CITY OF PALO ALTO OFFICE OF THE CITY AUDITOR

February 14, 2011

The Honorable City Council
Palo Alto, California

Sales Tax Digest Summary - Third Quarter Sales (July – September 2010)

BACKGROUND

Sales and use tax represents about 13%, or $18.2 million, of projected General Fund revenue in the City's Adopted Operating Budget for fiscal year 2011. According to the Administrative Services Department (ASD), projected sales and use tax revenue has increased and is now estimated at $19.5 million for fiscal year 2011. This revenue includes sales and use tax for the City of Palo Alto and pool allocations[1] from the State and Santa Clara County.

The City Auditor's Office contracts with MuniServices LLC (hereafter MuniServices), the City's sales and use tax consultant, to provide sales and use tax recovery services and informational reports. The City Auditor's Office uses the recovery services and informational reports to help identify misallocation of tax revenue owed to the City, and to follow up with the State Board of Equalization to ensure the City receives identified revenues. The City Auditor's Office includes information on sales and use tax recoveries in our quarterly reports to the Finance Committee.

The City Auditor's Office also shares the information provided by MuniServices with the Administrative Services Department (ASD) for use in revenue forecasting and budgeting, and Economic Development/Redevelopment for business outreach strategies. We coordinated this informational memo with them.

DISCUSSION

The attached report (Attachment A) was prepared by MuniServices and covers calendar year third quarter sales (July through September 2010). These funds are reported as part of the City's fiscal year 2011 revenue. Due to the timing of reporting by businesses and the State, MuniServices' detailed reports on fourth quarter sales (October through December 2010) should be available by May 2011. ASD advises that in mid-March, it should receive information from the State on aggregate sales and use tax receipts for fourth quarter 2010.

[1] See definitions on page 4.

Following are some highlights of the sales and use tax information we received:

- In Palo Alto, overall sales and use tax revenue (cash receipts) for the third quarter ending September 2010 increased by approximately $586,000, or 12.8%, (including pool allocations) compared to the third quarter ending September 2009.

- Statewide, some regions in California experienced increases while other regions experienced declines in sales and use tax revenue for the year ending September 2010, compared to the prior year ending September 2009. After ten consecutive quarters of decline or no growth, statewide sales and use tax revenue showed growth beginning first quarter ending March 2010. Statewide sales and use tax revenue has shown growth of 3.7% during the third quarter ending September 2010 compared to the third quarter ending September 2009.

- Sales and use tax revenue totaled $19.0 million for the year ending September 2010, an increase of 2.4% from $18.6 million in the prior year ending September 2009. This amount includes sales and use tax for the City of Palo Alto and pool allocations from the State and Santa Clara County.

More detailed information is shown on Attachment A.

Economic Influences on Sales and Use Tax

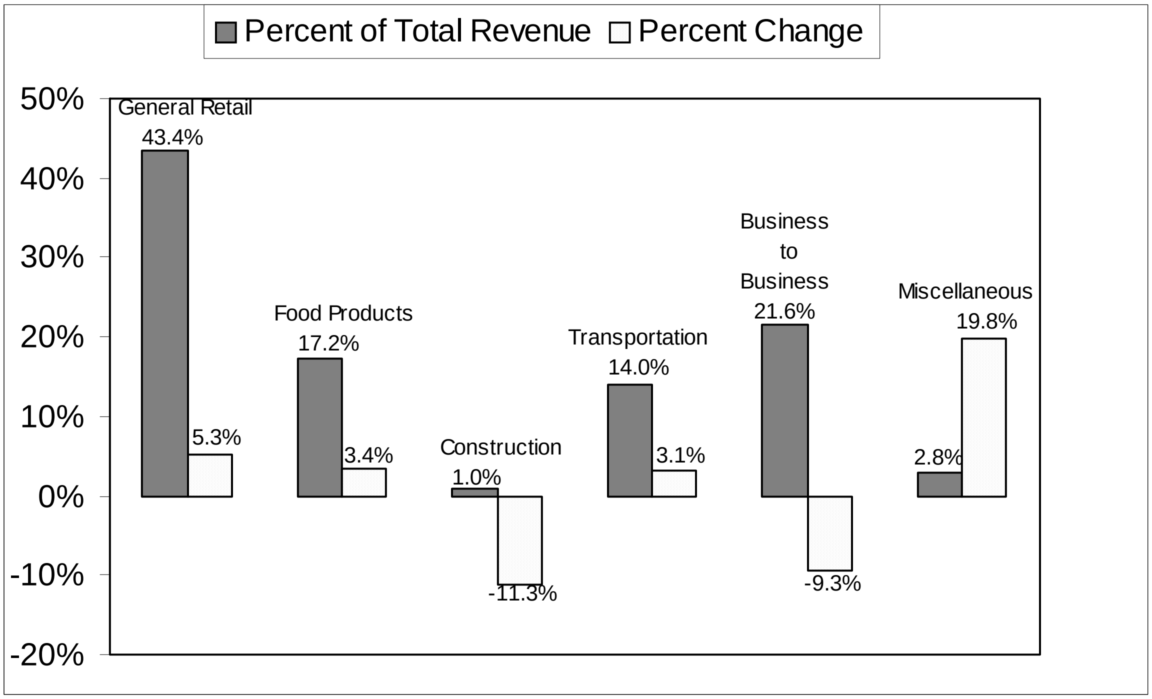
In its Economic Outlook (Attachment B), MuniServices discusses economic influences including online and retail sales, consumer confidence, auto sales, and forecast information that may affect the City's sales and use tax revenue.

Preliminary estimates show the December 2010 unemployment rate in Santa Clara County at 10.4% and Palo Alto at 5.6%.

Economic Category Analysis

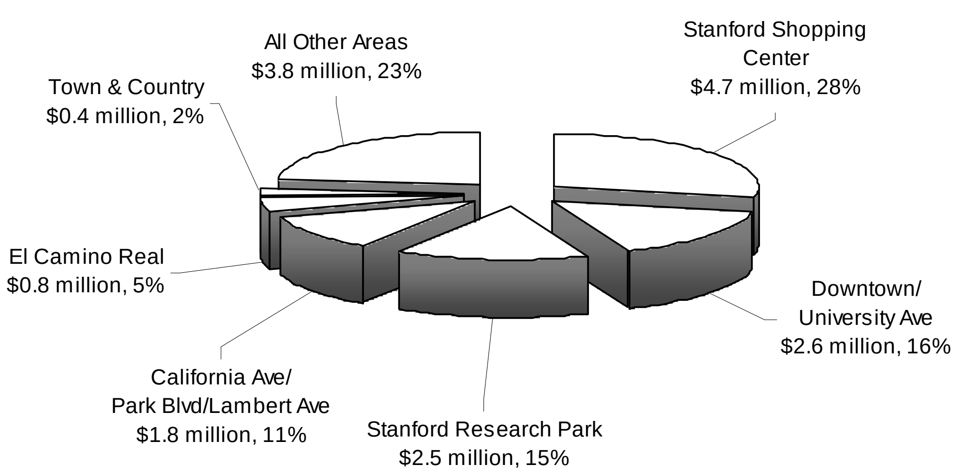
Analysis of six economic categories, for the year ending September 2010, shows that General Retail comprised the largest percentage of Palo Alto's sales and use tax revenue and experienced 5.3% growth. Business to business experienced a 9.3% decline and comprised 21.6% of total revenues. Construction experienced an 11.3% decline, but it also represented only 1.0% of total sales and use tax revenue.

Exhibit 1 - Comparison of Palo Alto's Sales and Use Tax Revenue and Percent Change by Economic Category for the Year Ending September 2010



The following chart shows sales and use tax revenue by geographical area based on information provided by MuniServices.

Exhibit 2 - Palo Alto's Sales and Use Tax Revenue by Geographical Area For the Year Ending September 2010 (Amounts include tax estimates and exclude pool allocations)



DEFINITIONS

In California, either sales tax or use tax may apply to a transaction, but not both. The sales and use tax rate in Palo Alto is 8.25%, and the City should receive 1% of every taxable transaction. A temporary tax rate increase to 9.25% went into effect April 1, 2009 and is scheduled to expire on July 1, 2011.

Sales tax - imposed on all California retailers; applies to all retail sales of merchandise (tangible personal property) in the state.

Use tax - generally imposed on: consumers of merchandise (tangible personal property) that is used, consumed, or stored in this state; purchases from out-of-state retailers when the out-of-state retailer is not registered to collect California tax, or for some other reason does not collect California tax; leases of merchandise (tangible personal property).

Countywide/statewide pools - mechanisms used to allocate local tax that cannot be identified with a specific place of sale or use in California. Local tax reported to the pool is distributed to the local jurisdiction each calendar quarter using a formula that relates to the direct allocation of local tax to each jurisdiction for a given period.

Examples of taxpayers who report use tax allocated through the countywide pool include construction contractors who are consumers of materials used in the improvement of real property and whose job site is regarded as the place of business, out-of-state sellers who ship goods directly to consumers in the state from inventory located outside the state, and California sellers who ship goods directly to consumers in the state from inventory located outside the state.

Other examples of taxpayers who report use tax through the pools include auctioneers, construction contractors making sales of fixtures, catering trucks, itinerant vendors, vending machine operators and other permit holders who operate in more than one local jurisdiction, but are unable to readily identify the particular jurisdiction where the taxable transaction takes place.

Sources: MuniServices; the State Board of Equalization; the City's Adopted Operating Budget Fiscal Year 2011

Audit staff: Lisa Wehara

ATTACHMENTS:

- Attachment A: City of Palo Alto Sales Tax Digest Summary (PDF)
- Attachment B: Economic Outlook (PDF)

City of Palo Alto
Sales Tax Digest Summary
Collections through December 2010
Sales through September 2010 (2010Q3)

California Overview

The percent change in cash receipts from the prior year was 1.1% statewide, 1.4% in Northern California and 0.9% in Southern California. The period's cash receipts include tax from business activity during the period, payments for prior periods and other cash adjustments. When we adjust for non-period related payments, we determine the overall business activity increased for the year ended 3rd Quarter 2010 by 0.1% statewide, 0.4% in Northern California and declined by (0.1%) in Southern California.

City of Palo Alto

For the year ended 3rd Quarter 2010, sales tax cash receipts for the City grew by 2.4% from the prior year. On a quarterly basis, sales tax revenues increased by 12.8% from 3rd Quarter 2009 to 3rd Quarter 2010. The period's cash receipts include tax from business activity during the period, payments for prior periods and other cash adjustments.

Excluding state and county pools and adjusting for anomalies (payments for prior periods) and late payments, local sales tax increased by 1.3% for the year ended 3rd Quarter 2010 from the prior year. On a quarterly basis, sales tax activity grew by 11.0% in 3rd Quarter 2010 compared to 3rd Quarter 2009.

Regional Overview

This seven-region comparison includes estimated payments and excludes net pools and adjustments.

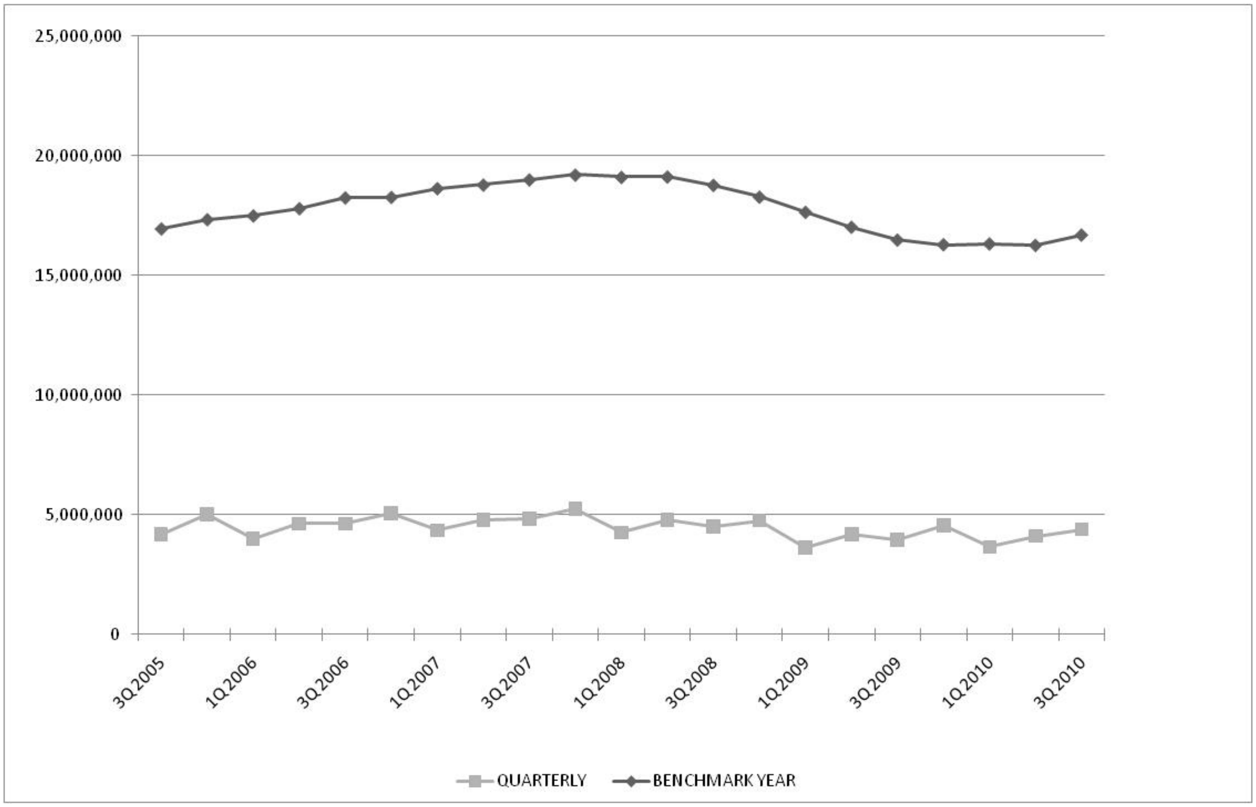
ECONOMIC CATEGORY ANALYSIS FOR YEAR ENDED 3rd QUARTER 2010

	Palo Alto	California Statewide	S.F. Bay Area	Sacramento Valley	Central Valley	South Coast	North Coast	Central Coast
General Retail *% of Total / % Change*	*43.4 / 5.3*	*30.9 / 0.5*	*30.5 / 0.9*	*31.0 / 0.0*	*33.7 / 1.3*	*30.8 / 0.1*	*30.4 / -0.3*	*33.6 / -3.1*
Food Products *% of Total / % Change*	*17.2 / 3.4*	*19.4 / -1.1*	*19.9 / -0.1*	*17.5 / -1.6*	*17.7 / -1.0*	*19.9 / -1.3*	*19.3 / -0.8*	*29.8 / 0.3*
Construction *% of Total / % Change*	*1.0 / -11.3*	*8.7 / -6.0*	*8.3 / -4.3*	*10.4 / -9.0*	*10.8 / -7.8*	*8.0 / -5.2*	*12.3 / -11.9*	*9.3 / -3.9*
Transportation *% of Total / % Change*	*14.0 / 3.1*	*22.3 / 7.0*	*19.4 / 10.3*	*24.4 / 3.4*	*23.6 / 5.9*	*22.7 / 6.3*	*26.8 / 7.2*	*19.4 / 15.2*
Business to Business *% of Total / % Change*	*21.6 / -9.3*	*17.4 / -3.6*	*20.6 / -2.8*	*15.3 / -5.9*	*13.1 / -4.4*	*17.4 / -4.1*	*8.9 / -0.2*	*6.4 / -2.3*
Miscellaneous *% of Total / % Change*	*2.8 / 19.8*	*1.3 / -8.2*	*1.3 / -7.3*	*1.3 / -6.4*	*1.1 / -5.1*	*1.2 / -12.4*	*2.4 / 131.3*	*1.5 / 7.5*
Total	***100.0 / 1.3***	***100.0 / 0.1***	***100.0 / 1.0***	***100.0 / -1.5***	***100.0 / 0.0***	***100.0 / -0.2***	***100.0 / 1.2***	***100.0 / 1.2***

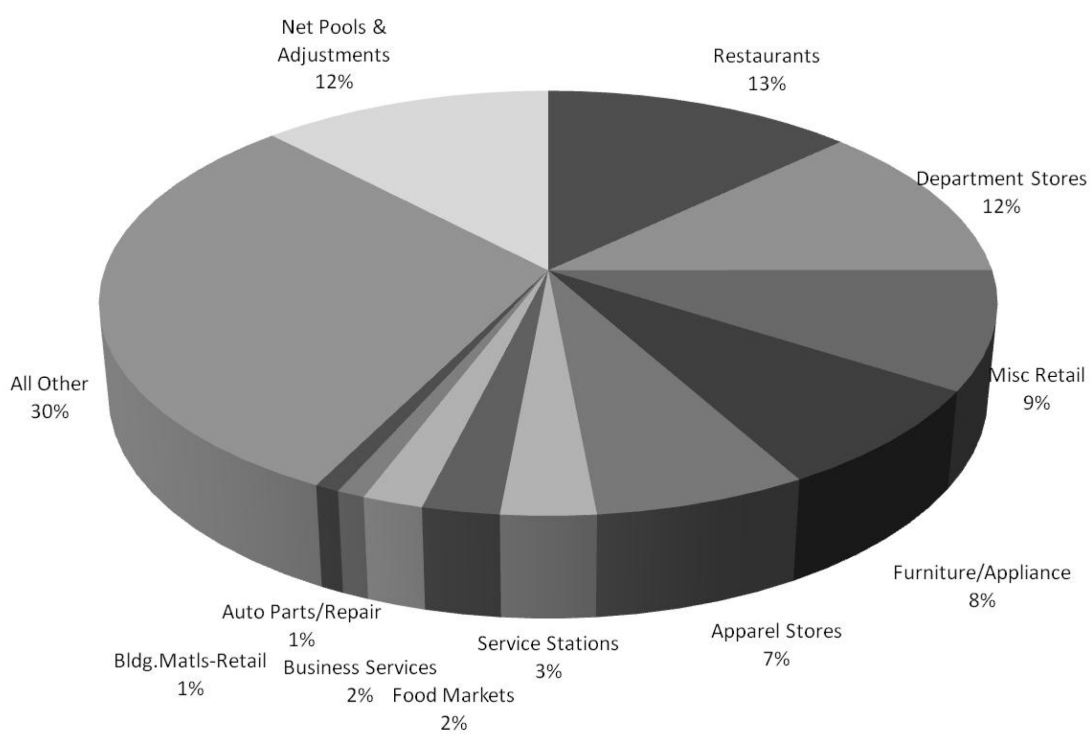
THREE LARGEST SEGMENTS FOR YEAR ENDED 3rd QUARTER 2010

	Palo Alto	California Statewide	S.F. Bay Area	Sacramento Valley	Central Valley	South Coast	North Coast	Central Coast
Largest Segment	**Restaurants**	**Restaurants**	**Restaurants**	**Department Stores**	**Department Stores**	**Restaurants**	**Department Stores**	**Restaurants**
% of Total / % Change	*14.8 / 2.2*	*13.2 / -1.0*	*13.7 / -0.2*	*13.1 / 2.5*	*16.1 / -0.4*	*14.0 / -0.8*	*13.2 / -0.6*	*19.7 / -1.3*
3rd Largest Segment	**Department Stores**	**Department Stores**	**Department Stores**	**Restaurants**	**Service Stations**	**Department Stores**	**Services Stations**	**Misc. Retail**
% of Total / % Change	*13.6 / 5.5*	*11.5 / 1.9*	*10.4 / 3.0*	*10.9 / -2.6*	*10.7 / 14.7*	*11.0 / 2.1*	*12.2 / 18.4*	*10.7 / -4.6*
3rd Largest Segment	**Electronic Equipment**	**Service Stations**	**Service Stations**	**Service Stations**	**Restaurants**	**Service Stations**	**Restaurants**	**Department Stores**
% of Total / % Change	*Confidential/ -10.0*	*9.5 / 14.8*	*8.2 / 16.3*	*9.5 / 14.6*	*10.3 / -2.0*	*9.5 / 14.0*	*9.9 / -3.4*	*9.3 / -5.9*

Gross Historical Sales Tax Performance by Benchmark Year and Quarter (Before Adjustments)



Net Cash Receipts for Benchmark Year 3rd Quarter 2010: $18,999,513

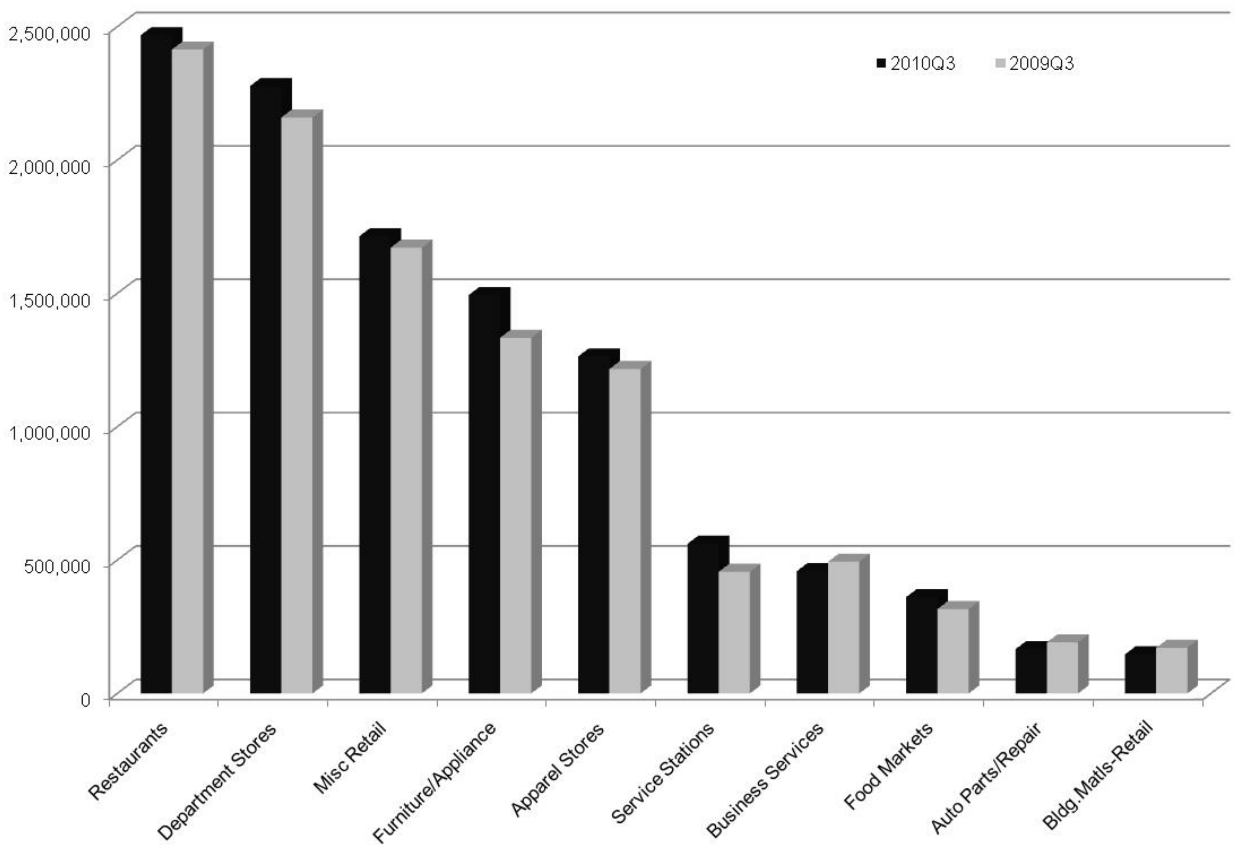


TOP 25 SALES/USE TAX CONTRIBUTORS

The following list identifies Palo Alto's Top 25 Sales/Use Tax contributors. The list is in alphabetical order and represents the year ended 3rd Quarter 2010. The Top 25 Sales/Use Tax contributors generate 52.1% of Palo Alto's total sales and use tax revenue.

Anderson Honda	Hewlett-Packard	Stanford University
Apple Stores	Integrated Archive Systems	Stanford University Hospital
Bloomingdale's	Keeble & Shuchat Photography	The Gap
Carlsen Motor Cars	Loral Space Systems	Tiffany & Company
Carlsen Subaru	Macy's Department Store	Valero Service Stations
Crate & Barrel	Magnussen's Toyota	Varian Medical Systems
CVS/Pharmacy	Neiman Marcus Department Store	Walgreen's Drug Stores
Dow Jones & Company	Nordstrom Department Store	
Fry's Electronics	Pottery Barn	

Sales Tax from Largest 10 Non-confidential Economic Segments



Historical Analysis by Calendar Quarter

Economic Category	%	2010Q3	2010Q2	2010Q1	2009Q4	2009Q3	2009Q2	2009Q1	2008Q4	2008Q3
General Retail	35.1%	1,810,271	1,864,922	1,473,821	2,064,636	1,615,455	1,671,676	1,401,746	2,134,924	1,942,546
Business To Business	19.5%	1,006,576	788,373	849,181	993,411	894,386	1,096,153	871,861	1,003,360	949,417
Food Products	14.1%	726,360	739,629	666,388	699,788	665,680	694,271	649,563	730,351	733,080
Transportation	11.2%	576,597	551,313	534,793	516,345	594,725	726,213	495,640	596,634	665,857
Miscellaneous	4.2%	217,465	78,340	67,673	70,822	79,799	79,758	101,377	111,476	115,678
Construction	0.9%	44,171	40,415	37,914	48,862	44,182	38,589	56,568	59,367	72,868
Net Pools & Adjustments	15.2%	782,981	626,593	487,801	634,071	684,537	508,710	619,790	331,300	550,414
Total	100.0%	5,164,421	4,689,585	4,117,571	5,027,935	4,578,764	4,815,370	4,196,545	4,967,412	5,029,860

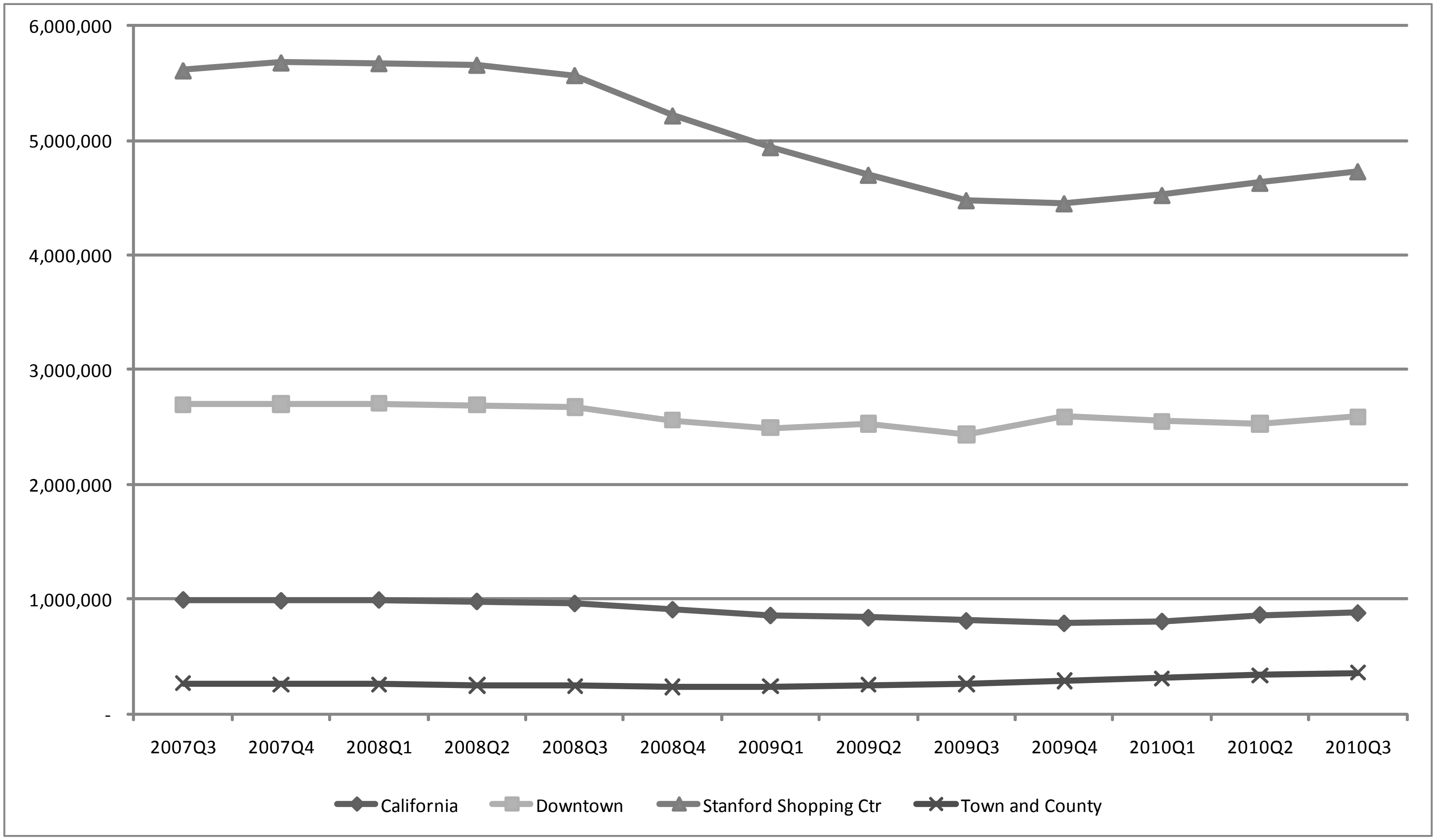
Economic Segments	%	2010Q3	2010Q2	2010Q1	2009Q4	2009Q3	2009Q2	2009Q1	2008Q4	2008Q3
Restaurants	12.1%	622,517	636,566	568,305	597,762	580,829	604,861	565,461	627,710	641,492
Department Stores	10.5%	541,942	565,706	455,378	714,431	480,038	529,267	426,855	723,247	571,259
Miscellaneous Retail	7.7%	396,580	381,222	325,512	459,998	341,947	360,311	304,199	474,090	412,826
Furniture/Appliance	8.7%	447,946	416,128	282,989	345,141	352,050	302,007	292,437	378,643	449,934
Apparel Stores	5.8%	299,340	321,787	267,315	375,133	286,511	299,896	243,222	385,510	335,428
Service Stations	2.8%	143,233	140,859	139,906	128,317	134,369	119,637	95,957	111,830	173,307
Business Services	2.2%	112,153	143,241	110,989	113,481	124,575	116,394	109,472	143,531	132,365
Food Markets	1.8%	93,651	92,036	86,892	88,469	74,317	75,997	72,517	88,559	78,856
Auto Parts/Repair	0.9%	45,689	40,037	39,150	39,592	40,669	65,174	37,341	39,787	49,199
Leasing	0.8%	40,480	36,129	34,760	37,222	41,697	34,892	36,308	37,049	45,324
Bldg.Matls-Retail	0.8%	39,747	35,783	33,297	38,766	39,314	33,879	50,548	53,188	61,367
Liquor Stores	0.2%	10,192	11,027	11,162	13,297	10,534	13,313	11,585	14,075	12,707
Miscellaneous Other	0.1%	5,751	7,689	6,550	9,061	7,637	6,730	6,092	9,847	7,223
Heavy Industry	0.1%	3,288	4,887	4,782	5,944	5,090	5,369	5,596	9,069	5,829
Bldg.Matls-Whsle	0.1%	4,424	4,632	4,617	10,096	4,868	4,710	6,020	6,179	11,501
All Other	30.5%	1,574,507	1,225,263	1,258,166	1,417,154	1,369,782	1,734,223	1,313,145	1,533,798	1,490,829
Net Pools & Adjustments	15.2%	782,981	626,593	487,801	634,071	684,537	508,710	619,790	331,300	550,414
Total	100.0%	5,164,421	4,689,585	4,117,571	5,027,935	4,578,764	4,815,370	4,196,545	4,967,412	5,029,860

*Net Pools & Adjustments reconcile economic performance to periods' net cash receipts. The historical amounts by calendar quarter: (1) include any prior period adjustments and payments in the appropriate category/segment and (2) exclude businesses no longer active in the current period.

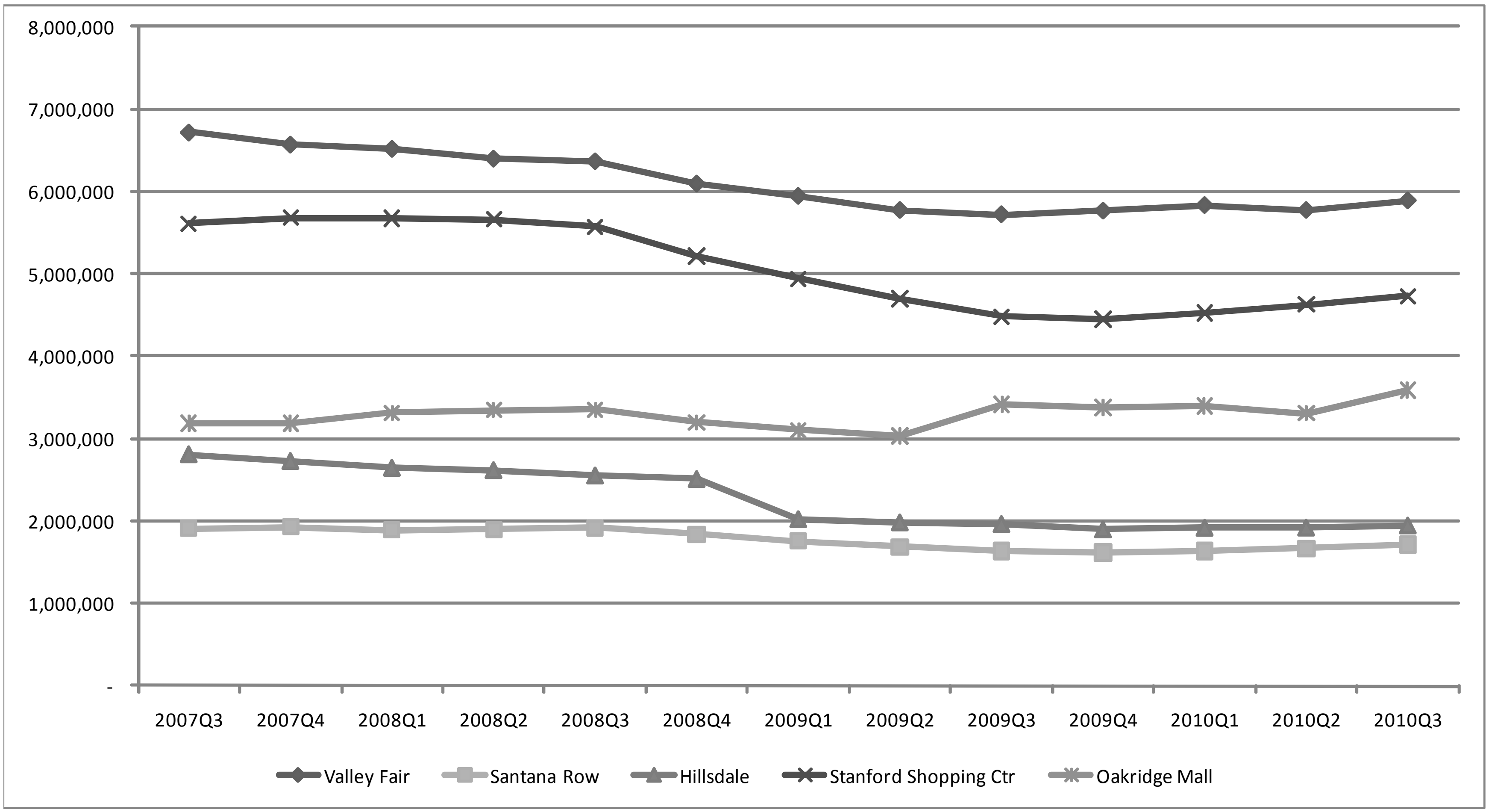
Quarterly Analysis by Economic Category, Total and Segments: Change from 2009Q3 to 2010Q3

	General Retail	Food Products	Transportation	Construction	Business to Business	Miscellaneous	2010/3 Total	2009/3 Total	% Chg	Largest Gain	Second Largest Gain	Largest Decline	Second Largest Decline
Campbell	-3.1%	1.5%	7.0%	-13.5%	-5.2%	-6.6%	1,733,523	1,783,223	**-2.8%**	Service Stations	Food Processing Eqp	Bldg.Matls-Whsle	Miscellaneous Retail
Cupertino	-8.2%	1.2%	12.1%	0.7%	51.1%	-12.7%	4,461,000	3,337,693	**33.7%**	Business Services	Office Equipment	Department Stores	Health & Government
Gilroy	2.3%	-6.0%	0.4%	-11.6%	25.6%	-5.6%	2,692,328	2,661,020	**1.2%**	Apparel Stores	Energy Sales	Bldg.Matls-Whsle	Auto Sales - New
Los Altos	-5.4%	5.4%	10.7%	-29.1%	-11.1%	56.0%	473,545	465,583	**1.7%**	Service Stations	Restaurants	Miscellaneous Retail	Bldg.Matls-Retail
Los Gatos	20.8%	2.0%	-10.4%	-12.4%	9.2%	24.3%	2,042,911	1,850,955	**10.4%**	Miscellaneous Retail	Furniture/Appliance	Auto Sales - New	Office Equipment
Milpitas	8.8%	4.1%	38.4%	-2.0%	33.8%	8.4%	3,642,746	3,091,848	**17.8%**	Electronic Equipment	Auto Sales - New	Office Equipment	Food Process. Eqp
Monte Sereno	31.1%	-100.0%	-38.5%	-100.0%	-25.5%	52.9%	2,419	3,084	**-21.6%**	Miscellaneous Retail	Department Stores	Auto Parts/Repair	Chemical Products
Morgan Hill	0.3%	0.1%	12.0%	-2.7%	64.4%	-29.9%	1,202,237	1,080,429	**11.3%**	Electronic Equipment	Service Stations	Recreation Products	Apparel Stores
Mountain View	-7.1%	0.5%	12.3%	3.8%	57.3%	2.5%	3,444,926	3,068,504	**12.3%**	Electronic Equipment	Business Services	Department Stores	Light Industry
Palo Alto	9.6%	5.7%	-3.8%	14.8%	-8.8%	170.7%	4,181,443	3,946,875	**5.9%**	Health & Government	Furniture/Appliance	Auto Sales - New	Electronic Equipment
San Jose	7.4%	1.3%	5.4%	16.9%	13.5%	-3.7%	28,914,688	26,713,952	**8.2%**	Office Equipment	Bldg.Matls-Whsle	Heavy Industry	Recreation Products
Santa Clara	12.1%	1.5%	5.2%	22.0%	4.9%	15.1%	7,403,481	6,890,693	**7.4%**	Bldg.Matls-Whsle	Electronic Equipment	Bldg.Matls-Retail	Misc. Vehicle Sales
Santa Clara Co.	-2.6%	9.4%	-10.1%	2.1%	50.4%	-90.2%	826,839	894,483	**-7.6%**	Energy Sales	Food Process. Eqp	Health & Government	Service Stations
Saratoga	24.8%	3.8%	4.6%	0.4%	7.5%	-15.5%	234,438	218,143	**7.5%**	Miscellaneous Retail	Restaurants	Furniture/Appliance	Liquor Stores
Sunnyvale	23.2%	3.8%	-9.2%	-3.1%	12.2%	5.1%	5,857,875	5,532,366	**5.9%**	Office Equipment	Department Stores	Auto Sales - New	Bldg.Matls-Whsle

City of Palo Alto - Selected Geographic Areas of the City Benchmark Year 3rd Quarter 2010													
	2007Q3	2007Q4	2008Q1	2008Q2	2008Q3	2008Q4	2009Q1	2009Q2	2009Q3	2009Q4	2010Q1	2010Q2	2010Q3
California	991,900	984,263	990,771	978,463	960,772	908,095	858,391	839,591	812,294	790,954	807,490	863,730	879,364
Downtown	2,694,704	2,703,079	2,705,829	2,692,680	2,674,057	2,557,974	2,493,666	2,528,443	2,434,567	2,591,213	2,549,106	2,528,095	2,589,660
Stanford Shopping Ctr	5,612,325	5,681,340	5,674,646	5,661,387	5,570,554	5,218,085	4,941,824	4,701,109	4,479,311	4,451,986	4,524,318	4,631,095	4,731,800
Town and County	266,728	256,553	256,612	248,359	243,683	233,208	237,307	251,608	261,294	288,103	309,848	336,444	360,254



City of Palo Alto - Regional Shopping Mall Comparison Benchmark Year 3rd Quarter 2010	2007Q3	2007Q4	2008Q1	2008Q2	2008Q3	2008Q4	2009Q1	2009Q2	2009Q3	2009Q4	2010Q1	2010Q2	2010Q3
Valley Fair	6,719,867	6,571,449	6,520,191	6,399,179	6,367,597	6,093,294	5,941,991	5,769,466	5,717,263	5,761,442	5,829,695	5,769,507	5,887,510
Santana Row	1,913,632	1,930,733	1,892,646	1,894,799	1,919,027	1,840,846	1,755,862	1,685,331	1,635,305	1,615,462	1,637,476	1,667,967	1,711,667
Hillsdale	2,808,965	2,727,880	2,644,727	2,616,817	2,551,004	2,509,227	2,020,719	1,981,010	1,961,708	1,895,456	1,915,711	1,917,510	1,943,391
Stanford Shopping Ctr	5,612,325	5,681,340	5,674,646	5,661,387	5,570,554	5,218,085	4,941,824	4,701,109	4,479,311	4,451,986	4,524,318	4,631,095	4,731,800
Oakridge Mall	3,184,516	3,183,645	3,313,152	3,349,138	3,355,538	3,199,518	3,105,561	3,035,077	3,419,383	3,380,772	3,395,994	3,308,231	3,589,119



ATTACHMENT B

Economic Outlook

4Q2010 News

National Economy

Growth too listless to spur hiring.
Economy shows signs of life, but not enough to change jobs picture.

The American economy is showing a little more pep in its step, the government reported recently, but not enough to help bring down high unemployment or put the country on the road to sustained and widespread prosperity.

The nation's gross domestic product - the total value of all goods and services produced inside U.S. borders - grew at a modest annual rate of 2 percent in the third quarter, up from 1.7 percent in the second quarter, the Commerce Department said.

"The most striking thing about the report on gross domestic product is that it shows that the U.S. economy is still smaller today than it was when the recession began -- even after more than a year after the recession officially ended," said EPI economist Josh Bivens."This remains an historically slow recovery. Never since (World War II) has it taken so long to recover to pre-recession levels of GDP," he said.

Business investment, too, was solid in the July-to-September period. Companies' spending on equipment and software again rose by double digits, although at a slower pace than in the second quarter, and investment in offices and other commercial buildings posted the first upturn after eight straight quarters of decline.

What's more, federal government expenditures continued to add juice to GDP growth. So why wasn't U.S. economic output stronger than 2 percent? In a word, imports. Although American exports were up in the quarter, imports rose at an even faster clip. And the resulting trade deficit, in effect, amounted to a halving of the GDP growth rate in the third quarter."It does say that we continue to basically consume more than we produce," said economist Lynn Reaser of the National Association for Business Economics. To be sure, exports are helping boost overall GDP, she said, and import growth is not a bad thing, as it reflects stronger American demand. But, she added, "We've got to do something about the trade deficits."

Friday's economic report isn't likely to change companies' outlook for the economy or give them more reason to beef up hiring. The GDP data was in line with expectations, painting a picture of an economy that faces a reduced threat of falling back into recession but that is nonetheless plodding along at an unsatisfactory speed. "The pace of growth is still too weak to get a real recovery in the labor market... and that's the key ingredient to a sustained recovery that'll lead to more consumer spending and more support for the housing market," said David Regan, a senior investment specialist at JP Morgan Private Wealth Management in Los Angeles.

Weak economic growth expected through 2011

Survey sees little improvement in jobs, housing and the deficit.

Top forecasters say the economy will grow this year and next at a slower pace than previously thought, weakened by governments and consumers spending less so they can pay down debt.

That's the findings of a new survey released recently by the National Association of Business Economics. The 46 economists polled tempered their expectations after seeing weak expectation after seeing weak economic data in recent months. The panel reduced its forecast for annual economic growth to 2.6 percent in 2010 and 2011. That's down from its forecast of 3.2 percent in May. The economists expect the economy will add jobs through the end of 2011, but not enough to bring down the unemployment rate below 9.2 percent. They don't see home prices rising much or the nation's soaring deficit falling much.

The mainly downbeat report comes as persistently high unemployment, weak consumer spending and stagnant wages drag on the U.S. economy. The nation emerged last summer from the deepest recession since the 1930s.

But the economic recovery has not yet led to widespread job gains or growth. "This summer's slowdown has exposed the economy's sensitivity to wealth losses, the unwinding of debt, and the reductions in economic stimulus," NABE President elect Richard Wobbekind said in a statement. The NABE's Outlook survey is conducted four times per year. It compiles economists' big picture expectations for factors such as growth, hiring, home prices and spending. The economists work for industry groups, government agencies, banks and economic analysis firms.

The economy grew at a 1.7 percent annual rate in the second quarter, according to the government's latest estimate. That's a sharp slowdown from a 3.7 percent growth rate logged in the January-March quarter. Most economists expect growth to be similarly weak in the July - September quarter, with estimates ranging between 1.5 percent and 2 percent.

Consumer spending accounts for about 70 percent of economic activity. Economists told the NABE that consumer spending is likely to remain low over the next year. The housing market also will struggle, the economists said. Home prices will not rise enough in 2011 to keep up with inflation, and housing starts will remain near record lows, they said. Still, they expressed few concerns about inflation, deflation or so-called stagflation - a dangerous mix of rising prices and slow economic growth.

The economists expected hiring to increase at a painfully slow rate. They predicted the economy will add 150,000 or fewer jobs each month until the middle of 2011, after which the numbers will improve to about 175,000. Only then will the jobless rate begin dropping, from 9.6 percent to 9.2 percent, the economists said. The economy needs to add 125,000 net new jobs each month just to keep up with population growth. The biggest concern among the economists was the federal deficit. They predicted it will shrink by only about $100 billion to $1.2 trillion - a level the NABE called "extreme."

There were a few bright spots. Economists expected businesses to increase spending on equipment and software as their profits keep rising. Spending by businesses has helped keep up demand for goods from American factories, a vital sector for the economic recovery.

Growth will strengthen over the next three years, but not enough to bring unemployment back down to more normal levels of around 5.5 percent to 6 percent, according to the Fed's forecasts. At best, the Fed projects 3.6 percent growth in 2011, and 4.5 percent growth in 2012 and 2013.

The latest Fed projections also suggest no better than 8.9 percent unemployment next year, roughly 8 percent in the 2012 presidential election year and, at best, just under 7 percent for 2013. Under one rule of thumb, the economy would need to grow by 5 percent for a full year to push down the unemployment rate by a full percentage point. The Fed acknowledged that progress in reducing unemployment has been "disappointingly slow."

Cyber Monday sales top $1 billion for first time

Free shipping and sales made it busiest online shopping day ever.

Americans jumped on deals and promotions offered online on Cyber Monday, spending $1 billion and making it the busiest online shopping day ever, according to new data. Research firm comScore Inc. says revenue rose 16 percent from a year ago to $1.03 billion on the Monday after Thanksgiving, the first one-day spending total above $1 billion ever. Since the beginning of November, online sales are up 13 percent to $13.55 billion.

Meanwhile, another company that tracks online spending, IBM's Coremetrics, found Cyber Monday sales rose 19.4 percent over last year. Cyber Monday was also PayPal's biggest day ever. Online payments rose 19 percent from last year. Though it is growing quickly, online spending makes up only 8 to 10 percent of total holiday spending.

The Cyber Monday figures come a day after a report showed American's confidence in the economy rose to a five-month high in November and is welcome news for retailers hoping that Americans start spending more freely. But shoppers are still holding out for bargains and spending cautiously as unemployment remains high. According to ShopperTrak figures, revenue at stores in shopping malls was flat over the weekend following Thanksgiving, but traffic rose 2.8 percent. ComScore said the number of buyers online increased at a slower rate than total spending, up 4 percent to 9 million. The average shopper spent 12 percent more, at $114.24 each, according to the data.

Cyber Monday got its name from the National Retail Federation trade group in 2005 to describe the unofficial kickoff to the online shopping season. The idea was that people returning to work after the long weekend would shop at their desks. It never really was the busiest online shopping day of the year, but it has gained significance as sellers have trained shoppers to expect deals that day. Nearly 90 percent of U.S. retailers offered some kind of Cyber Monday promotion this year, compared to 72 percent in 2007.

While people used to shop at work to take advantage of broadband connections, the data shows even though broadband has become common at home, about 49 percent of the dollars spent at U.S. Web sites originated from work computers, down 4 percent from last year, comScore says. Buying at home rose just 4 percent to make up about 45 percent of dollars spent. International shoppers on U.S. sites made up the rest.

The fact that buying at work remains so prevalent suggests they are doing it "to shop for holiday gifts while minimizing the risk that their children, spouses and significant others might see" them shop, Fulgoni said.

Holiday Retail Sales

Shopping surge spurs higher holiday outlook.

A bigger-than-expected surge in holiday spending in November led a prominent research firm to raise its forecast for the season for the second time in a matter of weeks. The upgraded forecast by ShopperTrak follows an upgraded outlook from the National Retail Federation. The early buying surge is likely to offset a disappointing start to December.

ShopperTrak, based in Chicago, said it expects holiday sales to rise 4 percent over last year, up from a projection of 3.2 percent made in mid-November. The original estimate was for a 2.9 percent increase. ShopperTrak said November's revenue rose 5.8 percent compared with a year ago, as stores successfully pulled in shoppers with discounts. ShopperTrak had expected 3.7 percent.

The National Retail Federation now expects total holiday sales to rise 3.3 percent, 1 percentage point higher than the original 2.3 percent growth forecast. The increasing optimism comes as government figures released recently showed that retail sales for November jumped 0.8 percent over October, marking the fifth straight monthly gain. The increase was led by department stores, which posted a 2.8 percent gain.

Retail Sales November

Retailers see best November in four years.

Generous discounts lured American’s to stores and online for holiday gifts in November, providing cheer and delivering the best gains for retailers in four years. That raises hopes, already buoyed by reports of crowded malls and early numbers, for a strong holiday shopping season and is an encouraging sign for the economic recovery.

The International Council of Shopping Centers' index reported a 5.8 percent gain, much better than the 3 to 4 percent increase expected. It marked the biggest increase since March when a quirk of the Easter calendar resulted in a 9 percent gain. Aside from that month, the last time retailers reported such a big increase was in September 2006, when it registered 6.2 percent increase.

"All forces came together to yield a performance better than what we've seen in the last four years," said Mike Niemira, chief economist at International Council of Shopping Centers. November's sales results are being compared with weak spending over the last two years, but Niemira said that plenty of discounting along with what appears to be a sustained recovery is helping to boost spending.

As retailers report their monthly results, they showed that many types of shoppers were in the mood to buy - if the product and price were right. Stores reporting gains that topped Wall Street expectations included Costco Wholesale Corp., Target Corp., Victoria's Secret and pricey teen retailer Abercrombie & Fitch.

Others who topped expectations:

- Target Corp., with a 5.5 percent increase, above the 3.7 percent estimate.

- Limited Brands, which owns Victoria's Secret and Bath & Body Works, 10 percent increase, 4 percent expected.

- Macy's Inc. reported a 6.1 percent gain; analysts had expected 5 percent. The department store chain raised its outlook for fourth-quarter earnings and revenue at stores open at least a year.

- Teen retailer Abercrombie & Fitch, which had been hurt by young people flocking to less expensive brands during the depths of the recession, reported a robust 22 percent gain, far above the 6.8 percent estimate. That compares with a 17 percent drop in 2009 compared with the previous year. That's a strong signal that teen shoppers are ready to splurge, Perkins said.

Consumer confidence hits 5-month high

Americans' confidence in the economy rose to a five-month high in November amid more hopeful signs. The Conference Board, a private research group based in New York, said recently that its Consumer Confidence Index rose to 54.1 in November, up from a revised 49.9 in October. The November reading is the highest since June, when the index stood at 54.3. Economists surveyed by Thomson Reuters expected 52.0. September's index had been the lowest since February and was down sharply from 53.2 in August. It takes a level of 90 to indicate a healthy economy, which hasn't been approached since the recession began in December 2007.

One component of the index, how Americans feel now about the economy, rose to 24.0, up from 23.5. The other gauge, which measures how American feel about the economy over the next six months, rose to 74.2, up from 67.5 last month.

"Consumer confidence is now at its highest level in five months, a welcome sign as we enter the holiday season," Lynn Franco, director of The Conference Board Consumer Research Center, said in a statement. "Consumers' assessment of the current state of the economy and job market, while only slightly better than last month, suggests the economy is still expanding, albeit slowly. Hopefully, the improvement in consumers' mood will continue in the months ahead."

The index, which measures how respondents feel about business conditions, the job market and the next six months, has recovered fitfully since hitting an all-time low of 25.3 in February 2009. In October 2009, the index stood at 48.7. Since then, it has hovered in a tight range between the mid-40s and the high 50s. May 2010 was the only month when the index topped 60.

Economists watch confidence closely because consumer spending accounts for about 70 percent of U.S. economic activity and is critical to a strong rebound. But a rebounding job market is necessary for shoppers to feel like spending again.

There have been some encouraging signs. Americans' income rose 0.5 percent in October, boosted by a 0.6 percent rise in wages and salaries, according to a government report released last month. That was after incomes didn't rise at all in September.

November Auto Sales

Major automakers, except Toyota, show strong November sales gains.

All major automakers except Toyota reported strong U.S. sales increases in November as the auto industry's slow-motion recovery continued to gain traction. Ford, General Motors, Chrysler, Nissan, Hyundai and Honda all reported double-digit increases, and only Toyota, which has been hurt by a string of safety recalls, had a sales drop. Overall, according to Autodata Corp., U.S. sales last month rose 17 percent from November 2009, a month marked by consumer paralysis due to high unemployment.

The November performance helped an industry that is trying to recover from last year's historic lows as credit froze up and two major automakers slid through bankruptcy court. Sales started the year with promise, peaked in May as consumer confidence rose, fell off during the summer and now have started to rebound.

Industry analysts say the solid November sales numbers, combined with a strong October, show that consumers who have kept their jobs through the economic downturn are now feeling confident enough to spend money and replace older vehicles. Bob Carter, Toyota's top U.S. sales executive, said Toyota could tell things were shifting because buyers are opting for more highly equipped sport utility vehicles, which indicates they aren't buying just because they need family transportation. "At the beginning of the year, the vast majority of buyers were those who needed a car, versus wanted a car," he said.

Those who spent money last month also bought crossovers like the Chevrolet Equinox and the Hyundai Santa Fe. Midsize cars like the Ford Fusion and Hyundai Sonata also sold well. The increased sales are probably due to a combination of rising confidence and delayed buying as people replace vehicles they have kept for longer than normal during a severe auto industry downturn, said Bruce Clark, senior vice president of Moody's Investors Service. "There is a degree of pent-up demand that's being met gradually by people who have kept jobs and can go out and afford to do such things," Mr. Clark said. The sales are not as robust as historic highs from the early 2000s, but they are still a good sign for the industry, Mr. Clark said.

Yingzi Su, GM's senior economist, said the stable and increasing auto sales mean that consumers with jobs are starting to spend again, the start of an upward trend for automakers and a good sign for the broader economic recovery going into next year. Incentives such as sweet lease deals and rebates also helped push up sales last month. Automakers raised incentive spending about 6 percent over October to an average of $2,712 per vehicle, said the auto website TrueCar.com.

Of the major automakers, Hyundai Motor Co. had the biggest increase, up 45 percent from the same month last year. Nissan Motor Co. sales were up 27 percent, followed by Honda Motor Co. at 21 percent and Ford Motor Co. with 20 percent. Chrysler had a 17 percent increase, while General Motors reported sales up 11 percent from November of last year.

Toyota sales dipped 3 percent, with the company blaming the drop on a 60 percent cut in sales to fleet buyers such as rental car companies. Mr. Carter said Toyota didn't want to match competitors' low prices on fleet vehicles.

Toyota said sales to individual customers were up slightly, but that they didn't increase as much as the industry average.

December Auto Sales

U.S. auto sales rose 11 percent in 2010

Toyota only major automaker to sell fewer cars last year than in 2009

Auto sales rose in the United States last year for the first time since the recession. They're still far from what they were just a few years ago — but that's just fine with the downsized auto industry, which can post profits even if it sells millions fewer cars and trucks.

For the year, new car and truck sales came in at 11.6 million, up 11 percent from last year, automakers reported Tuesday. For December alone, sales were 1.14 million, also up 11 percent from a year earlier.

While the figures have some in the industry talking about a return to the glory days, it's a fragile idea. Rising gas prices or more economic trouble could still shake the confidence of American car buyers.

But for now, executives are optimistic about this year. General Motors, Ford and Toyota all predict sales will come in at 12.5 million to 13 million for 2011. It will take years, analysts expect, to get back to the peak sales of last decade - more like 17 million.

"The economic downturn has lasted quite a while," says Jessica Caldwell, director of pricing and analysis for consumer website Edmunds.com. "It's going to be slow and gradual rather than a fast bounceback."

Toyota was the only company that sold fewer cars and trucks than in 2009. The company was stung by sudden-acceleration recalls in early 2010 and never fully recovered despite luring buyers with generous incentives. Production problems at its San Antonio plant cut its supply of Tundra and Tacoma pickup trucks, and troubles importing the Prius hybrid also hurt sales.

Over the past two years, many Americans, even those who had enough money to buy a car during the recession, had been wary to commit to monthly car payments, so they put off making such a large purchase. Many opted to repair or make do with what they had.

Those buyers are easing back into the market, replacing aging vehicles. The average vehicle on U.S. roads is now 10.2 years old — the oldest since 1997 and a full year older than in 2007, before the recession, according to the National Automobile Dealers Association.

"With 240 million vehicles out there on the road, a lot of them are going to be ripe for replacement," says Ellen Hughes-Cromwick, Ford's chief economist.

Auto sales peaked in 2005 at 17.4 million and bottomed out at 10.6 million in 2009. The peak was fueled, in part, by big incentives — like the employee-discounts-for-everyone schemes that were popular in the summer of 2005. But those deals may be a thing of the past.

Chipmakers bullish on next year

Survey shows that most expect increased revenue in 2011.

Despite the still sluggish economy, senior chip-industry executives generally are upbeat about 2011 and many are even planning to do some hiring, according to a survey released recently. Of 118 executives queried in September and October by the corporate advisory firm KPMG, in conjunction with the Semiconductor Industry Association, 78 percent said they expect their revenue to grow by more than 5 percent next year and 29 percent predicted their workers' ranks would increase by about the same rate.

That is noteworthy given what usually happens when chip sales surge in any given year, as was the case in 2010 when chip sales jumped 33 percent, said Ron Steger, a KPMG partner who specializes in the chip business. "If you look at the history of the semiconductor industry, whenever you have a year of growth of 20 percent or more, it is almost always followed by a year of double-digit decline," he said. Consequently, after seeing the survey results, he added, "I was surprised."

Overall, about 90 percent of the executives surveyed said they expected some revenue increase and 39 percent foresee their sales rising by 10 percent or more in 2011, said Gary Matuszak, another KPMG executive involved with the study. In addition, 37 percent expect their profit to increase by more than 5 percent next year.

"That was pretty optimistic," Matuszak said, noting that many of the executives planned to expand their operations in the United States, which suggests a significant number of their new employees will be added in this country. Asked which market sectors they expected to boost sales of chips next year, 68 percent of the executives cited wireless communication devices, 62 percent energy-efficient gadgets and 38 percent automotive products. In addition, 70 percent considered China the most important driver of chip sales in the next three years. But an increasing number of executives see Europe and the U.S. as important sources of revenue, too.

Still, experts generally agree the remarkable growth in chip sales experienced last year is tailing off. While worldwide sales for 2010 are expected to total $300.5 billion, an increase of 33 percent over 2009, the increase should only be 6 percent in 2011 and 3.4 percent in 2012, the Semiconductor Industry Association predicted last month.

UCLA Anderson Forecast

No quick fix to state's jobless.

California will remain stuck at a historically high unemployment rate for at least two more years and any recovery will likely be spurred by the high-tech and health care industries, a report released recently says. By the time the final three months of 2012 roll around, California should manage a jobless rate of 9.9 percent, the UCLA Anderson Forecast said in a closely watched report. California's unemployment rate at present is about 12.4 percent. "It is difficult to be very optimistic about the near term," said Jerry Nickelsburg, a senior economist with the forecast. "On the job front, California has yet to make meaningful progress."

California must scale an economic Mount Everest. Since the recession began, the statewide employment loss has been about 1.3 million jobs. Yet through the first 10 months of 2010, California has added 48,000 payroll jobs, or an average of 4,800 jobs a month. Put another way, at that pace of per-month job creation, it would take 270 months, or more than 22 years, for California to get back to where it was in 2008 before the slump began. "These are scary numbers," said Christopher Thornberg, a partner with Beacon Economics, which tracks regional economies. "Things are in a bit of a mess." If job creation picked up to a robust 48,000 jobs a month, it would take more than two years for California to reach its pre-recession heights.

Other economists think California must traverse an even more forbidding financial landscape. Jeffrey Michael, director of the Stockton-based Business Forecasting Center at the University of the Pacific, said the state will not achieve a jobless rate below 10 percent even by the end of 2012. "We see things as being even weaker," Michael said. "The double-digit jobless rate in California will continue until the second half of 2013."

Among the key predictions for the UCLA Anderson Forecast:

- The unemployment rate, now at 12.4 percent, will drop to an average 11.4 percent in 2011 and an average 10.3 percent in 2012, before dropping to 9.9 percent by the end of 2012.

- Personal income, adjusted for inflation, will rise 1.4 percent in 2010, by 1.6 percent in 2011 and 3.6 percent in 2012.

- Taxable sales, on an inflation-adjusted basis, will increase 1.1 percent in 2010, 1.4 percent in 2011 and by 2 percent in 2012. "As compared to our forecast of last June, the current forecast is slightly weaker in the near term and slightly stronger in the long term," said Nickelsburg, the Anderson economist.

The collapse of the housing market was one of the prime culprits that unleashed the national and statewide recession. In California, those woes persist amid an economic recovery that a number of pundits trumpet. "The problem is one part of our economy, the housing and construction markets, have been hit so hard by the downturn," Thornberg said. "The other problem is California has such a high proportion of low-skilled workers."

He suggested numerous jobs that have materialized in the feeble upswing are beyond the skill sets of many unemployed workers."Those low-skilled workers will find it hard to secure employment on the back end of this downturn," Thornberg said. "The recovery is too weak to carry these low-skilled workers."

Until housing improves measurably, California could remain mired in economic woes. "Housing and construction have gone nowhere," Michael said. "Nearly half of the jobless problems California has had are related to real estate and construction. Those industries are still lying flat on the floor."

Yet as brutal as things seem now, the future remains promising for California, the Anderson forecasters said."We are seeing a restructuring of the economy in California that is laying the foundation for longer-term economic growth," Nickelsburg said." The primary drivers of the long-term rebound in California will be high-tech and other sectors, he said. "There is growth in high-tech manufacturing, exports, logistics, and professional business services," he said. "They might not be hiring right now. But they are laying the groundwork to absorb a larger work force in the future."

Sources:
Valley Times
San Jose Mercury News
San Francisco Chronicle
Wall Street Journal
Economy.com