



## ARIZONA

Participants in our second Arizona *Business Leaders Confidence Index*® survey expect continued improvement in the fourth quarter 2003. Prospects for the economy have brightened considerably in recent months. GDP growth is accelerating, productivity remains strong, inventory-to-sales ratios are at record lows, companies' liquidity is the best it's been in years, orders for durable goods are moving upward, sales of computers and other electronic goods are rebounding – even the demand for labor appears to be firming. It's not surprising then that Arizona panel members boosted the BLCI this quarter. In many cases, panelists changed their responses from "No Change" to "Moderate Increase," especially concerning expectations for the national and state economies, reflecting

improvement in the economic environment. The numbers don't yet signal unrestrained enthusiasm, but these are solid readings.

Holiday retail sales are a popular topic of discussion for the fourth quarter. The cut in federal income tax withholding, rebate checks for taxpayers with children, and recent record-level cash-out mortgage refinancing activity have provided consumers with the means to boost spending this holiday season. Improving consumer confidence backed by better numbers for the economy and labor markets are bolstering consumers' willingness to spend. In mid-September, the National Retail Federation released a forecast stating that 2003 holiday retail sales would be 5.7% greater than last year.

## Arizona Business Leaders Confidence Index

The BLCI rose 1.5 points in the fourth quarter to 62.3, from a revised third quarter reading of 60.8. Increases in the outlook for the Arizona economy and for industry profits account for most of the upward change. Index values range between 0 and 100, and values above 50 indicate expectations for conditions to increase, while readings below 50 indicate decreases. Among the industry expectations components (sales, profits, hiring, and capital expenditures), expectations are highest for sales, while hiring expectations remain the lowest. Panel members reversed course on expectations for interest rates as the index swung from below to well above 50, i.e. they now expect interest rates to move upward going forward. Expectations for the Arizona

economy rose significantly and now compare favorably to views regarding the national economy.

Index History			
	Q3 2003	Q4 2003	Change
Sales	64.3	64.7	0.4
Profits	59.9	62.8	2.9
Hiring	57.4	56.3	-1.1
Capital Expenditures	59.6	59.5	-0.1
State Outlook	60.0	65.5	5.5
National Outlook	63.9	65.1	1.2
<b>BLCI</b>	60.8	<b>62.3</b>	1.5
Interest Rates	46.3	62.1	15.8

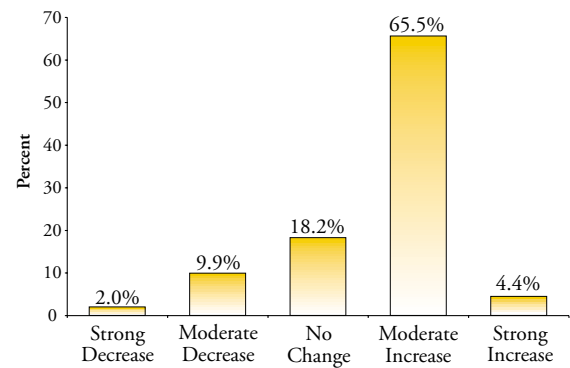
\* See page 4 for calculation details

## Expectations for the National Economy

Nearly 70% of our panelists expect the nation's economy to improve in the fourth quarter, but few (4.4%) expect to see a strong increase. One in six expect no change. Nearly 12% see the risk of a decrease, or new recession.

Recent revisions to the national income and product accounts boosted real GDP growth to more than three percent in the second quarter (a moderate increase). Economists widely believe that growth in the third quarter approached 5% (a strong increase). Although panelists showed more optimism in the current survey (a boost of 1.2 index points compared to three months ago), the change was muted when compared to recent GDP revisions.

Q4 2003 National Economic Outlook

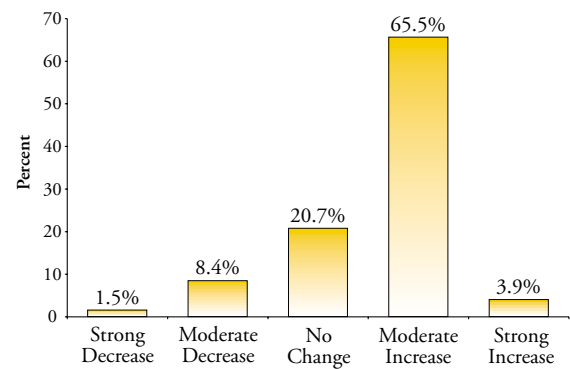


## Expectations for the State Economy

Panelists are much more optimistic than last quarter about prospects for the Arizona economy. Nearly 70% expect to see an increase, with almost four percent expecting a strong increase. One in five expect no change, while less than 10% of panelists foresee a decrease.

These readings are nearly identical to those for the nation. In last quarter's survey, expectations for Arizona were considerably lower; this question's index score jumped by 5.5 points.

Q4 2003 Arizona Economic Outlook



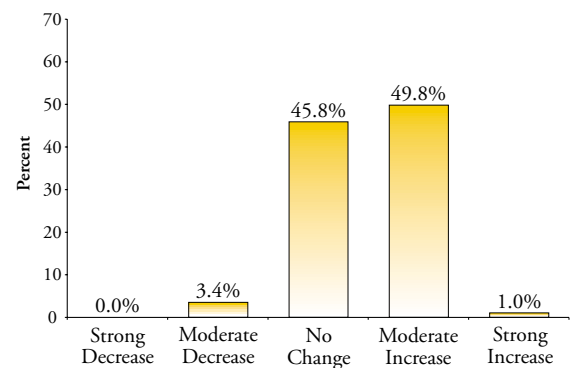
## Interest Rate Expectations

Sentiment for the direction of interest rates changed markedly during the past three months. Last quarter, our panel correctly anticipated the Fed's cut in the bellwether Fed Funds rate (to 1%), which occurred only a week after the survey ended.

Panelists expect the next change to be upward. Half think that interest rates will increase in the fourth quarter, while nearly all the rest (45.8%) think they will remain unchanged. Only 3.4% expect rates to decline.

A strong case can be made that we recently passed a turning point for interest rates. Fears of deflation during the second quarter, which drove rates lower, were exaggerated. A stronger economy, coupled with huge federal budget deficits, will lead to higher interest rates down the road.

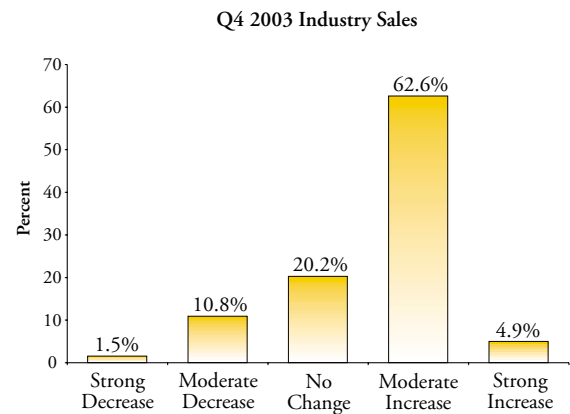
Q4 2003 Interest Rate Expectations



## Industry Sales Expectations

Expectations for industry sales remain optimistic. Over two-thirds of our panel expect an increase during the fourth quarter – 62.6% foresee a moderate increase, while nearly five percent see a strong increase. Only 12.3% expect to see a decrease in sales.

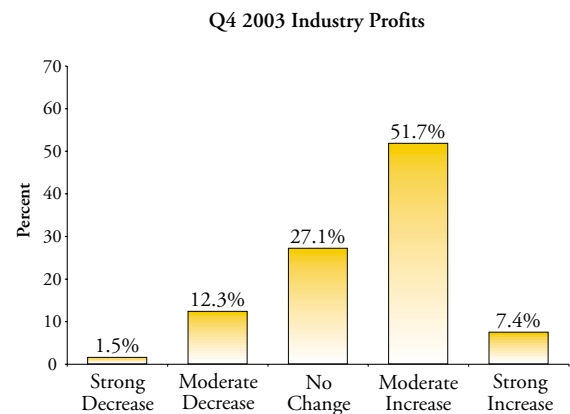
The fourth quarter traditionally accounts for 40% or more of annual sales for many retailers. With consumer inflation running at 1.5%, most of the projected increase reflects increased volume.



## Industry Profits

Our panelists' outlook for industry profits in the fourth quarter improved considerably (from what was already a decidedly positive reading). Nearly three of every five panelists expect an increase – 7.4% strongly so. Less than 14% expect profits to decrease, while just over 27% expect no change.

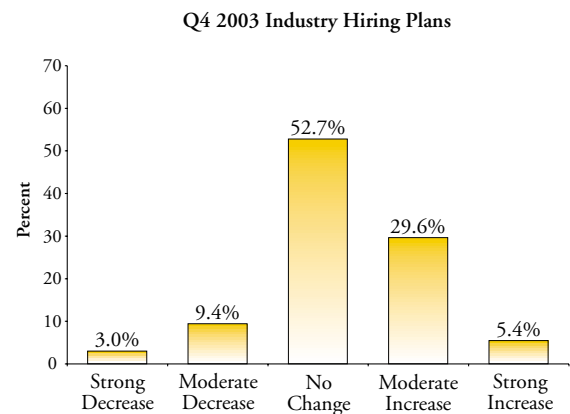
Profits reported by publicly traded companies continue to exceed expectations of Wall Street analysts, driven by relentless cost cutting and the return of modest pricing power in most industries. Companies have used profits to restructure or pay down debt and to build cash balances, which enables spending on plant and equipment to respond quickly when sales improve.



## Industry Hiring Plans

Hiring plans weakened from last quarter, a surprising result since the fourth quarter typically brings additional employees for the holiday shopping season. Arrival of winter visitors and university students also inflate the state's population and thus the demand for labor. As the weakest among industry expectations components, these results show that business leaders remain cautious about hiring.

Nevertheless, this component continues to contribute favorably to the BLCI. Fully 35% of our panelists expect their industry to add workers during the fourth quarter. One in eight panelists expect decreases, while over half foresee no change.

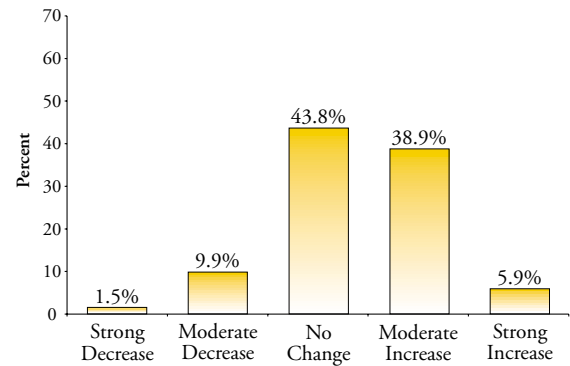


## Industry Capital Expenditures

Panel members' expectations for capital expenditures remain positive and little changed from last quarter. Nearly half (43.8%) expect no change in spending, which reflects the fact that budgets for capital expenditures generally are set once a year, during the annual budgeting process. An almost equal number (44.6%) expect capital expenditures to improve in the fourth quarter. Only 11.4% expect a decrease.

Companies have boosted capital spending for computers and software in recent months, but spending on other equipment, such as machine tools, continues to lag. Capacity utilization remains at low readings for this stage of the business cycle, and that is restraining capital spending on machinery and new buildings.

Q4 2003 Industry Capital Expenditures



## BLCI Calculation Notes

Panelists were asked to choose their responses from a scale that included Strong Decrease, Moderate Decrease, No Change, Moderate Increase, and Strong Increase. A numerical value ranging from -2 (Strong Decrease) to +2 (Strong Increase) was assigned to each of these. A score was then calculated for each question and transformed into a scale that ranges from 0 to 100. Index values above 50 indicate expectations for increases, and index values below 50 indicates expectations for decreases.

The BLCI combines six measures (excluding interest rate expectations) using equal weighting. Interest rates are excluded because of ambiguity concerning how changes affect overall confidence.

We are pleased with the level of panelist participation and wish to thank all of our panel members. We make no pretense that this survey is representative of all business leaders in Arizona. What we report here are the responses of the panelists who participated in our survey. As we continue to increase the size of the panel, we hope to add analysis for individual industries and sub-state areas. Please join us in early December for the 1st Quarter 2004 survey at [www.blcindex.com/arizona/](http://www.blcindex.com/arizona/).

*Compilation and analysis provided by Marshall J. Vest, Director of Economic and Business Research at the Eller College of Business and Public Administration, The University of Arizona.*



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Compass on Business  
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