



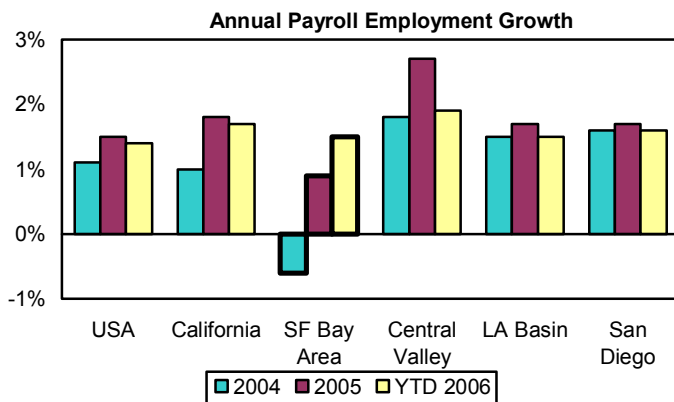
The San Francisco Bay Area Finally Catches up with the Rest of the State

Among the most positive developments related to the California economy observed this year is the continued acceleration of the San Francisco Bay Area economy. This fact is all the more remarkable, because it took the Bay Area longer than any other region in the state to emerge from the recession earlier this decade. Its employment growth did not turn positive until 2005.

The Bay Area economy has gained momentum.

During the first eight months of this year, nonfarm payroll employment in the region averaged 3.25 million, 1.5% higher than the monthly average for the same period in 2005. (Regional payroll data are not seasonally adjusted.) The rate is one and a half times greater than the 0.9% growth achieved in 2005. After years of extremely weak labor market conditions, this rapid pace of acceleration is quite noteworthy.

Not only that, the Bay Area was the only major regional economy that managed to pick up some momentum this year. Job growth in the Central Valley (including eight counties from San Joaquin to Kern), the five-county Los Angeles Basin, and San Diego County all slowed between 2005 and 2006. (See the chart below.)



Not seasonally adjusted. The year-to-date 2006 data are for the first 8 months of the year, compared with the same period in 2005. Source: California Employment Development Dept. (CAEDD)

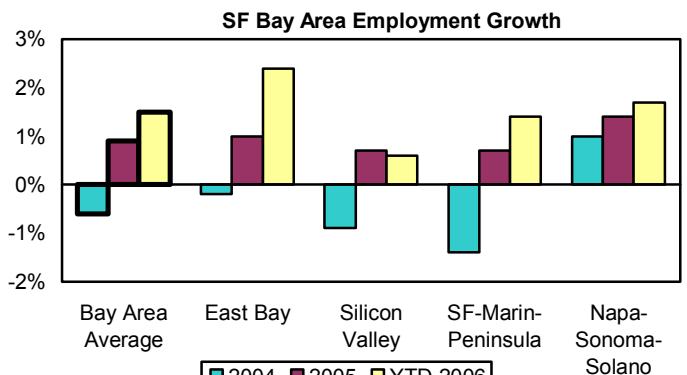
Granted, the Bay Area had a lot of room for improvement. Southern California and the Central Valley hardly experienced the dot-com recession and job growth has been strong over the past two years.

Both the Los Angeles Basin and San Diego County maintain steady paces, having added payroll jobs at the rates of 1.5% and 1.6% during the first eight months in 2006. The Central Valley enjoyed phenomenal expansion (+2.7%) in 2005, but the region decelerated lately because of the cooling housing market. Still, its year-to-date employment growth is quite respectable at 1.9%.

The Bay Area also narrowly surpassed the 1.4% job growth in the entire United States during the first eight months of this year. Statewide employment growth in California during the same period was 1.7%, suggesting that the economy of the Golden States has greater momentum than that of the nation as a whole. Needless to say, all major regions in the state now enjoy rates of growth higher than the national average.

The growth is fastest in the East Bay.

Within the San Francisco Bay Area, Alameda and Contra Costa Counties (together locally referred to as the East Bay) have enjoyed the fastest growth. The area saw its payroll employment jump 2.4% year-to-date. (See the chart below.)



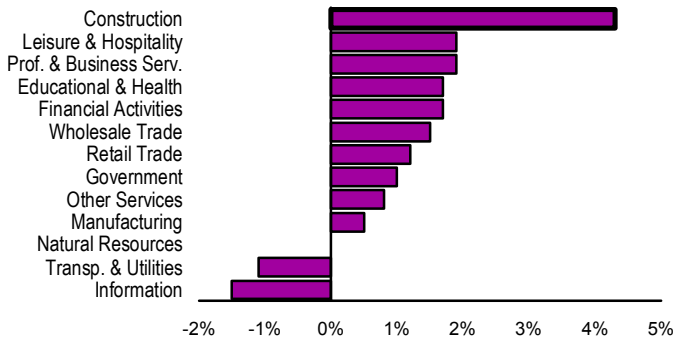
Not seasonally adjusted. Silicon Valley includes Santa Clara and San Benito Counties. Source: CAEDD.

Increased home building activities in recent years have been a boon for the East Bay. Construction employment increased 9.3% between August 2005 and 2006, and produced 7,100 new positions. The service sector has also been churning out a large number of jobs. Since August 2005, the area has gained 3,600 jobs in professional and business services, 3,300 in educational and health services, 2,900 in financial services, and 2,500 in leisure and hospitality.

The area north of the San Francisco Bay (including Napa, Sonoma, and Solano Counties) has also recorded a solid performance over the past few years. The area mainly known for its wine industry is relatively rural, but has enjoyed broad-based employment growth over the past twelve months, including 800 more jobs in professional and business services, and 500 new positions each in educational and health services, retail trade, and manufacturing.

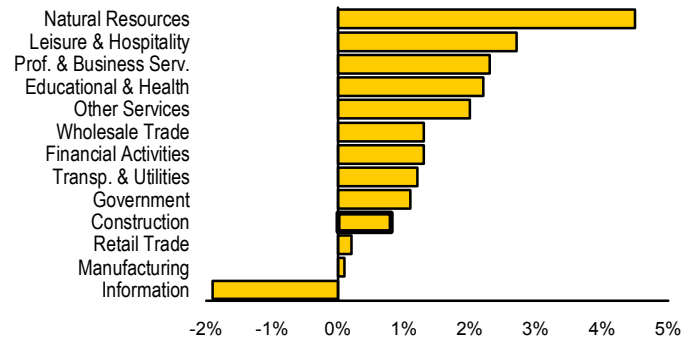
A part of the Bay Area that has been relatively slow to recover is Silicon Valley, the epicenter of the dot-com bust several years ago. It's the only area where annual job growth is yet to exceed 1%.

SF Bay Area Job Growth Aug. 2005 – 06



Change in the number of jobs. Not seasonally adjusted. Source: CAEDD.

California Job Growth Aug. 2005 – 06



Not seasonally adjusted. Source: CAEDD.

The housing boom accelerated the Bay Area's recovery.

The two charts above show annual growth rates of employment in various industries in the San Francisco Bay Area and the entire state. Except for the industries at the top, the two charts look similar—service industries rank high as sources of employment growth.

In the Bay Area, the building industry played a much more important role. The chart on the left shows that the construction sector expanded by 4.3% in the Bay Area since August 2005, while the chart on the right shows that the growth rate of the sector was only 0.8% statewide.

This suggests the Bay Area can be susceptible to the negative impact of softer housing demand. Within the area, the East Bay looks most vulnerable. Indeed, the number of housing permits has fallen 5.3% during the first eight months of this year, compared with the same period in 2005.

The softness, however, was not uniform. Single month data shows that the volume of permits in August was up 61% in the East Bay compared with a year earlier, while the number was down 52% in the San Francisco Metropolitan Statistical Area (MSA), and down 37% in the San Jose MSA.

Single family construction activities are obviously slowing, but momentum is picking up in the multi-family sector. Nonresidential construction activities also remain brisk.

What will create the next wave of growth?

When the economy is slowing but retains significant momentum, it's easy to get caught up in a debate of whether the glass is half full or half empty. What the area should focus on, however, is not what's left in the glass, but where the next round of drinks will come from, so to speak.

At a recent economic conference in San Francisco, Mayor Gavin Newsom identified three emerging industries as sources of future growth for the city (and, by extension, for the entire Bay Area). They were: digital media, biotechnology, and clean/alternative energy. If the Bay Area, capitalizing on its brain power, can successfully capture the full potential of these early-stage technologies, the region's economic future will be bright indeed.

*Keitaro Matsuda, Senior Economist
Union Bank of California, NA
San Francisco, California*

Economic Forecast – October 2006

UNITED STATES	2004	2005	2006	2007
Real GDP Growth (%)	3.9	3.2	3.5	2.7
Unemployment (%)	5.5	5.1	4.7	4.8
Nonfarm Employment Growth (%)	1.1	1.5	1.4	1.0
CPI Change (%)	2.7	3.4	3.6	2.4
Federal Funds (%)	1.3	3.2	5.0	5.1
CALIFORNIA				
Real GSP Growth (%)	5.2	4.4	4.5	3.4
Nonfarm Employment Growth (%)	1.0	1.8	1.3	0.8
Personal Income Growth (%)	6.6	6.0	5.9	5.5

Bold: Actual. GSP stands for Gross State Product.

The information in this report is based on data available as of October 3, 2006, and has been obtained from sources believed to be reliable, but its accuracy, completeness, and interpretation are not guaranteed. We do not think it should necessarily be relied on as a sole source of information and opinion.