CITY OF PALO ALTO OFFICE OF THE CITY AUDITOR

September 6, 2011

The Honorable City Council
Palo Alto, California

City of Palo Alto Sales Tax Digest Summary First Quarter Sales (January - March 2011)

This is an informational report and no action is required.

BACKGROUND

Sales and use tax represents about 14%, or $19.5 million, of the City's projected General Fund revenue 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 misallocations of tax revenues 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 first quarter sales (January through March 2011). 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 second quarter sales (April through June 2011) should be available by November 2011. ASD advises that in mid-September, it should receive information from the State on aggregate sales and use tax receipts for second quarter 2011.

[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 first quarter ending March 2011 increased by approximately $611,000, or 14.8%, compared to the first quarter ending March 2010. This amount includes sales and use tax for the City of Palo Alto and pool allocations from the State and Santa Clara County.

- Sales and use tax revenue totaled $19.7 million for the year ending March 2011, an increase of 6.5% from $18.5 million in the prior year ending March 2010 (including pool allocations).

- Statewide, every region in California experienced a slight increase of 2.5% in sales and use tax revenue for the year ending March 2011, compared to the prior year ending March 2010. 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 7.6% during the first quarter ending March 2011 compared to the first quarter ending March 2010.

More detailed information is shown on Attachment A.

Economic Influences on Sales and Use Tax

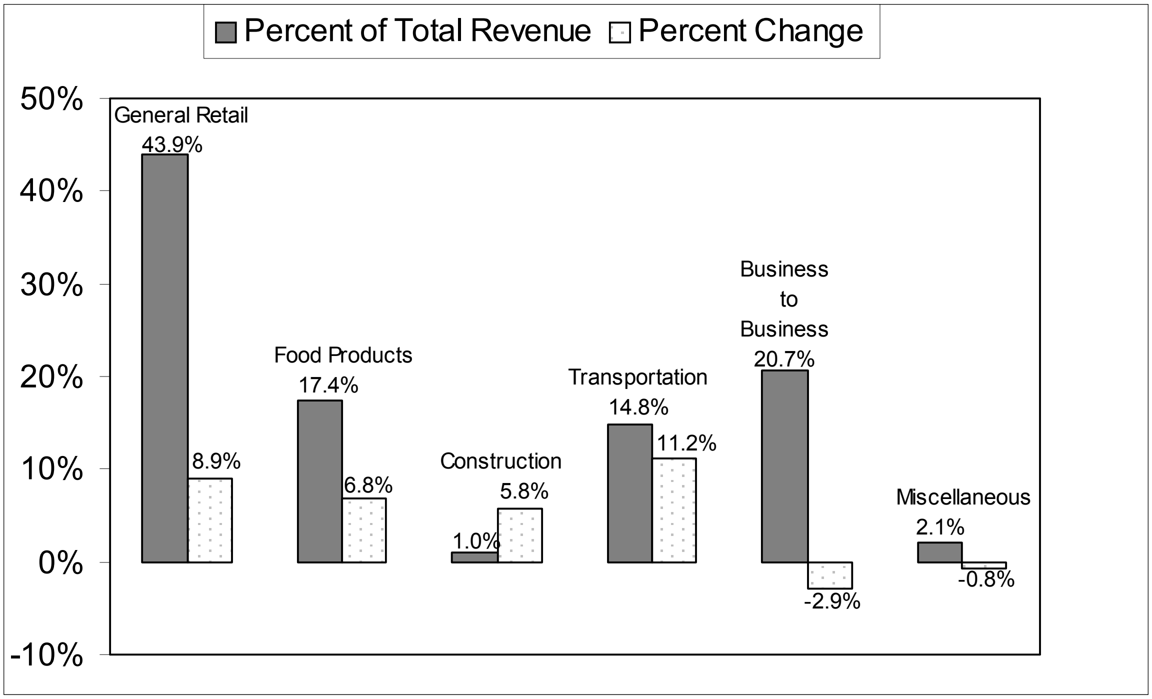
In its Economic Outlook (Attachment B), MuniServices discusses economic influences including job losses, retail sales, auto sales, and forecast information that may affect the City's sales and use tax revenue.

Preliminary estimates show the June 2011 unemployment rate in Santa Clara County at 10.3% and Palo Alto at 5.6%.

Economic Category Analysis

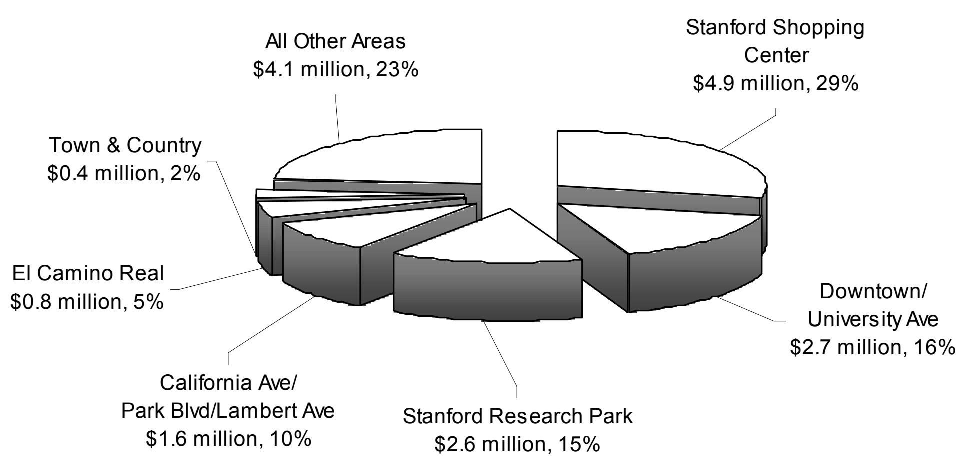
Analysis of six economic categories, for the year ending March 2011, shows that General Retail comprised the largest percentage of Palo Alto's sales and use tax revenue and experienced 8.9% growth. Transportation experienced an 11.2% increase and comprised 14.8% of total revenues. Business to business experienced a 2.9% decline and comprised 20.7% of total revenues.

Exhibit 1 - Comparison of Palo Alto's Sales and Use Tax Revenue and Percent Change by Economic Category for the Year Ending March 2011



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 March 2011 (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% expired 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.

Respectfully submitted,

Michael A. Edmonds

Michael Edmonds
Interim City Auditor

Sources: MuniServices; the State Board of Equalization; the City's Adopted Operating Budget
Audit staff: Lisa Wehara

ATTACHMENTS:

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

Department Head: Mike Edmonds, Interim City Auditor

City of Palo Alto
Sales Tax Digest Summary
Collections through June 2011
Sales through March 2011 (2011Q1)

Attachment A

California Overview

The percent change in cash receipts from the prior year was 6.3% statewide, 7.0% in Northern California and 5.7% 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 1st Quarter 2011 by 2.5% statewide, 1.1% in Northern California and increased by 2.1% in Southern California.

City of Palo Alto

For the year ended 1st Quarter 2011, sales tax cash receipts for the City grew by 6.5% from the prior year. On a quarterly basis, sales tax revenues increased by 14.8% from 1st Quarter 2010 to 1st Quarter 2011. 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 5.9% for the year ended 1st Quarter 2011 from the prior year. On a quarterly basis, sales tax activity grew by 8.3% in 1st Quarter 2011 compared to 1st Quarter 2010.

Regional Overview

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

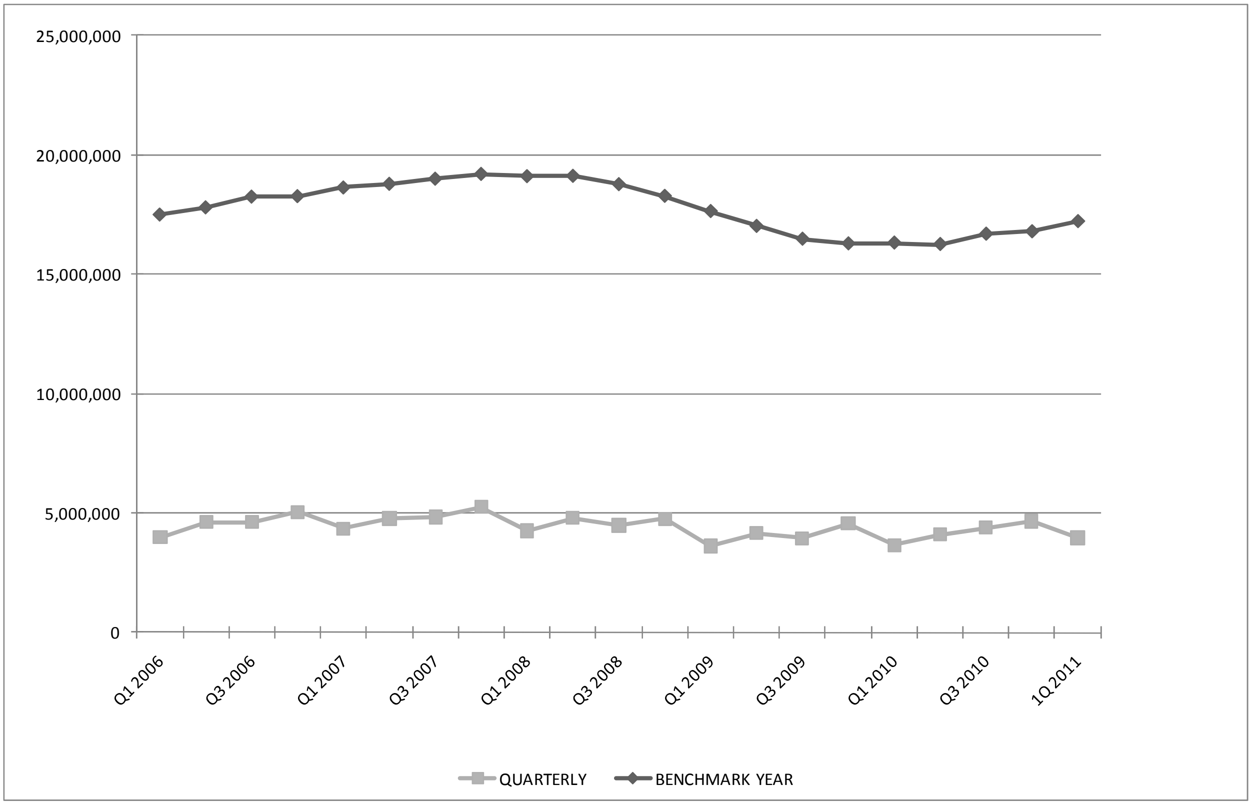
ECONOMIC CATEGORY ANALYSIS FOR YEAR ENDED 1st QUARTER 2011

	Palo Alto	California Statewide	S.F. Bay Area	Sacramento Valley	Central Valley	South Coast	North Coast	Central Coast
General Retail *% of Total / % Change*	*43.9 / 8.9*	*30.4 / 0.3*	*30.0 / 1.8*	*31.0 / 1.5*	*33.0 / 2.5*	*30.3 / -0.1*	*30.2 / -0.2*	*33.0 / -1.6*
Food Products *% of Total / % Change*	*17.4 / 6.8*	*19.2 / 0.0*	*19.8 / 1.7*	*17.4 / 1.6*	*17.1 / 0.2*	*19.7 / -0.1*	*19.3 / 0.1*	*30.4 / 2.1*
Construction *% of Total / % Change*	*1.0 / 5.8*	*8.5 / -1.0*	*8.1 / 0.4*	*10.2 / -0.9*	*10.4 / 0.4*	*8.0 / -0.5*	*11.9 / -9.1*	*9.1 / 1.8*
Transportation *% of Total / % Change*	*14.8 / 11.2*	*22.9 / 7.6*	*19.9 / 9.0*	*25.4 / 7.5*	*24.3 / 11.7*	*23.2 / 6.8*	*28.5 / 11.6*	*20.0 / 14.3*
Business to Business *% of Total / % Change*	*20.7 / -2.9*	*17.6 / 5.4*	*21.0 / 7.6*	*14.3 / 2.6*	*14.0 / 13.6*	*17.7 / 4.5*	*9.3 / 10.3*	*5.9 / -3.2*
Miscellaneous *% of Total / % Change*	*2.1 / -0.8*	*1.3 / -3.7*	*1.2 / -1.6*	*1.6 / -3.1*	*1.2 / 6.5*	*1.2 / -3.2*	*1.0 / -61.2*	*1.5 / 7.6*
Total	***100.0 / 5.9***	***100.0 / 2.5***	***100.0 / 4.1***	***100.0 / 2.8***	***100.0 / 5.4***	***100.0 / 2.1***	***100.0 / 1.1***	***100.0 / 2.7***

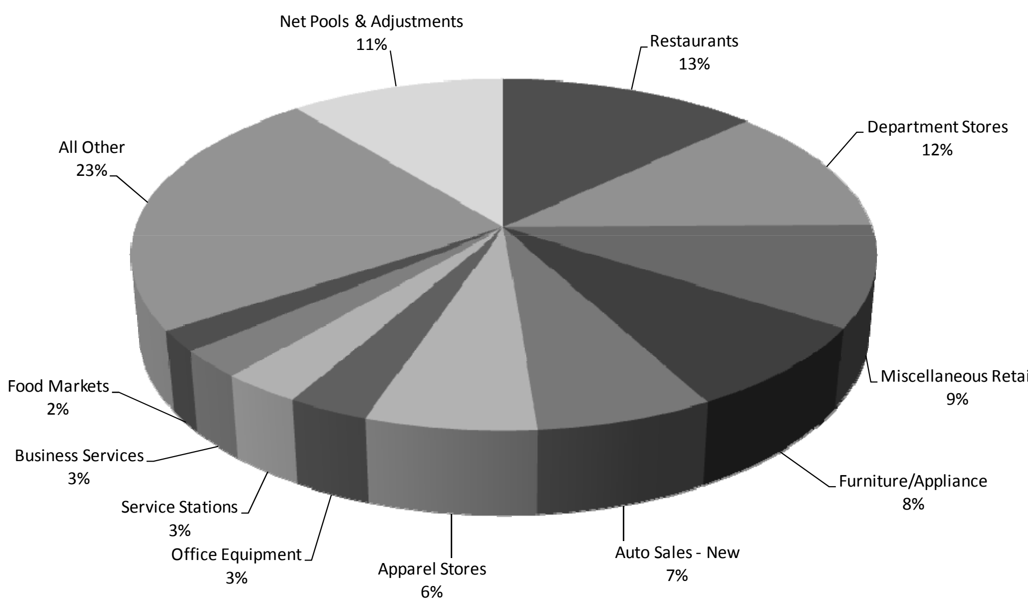
THREE LARGEST SEGMENTS FOR YEAR ENDED 1st QUARTER 2011

	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	14.9 / 5.6	13.1 / 0.7	13.7 / 2.7	12.9 / 2.3	15.7 / 1.9	14.0 / 0.7	*13.0 / -0.1*	*20.0 / 2.3*
3rd Largest Segment	**Department Stores**	**Department Stores**	**Department Stores**	**Restaurants**	**Service Stations**	**Department Stores**	**Services Stations**	**Misc. Retail**
% of Total / % Change	13.5 / 7.0	11.2 / -0.3	10.1 / 0.7	10.8 / 1.0	11.2 / 16.1	10.8 / -0.3	*13.4 / 19.2*	*10.5 / -4.7*
3rd Largest Segment	**Electronic Equipment**	**Service Stations**	**Service Stations**	**Service Stations**	**Restaurants**	**Service Stations**	**Restaurants**	**Department Stores**
% of Total / % Change	*Confidential* / -9.3	9.8 / 10.6	8.4 / 11.6	10.1 / 12.5	10.0 / 0.2	9.8 / 9.6	*10.0 / 0.4*	*9.0 / -2.4*

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



Net Cash Receipts for Benchmark Year 1st Quarter 2011: $19,743,699

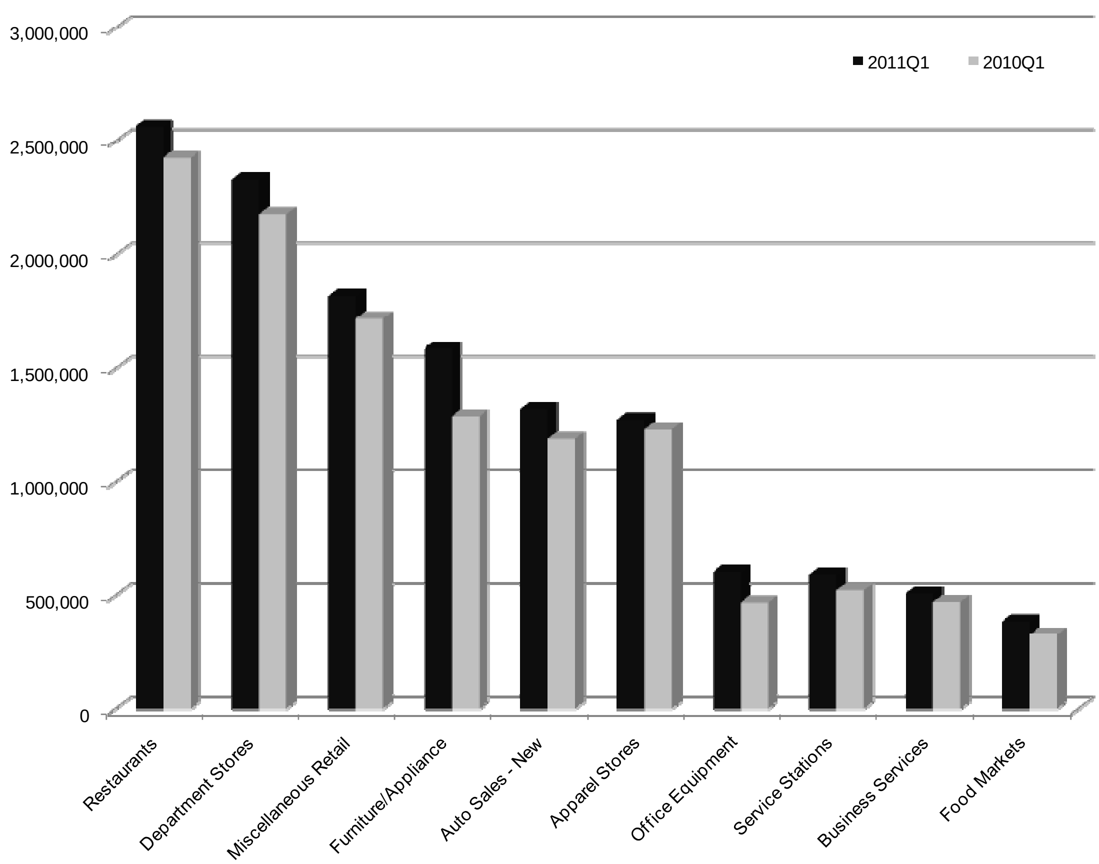


TOP 25 SALES/USE TAX CONTRIBUTORS

The following list identifies Palo Alto's Top 25 Sales/Use Tax contributors. The list is in alphabetical order and represents the year ended 1st Quarter 2011. The Top 25 Sales/Use Tax contributors generate 52.2% of Palo Alto's total sales and use tax revenue.

Anderson Honda	Hewlett-Packard	Shell Service Stations
Apple Stores	Integrated Archive Systems	Stanford University Hospital
Bloomingdale's	Keeble & Shucat 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	%	2011Q1	2010Q4	2010Q3	2010Q2	2010Q1	2009Q4	2009Q3	2009Q2	2009Q1
General Retail	33.3%	1,573,474	2,275,627	1,810,271	1,864,922	1,473,821	2,064,636	1,615,455	1,671,676	1,401,746
Business To Business	19.6%	925,263	887,037	1,006,576	788,373	849,181	993,411	894,386	1,096,153	871,861
Food Products	15.7%	740,594	769,253	726,360	739,629	666,388	699,788	665,680	694,271	649,563
Transportation	12.5%	593,452	590,209	576,597	551,313	534,793	516,345	594,725	726,213	495,640
Miscellaneous	1.9%	87,535	75,077	217,465	78,340	67,673	70,822	79,799	79,758	101,377
Construction	0.8%	38,765	54,645	44,171	40,415	37,914	48,862	44,182	38,589	56,568
Net Pools & Adjustments	16.2%	769,789	508,973	782,981	626,593	487,801	634,071	684,537	508,710	619,790
Total	100.0%	4,728,872	5,160,821	5,164,421	4,689,585	4,117,571	5,027,935	4,578,764	4,815,370	4,196,545

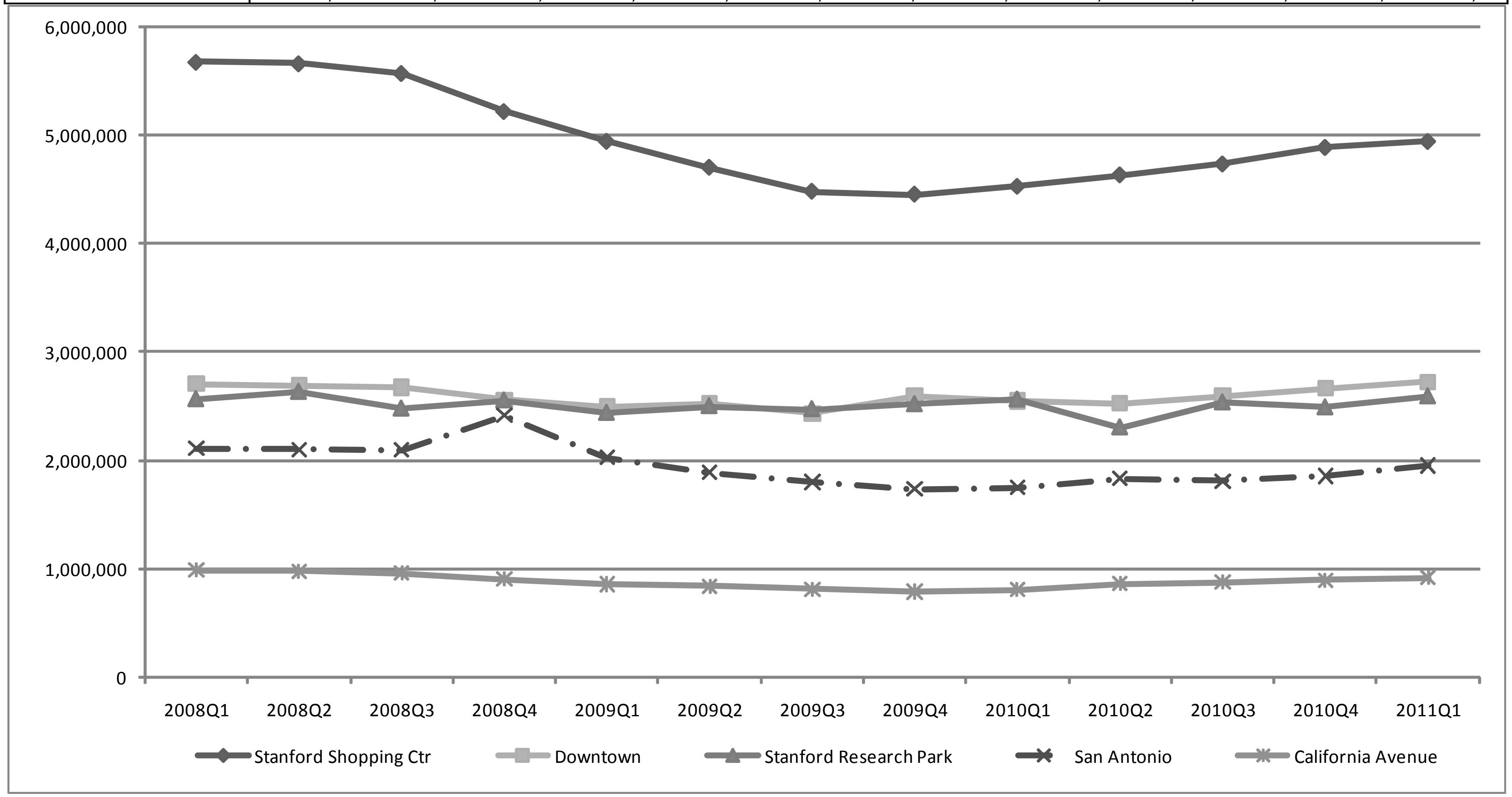
Economic Segments	%	2011Q1	2010Q4	2010Q3	2010Q2	2010Q1	2009Q4	2009Q3	2009Q2	2009Q1
Restaurants	13.5%	639,353	651,614	622,517	636,566	568,305	597,762	580,829	604,861	565,461
Department Stores	10.0%	474,566	748,885	541,942	565,706	455,378	714,431	480,038	529,267	426,855
Miscellaneous Retail	8.4%	399,243	584,895	396,580	381,222	325,512	459,998	341,947	360,311	304,199
Furniture/Appliance	6.4%	301,427	421,877	447,946	416,128	282,989	345,141	352,050	302,007	292,437
Apparel Stores	5.6%	266,990	387,682	299,340	321,787	267,315	375,133	286,511	299,896	243,222
Service Stations	3.4%	158,421	147,520	143,233	140,859	139,906	128,317	134,369	119,637	95,957
Business Services	2.1%	100,241	146,732	112,153	143,241	110,989	113,481	124,575	116,394	109,472
Food Markets	1.9%	91,274	105,573	93,651	92,036	86,892	88,469	74,317	75,997	72,517
Auto Parts/Repair	1.0%	47,157	43,537	45,689	40,037	39,150	39,592	40,669	65,174	37,341
Leasing	0.7%	34,857	36,962	40,480	36,129	34,760	37,222	41,697	34,892	36,308
Bldg.Matls-Retail	0.7%	34,016	48,591	39,747	35,783	33,297	38,766	39,314	33,879	50,548
Liquor Stores	0.2%	9,967	12,060	10,192	11,027	11,162	13,297	10,534	13,313	11,585
Miscellaneous Other	0.2%	6,458	8,714	5,751	7,689	6,550	9,061	7,637	6,730	6,092
Heavy Industry	0.2%	3,833	3,580	3,288	4,887	4,782	5,944	5,090	5,369	5,596
Bldg.Matls-Whsle	0.2%	4,749	6,054	4,424	4,632	4,617	10,096	4,868	4,710	6,020
All Other	29.3%	1,386,531	1,297,572	1,574,507	1,225,263	1,258,166	1,417,154	1,369,782	1,734,223	1,313,145
Net Pools & Adjustments	16.2%	769,789	508,973	782,981	626,593	487,801	634,071	684,537	508,710	619,790
Total	100.0%	4,728,872	5,160,821	5,164,421	4,689,585	4,117,571	5,027,935	4,578,764	4,815,370	4,196,545

*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.

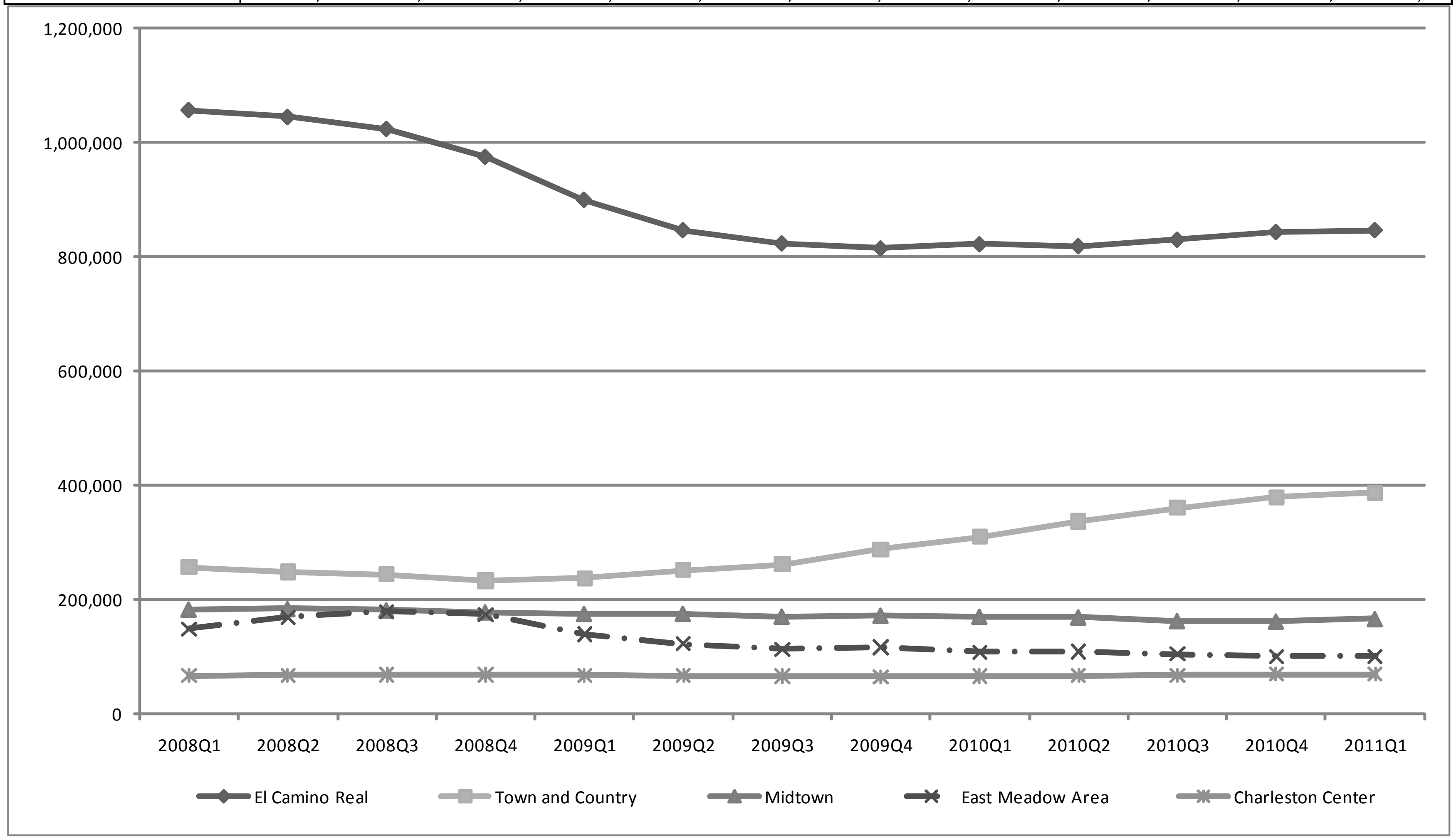
Quarterly Analysis by Economic Category, Total and Segments: Change from 2010Q1 to 2011Q1

	General Retail	Food Products	Transportation	Construction	Business to Business	Miscellaneous	2011/1 Total	2010/1 Total	% Chg	Largest Gain	Second Largest Gain	Largest Decline	Second Largest Decline
Campbell	-4.6%	5.1%	14.7%	0.9%	24.8%	-18.5%	1,719,272	1,637,016	**5.0%**	Service Stations	Office Equipment	Miscellaneous Retail	Furniture/Applian ce
Cupertino	-2.8%	4.2%	26.3%	13.6%	24.3%	-9.5%	3,562,248	3,030,520	**17.5%**	Business Services	Office Equipment	Electronic Equipment	Heavy Industry
Gilroy	5.3%	3.3%	18.2%	2.2%	5.8%	251.5%	2,483,832	2,282,959	**8.8%**	Service Stations	Apparel Stores	Heavy Industry	Misc. Vehicle Sales
Los Altos	-4.6%	0.9%	26.1%	66.4%	4.1%	36.5%	449,762	422,827	**6.4%**	Service Stations	Food Markets	Restaurants	Furniture/Applian ce
Los Gatos	21.5%	5.4%	11.9%	-11.8%	2.9%	-0.8%	2,081,615	1,803,658	**15.4%**	Miscellaneous Retail	Auto Sales - New	Electronic Equipment	Food Markets
Milpitas	3.6%	5.3%	16.7%	-5.4%	-12.6%	8.7%	3,287,536	3,276,176	**0.3%**	Auto Sales - New	Apparel Stores	Office Equipment	Department Stores
Monte Sereno	- 43.7%	-100.0%	-45.7%	-100.0%	233.8 %	405.0%	2,079	3,268	**-36.4%**	Electronic Equipment	Miscellaneous Other	Auto Parts/Repair	Miscellaneous Retail
Morgan Hill	2.8%	3.5%	28.9%	1.4%	41.3%	29.1%	1,214,293	1,034,841	**17.3%**	Electronic Equipment	Service Stations	Light Industry	Bldg.Matls-Retail
Mountain View	-1.4%	4.6%	-3.3%	-58.4%	-9.1%	-8.8%	3,015,180	3,223,092	**-6.5%**	Electronic Equipment	Restaurants	Bldg.Matls-Whsle	Light Industry
Palo Alto	5.3%	8.6%	10.5%	1.4%	12.0%	13.9%	3,959,083	3,654,362	**8.3%**	Electronic Equipment	Restaurants	Business Services	Chemical Products
San Jose	6.1%	2.9%	15.7%	5.8%	-2.1%	-15.1%	27,011,045	25,617,951	**5.4%**	Service Stations	Auto Sales - New	Office Equipment	Light Industry
Santa Clara	5.9%	5.1%	18.8%	23.6%	22.1%	3.4%	7,731,334	6,660,649	**16.1%**	Electronic Equipment	Auto Sales - New	Business Services	Bldg.Matls-Retail
Santa Clara Co.	0.5%	-1.9%	9.7%	14.4%	53.8%	-20.8%	777,434	746,222	**4.2%**	Electronic Equipment	Office Equipment	Health & Government	Food Processing Eqp
Saratoga	0.5%	2.5%	45.0%	6.3%	-33.8%	-29.5%	203,287	194,307	**4.6%**	Service Stations	Furniture/Appl iance	Electronic Equipment	Miscellaneous Retail
Sunnyvale	6.1%	9.8%	20.1%	-3.8%	22.5%	2.2%	6,046,752	5,241,088	**15.4%**	Electronic Equipment	Auto Sales - New	Bldg.Matls-Whsle	Miscellaneous Other

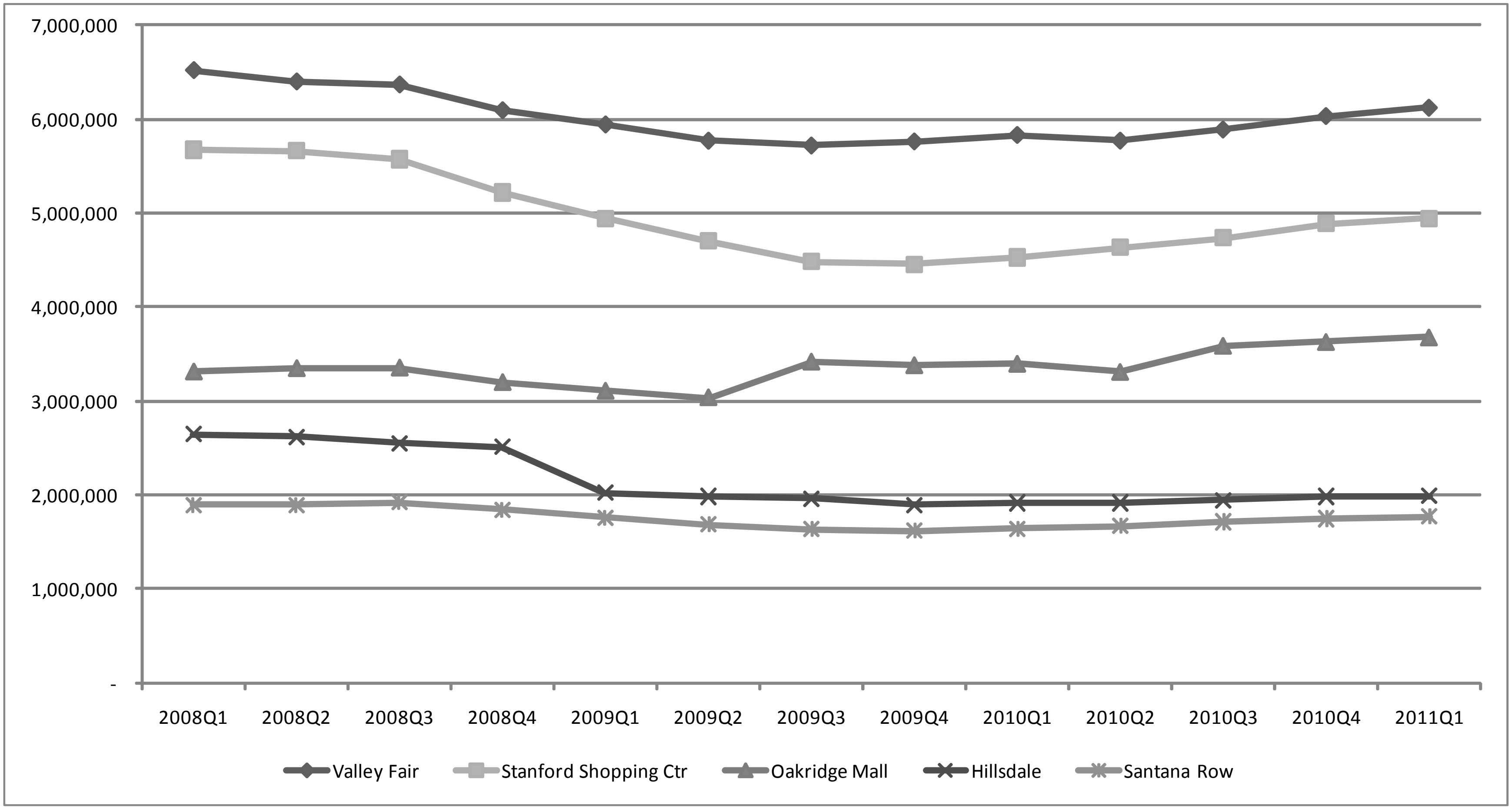
City of Palo Alto - Selected Geographic Areas of the City Benchmark Year 1st Quarter 2011	2008Q1	2008Q2	2008Q3	2008Q4	2009Q1	2009Q2	2009Q3	2009Q4	2010Q1	2010Q2	2010Q3	2010Q4	2011Q1
Stanford Shopping Ctr	5,674,646	5,661,387	5,570,554	5,218,085	4,941,824	4,701,109	4,479,311	4,451,986	4,524,318	4,631,095	4,731,800	4,884,843	4,941,127
Downtown	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	2,663,500	2,723,552
Stanford Research Park	2,564,034	2,631,124	2,478,283	2,552,881	2,439,025	2,500,473	2,472,512	2,517,622	2,560,998	2,305,707	2,534,669	2,489,301	2,589,986
San Antonio	2,109,006	2,099,822	2,094,820	2,414,351	2,028,139	1,890,196	1,802,851	1,737,780	1,752,653	1,831,894	1,811,722	1,856,817	1,954,526
California Avenue	990,771	978,463	960,772	908,095	858,391	839,591	812,294	790,954	807,490	863,730	879,364	895,989	917,851



City of Palo Alto - Selected Geographic Areas of the City Benchmark Year 1st Quarter 2011	2008Q1	2008Q2	2008Q3	2008Q4	2009Q1	2009Q2	2009Q3	2009Q4	2010Q1	2010Q2	2010Q3	2010Q4	2011Q1
El Camino Real	1,056,772	1,044,603	1,023,703	974,931	900,018	846,897	823,627	814,940	822,245	818,947	830,152	843,626	846,897
Town and Country	256,612	248,359	243,683	233,208	237,307	251,608	261,294	288,103	309,848	336,444	360,254	379,066	386,944
Midtown	182,945	183,753	181,687	178,212	175,471	175,723	170,741	172,297	170,517	169,297	162,869	162,122	166,440
East Meadow Area	148,731	168,378	179,006	173,424	139,391	122,493	112,819	116,128	107,931	108,922	104,777	100,155	100,032
Charleston Center	66,681	67,554	68,363	68,585	67,632	66,529	65,328	64,981	65,642	66,446	67,447	68,693	69,150



City of Palo Alto - Regional Shopping Mall Comparison Benchmark Year 1st Quarter 2011													
	2008Q1	2008Q2	2008Q3	2008Q4	2009Q1	2009Q2	2009Q3	2009Q4	2010Q1	2010Q2	2010Q3	2010Q4	2011Q1
Valley Fair	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	6,031,602	6,119,960
Stanford Shopping Ctr	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	4,884,843	4,941,127
Oakridge Mall	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	3,630,341	3,679,073
Hillsdale	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	1,982,532	1,989,259
Santana Row	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	1,749,506	1,770,255



MUNISERVICES

Economic Outlook

2Q2011 News

Economic Overview

Oil prices take bite out of economy

Growth in the first quarter is estimated at 1.8%. High gasoline prices, government budget cuts and weaker-than-expected consumer spending caused the economy to grow only weakly in the first three months of the year.

The Commerce Department estimated recently that the economy grew at an annual rate of 1.8 percent in the January-March quarter. That was the same as its first estimate a month ago. Consumer spending grew at just half the rate of the previous quarter. And a surge in imports widened the U.S. trade deficit.

Most economists think the economy is growing only slightly better in the current April-June quarter. Consumers remain squeezed by gas prices, scant pay increases and a depressed housing market. Analysts estimate that growth has accelerated slightly to around 2.5 percent in the current April-June quarter. For the entire year, they think the economy will grow around 3 percent. That would be little changed from the 2.9 percent growth in 2010.

Growth is expected to improve modestly in the second half of 2011 as stepped-up hiring helps stimulate consumer and business spending. Companies are also benefiting this year from a tax break that lets profitable businesses write off large capital expenditures right away rather than gradually. However, economists caution that their brighter outlook could be derailed if oil prices head higher or if financial markets are jolted by Europe's debt crisis or a failure by Congress to raise the government's borrowing authority this summer.

"I think consumers will hang on and start to do their part to lift the economy," said Mark Zandi, chief economist at Moody's Analytics. "The job market is improving, and more job growth means more income growth and that will help spending." The latest U.S. data definitely fit into a growing pattern of softer-than-expected reports," said Alan Ruskin, an analyst at Deutsche Bank. Economists had been more optimistic when the year began. They assumed that a cut in workers' Social Security taxes, which raised take-home pay, would boost consumer spending.

Survey shows analysts feel best medicine is time

Poll also highlights warnings about more government stimulus

The best cure for the economy now is time. That's the overwhelming opinion of leading economists in a new Associated Press survey. They say the Federal Reserve shouldn't bother trying to stimulate the economy — and could actually do damage if it did.

The economists are lowering their forecasts for job creation and economic growth for the rest of this year, mainly because of high oil prices. A batch of bleak data over the past month has suggested that the 2-year-old economic recovery is slowing. The economists now expect the nation to create 1.9 million jobs this year, about 200,000 fewer than when they were last surveyed eight weeks ago. They expect the unemployment rate, now 9.1 percent, to be 8.7 percent at year's end. Before, they expected 8.4 percent. Despite their gloomier outlook, 36 of the 38 economists surveyed oppose any further efforts by the Fed to invigorate growth. The Fed has already cut short-term interest rates to near zero. And it's ending a program to buy $600 billion in Treasury bonds to keep longer-term rates low to help spur spending and hiring.

The economists say another round of bond-buying wouldn't provide much benefit, if any. And some fear it could make things worse by unleashing high inflation and disrupting financial markets. When it buys bonds, the Fed in effect prints massive amounts of money. All that extra money in the system raises the nominal value of the things we buy, weakening the dollar, and it can create bubbles in the prices of stocks and commodities.

What the economy needs most, says John Silvia, chief economist at Wells Fargo, is time. Consumers must further shrink huge debts amassed in the mid-2000s. And the depressed housing market needs time to recover from a collapse in prices and sales. "There are no magic bullets," Silvia says. "A lot of this stuff just really needs to be dealt with. It's not a question of stimulus."

In Washington, there's little appetite for major spending projects to try to strengthen the economy. Lawmakers are focused instead on whether to raise the nation's borrowing limit and how to cut its long-term debt.

In the AP survey, the economists said they expected the economy to expand at a 2.3 percent annual pace this quarter, far less than their earlier 3.2 percent forecast. Their outlook for the July-September and October-December quarters and the full year has dimmed, too. Since the economists were surveyed in April, the government has said the economy grew at a 1.8 percent rate in the January-March period.

U.S. recovery leaves jobs behind

The Cycle: Foreign competition stronger; technology allows for fewer workers; nation saddled with debt

Still limping two years after officially emerging from the recession and buffeted by a new wave of bad news, the U.S. economy is struggling with problems that run far deeper than higher oil prices, the European debt crisis or auto industry slowdown stemming from the Japanese earthquake and tsunami.

As serious as those problems are, what's crippling the job market and chilling recovery on almost every front is a confluence of factors that economists and business leaders say are fundamentally re-shaping the economic landscape in which Americans live and work. Taken together, these factors have created a vicious circle: Incomes of average families are barely growing, even as many struggle with heavy debts left over from the boom times. That in turn has curbed consumer spending power. And businesses, seeing little chance for a surge in more sales, have had little reason to expand - neither hiring more workers nor paying their existing workers more.

"One argument is that this phenomenon (of poor job growth) is cyclical: We had the mother of all recessions after a near death experience, and what we're seeing is just that when you get hit that hard, it takes longer to recover but that there's nothing abnormal," said Michael Spence, the Nobel economics laureate who teaches at New York University's Stern School of Business. "I don't believe that's right," he said. "The employment problem is new. I think everybody has to admit that. However we did it (in the past), we didn't really have a major employment problem until now."

And without more jobs and greater consumer spending power, it's hard to see how the U.S. economy can regain its old vigor. The first big change behind this economically crippling cycle is advances in technology - especially computers and other information technology. Companies are increasingly able to maintain or even expand production without adding workers. That's one reason the country is going through a so-called "jobless recovery."

The process has been under way for decades, but it appears to have accelerated. In the last two years, U.S. companies have spent billions of dollars on new equipment, but unemployment has remained near 10 percent and the economy has replaced only 1.8 million of the 8.7 million jobs lost between 2007 and 2009, when the recession technically ended.

The second factor that spells deep-rooted trouble for the U.S. economy is a dramatic change in the nature of foreign competition. In the past, emerging nations such as India, China and South Korea once lured U.S. jobs offshore primarily because their workers - while relatively unskilled - were paid only a fraction of what American workers received. Today, those countries are producing millions of well-educated workers, not just engineers and computer scientists, but medical researchers, financial experts and even lawyers who compete with U.S. workers, who previously seemed immune to offshore competition. And their expanding markets have attracted one American company after another. From 1999 through 2009, U.S. multinational companies added 2.4 million employees overseas while cutting their domestic staffing by 2.9 million, according to the Commerce Department. And these figures don't include outsourcing of jobs to non-U.S. companies abroad.

A broad measure of productivity meant to capture the effects of technology change and labor at service and manufacturing companies showed that it rose 3.2 percent last year - the highest since the index was designed in 1987. That's faster than the economic output last year, meaning businesses didn't need to add much staff to meet increased orders.

The final major factor in the new economic landscape is the huge debt burden left over from the recession - in housing, consumer credit and government spending - that acts as a massive drag on the economy. Worry about the deficit also is preventing the federal government from continuing the kinds of stimulus programs put in place right after the recession began.

But a growing body of evidence suggests that simply curing consumers' debt hangover and increasing their saving while reducing spending won't be enough, at least not when it comes to jobs. The emerging giants of today's economy, Amazon, Google and Facebook, are surging with customers and revenue but doing so without the kinds of booming employment growth that accompanied the rise of corporations such as General Motors and Procter & Gamble.

"Technology allows you to build large, global, scalable companies with a fraction of the people that 20th century companies had," said Michael Schrage, a research fellow at the Massachusetts Institute of Technology Sloan School's Center for Digital Business. "That's a real issue for the future composition of employment." The unemployment rate, 9.1 percent in May, has been at or above 8.5 percent for 27 straight months - longer than at any other time since the Great Depression.

Public job losses weigh on economy

Shrinking governments slowing recovery's momentum

In a healthy economic recovery, states and localities start hiring, expand services and help fuel the nation's growth. Then there's the 2011 recovery.

The U.S. economy is moving ahead, however fitfully. Yet state and local governments are still stuck in recession. Short of cash, they cut 30,000 jobs in May, the seventh straight month they've shed workers. Rather than add to U.S. economic growth, they're subtracting from it. And ordinary Americans are feeling it — from reduced services to fewer teachers, police officers and firefighters.

The Great Recession officially ended two years ago this month. By the same point during previous recoveries, state and local governments were engines of growth: In the two years after the 1990-91 recession ended, for example, they'd added 430,000 jobs. At the same point after the 2001 recession ended, they had added 249,000.

This time is different. More than 467,000 state and local government jobs have vanished since the recession officially ended in June 2009, including 188,000 in schools. Few see the pain subsiding soon. Mark Vitner, senior economist at Wells Fargo Securities, expects state and local governments to slash 20,000 to 30,000 jobs a month through the middle of 2012.

Joel Naroff of Naroff Economic Advisors notes that when states cut spending to balance their budgets, as required annually, a ripple effect multiplies the damage: Companies that do business with states and localities suffer. These companies, in turn, scale back their own hiring. "There's a whole slew of private companies that have to cut back when they don't get the (government) contracts they had been getting," Naroff said. "You can't balance a budget and say everything's going to be beautiful."

Moody's Analytics estimates that each job in state and local government supports an additional 1.3 jobs elsewhere in the economy. The Great Recession of 2007-2009, the longest and deepest downturn since the 1930s, dried up state and local tax revenue. It also escalated demands for social programs like Medicaid and unemployment benefits and "ate through their rainy-day funds," notes Michael Gapen, senior U.S. economist at Barclays Capital. For a while, federal stimulus spending cushioned the blow to state and local finances. But that money is running out. And it probably won't be replenished. The federal government is preparing to cut its own spending to shrink huge budget deficits.

May Retail Sales

Retail sales fall for first time in almost a year

First decline in 10 months another signal economy is losing steam

Americans bought fewer cars in May, pulling retail sales down for the first time in nearly a year. Sales among U.S. retailers fell 0.2 percent last month, the Commerce Department said. It was the first decline after 10 straight increases and the latest report signaling the economy has lost momentum. Consumers are struggling to deal with high gasoline prices and a slowdown in hiring.

Auto sales dropped 2.9 percent, the largest decline since February 2010. But excluding the weak car sales, retail sales rose 0.3 percent. A lack of deals and the shortage of some fuel-efficient models in high demand were to blame for the decline in auto sales. The natural disasters in Japan disrupted shipments of cars and component parts to the United States.

Prices at the wholesale level rose at the slowest pace in 10 months, according to separate report from the Labor Department. Food costs fell by the most in a year and gas prices rose by the smallest amount in eight months. The figures suggest consumers could see some relief from rising prices soon.

Higher gas prices have left consumers with less to spend on discretionary goods. Analysts hope that the economy will regain momentum in the second half of this year if gasoline prices fall further. A majority of leaders for the largest U.S. companies appear to share that optimism, according to a survey. The Business Roundtable, which represents CEOs for the 200 biggest U.S. companies, said 51 percent of chief executives plan to step up hiring in the second half of the year. That's nearly in line with last quarter's 52 percent - the highest percentage since the trade group began polling its members in 2002.

The survey began in mid-May and ended on June 3, the day the government released the May jobs report, which showed a steep pullback in hiring. The unemployment rate rose to 9.1 percent.

Wal-Mart unveils Express store

Discount giant scales down to compete with smaller rivals.

Wal-Mart Stores Inc. is thinking small as it takes its fight against the growing threat of dollar stores to its own backyard. In rural Arkansas, the first drugstore-sized Walmart Express store offers a peek at how the world's largest retailer plans to expand in big cities and tiny towns.

The world's largest retailer unveiled recently the first of the stores, about a half-mile away from rival Dollar General in rural Gentry. The store looks like a tinier version of Wal-Mart's usual sprawling self. The long, narrow concrete box, which features a powder-blue Walmart Express sign, is less than one-tenth of the size of a super center. The store, which has exposed pipes and yellow walls, carries most of the basics that its bigger cousin carries, from bacon and milk to socks and DVDs.

That's ideal for customers who are in a fix — they've run out of milk or their toaster just broke, or they're just bored and need to pick up a DVD. But the selection is less — 11,000 to 13,000 items, a tenth of what a superstore carries. Walmart Express is intended to be a two-pronged strategy: stores in small towns that aren't big enough to support a full-sized Walmart, and stores in big cities where building a whole supercenter is impractical.

Wal-Mart is experimenting with a Walmart Express prototype for urban markets in Chicago, to open later this summer. It plans to build 15 to 20 Walmart Express stores, focusing on Arkansas, North Carolina and Chicago, by the end of its fiscal year in January 2012."This is about access to breadth of assortment" and everyday low prices, said Anthony Hucker, vice president of strategy and business development, which is spearheading the new format.

If the retailer gets the prototypes right for both urban and rural areas, it sees the potential to build about 350 Express stores per year, the same pace as the height of its super center expansion in 2005 and 2006. Walmart's U.S. business has been chipped away by dollar stores, which have adroitly maneuvered the post-recession economy.

Dollar stores, with their small size and convenient locations ideal for quick shopping, have added brand-name products and become more competitive on price. They're also expanding quickly, opening stores closer to customers' homes, an advantage in an era of high gas prices.

May Auto Sales

U.S. automobile sales shift into reverse during May

Lack of promotions and short supply of vehicles dent activity

U.S. auto sales cooled off in May as dealers started running short on some popular, fuel-efficient models and buyers were turned off by sharply lower incentives. Deals aren't likely to come back until the end of this summer. Some experts are advising people to delay their purchases if they can. "If you don't have to buy, wait until fall. If you lease a car, extend it," said Edmunds.com chief Jeremy Anwyl.

Consumers heard that message in May. U.S. auto sales were expected to be around 1 million cars and trucks, down 8 percent from April and 4 percent from last May. Toyota Motor Corp. and Honda Motor Co. and Nissan Motor Co., all of which ran short of models due to parts shortages caused by the March 11 earthquake in Japan, had the biggest sales declines, with Toyota down 33 percent, Honda off 23 percent and Nissan off 9 percent compared with May of last year.

General Motors Corp. sales dropped 1.2 percent, as falling pickup truck sales offset strong sales of more fuel-efficient cars and crossovers. It was the same story at Ford Motor Co., which saw sales fall 2.4 percent for the month. Pickup sales dropped more than 10 percent at both companies.

Once again, small, compact and midsize car sales were up and truck sales were down because of high gas prices. At Ford, where the F-Series pickup is traditionally the top-selling vehicle in the U.S., fuel economy clearly was driving sales. For the first time in decades, the company sold more F-150s with V6 engines (55 percent) than it did with larger V8s.

Despite a raft of bad economic data in the past few days, automakers generally said they were still optimistic for the year, with Ford and GM sticking with annual forecasts of around 13 million in U.S. sales. That's far short of the 2000 peak of 17.3 million, but better than the 10.4 million trough in 2009.

Demand, prices climb for used cars

Gas guzzlers idle while fuel-efficient models move more quickly

A decade ago, gas-guzzling SUVs were so hot dealers could barely keep them on lots. After a deep recession and a doubling of oil prices, the tables have turned. New SUVs languish, but used Civics and Corollas are suddenly cool. "Quite clearly, consumers are looking to downsize their vehicles and their ownership costs, and used cars are a great way to do that," said Jeff Bartlett, an auto editor at Consumer Reports.

With demand soaring, used cars aren't the bargain they once were. By one measure, values for fuel-efficient used cars have reached record levels. Auto auctioneer Manheim said its used-car index rose 1.9 percent in April to its highest level ever. Wholesale prices have risen 4.9 percent in the past year, with fuel-efficient models rising the most and big SUVs losing value. "In the simplest words, it's supply and demand," said Tom Webb, chief economist at Manheim Consulting.

The supply of both new and used cars has dwindled for a variety of reasons. Stung by plummeting sales in recent years, carmakers are building fewer autos. The Cash for Clunkers program took about 680,000 vehicles off the road. And the earthquake and tsunami in Japan disrupted the manufacture of some models.

Even with used-car prices rising, they still can offer better values than new cars. With inventories lean, manufacturers mostly have stopped offering incentives on new cars, and dealers are holding out for higher prices on showroom models. "If you must buy now, you will certainly pay a bit of a premium because of the market conditions," said Jeff Bartlett, Consumer Reports.

June Auto Sales

Auto Sales stuck in slow lane in June

Slowdown attributed to shortage of supply, consumer wariness

U.S. auto sales in June ran at the slowest pace in 12 months, as small-car supply dwindled and consumers deferred purchases amid a slowing economic recovery. General Motors and Ford Motor said U.S. sales rose 10 percent in June, missing the average estimate of seven analysts surveyed by Bloomberg. Toyota and Honda deliveries each fell 21 percent, more than analysts estimated. Nissan recorded an 11 percent gain, less than projected, while Chrysler sales topped forecasts.

Industrywide, light-vehicle sales slowed to an 11.5 million seasonally adjusted annual rate, trailing the 12 million average estimate of 12 analysts. Small-car purchases are being lost due to supply constraints hurting all automakers. “What we thought was going to be a stable recovery was shattered by the Japanese problems in the first half,” Jesse Toprak, an analyst at TrueCar.com, said in a telephone interview. “These are fragile blocks we’re stepping on to get to more stable ground.”

U.S. total light-vehicle sales rose 7.1 percent in June from a year earlier, researcher Autodata said in an e-mailed statement. The March 11 earthquake near Japan limited production and led to depleted vehicle inventories for Toyota and Honda. The percentage of consumers planning to buy a new vehicle within six months fell to 3.1 percent, the lowest since December, the New York-based Conference Board said this week. U.S. auto sales will recover in the second half and annual deliveries will rise to 12.9 million vehicles, according to forecasters at Edmunds.com and J.D. Power & Associates.

UCLA Anderson School Forecast

Bay Area could lead in state job creation

But economic forecast warns recovery won't happen right away

California won't recover the jobs it lost during economic meltdown until at least 2014 - but the Bay Area could recapture its losses sooner than that, a report released recently suggested. Urban centers along the coast such as the Bay Area, Los Angeles, Orange County and San Diego are poised to rebound more rapidly than California overall. The most sluggish pace of recovery is expected for inland areas such as Sacramento, the Central Valley and the Riverside-San Bernardino-Ontario region. "This is a bifurcated recovery," said Jerry Nickelsburg, a senior economist with the UCLA Anderson Forecast, which released the report.

A jobs recovery will materialize in regions such as the Bay Area that are being bolstered by the tech rebound, along with exports and imports, the Anderson Forecast economists said. "Coastal California, particularly the Bay Area with its technology and software industries, will lead in job growth," according to the forecast. Areas that depend more strongly on residential construction - such as inland regions of California - will struggle to produce an employment revival, Nickelsburg said.

A region such as the East Bay, however, could experience an uneven pace of recovery. The East Bay has some high-tech in places such as Fremont, Pleasanton and Livermore. It also has a considerable amount of clean-tech operations sprinkled through the region. The East Bay also enjoys manufacturing and distribution operations that are enhanced by the Port of Oakland's import and export activity.

Housing and financial services, which melted down during the recession, also are a big part of the East Bay economy, however. Those anchors could drag down the pace of the employment rebound in the Alameda County-Contra Costa County region. "The East Bay is pretty interesting," Nickelsburg said. "It's kind of a mix of industries."

The biggest benefit for the East Bay could be its location near the primary recovery engines that are powered by the digital boom in Silicon Valley, San Francisco and San Mateo County. "The spillover from high-tech in Silicon Valley will create employment opportunities in the East Bay," said Jeffrey Michael, director of the Stockton-based Business Forecasting Center at University of the Pacific.

Real estate will remain a problem for job creation in the East Bay, however."High tech and exports and imports somewhat offset the housing hangover," Michael said. "But the East Bay was hit as hard as anyplace else through the recession when it comes to jobs."

In contrast, things appear more solid in Santa Clara County. "Silicon Valley is already recovering," Michael said. The Anderson Forecast predicted that California will experience "slow growth" through the end of this year.

The forecasters also predicted:

- Statewide unemployment, now at less than 12 percent, will continue to fall through the second half of 2011 and average 11.7 percent.
- Job growth in 2012 will push the jobless rate down "marginally."
- The unemployment rate won't reach 9.9 percent until the second quarter of 2013.
- Growth in real personal income is forecast to be 1.7 percent in 2011 and 3.3 percent in 2012.

"The bifurcated recovery will be with us for some years to come," the Anderson Forecast said.

Sources:
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