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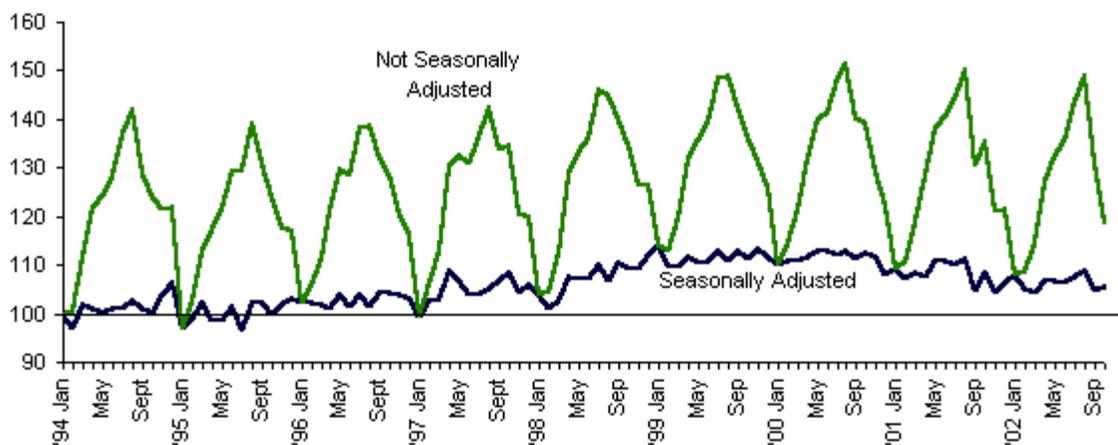
[HSU Economics Department](#)

**Professor Steven Hackett, Executive Director
John Manning, Managing Director**

November 2002

This month's report is sponsored by Humboldt Bank

Composite Index



Key Statistics		Leading Indicators	
Humboldt County		Seasonally Adjusted	% Change From Previous Month
Median Home Price*	\$180,000	Help Wanted Advertising	-4.4
30 Yr. Mortgage Rate	n/a	Building Permits	+14.5

Average Hotel Occupancy Rate	52.8%	Unemployment Claims	-1.0
Unemployment Rate**	5.0%	Manufacturing Orders	+9.5
* 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	141.5	+22.5	+7.2	+20.7	+48.9	+67.5	+24.1
Retail Sales	124.9	-8.4	-6.7	+1.2	-2.7	-4.7	+9.4
Hospitality	95.6	+7.6	-9.6	-13.8	-4.0	-7.9	-10.1
Electricity Consumption	104.0	+5.2	+1.9	-20.0	-21.1	--	--
Total County Employment	102.4	-1.1	+1.2	-2.5	-2.4	-1.5	-0.2
Lumber Manufacturing	82.7	-5.9	-14.9	-20.2	-27.6	-34.3	-33.6

Humboldt County Employment Estimate

November 2002	Estimated Employment*	95% Confidence Interval*	M/M Change**	Accuracy***
Model 1	58,100	54,500 - 61,800	+400	82.8%
Model 2	56,700	53,800 - 59,600	-1,000	74.2%

* All numbers are rounded off to the nearest 100.

** Number of jobs added or lost from the previous month's EDD preliminary estimate to our estimated level for the current month.

*** Accuracy of model in correctly predicting an increase or decrease in the level of total county employment from the previous month. This does *not* apply to the magnitude of month-to-month movement.

Both models are regression-based estimators of employment in the current month. Model 1 uses lagged employment, retail, manufacturing, and help-wanted advertising data, while Model 2 uses lagged employment, help-wanted advertising and unemployment insurance claims data. These numbers are *not* seasonally adjusted.

Discussion

Composite Index and Overall Performance

The *Index of Economic Activity's* seasonally adjusted composite value, which now stands at 105.4, rose 0.5 percent from last month's upwardly revised figure.

A look at the graph above shows that the local economy in October regained some of the ground lost in a September downturn that was not quite as sharp as originally reported. The *Index's* seasonally adjusted

composite value remains 3.0 percent lower than it was at its August peak. Home sales recovered nicely from a huge September decline and most indications point towards continued, though possibly slowing, growth in this sector. Hospitality is also showing renewed vigor with a healthy increase in activity during October and third quarter transient occupancy tax receipts that are up over last year. The large drop in retail's *Index* value is a bit disconcerting given this sector's lack of growth in September, but improving conditions in national consumption and consumer confidence are encouraging. Employment fell by over one percent in October. This measure has been bouncing up and down over the past few months, though, so it's unclear where the local labor market is headed in the near future. While employment is up over October 2001, it is down in all of the other year-over-year comparisons. The lumber-based manufacturing sector continues to bleed, but since September's figure was revised substantially upwards, conditions are not quite as bad as they seem.

October's leading indicators are mostly positive. Building permits are up by a double-digit percentage for a second straight month as local contractors appear to be taking advantage of the unseasonably dry weather. A large increase in manufacturing orders indicates the county's lumber industry is benefiting as a result of strong construction activity throughout the Western region. The two labor market indicators are mixed, which seems to suggest the back and forth movement in total county employment might continue. The fairly large drop in help-wanted advertising at a time when retailers are usually hiring seasonal help may be cause for concern. Finally, unemployment claims declined for a third consecutive month, so the upward trend here over the last several months (as expressed by the four-month moving average) should be reaching a crest.

We are introducing the Humboldt County Employment Estimate to the *Index* this month. At present, actual monthly total county employment, as determined by the Employment Development Department, is not available until several weeks after a given month. Our hope is to provide interested parties with an accurate estimate of countywide employment in the current month. See the employment section [below](#) for further details.

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.

Local real estate market activity in October rebounded from September's precipitous decline with the seasonally adjusted *Index* value for this sector jumping 22.5 percent from the previous month's performance. This measure now stands at its second highest level in eight years.

October's median home price rose a scant 0.1 percent from September's \$179,750. This sometimes volatile measure is a whopping 24.2 percent higher than it was in October 2001. The current statewide median sale price for existing homes fell for a second consecutive month to \$322,730. This figure is 0.2 percent lower than it was in September and 22.7 percent higher than in October 2001, when it was \$263,020 (www.car.org). October's national median price for existing homes is up 0.4 percent from September's level to \$159,600, while the similar figure for new homes is up 0.2 percent to \$176,700. These two measures rose by 9.8 percent and 3.2 percent, respectively over October 2001 (www.realtor.org and www.census.gov).

The nationwide average for a 30-year fixed rate mortgage (11/22) rose slightly to 6.03 percent according to the country's largest mortgage company, Freddie Mac. One week earlier, this rate was at 5.94 percent, the lowest level since Freddie Mac began keeping track in 1971 (nytimes.com).

The California Association of Realtors announced that its Housing Affordability Index remained at 28 percent in September. This measure, which represents the percentage of California households that can afford to purchase a median priced home, is 5 percentage points lower than it was in September 2001. The figure for Northern California, which does *not* include the Bay Area or the Wine Country, was 35 percent, down 4 percentage points from one year earlier (www.car.org).

The huge increase in national housing construction in September was followed by an even larger drop in October. The Commerce Department reports October housing starts plunged 11.4 percent from the previous

month, the biggest one-month drop since January 1994. September's downwardly revised 11 percent rise from August was the largest one-month increase since December 1986. Activity fell in every region of the country except the West where starts rose by 3.6 percent. Housing market analysts claim that while activity remains strong, October's performance probably indicates that housing construction has reached a high water mark and is unlikely to contribute more to overall economic growth than it already is (www.nytimes.com).

Retail Sales

Seasonally adjusted October sales at participating retailers dropped a sharp 8.4 percent from September's flat level. This measure is also down when compared to same month activity in three of the five most recent years. It remains to be seen if the mildly positive indications appearing at the national level will lead to an improvement locally as the holiday shopping season gets underway.

A comparative lack of seasonal hiring in this sector is one cause for concern. According to a recent article in the Times-Standard, there are relatively few temporary retail jobs available this holiday season. An informal survey of local retailers shows that shops throughout central Humboldt County are hiring little or no extra help this year. A spokesperson at the Employment Development Department confirmed the situation saying the usual demand for extra temporary employees has not occurred as of yet. Business owners gave a variety of reasons for not needing additional workers including the availability of family members, friends and currently employed part-timers willing to work extra hours. Another, unstated, explanation may be concern over the possible negative impact of perceived economic weakness on a shopping season that has already been shortened one week due to a later than usual Thanksgiving.

National retail sales were unchanged from in October from the previous month's downwardly revised level. Economists had been expecting a 0.2 percent decline. Declines in automobile and home furnishing sales and sales at eating and drinking establishments were offset by increased sales of clothing, health and beauty products and general merchandise. Overall retail sales were 0.7 percent lower than in October 2001 (www.sfgate.com and www.census.gov).

The Conference Board's Consumer Confidence Index improved for the first time in six months in November when it rose to 84.1. The Conference Board's head of consumer research said "the rebound in expectations suggests consumers do not expect economic conditions to become worse...[and] signals a brighter holiday spending season than was anticipated only a month ago." (www.conference-board.org).

Hospitality

We use average occupancy at a cross section of local hotels, motels and inns as our indicator of economic activity in the hospitality sector. While the performance of this sector is, in turn, a good indicator of performance in the local tourism industry, it's important to note that not all visitors to Humboldt County are tourists, nor do all tourists stay in lodging establishments.

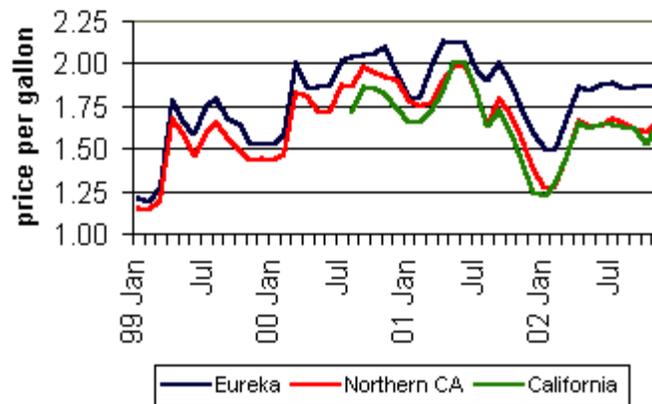
Average occupancy at the participating hotels, motels and inns in September fell from the previous month's downwardly revised level. Nevertheless, the *Index* level for this sector increased by a fairly large amount due to seasonal adjustment. The measure is down in all of the year-over-year.

Humboldt County's third quarter transient occupancy tax receipts were up 6.3 percent over the same period last year after adjusting for inflation. Tourist hotspots like Ferndale and Trinidad recorded the biggest gains with TOT receipts more than tripling in the former community and rising 26.5 percent in the latter. Eureka, Arcata and the county's unincorporated areas also saw improvements of 0.5 percent, 7.4 percent and 3.4 percent, respectively. Increases in the number of visitations to Redwood National Park and the California Welcome Center in Arcata suggest a higher level of tourist activity is behind the rise in revenue. Don Leonard, executive director of the Humboldt County Convention and Visitor Bureau, says the state's efforts to promote tourism in the wake of 9/11 appear to have been successful. (www.times-standard.com). Leonard expects fourth quarter receipts to show a similar improvement over 2001.

Gasoline Prices:

Average Price* (as of 11/12)		Change From Prev. Month (cents/gal.)
Eureka	\$1.86	0
Northern CA	\$1.66	+7
California	\$1.63	+11

* Current average price per gallon of self-serve regular unleaded gasoline as reported by The American Automobile Association's monthly gas survey (www.csaa.com).



Click [here](#) for a brief description of the local gasoline market's structure.

An oil industry analyst claims that under a worst-case scenario involving an extended war in Iraq and a planned phase-out of the gasoline additive MTBE, California gas prices could jump to as high as \$4 per gallon early in 2003. Philip Verleger, a member of both the Council on Foreign Relations and the National Petroleum Council, says if crude oil prices spike to around \$40 per barrel as a result of an U.S. invasion at the same time California refineries are converting their facilities to use ethanol rather than MTBE, the state's consumers could end up paying double the current price for gasoline. MTBE, which is considered to be a health risk, was originally scheduled to be phased out beginning in January 2002, but the mandate was postponed one year due to concerns about inadequate infrastructure and the supply of ethanol. Other experts maintain Verleger's forecast is unlikely to materialize. They claim that if a war occurs at all, most expectations are for a brief one that will not affect other oil producing nations in the region. As such, the loss of Iraq's limited production would have little effect on the global oil market. Furthermore, they say the relatively low demand for oil domestically due to the sputtering U.S. economy makes price spikes anything but certain (www.sfgate.com).

A recent article in the Times-Standard reports that the profit margins of most Humboldt County gasoline retailers may be among the highest in the nation. Using a formula provided by the California Energy Commission, the wholesale price of regular unleaded gasoline produced within the state is roughly \$1.56 per gallon when it leaves the refinery. Transportation costs to Humboldt County can range from a reported 4 cents per gallon when the fuel is shipped by barge to 12 cents per gallon when carried on trucks. This results in a wholesale price to local retailers of between \$1.60 and \$1.72 per gallon. At least one local industry official corroborates the lower price. This means that at the current price of \$1.86, retailers here are making between 14 cents and 26 cents per gallon in profit. According to the American Automobile Association, the average profit margin for California retailers is currently around 5 cents per gallon. Nationally, the average is typically between 10 cents and 15 cents per gallon. So, if local retailers are operating at or near the higher end of the profit margin range, they are making as much as five times more per gallon than the average retailer in the

state and twice as much as the industry norm. This large potential margin may explain why the local price did not change over the last month while the statewide average jumped 11 cents per gallon (www.times-standard.com and www.csaa.com).

According to economic theory, another potential cause of high price is the lack of economies of scale. Whenever the volume of sales is low, sellers must charge a higher price to recover the higher per unit cost of supplying a good. Despite past claims by local gasoline distributors that this is one of the reasons behind the higher price of gas in Humboldt County, figures from the California Energy Commission suggest this condition does not apply to the local market. Humboldt ranks 35th out of the 58 California counties in terms of gasoline sold per retail station. Given this fact, one would expect higher prices in at least several of the other 23 counties with lower volumes of gasoline sales. Clearly, this is not the case.

Electricity Consumption

We use kilowatts-hours 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 reduce the sector's *Index* value. Because we collect our data for this sector quarterly, values are estimated, and are revised when the quarterly data are received.

Estimated October consumption of electricity rose a seasonally adjusted 5.2 percent from the previous month.

A pair of recent decisions by the California Public Utilities Commission will cost the average customer of the state's two largest utilities an additional \$270 in 2003. In the first decision, the commission unanimously approved an open-ended extension of the "temporary" surcharges imposed during the energy crisis last year. The PUC claims the extra money (around \$22.50 per month for a typical household) is needed to return PG&E and Southern California Edison to credit worthiness. The projected total cost to consumers next year is approximately \$5 billion. The second decision capped the "exit fees" large corporate customers must pay to leave the state's regulated utility system in order to directly contract with suppliers for lower-priced power. One of the two dissenting commissioners called the move "unjust to the vast majority of consumers" and said the total cost to smaller customers will be an additional \$1 billion over the next year (www.sfgate.com).

Whatever happened to Southern hospitality?

A federal grand jury working in San Francisco recently issued subpoenas to seven energy firms as part of an investigation of alleged antitrust violations related to California's failed attempt to deregulate its electricity market. Prosecutors are examining whether AES Corp. of Arlington, VA, Duke Energy of Charlotte, NC, Dynegy of Houston, Mirant Corp. of Atlanta, Reliant Resources of Houston, Southern Cos. of Atlanta, and Williams Cos. of Tulsa colluded to drive up the price of wholesale electricity during last year's energy crisis. Houston-based Enron Corp. is already the subject of an ongoing investigation into its role in price manipulation. Last month, the head of Enron's trading office in Portland, OR pled guilty to conspiracy to commit wire fraud, and has since been cooperating with investigators. At least five of the companies listed above were trading partners with Enron in the California market. All together, the seven firms own or operate some two dozen power plants in the state (www.sfgate.com).

In a separate action, federal regulators released portions of recorded telephone communications between employees of Williams and AES that seem to confirm allegations that the two companies, which operate as a partnership in the California market, conspired to manipulate prices by withholding generation capacity. According to a Federal Energy Regulatory Commission report, a Williams energy trader and an AES power plant worker discussed prolonging a shutdown in the spring of 2000 in order to take advantage of higher prices offered by the California Independent System Operator due to the resulting shortage of electricity. In a second incident that occurred during the same two-week period, AES temporarily shut down another plant in Southern California because the cost of required emissions credits was too high. When ISO officials claimed that was insufficient reason under the terms of an existing contract, AES said the shutdown was needed to conduct repairs. Another recorded conversation between Williams and AES workers characterized the plant

outage as "weird" and that "it's just some big game they're playing right now." Under the contract, the ISO paid \$63 per megawatt hour to Williams for electricity generated at the AES operated plants. When the contracted power was not available, the ISO was forced to pay \$750 per megawatt hour on the open market. Williams made a reported \$10.3 million during the time the plants were not operating. FERC later ordered \$8 million of that amount returned to the ISO (www.sfgate.com).

According to a spokesperson in the governor's office, the above revelations may threaten a settlement reached between California and Williams several days prior to the release of the FERC report. Williams had agreed to pay more \$400 million to settle accusations of price manipulation during the energy crisis. It had also agreed to renegotiate a long-term, \$4.3 billion contract signed in the summer of 2001 to provide power to the state. Officials claim the settlement could save as much as \$1.4 billion over a 10-year period. So far, no action has been taken to void the deal, but a statement issued by a spokesperson for the attorney general left open the possibility of criminal prosecution (www.sfgate.com).

Meanwhile, a state Senate committee is investigating the role played by suppliers of natural gas in the energy crisis. In addition to looking into allegations that El Paso Corp. manipulated prices by illegally restricting supply through its pipelines, the committee has heard testimony that during the winter of 2000/2001, several energy companies reported false information to two trade journals whose indexes are widely used to set natural gas prices in the California market. Investigators maintain that as a result, gas prices nearly tripled, wholesale electricity prices skyrocketed and the state's electricity market ultimately collapsed costing consumers billions of dollars. So far, four firms have admitted to providing fudged data to the indexes, but each stated the responsible employees had been disciplined or fired. Officials claim the finding should aid California's effort to have some \$9 billion in alleged overcharges refunded (www.sfgate.com and www.nytimes.com).

Total County Employment

In their preliminary report for October, the Employment Development Department (EDD) reported that 57,700 people were employed in Humboldt County. This is a 0.5 percent increase over September's figure and it indicates that a net 300 jobs were created during the month. When seasonality is considered, however, the local labor market declined 1.1 percent as indicated by the seasonally adjusted *Index* value. This measure is also down in most of the year-over-year comparisons.

Preliminary EDD data indicate the following changes in Humboldt county employment:

- Total county employment in the various service industries increased 1.1 percent from a revised 43,500 in the month of September to a preliminary 44,000 for the month of October. This sector is up 3.0 percent over last year's figure. Most of the month-over-month gain once again occurred in the *State Government* and *Local Government* classifications. *Hotels and Other Lodging* and *Transportation* each lost around 100 positions. The preliminary figure for the retail subsector shows 11,800 jobs, which is unchanged from September's figure. This number is 9.3 percent higher than it was in October 2001.
- Total county manufacturing employment came in at a preliminary 4,800. This is 5.9 percent lower than September's 5,100. Approximately 100 jobs each were lost in the *Sawmills, Other Lumber and Wood Products* and *Other Nondurable Goods* classifications. Total manufacturing employment is down 7.7 percent from October 2001.

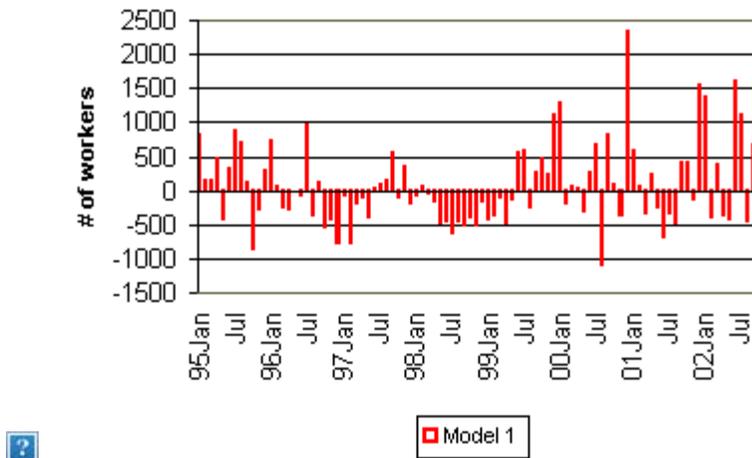
Humboldt County Employment Estimate

This new feature is comprised of two separate regression-based models. Each model has strengths and weaknesses relative to the other. These are explained below. We will be running the two models through a shakedown of sorts over the next several months in order to determine their comparative value.

Model 1 uses lagged employment, lagged retail, lagged manufacturing, and lagged help-wanted advertising data to estimate current employment. When compared to the EDD's employment numbers from January 1995

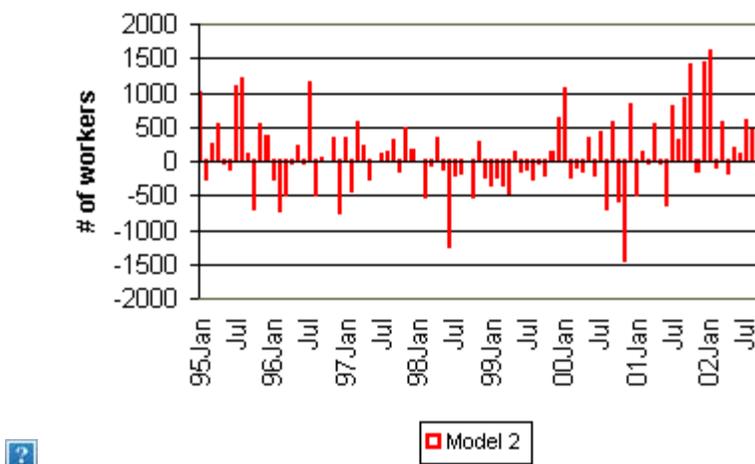
through October 2002, this model correlates to actual performance at the 88.4 percent level and correctly predicts an increase or decrease in the total number of people employed 82.8 percent of the time. The average deviation (absolute value) of the estimated level from the actual level each month is 437.

**Humboldt County Employment
Deviation from Actual Performance**



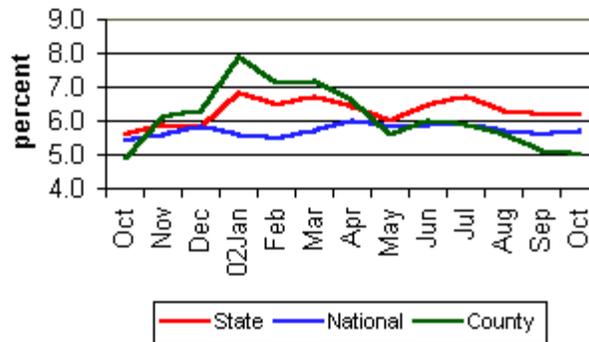
Model 2 makes its estimation based on lagged employment, lagged help-wanted advertising and lagged unemployment insurance claims data. When compared to the EDD's figures over the same period, it correlates to actual performance at the 89.6 percent level and correctly predicts up or down movement in total county employment 74.2 percent of the time. This model's average deviation each month is slightly better at 407. Model 2 also has a tighter average confidence interval.

**Humboldt County Employment
Deviation from Actual Performance**



The unemployment rate for Humboldt County fell from September's upwardly revised 5.1 percent to the current 5.0 percent according to the preliminary EDD report. Meanwhile, the national rate rose one-tenth of a percentage point to 5.7 percent and the state rate remained unchanged from September's downwardly revised 6.3 percent.

Unemployment Rates (Oct '01 - Oct '02)



Some economists think the unemployment figures underestimate the current softness in the labor market. To be officially counted as unemployed, a person must be out of work and actively seeking a job. As a result, discouraged workers who have given up on their job searches and underemployed people--those who work part-time because they have been unable to find full-time jobs--are not included when unemployment rates are computed. The Labor Department estimates there were as many as 1.4 million individuals who wanted work in October, but were not actively seeking it. When these people are included, the national unemployment rate rises to 6.3 percent. The figure jumps to 9 percent if underemployed workers are added. Analysts expect the state unemployment rate to continue to grow slowly, reaching a peak sometime in mid 2003 (www.sfgate.com).

The number of long-term unemployed workers--those who have been out of work longer than 26 weeks--now account for a full fifth of those looking for jobs. In yet a further indication of labor market weakness, the Labor Department reports that according to August data, the most recent available, there are more than two unemployed workers for every available position (www.sfgate.com).

Proposed legislation to extend benefits to the long-term unemployed was not acted on by the 107th Congress before it adjourned on November 22. A temporary 13-week benefit extension enacted earlier this year expires on December 28. Some 830,000 people, including around 300,000 Californians, will be affected. According to an Associated Press report, the Senate and House each passed bills one week earlier that would have extended benefits. The Senate's \$5 billion plan called for another 13-week extension to workers who have exhausted their state benefits, while the House measure would have provided \$900 million for a five-week extension to workers in only a handful of states that have been particularly hard hit by the economic downturn. Some economists argue that extending benefits would put money into the hands of the people most likely to pump it right back into the economy, thus providing needed fiscal stimulus. They also maintain the budget can handle the increased expenditure since the federal unemployment insurance trust fund currently holds more than \$25 billion. The total number of impacted individuals is expected to expand by 95,000 each week after the new year as more workers use up their state benefits. House leaders have pledged to take up the issue when the 108th Congress convenes in early January (www.sfgate.com).

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.

The preliminary October *Index* value for this sector fell from the previous month's level. September's figure was revised upward to 87.9.

Production at the nation's factories, mines and utilities dropped for a third consecutive month in October. The 0.8 percent decline, the worst one-month showing since September 2001, is at least partly attributable to the 11-

day lockout at West Coast ports, which limited automobile production (www.nytimes.com and www.sfgate.com).

National manufacturing output in October, as measured by the Institute of Supply Management, contracted for a second straight month. The current ISM Index level of 48.5 implies that output fell at a greater rate than in September when the figure was 49.5. A number higher than 50 indicates growth (www.ism.ws).

The slowing rate of industrial activity is reflected in rising rate of manufacturing job loss. Employment in this sector, which has fallen for a staggering 27 consecutive months, was reduced by a further 49,000 positions during October. The average number of monthly jobs lost rose from around 20,000 in the second quarter to 47,000 during the third quarter (www.nytimes.com). For much of 2001, more than 100,000 workers in this sector were thrown out of work each month.

Leading Indicators

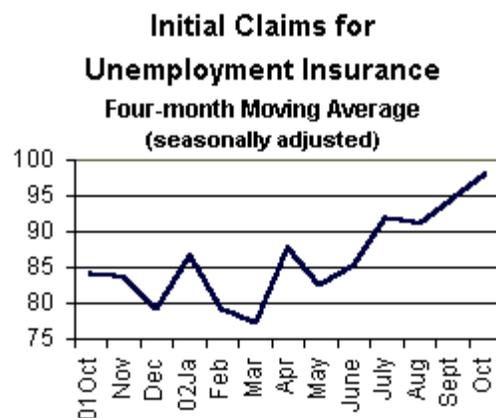
We track four leading indicators to get a sense of the direction of change in the county economy in the near future. The four leading indicators are (i) number of help-wanted advertisements in the *Times Standard*, (ii) number of claims for unemployment insurance, (iii) volume of manufacturing orders, 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.



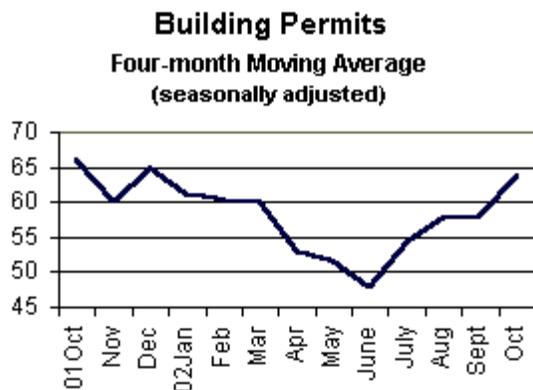
Manufacturing Economic Indicator:

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

The nation's gross domestic product grew 4 percent in the third quarter, a faster rate than most economists had expected. According to the Commerce Department's latest release, increases in government spending, rising inventories and exports, and growth in consumer spending over the July to September period all contributed to the gain. Despite the improvement, consensus among analysts has GDP growth in the current quarter slowing to around 1.4 percent, then rising to 2.5 percent in the first quarter of 2003 (www.sfgate.com).

The lack of optimism is corroborated by the latest release of the Federal Reserve Bank's Beige Book, which reports on economic activity in late October through early November. Conditions are generally described as having been soft or sluggish. A strong national housing market and good agricultural harvests in most parts of the country were exceptions to the overall weakness. The San Francisco district reported continued growth, but at a slower pace than in the previous survey period (www.federalreserve.gov).

The Federal Reserve Bank lowered interest rates for the first time in nearly a year at the most recent meeting of its Federal Open Market Committee. A statement released by the committee said that while some important economic factors such as productivity continue to improve, "incoming economic data have tended to confirm that greater uncertainty...is currently inhibiting spending, production, and employment." Low inflation and inflation expectations gave the Fed room to cut the federal funds target rate by half a percentage point to 1.25 percent (www.federalreserve.gov).

In Congressional testimony one week later, Fed chairman Alan Greenspan explained that the larger than expected cut was the central bank's response to a number of factors holding back economic growth. Greenspan specifically cited the corporate accounting scandal, the reluctance of businesses to increase investment spending and "heightened geopolitical risks" as causes for continued concern (www.nytimes.com)

Yale economist William Nordhaus attempts to put a price tag on some of the geopolitical risks mentioned above in the most comprehensive estimate of the potential economic cost of a war with Iraq yet released. In his analysis, Nordhaus examined the economic aspects of the United States' past wars, defined a range of possible outcomes to a second Gulf War and determined a range of costs (and benefits) based on various factors such as direct military spending, occupation and peacekeeping, reconstruction and nation-building, humanitarian assistance, impact on oil markets, and macroeconomic impact. Under the best-case scenario, Nordhaus estimates a total cost of around \$121 billion, much of it to be paid for with Iraqi oil reserves. At the other extreme, Nordhaus predicts costs could soar as high as \$1.6 trillion. He explains that "the unfavorable case is a collage of potential unfavorable outcomes rather than a single scenario. It shows the array of costs that might be incurred if the war drags on, occupation is lengthy, nation building is costly, the war destroys a large part of Iraq's oil infrastructure, there is lingering military and political resistance to U.S. occupation in the Islamic world, and there are major adverse psychological reactions to the conflict." Nordhaus concedes that it is, of course, impossible to accurately estimate these matters before the fact, but he cautions that humanity has a long history of underestimating the cost of war. Click [here](#) to read the entire report.

After bungling the appointment of William Webster to head the Securities and Exchange Commission's new accounting industry oversight board, SEC chairman Harvey Pitt announced his resignation on the evening of the midterm election. One week later, Webster announced his resignation claiming his "continued presence on the board will only generate more distractions, which will not be helpful to the important mission of the board." Replacements for the two positions have yet to be announced. The SEC fiasco, along with a Republican sweep in the election, increases skepticism over the Bush Administration's commitment to corporate reform (www.sfgate.com).

Finally, an acrimonious dispute between labor and management on West Coast docks, which had been contributing to economic uncertainty over the past couple of months, appears to have ended when the International Longshore and Warehouse Union and the Pacific Maritime Association tentatively agreed on a new contract. Details of the six-year pact were not released, but the chief federal mediator involved in the negotiations said the deal provides "substantial improvements in wages and benefits for union members and also provides the necessary technology and dispute-resolution improvements needed to ensure that America's West Coast ports continue to modernize and increase both efficiency and productivity." Ratification of the proposed contract will be voted on by the full membership of the ILWU sometime in mid December (www.sfgate.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 "November 2002" report reflects data from October 2002. As is common, our initial report is preliminary, and as we receive final data we revise our reports accordingly.

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