still seeking investment and/or outright buyers. Blue Lake Forest Products, which shut down its operations in April, needs a financial injection of more than one million dollars to resume production. Failing that, the company would like to sell the plant intact according to CEO and co-owner Bruce Taylor, Sr. One offer to purchase the facility as a whole was recently turned down, presumably because it was too low. Taylor says that if the mill is not sold by August 2, 2002, its machinery and equipment will be sold individually at auction. Eel River Sawmills also hopes to sell all or parts of its four mills, power plant, and 25,000 acres of timberlands. A promising offer made by a group of Nevada investors stalled reportedly due to difficulties in arranging the financing. Since then, two other offers have been put on the table. One, made by local investors already involved in the timber industry, would purchase the mills and power plant, but not the timberlands and the other, made by a group of Seattle-based investors, would buy the shares of the majority stockholder (www.times-standard.com).

Meanwhile, the sale of Lousiana-Pacific's Arcata particleboard plant to Hambro Forest Products of Crescent City was recently finalized. The facility resumed production in early July after a two-week shutdown, retaining 85 of L-P's 106 employees (www.times-standard.com).

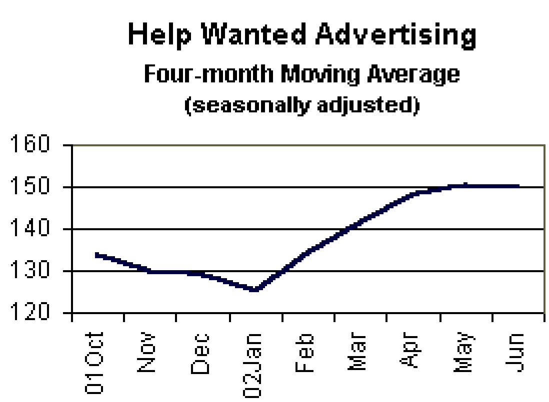
The national manufacturing picture continues to brighten. According to the Commerce Deptment, industrial production rose 0.8 percent in June, the sixth consecutive month of improvement for this measure (www.sfgate.com). The Institute of Supply Management's Index of business activity climbed for the fifth straight month. It currently stands at 56.2 (a level higher than 50 indicates expansion) (www.ism.ws).

Leading Indicators

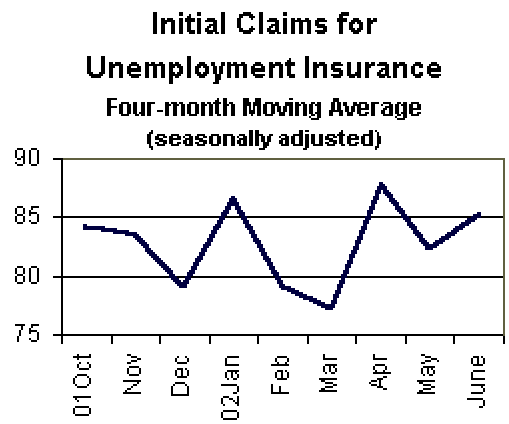
We track four leading indicators to get a sense of the direction of change in the county economy in the near future. The four leading indicators are (i) number of help-wanted advertisements in the *Times Standard*, (ii) number of claims for unemployment insurance, (iii) volume of manufacturing orders, and (iv) number of building permits issued. Our graphs in this section use a four-month moving average in order to "smooth" ordinary month-to-month volatility. In this way, any underlying trends present in the series become more apparent.

Employment-Based Economic Indicators:

A count of help-wanted ads indicates the number of new job openings.



Claims for unemployment insurance indicate the number of newly unemployed people in Humboldt County. Thus the number of new unemployment claims is a negative indicator of economic activity.

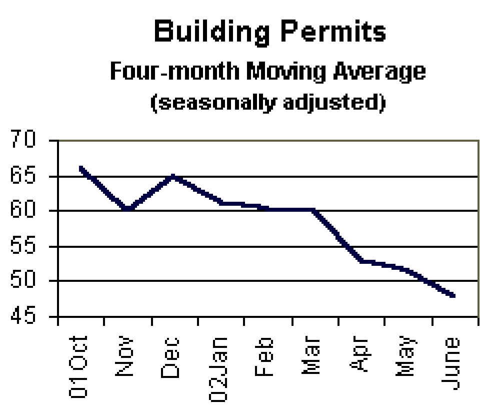


Manufacturing Economic Indicator:

Manufacturing orders, are a leading indicator of activity and employment in the County.

Home Sales Economic Indicator:

Building permits are an indicator of both construction activity and the availability of new housing stock.



The Bigger Picture

In an effort to save capitalism from the capitalists, Congress forced President George W. Bush's hand, resulting in the signing into law this month of the broadest set of anti-fraud reforms since the New Deal. The question remains, however, whether the legislation goes far enough to stem hemorrhaging investor confidence. Among the new law's measures are provisions that:

- **toughen criminal penalties for corporate fraud**
- **make it more difficult for financial auditors to provide many non-audit services**
- **create a federal oversight board for the accounting industry**
- **prohibit company loans to corporate insiders**
- **strengthen protection for corporate whistleblowers**
- **nearly double the budget of the Security and Exchange Commission.**

Glaring ommissions in the bill that survived sometimes rancorous debate in the Congressional conference committee were suggested provisions that would have:

- **required the expensing of stock options (this loophole allows firms to continue to keep the cost of options off the books even when options are used to reduce tax liability)**
- **required CEOs to certify financial statements**
- **extended responsibility for fraud to accountants, lawyers, and bankers who abet criminal behavior**
- **required the oversight board to make disciplinary actions public.**

Furthermore, one of the law's provisions that is receiving little attention in the mainstream media raises the legal standard of what constitutes fraudulent activity from "reckless" to "knowing," making it substantially more difficult for prosecutors to prove cases (www.nytimes.com and www.citizenworks.org).

In his semi-annual report to Congress, Federal reserve Chairman Alan Greenspan recently warned the Senate Banking Committee that "[c]onsiderable uncertainties--about the progress of the adjustment of capital spending and the rebound in profitability, about the potential for additional revelations of corporate malfeasance and about the possible risks from global political events and terrorism--still confront us." Nevertheless, Greenspan claimed that the fundamentals needed to sustain economic growth are currently in place, and that the Fed expects the economy to grow between 3.5 percent and 3.75 percent this year (www.sfgate.com).

Unfortunately, Wall Street did not respond as hoped. Stock market performance in the week-and-a-half following Greenspan's testimony was among the worst in history (www.sfgate.com).

The preliminary figure on second quarter GDP growth definitely doesn't help the situation. The Commerce Department reported that the national economy grew by an anemic 1.1 percent during the months of April, May and June. This number is appreciably lower than the 2.5 percent most economists had expected. Analysts claim that a large jump in the trade deficit and reduced spending at all levels of government are primarily responsible for the slowdown. Slowing growth in consumer spending also adversely affected the overall figure. The bad news continues with the latest revision of first quarter GDP growth, which was lowered from 6.1 percent to 5 percent and with revised data for 2001, which now shows that economic activity nationwide actually shrank, albeit slightly, for three consequetive quarters. GDP growth contracted in the first three quarters of 2001 by 0.6 percent, 1.6 percent and 0.3 percent, respectively. Fourth quarter 2001 growth was revised to 2.7 percent, a full percentage point higher than the previous estimate. Another small bit of good news is that the second quarter saw the first rise in new equipment and software investment in nearly two years and businesses began to rebuild inventories following five quarters of inventory reduction (www.nytimes.com).

As a result of the continued uncertainty, most economists believe the Fed will not raise interest rates at the next meeting of its Open Market Committee on August 13. The federal funds target rate remains at a forty year low of 1.75 percent (www.sfgate.com and www.nytimes.com).

Explanatory Note: For those of you who are new or less familiar with the *Index*, we have been tracking economic activity since January 1994. The composite indices plotted as blue and green lines in the diagram at the top of this page are weighted averages of each of the six sectors described in the table above. Each sectoral index, and the composite index, started at a value of 100 in 1994. Thus if the retail sectoral index value is currently 150, that means that (inflation-adjusted) retail sales among the firms that report data to us are 50 percent higher than in January 1994. We also *seasonally adjust* each sector, and the composite index, to correct for "normal" seasonal variation in the data, such as wet season vs. dry season, and so trends in the seasonally-adjusted composite index (the blue line in the diagram above) provide a better indication of underlying growth and fundamental change in the economy. This month's report reflects data gathered from the previous month, and so the "July 2002" report reflects data from June 2002. As is common, our initial report is preliminary, and as we receive final data we revise our reports accordingly.

The Eureka Times-Standard website

The San Francisco Chronicle website

The New York Times website

California Association of Realtors website

National Association of Realtors website

The Conference Board website

Institute of Supply Management webpage

Citizenworks webpage

U.S. Bureau of the Census's Economic Briefing Room webpage

The Federal Reserve Bank's Beige Book webpage

Back to Main Index Page

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