

Jobs and the Presidency

Professor Neil Bruce of the University of Washington recently lectured on the economy's impact on the presidential election. Making use of the Fair Model, he predicted that President Bush would win in November with a 54 percent vote. The principal considerations in the model all favor Bush: incumbency (yes), growth in real Gross Domestic Product (healthy), and inflation (low).

Although the model has a good track record of predicting the winner, it has occasionally missed. A potential wild card in the

upcoming election is the jobless recovery. Whatever its cause, the simple fact of the matter is that, despite federal tax cuts, massive spending for security, and rock-bottom interest rates, the national economy has not been growing fast enough to create many jobs. As a consequence, the nation could have fewer jobs at election time than when President Bush first took office.

If jobs do count in presidential elections, it will be even more difficult for Bush to win votes in the Puget Sound region. In relative terms, the region lost more jobs than the nation during the recession, 5.3 percent from peak to trough versus 2.0 percent. Moreover, the region is likely to recover more slowly than the nation. In 2004, regional employment is predicted to expand at a 0.9 percent rate, 0.4 percentage points less than the national rate.

Nevertheless, as political observers like to say, timing is everything. In this regard, President Bush may get a break. By late summer, the national economy will be generating 200,000 jobs per month, while the regional economy will be adding 2,000 jobs per month, according to the current outlook.

Who do we think will win the presidential election? It is too early to call.

Summary Forecast

Annual Percent Change	2002	2003	2004	2005
Puget Sound Region				
Employment	-2.6	-0.6	0.9	1.9
Personal income (cur. \$)	0.1	2.7	4.5	4.7
Consumer price index	1.9	1.7	0.9	1.9
Housing permits	-0.1	-0.6	-1.1	-0.3
Population	1.0	0.7	0.8	0.7
United States*				
GDP (\$00)	2.2	3.1	4.6	3.7
Employment	-1.1	-0.2	1.3	2.3
Personal income (cur. \$)	2.3	3.2	5.3	5.5
Consumer price index	1.6	2.3	1.7	2.1
Housing starts	6.9	4.3	-2.0	-4.6

*Source: Blue Chip Economic Indicators

Regional Outlook

Got jobs?

Economics would be dry without its little mysteries. What is baffling economists right now is the jobless recovery. Since the bottom of the national recession in the third quarter of 2001, real Gross Domestic Product (GDP) has risen 7.8 percent but payroll employment has fallen 1.2 percent. Employment inched up last quarter but still remained more than two million jobs below the peak of three years ago.

Considering the lingering effects of our deep downturn, the lack of job growth in the Puget Sound region is less puzzling. Nevertheless, based on our recent predictions, the local demand for labor has not been as strong as expected, indicating that the malaise in the national job market has infected the region.

Economists have offered four explanations for this perplexing development: productivity gains; a labor squeeze; the cyclical upturn; and bad data.

There is no doubt that the U.S. economy has experienced substantial advances in productivity since 1995. Last year real GDP

grew 3.1 percent, while employment fell 0.2 percent, implying a 3.3 percent jump in output per worker, more than twice the

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Regional Outlook

30-year average. What is at issue is the source of this improvement. Most analysts point to new information technologies and heavy investment in computers, software, and telecommunications. They further contend that the string of productivity gains has not run out, since the diffusion of technology is a slow process.

Other economists believe that the pick-up in productivity, especially since the recession, stems from a squeeze on labor. Disappointed by past earnings, businesses have embarked on a concerted effort to slash labor costs, according to this view. Consequently, businesses have not only been applying new technologies but also cutting jobs, working employees harder, requiring overtime (sometimes with no pay), hiring temps, and outsourcing work.

Proponents of the cyclical upturn theory argue that the jobless problem lies not with the surge in productivity, which is normal for this stage of an economic cycle, but with the weakness of the recovery. They point out that labor

much less than the 6.6 percent gain in the two years following the 2001 downturn. But the earlier recovery created 4.8 million jobs because of robust growth in real GDP (4.5 percent in 1983 and 7.2 percent in 1984). In contrast, the relatively anemic growth of the current recovery (2.2 percent in 2002 and 3.1 percent in 2003) has led to additional job losses.

The fourth explanation for the jobless recovery is bad data. Whereas payroll employment counts were down 0.5 million in 2003, according to the Bureau of Labor Statistics, the number of persons employed was up 1.2 million, according to the Bureau of the Census. This discrepancy is too large to be dismissed as simple differences in employment definitions or measurement procedures. It is possible that job growth has been stronger, and productivity gains weaker, than generally supposed.

If we are in the midst of a technological revolution, it is unclear when jobs will be expanding again. On the other hand, if we are witnessing a one-off labor pinch or a cyclical upturn in productivity, renewed job growth may be just around the corner.

While national forecasters are expecting another good round of productivity gains (3.3 percent) in 2004, they are predicting that strong real GDP growth (4.6 percent) will give rise to decent job growth (1.3 percent). In 2005, despite a slower pace for the economy (3.7 percent), employment

Puget Sound and U.S. Employment

	2002	2003	Change
Puget Sound Region			
Employment (thous.)	1661.2	1650.8	-10.4
Persons employed (thous.)	1680.7	1692.8	12.1
United States			
Employment (mils.)	130.4	129.9	-0.5
Persons employed (mils.)	136.5	137.7	1.2

growth will accelerate (2.3 percent) because of a drop-off in productivity gains (1.4 percent).

The pattern of employment growth in the Puget Sound region will be similar. However, because of the repercussions of our severe recession, the expansion rates will be lower, 0.9 percent in 2004 and 1.9 percent in 2005. Not until Boeing starts hiring again will the region outpace the nation.

Welcome to NAICS.

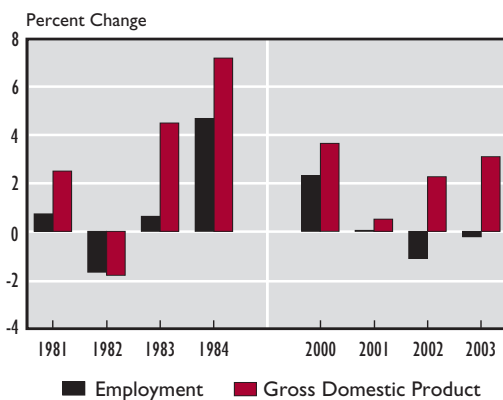
We are now forecasting employment in accordance with the North American Industrial Classification Scheme (NAICS). By way of introduction, we present a brief overview of the new NAICS industries, which are divided into two sectors: goods producing and services producing.

Goods producing. This sector consists of three industrial groups: natural resources and mining; construction; and manufacturing.

Natural resources and mining primarily includes logging and sand and gravel mining. This small industry tends to move up and down with building cycles.

Construction employment, which is volatile in the short term, has more than doubled since 1980. Residential construction has held up reasonably well during the recession because of low mortgage rates, but nonresidential construction, especially office building, has

U.S. Employment and Real Gross Domestic Product



productivity, as measured by real GDP per worker, increased a total of 6.3 percent in the two years after the 1982 recession. This is not

suffered because of the great job loss.

Manufacturing has shed 80,000 jobs since its all-time peak in 1998. The loss of 50,000 aerospace jobs, mostly at Boeing, is well documented. But there has also been a loss of 18,000 jobs in other durable goods (principally, wood products, metals, machinery, and other transportation equipment) and 12,000 jobs in nondurable goods (principally, food products, apparel, paper products, printing, and chemicals).

Services producing. The services producing sector includes government and six industrial groups: wholesale and retail trade; transportation and public utilities; information; financial activities; professional and business services; and other services.

Under NAICS wholesale and retail trade no longer includes eating and drinking places, one of the region's fastest growing industries. Nevertheless, wholesale and retail trade still accounted for 100,000 new jobs over the past twenty years. The dot-com bust coupled with productivity gains in retail stores, however, have cost the industry 15,000 jobs since 2000.

Ground, air, and water transportation and electric and gas utilities constitute the relatively small and slow-growing transportation and public utilities industry, at least from a jobs standpoint. Having added just 20,000 employees since 1980, the industry now employs about 60,000 people.

Information is an odd collection of businesses: Microsoft, The

Seattle Times, AT&T Wireless, and Cinerama. The industry expanded rapidly in the 1990s, adding 45,000 workers. Microsoft was responsible for about two-fifths of this growth.

Financial activities is just a new moniker for finance, insurance, and real estate. This is the only industry that thrived during the recession, as forty-year low mortgage rates boosted homebuying and refinancing to record levels.

Professional and business services is the fastest growing industry in the region, having tripled in employment since 1980. Many of the industry's 206,000 jobs are in high-paying occupations, such as architecture, engineering, and management. The average annual wage in the industry last year was \$52,500, about \$8,000 above the overall average in the region.

Other services, which primarily includes health services, educational services, leisure (restaurants and hotels), and personal services, employs nearly 400,000 people. Steady growth, even during recessions, is the distinguishing characteristic of this industry.

Government includes state and local government and federal government (excluding the military). State and local government, which accounts for about one-seventh of all Puget Sound jobs, tends to grow along with population. Local government continued to add jobs during the recession, many of them in education. The postal service and the Puget Sound Naval Shipyard make up one-third of federal government employment. The number of federal jobs has been fairly flat since 1980.

Puget Sound Employment

Thousands	1990	2000	2003	Change	
				1900-00	2000-03
Employment	1366.5	1720.6	1650.8	354.1	-69.8
Goods producing	313.4	321.1	268.4	7.7	-52.7
Natural resources and mining	2.5	2.7	2.4	0.2	-0.3
Construction	77.6	103.4	96.3	25.8	-7.1
Manufacturing	233.4	215.0	169.7	-18.4	-45.3
Aerospace	112.3	84.5	64.3	-27.8	-20.2
Other durable goods	78.3	83.4	66.9	5.1	-16.5
Nondurable goods	42.8	47.0	38.5	4.2	-8.5
Services producing	1053.1	1399.5	1382.4	346.4	-17.1
Wholesale and retail trade	221.2	273.4	258.1	52.2	-15.3
Transportation and public utilities	57.5	65.0	59.3	7.5	-5.7
Information	36.4	80.9	75.7	44.5	-5.2
Financial activities	82.0	102.9	107.3	20.9	4.4
Professional and business services	143.8	226.4	205.8	82.6	-20.6
Other services	293.6	389.0	397.8	95.4	8.8
Government	218.6	261.9	278.5	43.3	16.6
State and local	165.2	213.0	228.8	47.8	15.8
Federal	53.4	49.0	49.7	-4.4	0.7

Retail Sales

Interest rates matter.

The welcome recovery predicted for the Puget Sound economy this year is expected to boost retail spending by 4.7 percent. This is one percentage point higher than last year's growth rate. Faster personal income growth, declining unemployment, and low interest rates (at least for most of the year) will be the driving forces. Our forecast for 2005, however, calls for the spending pace to weaken a bit to 3.8 percent, as durable goods sales advance more slowly in response to climbing interest rates.

Does this response make sense in a world where cheap home equity loans fund consumer spending and where auto loans come with a zero percent interest rate? Our analysis of durable goods sales shows that interest rates do matter. If nothing else, higher interest rates will reduce the demand for home equity loans and make it

more costly for auto companies to offer no interest loans.

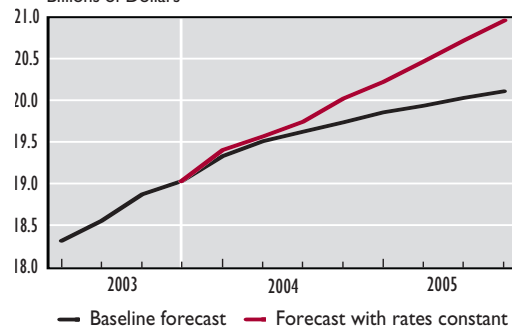
In our model for motor vehicle sales the interest rate term is specified as a weighted average of interest rates over five quarters. Thus, as rates begin to rise later this year they will act to restrain motor vehicle sales next year, offsetting the stimulus from rising incomes and lower unemployment.

Consequently, motor vehicle sales are predicted to increase only 1.3 percent in 2005, down from 4.4 percent in 2004.

A simulation with the forecasting model in which interest rates are held constant helps gauge the impact of the expected rate increase. This exercise shows that total retail sales would increase 4.9 percent in both 2004 and 2005 if interest rates remained where they are. These results imply that higher rates will reduce motor vehicle sales by \$102.2 million (0.8

Puget Sound Retail Sales of Durable Goods

Billions of Dollars



percent) this year and by \$523.5 million (4.0 percent) in 2005. Total durable goods sales will be lowered by 0.6 percent this year and 3.1 percent next year.

This simulation is oversimplified, since the forecasts of personal income and the unemployment rate were not adjusted to be consistent with the interest rate assumption. Still, it illustrates the sway that interest rates have on retail spending, one which may have been taken for granted during the three-year recession.

PUGET SOUND RETAIL SALES

	2003		2004			Years			
	3	4	1	2	3	2002	2003	2004	2005
Retail sales (bils. \$)	48.809	49.389	50.041	50.628	51.077	46.808	48.557	50.818	52.745
Building materials	4.221	4.145	4.219	4.318	4.378	3.992	4.129	4.334	4.496
Motor vehicles and parts	11.912	12.238	12.373	12.429	12.428	11.493	11.901	12.422	12.590
Furniture and electronics	2.732	2.696	2.748	2.795	2.828	2.597	2.673	2.806	2.907
General merchandise	5.916	6.020	6.119	6.210	6.291	5.582	5.887	6.248	6.579
Food and beverage	6.573	6.615	6.662	6.713	6.762	6.472	6.561	6.737	6.931
Gasoline stations	3.284	3.332	3.387	3.443	3.494	3.171	3.321	3.467	3.683
Clothing and accessories	2.455	2.473	2.492	2.511	2.528	2.368	2.442	2.518	2.592
Food services and drinking	4.554	4.603	4.659	4.711	4.757	4.382	4.533	4.733	4.942
Other retail sales	7.161	7.267	7.381	7.499	7.611	6.750	7.111	7.553	8.024
Taxable retail sales (bils. \$)	56.360	56.804	57.400	58.423	59.364	54.132	55.536	58.838	62.023
Retail trade	29.774	30.064	30.488	30.847	31.135	27.828	29.295	30.973	32.201
Other taxable sales	26.586	26.740	26.912	27.576	28.229	26.304	26.241	27.865	29.822
Annual growth (% change)									
Retail sales	5.5	4.7	5.3	4.7	3.5	0.6	3.7	4.7	3.8
Taxable retail sales	9.0	3.2	4.2	7.1	6.4	-1.2	2.6	5.9	5.4

Quarterly data are seasonally adjusted and expressed on an annual basis.

Construction and Real Estate

Here and there.

Puget Sound home sales went through the roof in 2003, according to the final tally by Northwest Multiple Listing Service. Closed sales climbed to 70,000, a 19.2 percent increase over the prior year. The average home price rose 4.3 percent to \$273,900. At that price the total volume of sales in the four-county area amounted to more than \$19 billion.

The hot residential housing market was not unique to our corner of the country. Following a 6.0 percent gain in 2002, U.S. new and existing home sales jumped 9.4 percent in 2003. The buying frenzy resulted in a 7.9 percent hike in the average price of a new home. Adjusted for quality, the National Association of Home Builders reported that new home prices increased 5.6 percent last year.

The principal source of energy in the housing market was the lowest

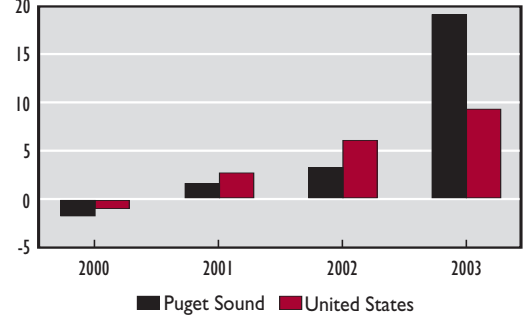
mortgage rate in four decades. Averaging 5.8 percent, it made buying a house as cheap as renting an apartment, all things considered (house payments, rent, and home price appreciation).

In light of the severity of our recession, it is somewhat surprising that the regional real estate market has in general fared as well as the national market. Perhaps this reflects the fact that downturns, even nasty slumps like the current one, affect only a handful of people (in this case, principally dot-com and aerospace workers). In other words, for most of the residents in the Puget Sound region, it has been business as usual in recent years.

The regional forecast is similar to the national outlook: little change in home sales between 2003 and 2004, but a decline in the rate of sales during the year. Accordingly, we predict that

Puget Sound and U.S. Homes Sales

Percent Change



another 70,000 single-family homes and condominiums will be sold this year. On the other hand, the annual rate of sales will drop from 74,800 in the fourth quarter of 2003 to 67,700 in the fourth quarter of 2004. The weakening housing market will be more evident in the numbers for 2005: an 8.9 percent decline in sales and a modest 1.5 percent rise in home prices.

[Note: We are now forecasting closed home sales rather than pending home sales. Closed sales tend to lag pending sales by about one quarter.]

PUGET SOUND CONSTRUCTION AND REAL ESTATE

	2003		2004			Years			
	3	4	1	2	3	2002	2003	2004	2005
Housing permits (thous.)	25.1	19.7	20.7	21.7	22.4	22.2	22.1	21.8	21.8
Single-family	16.4	16.4	15.5	15.8	15.9	15.6	15.9	15.8	14.8
Multi-family	8.6	3.3	5.3	5.8	6.5	6.6	6.1	6.1	7.0
Housing permits (mils. \$)	3661.3	3299.6	3247.7	3320.4	3375.5	2925.0	3315.2	3335.4	3262.1
Single-family	2867.5	3018.2	2773.4	2798.8	2800.5	2388.5	2765.8	2792.6	2628.4
Multi-family	793.8	281.4	474.3	521.7	574.9	536.5	549.4	542.8	633.7
Average home price (thous. \$)	276.7	282.6	285.8	286.1	286.5	262.6	273.9	286.5	290.7
Active home listings (thous.)	21.1	19.6	19.8	20.0	20.2	21.2	21.6	20.1	20.9
Home sales (thous.)	72.1	74.8	71.4	70.9	69.7	58.7	70.0	70.0	63.8
Apartment vacancy rate (%)	7.5	7.4	7.5	7.4	7.2	7.4	7.5	7.3	7.0
Average apartment rent (\$)	806	810	817	825	833	810	807	829	864
Annual growth (% change)									
Housing permits (mils. \$)	54.2	-39.5	-6.3	9.0	6.6	7.1	13.3	0.6	-2.2
Average home price	8.9	8.5	4.6	0.4	0.5	6.4	4.3	4.6	1.5
Average apartment rent	0.5	2.0	3.4	4.0	4.0	0.6	-0.4	2.8	4.2

Quarterly data are seasonally adjusted and expressed on an annual basis.

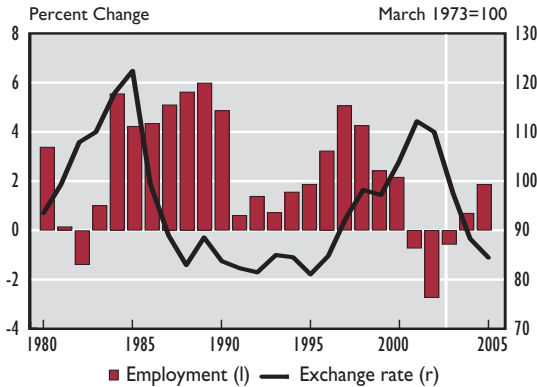
Special Topic: The Dollar

In praise of weakness.

The value of a dollar is always a dollar. But the value of a dollar is not always 107 Japanese yen, as it was in February. Two years ago a dollar could buy 134 yen.

Like other goods, currencies have prices or exchange rates. An

Puget Sound Employment and U.S. Real Exchange Rate



exchange rate is the rate, or price, at which the currency of one country is swapped for the currency of another country. For example, if a dollar costs 107 yen, the exchange rate for the dollar is 107 yen. Conversely, the exchange rate for the yen is 0.009 (=1/107) dollars, since a yen costs 0.9 cents.

International trade and foreign investment require currency exchange markets. If Americans want to buy Toyota automobiles or Sony televisions, for example, they must ultimately pay for them in yen. Likewise, Japanese must obtain dollars in order to purchase Disney DVD's or U.S. government securities. Market forces raise or lower exchange rates until the outflow of a nation's currency (demand) equals the inflow (supply).

Recently, the Japanese government has been buying dollars to increase the value of the dollar and lower the value of the yen. A strong currency is often a source of national pride, as it reflects a strong economy. However, a fall in

the yen effectively reduces the price of Japanese exports, making them more competitive in the world market. Japan's intervention in the foreign currency market is an attempt to ensure that its recovery from a ten-year recession is not prematurely derailed.

Fluctuations in exchange rates can have a significant impact on an economy. In the early 1980s, a sharp rise in the real exchange rate of the dollar increased export prices and decreased import prices in the United States. As a consequence, real net exports (exports less imports in 2000 dollars) swung from a surplus of \$12.6 billion in 1980 to a deficit of \$156.3 billion in 1986. This reversal in the trade balance contributed to the 1982 recession, hindered the ensuing recovery, and badly damaged the agricultural, steel, automobile, and textile industries.

In the late 1980s, the value of the dollar plummeted, dramatically changing the fortunes of U.S. exporters, especially in the Puget Sound region. Indeed, it would not be much of an exaggeration to characterize the resulting regional expansion as an international trade boom. Led by Boeing aircraft, regional sales to foreign countries more than doubled in real terms between 1985 and 1990. With the help of a robust national economy, the rapid growth of international

trade led to the creation of 300,000 regional jobs during the five-year period. Fifty thousand of these jobs were in manufacturing, something difficult to imagine in this day of disappearing factory workers.

Does the current two-year decline in the dollar hold promise of more good times for the regional economy? Certainly, the dollar's 30 percent depreciation against the euro has improved Boeing's competitive position in the aircraft market. Airbus can take steps to mitigate the impact of the weaker dollar, such as reducing the price of its airplanes or outsourcing some of its work to the United States, making the airplanes "more American." But the degree to which the dollar has fallen combined with stakeholder pressure on the European airplane company to turn a profit would suggest that, once the demand for aircraft recovers, Airbus will have a difficult time holding its current lead in market share.

The weaker dollar is not without cost, as it will eventually lead to higher import prices. This in turn will temper economic activity by increasing inflation, raising interest rates, and reducing real disposable income. But in the Puget Sound region, which ranks first in the nation in foreign exports per capita, the economic gains from the fall in the dollar will undoubtedly outweigh the losses.

Foreign Exchange Rates

Per U.S. Dollar	Monetary Unit	February 2002	February 2004	Percent Change
European Market	Euro	1.15	0.79	-31.3
Canada	Dollar	1.60	1.33	-16.9
Japan	Yen	133.64	106.71	-20.2
Mexico	Peso	9.11	11.03	21.1
China	Yuan	8.28	8.28	0.0
Real exchange rate*		116.76	89.96	-23.0

*Trade-weighted exchange rate adjusted for prices (March 1973=100).

FORECAST DETAIL 55 Percent Probability

	2003		2004			Years			
	3	4	1	2	3	2002	2003	2004	2005
Employment (thous.)	1648.5	1649.7	1656.8	1662.6	1668.2	1661.2	1650.8	1665.6	1697.3
Goods producing	267.4	266.5	266.5	266.7	266.8	285.9	268.4	266.8	271.1
Natural resources and mining	2.7	2.7	2.7	2.7	2.7	2.3	2.4	2.7	2.7
Construction	96.4	97.5	97.7	98.1	98.5	97.4	96.3	98.3	101.3
Manufacturing	168.3	166.3	166.1	165.8	165.6	186.1	169.7	165.7	167.1
Aerospace	63.0	61.5	61.0	60.5	59.9	74.6	64.3	60.2	60.1
Other durable goods	66.7	66.7	66.8	67.0	67.2	70.9	66.9	67.1	68.3
Nondurable goods	38.6	38.1	38.3	38.4	38.4	40.6	38.5	38.4	38.7
Services producing	1381.1	1383.2	1390.3	1395.9	1401.5	1375.3	1382.4	1398.8	1426.2
Wholesale and retail trade	258.1	257.6	258.0	258.4	258.8	261.1	258.1	258.6	261.7
Transportation and public utilities	59.0	58.3	58.9	59.1	59.2	60.1	59.3	59.2	60.0
Information	76.3	76.5	77.0	77.5	78.0	78.0	75.7	77.7	80.1
Financial activities	107.1	106.6	106.9	107.1	107.2	103.8	107.3	107.1	107.7
Professional and business services	204.4	206.4	208.6	210.6	212.7	205.2	205.8	211.8	222.6
Other services	398.8	399.7	401.6	403.1	404.6	391.4	397.8	403.8	410.4
Government	277.3	278.1	279.3	280.1	281.0	275.7	278.5	280.5	283.7
State and local	227.8	228.5	229.6	230.5	231.2	227.0	228.8	230.8	233.8
Federal	49.6	49.6	49.6	49.7	49.7	48.7	49.7	49.7	49.9
Unemployment rate (%)	7.2	6.6	6.5	6.4	6.4	6.9	6.9	6.4	6.2
Personal income (bils. \$00)	121.9	122.8	123.9	124.8	125.4	120.5	121.5	125.0	128.6
Personal income (bils. \$)	128.6	130.0	131.7	133.2	134.5	124.6	128.0	133.8	140.1
Wage and salary disbursements	78.1	79.0	80.0	80.7	81.2	76.5	77.9	80.9	84.1
Other income	50.6	51.0	51.8	52.5	53.2	48.2	50.1	52.9	56.0
Per capita personal income (\$)	37945	38285	38710	39067	39346	37069	37800	39198	40757
Consumer price index (82-84=1.000)	1.944	1.924	1.931	1.938	1.946	1.894	1.925	1.942	1.979
Housing permits (thous.)	25.1	19.7	20.7	21.7	22.4	22.2	22.1	21.8	21.8
Population (thous.)	3390.1	3396.5	3403.5	3410.8	3417.5	3362.0	3387.1	3413.8	3438.3
Net migration (thous.)	4.2	3.0	4.5	5.6	3.4	7.9	3.6	3.7	0.1
Three-month treasury bill rate (%)	0.9	0.9	1.0	1.2	1.4	1.6	1.0	1.3	2.6
Conventional mortgage rate (%)	6.0	5.9	6.1	6.3	6.6	6.5	5.8	6.4	7.1
Annual growth (% change)									
Employment	-0.6	0.3	1.7	1.4	1.4	-2.6	-0.6	0.9	1.9
Personal income (cur. \$)	3.9	4.4	5.3	4.6	3.6	0.1	2.7	4.5	4.7
Consumer price index	5.0	-4.2	1.5	1.5	1.7	1.9	1.7	0.9	1.9
Housing permits	52.8	-86.1	21.1	18.1	13.0	-0.1	-0.6	-1.1	-0.3
Population	0.7	0.8	0.8	0.9	0.8	1.0	0.7	0.8	0.7

Quarterly data are seasonally adjusted and expressed on an annual basis.

Leading Index

Another broad-based advance.

The Puget Sound leading index sent another strong, positive signal for regional economic recovery last quarter, as six of its seven components increased. The leading index has now climbed 3.4 percent since the second quarter of 2003 and 3.8 percent since its trough in the third quarter of 2002.

The most encouraging developments were the improvement in the labor market indicators and the revival in durable goods spending. The manufacturing work-week lengthened to an average of 40.8

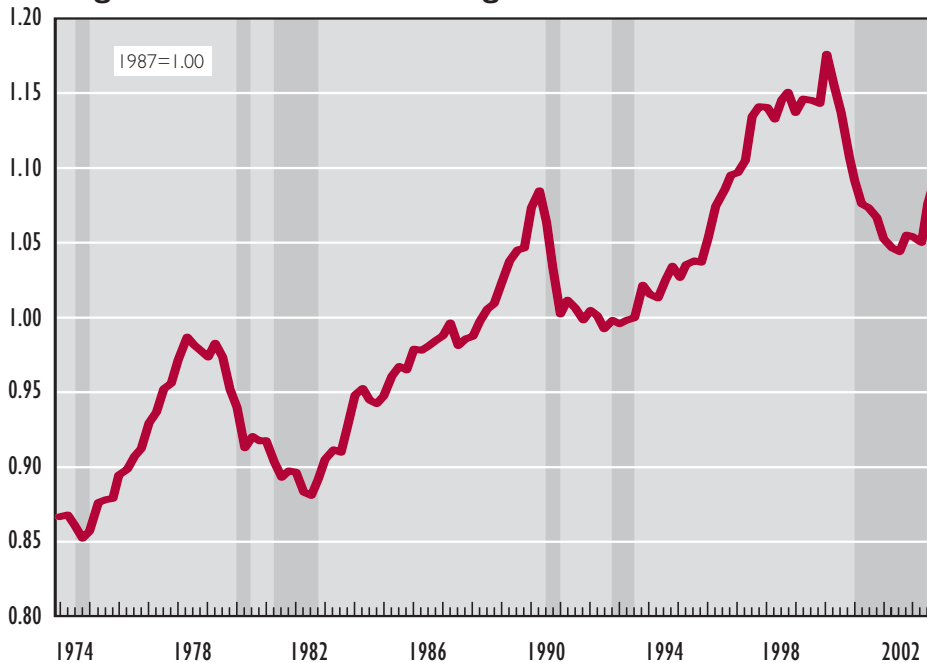
hours in the fourth quarter, the highest in more than three years, while initial claims for unemployment insurance dropped to a monthly average of 23,500, the sixth straight quarterly decline. Additionally, help-wanted ads, perhaps the single most reliable predictor of the direction of the economy, increased for the second consecutive quarter.

In response to improving labor market conditions as well as last year's tax cut, real durable goods spending climbed at an annual rate of 3.0 percent in the fourth quar-

ter. This was on top of a 5.6 percent jump in the third quarter.

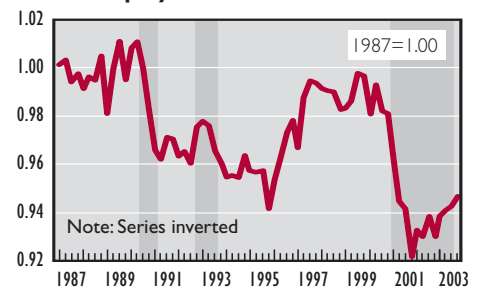
As argued in the December newsletter, the robust rise in the leading index points to imminent economic recovery. Now, with two quarters of meaningful gains and five quarters from the trough, the index clearly shows that the economy has turned the corner. Consistent with this contention, preliminary job figures for the fourth quarter show a slight rise in Puget Sound employment, the first gain in eleven quarters.

Puget Sound Index of Leading Economic Indicators

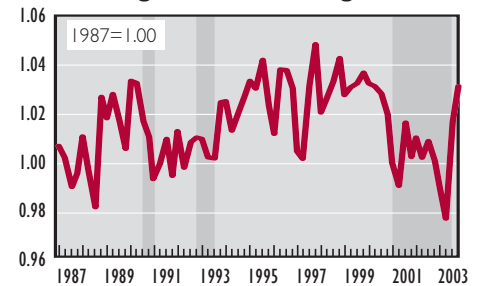


Shaded areas show recessions or periods of economic stagnation.

Puget Sound Initial Claims for Unemployment Insurance



Washington Manufacturing Hours



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The Puget Sound Economic Forecaster (ISSN 1520-7250) is produced with the aid of a regional econometric model. The newsletter is published four times a year. A one-year subscription is \$295 and includes periodic, between-quarter updates, as well as access to data. Discounts are available for multiple copies. For comment, subscription information, or change of address, please contact **Dick Conway or Doug Pedersen at Conway Pedersen Economics, Inc., P. O. Box 2241, Seattle, WA 98111-2241. Telephone (206) 329-1707; FAX (206) 324-8886.**

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