State Board of Equalization

Economic Perspective

Summary of Recent Economic Developments *February 2005*

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❖ U.S. Economic Developments

Job Creation Strong in Late 2004

An average of 182,000 U.S. nonagricultural payroll jobs per month were created in the fourth quarter of 2004, up from the 134,000 per-month average for the third quarter. For all of 2004 U.S. nonagricultural employment increased 1.1 percent, the first significant increase in jobs since 2000. With the increase in job creation, the U.S. unemployment rate fell from an average of 6.0 percent in 2003 to 5.5 percent in 2004.

Solid Economic Growth Expected in 2005

Real GDP increased an estimated 3.1 percent in the fourth quarter and 4.4 percent for all of 2004. The annual 2004 growth rate in real GDP was close to the highest annual growth rates of the 1990s – 4.5 percent in both 1997 and 1999. Many economic forecasters expect growth to continue at a pace close to the moderately strong growth rate of the fourth quarter. A survey of 34 professional forecasters polled by the Federal Reserve Bank of Philadelphia in November calls for real GDP to increase 3.5 percent in 2005. These forecasters predict that nonagricultural employment will increase 1.7 percent in 2005, up from 1.1 percent in 2004. However, the Philadelphia Federal Reserve survey shows that little change is expected in the unemployment rate, as more people are likely to enter the labor force. The forecasters surveyed expect a U.S. unemployment rate of 5.3 percent for 2005.

❖ California Economic Developments

California GSP Again Above U.S. in 2003

In late 2004 the U.S. Bureau of Economic Analysis (BEA) released its annual gross state product (GSP) estimates. The report included GSP estimates adjusted for inflation from 1999 through 2002. These data show that real California economic growth was nearly twice as fast as real national growth during the two-year period prior to the 2001 recession. However, with the technology downturn of the recession affecting California growth disproportionately more than the rest of the country, real GSP growth in the state fell close to that of the nation in both 2001 and 2002. A new feature of the BEA report is a set of prototype "accelerated" GSP estimates for 2003 (unadjusted for inflation). The estimates show that California economic growth in 2003 was once again faster than national growth following two years in which California lagged the nation. California GSP increased 5.7 percent in 2003, above national growth of 4.8 percent.

California Employment Growth Expected to Match U.S. in 2005

While GSP data are comprehensive measures of economic activity for states, they are not available in a timely manner. As mentioned earlier, the GSP data are published annually. The most recent GSP data are for 2003, and these came out as accelerated estimates in late 2004. One of the most comprehensive indicators of economic well being available for states on a timelier basis is nonagricultural payroll

employment. These data are published monthly, and they are released one month after the California Employment Development Department surveys employers. California nonagricultural employment increased 0.7 percent in 2004, somewhat below the 1.1 percent U.S. gain. (The California Employment Development Department plans to release a revision to this figure on February 25, 2005.) The *Western Blue Chip Economic Forecast*, a consensus California forecast, calls for California nonagricultural employment to rise 1.7 percent in 2005. The 2005-06 *Governor's Budget* forecasts California nonagricultural employment to increase 2.1 percent in 2005. These forecast growth rates are close to the U.S. consensus forecast of 1.7 percent growth in U.S. nonagricultural employment reported by the Philadelphia Federal Reserve Bank cited earlier.

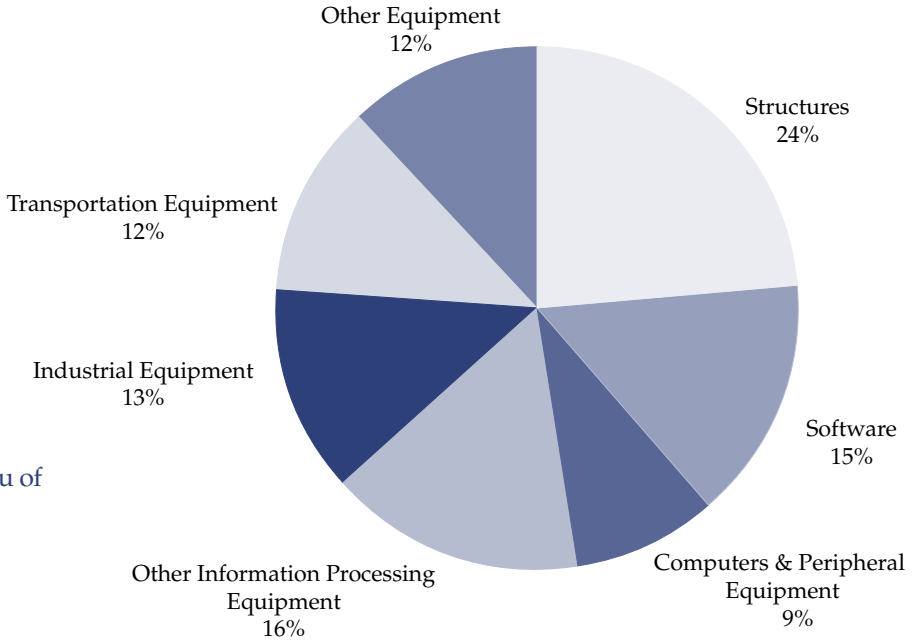
Improving California Unemployment Rate

The California unemployment rate averaged 6.1 percent in 2004, down from 6.7 percent in 2003. In 2004, the California unemployment rate was 0.6 percent above the U.S. unemployment rate. The difference between the state and national unemployment rates has narrowed in recent months. In the fourth quarter of 2004, the California unemployment rate averaged just 0.4 percent above the U.S. unemployment rate.

Continued Taxable Sales Growth in Third Quarter

Based on preliminary data, the Board of Equalization estimates an increase of 4.1 percent in California taxable sales for the third quarter of 2004 compared to taxable sales in the third quarter of 2003. There is much variability in these estimates, since they are based on incomplete reporting information. Taxable sales rose 4.3 percent for all of 2003. The 2005-06 *Governor's Budget* forcasts taxable sales to increase at a much stronger rate of 5.6 percent in 2005.

U.S. Business Capital Spending in 2003



Source: U.S. Bureau of Economic Analysis

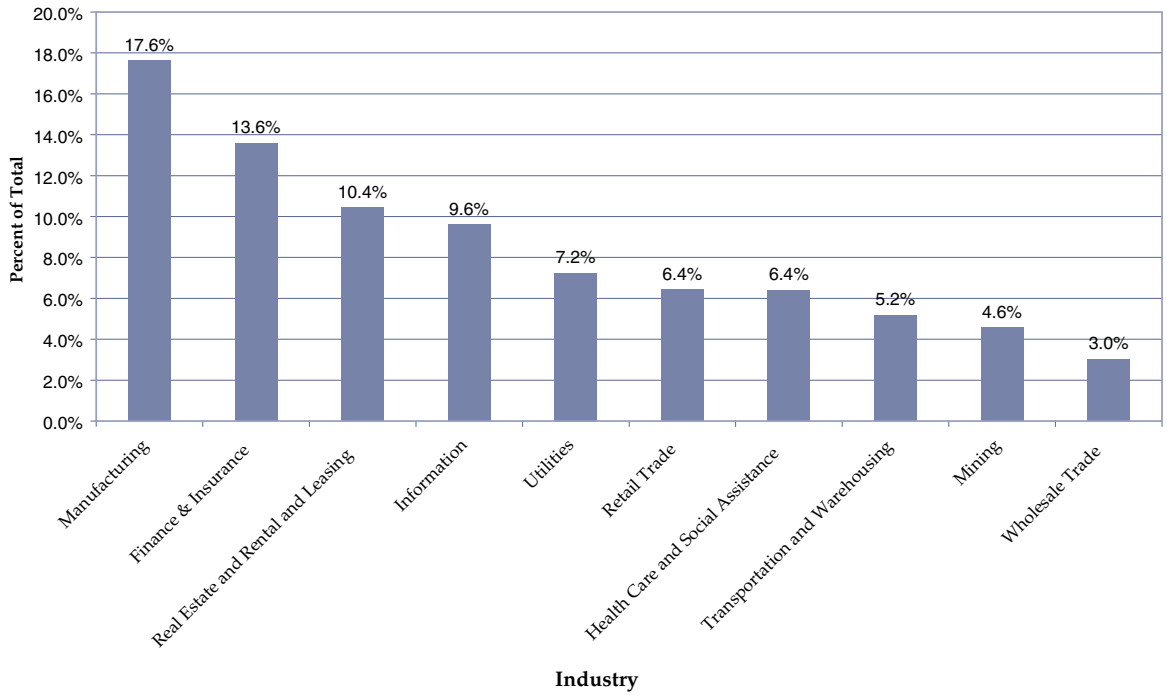
In-Depth Perspective: What Industries Purchase Capital Goods?

Business purchases of capital goods – defined as equipment, software and structures -- comprised 10 percent of GDP in 2003. Such transactions differ from most consumer spending or other business spending in that these purchases tend to be large and are usually made infrequently. This is a volatile component of GDP, generally growing much faster than overall GDP during expansions, but falling faster in recessions and in periods of weak economic growth. For example, real capital goods spending increased 12.1 percent at its most recent peak in 1997 (prior to the last recession), but fell 8.9 percent in 2002, the year after the recession started. About 40 percent of capital goods spending is for information technology, and this is a particularly important part of the California economy. The sales and use tax implications of spending on capital goods are also important. Failing to pay use tax on purchases from out-of-state vendors was the largest category of noncompliance in fiscal year 2002-03. A large portion of these purchases are capital goods.

Types of Capital Goods

All businesses are likely to need some equipment and structures, but what do businesses buy and which industries purchase the most? The two charts show the major categories of spending and the businesses that purchase the most capital goods. As shown in the pie chart, nonresidential structures was the largest capital spending category in 2003, accounting for 24 percent of the total. Information technology comprised an additional 40 percent of capital goods spending (computers at 9 percent, other information processing equipment at 16 percent, and software at 15 percent.) The remaining capital equipment spending was fairly evenly spread among industrial, transportation and other equipment.

Top Ten Industries in Capital Purchases in 2002
(Percent of Total Private Capital Spending, Ranked From Highest to Lowest)



High Software Spending Share

It is interesting to note the relatively high share of software spending by businesses. As shown in the pie chart, investment spending on software (15 percent of capital spending) was much greater than the share spent on computers and peripheral equipment (9 percent). More rapidly decreasing prices of technology hardware contributed to the smaller shares of spending on computers. BEA data show that $100 spent on a unit of computing power in 2000 would cost only $62.10 in 2003. This is a price decline of 37.9 percent. In contrast, the price of a standard unit of software fell only 3.1 percent over the same time period.

Capital Spending by Industry

The U.S. Census Bureau does an annual survey of industry purchases of capital goods, and the bar chart uses data from the most recent Census survey. It shows capital expenditures by companies with employees in the top ten industries, ranked from highest to lowest percentage of total capital spending. As shown in the bar chart, manufacturing purchases more capital goods and structures than any other industry, 17.6 percent of the total in 2002. The next largest industry is finance and insurance, at 13.6 percent. The third and fourth ranking industries are real estate and rental and leasing and information, each accounting for approximately 10 percent of all capital spending. These four industries combined comprise over half the capital spending in the economy, and are therefore important ones to consider in sales and use tax law compliance related to capital goods spending.

Online Resources

For more information about topics covered in this issue, please visit any of the websites listed below.
Some sites charge a fee to use their services.

Federal Reserve Bank of Philadelphia,
Survey of Professional Forecasters,
November 22, 2004
http://www.phil.frb.org/redirect.html;

National Association for Business Economists
http://www.nabe.com/

U.S. Bureau of the Census,
Annual Capital Expenditures: 2002, issued January 2004
http://www.census.gov

U.S. Bureau of Economic Analysis,
Survey of Current Business
http://www.bea.doc.gov/bea/pubs.htm

U.S. Department of Commerce, STAT-USA
http://www.stat-usa.gov

California Department of Finance
http://www.dof.ca.gov

California Employment Development Department (EDD),
Labor Market Conditions in California,
January 14, 2005
http://www.calmis.cahwnet.gov

Board of Equalization News Release,
2004 Taxable Sales – Third Quarter
http://www.boe.ca.gov (Forthcoming)

Western Blue Chip Economic Forecast,
Bank One Economic Outlook Center, Arizona State University

Contact Us

Please contact us if you would like to be added to our mailing list, need additional copies, or have any questions or comments.

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www.boe.ca.gov/news/epcont.htm.

Taxpayers' Rights Advocate: 888-324-2798