

Economics Group

Special Commentary

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Arizona Economy Takes A Hit From COVID-19

Shutdowns related to the COVID-19 crisis will be a significant challenge for the state, which had one of the fastest growing economies in the nation prior to the pandemic.

The Arizona economy was firing on all cylinders heading into the coronavirus crisis. In terms of job growth, employers were adding to payrolls at a blazing 2.7% annual pace in February, the third fastest rate in the nation. Unfortunately, Arizona’s long run of job gains likely came to an abrupt end in March, when efforts to suppress the spread of the coronavirus were put in place. Economic activity across the country ground to a halt in mid-March, as social distancing became the norm and most states instituted stay-at-home orders. Arizona officials have implemented similar measures, resulting in widespread business closures across the state.

With businesses shut down, layoffs have skyrocketed. At the national level, first time unemployment claims, which are a nearly real-time measure of layoffs, rose from around 200,000 in early March to 3.3 million in the week ended March 21, 6.9 million the next week and 6.6 million last week. The nearly 17 million claims in just three weeks is unprecedented, even during the worst recessions. Arizona saw a similar surge in jobless claims. After averaging less than 4,000 per week earlier this year, claims jumped to 29,000, 89,000 and 132,000 those same three weeks. Even with 250,000 jobs eliminated already, more layoffs are likely to come.

Arizona has already reported around 250,000 initial jobless claims.

Assuming labor force participation remains constant, a similar drop in household employment would push the unemployment rate from 4.5% to beyond the 10.9% Great Recession peak in November 2009. Regrettably, this is just the tip of the iceberg and the flood of layoffs is unlikely to abate as long as the economy is shutdown. The recently passed CARES Act, which provides businesses with forgivable loans if they are used to retain/rehire workers or make mortgage and rent payments, may stem the tide of layoffs somewhat, but it will likely be more helpful in speeding and reinforcing the subsequent recovery. We look for the U.S. and Arizona economies to begin to grow again in June.

Figure 1

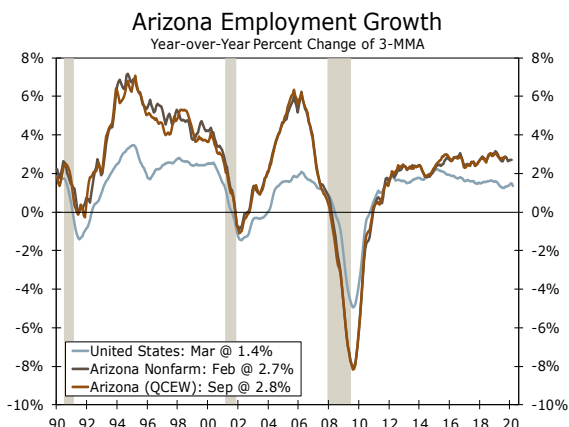
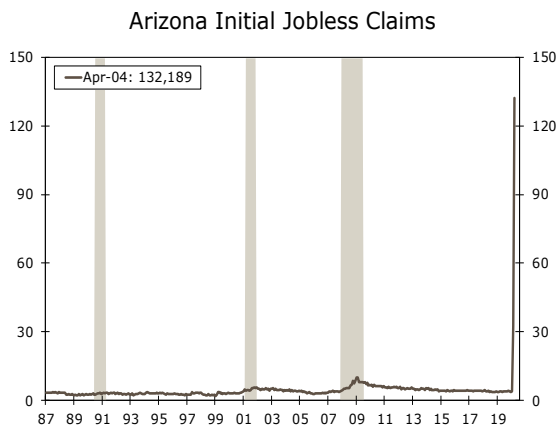


Figure 2



Source: U.S. Department of Labor and Wells Fargo Securities

Together we'll go far



Hospitality Sector Vulnerable to COVID-19 Shock

Arizona’s large leisure & hospitality sector accounts for much of the recent rise in jobless claims as tourism and travel spending have evaporated. In the week ending April 6, the hotel occupancy rate in Phoenix was off nearly 70 percentage points (22.1% vs. 89.5% last year), resulting in massive layoffs. Tourism plays an integral role to the state economy. In 2018, visitor spending amounted to roughly \$24.4 billion, which translates to about 7% of the state’s economic output. Many of the region’s natural amenities such as the Grand Canyon, Sedona, Monument Valley and the Hoover Dam have been closed to visitors. The shutdown of all non-essential businesses (including casinos) in nearby Nevada will also have an acute impact on Northwest Arizona, given the area receives considerable spillover travel from Las Vegas. Moreover, with stay-at-home orders in place, most restaurants and bars have closed in-house dining, resulting in thousands of layoffs. The shutdown marks a sharp reversal for Arizona’s leisure & hospitality industry, which employs roughly 340,000 and accounts for 11.3% of total payrolls. As recently as February, leisure & hospitality payrolls were up 2.9% over the past year.

The widespread closures of non-essential businesses and pullback in consumer spending will also weigh heavily on an already weak retail trade sector. While most of the state’s sectors have expanded payrolls at a robust pace over the past year, retail payrolls have been essentially flat (+0.3%). With many shopping malls and major national and regional chains closed, job losses are likely to be massive in the short run. While grocery stores, pharmacies and home improvement stores are considered “essential” and appear to be holding their own, retail properties deriving foot traffic from restaurants, gyms, yoga studios, hair salons and medical offices—which are all closed—are being hit hard. As of February, retail trade employed 330,000 workers across the state, but we expect the sector to lose close to 80,000 jobs over the next six months and look for only a modest recovery later this year.

Tourism and travel spending have evaporated.

Figure 3

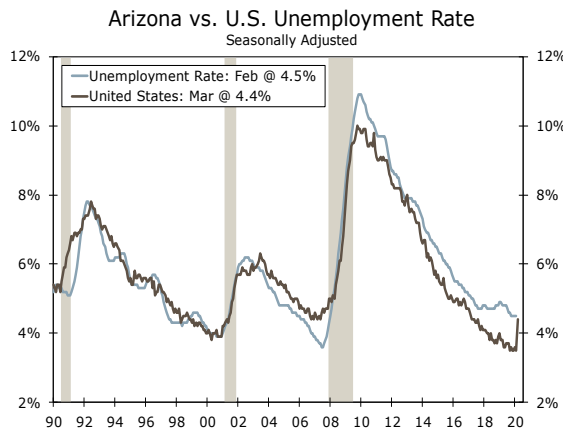
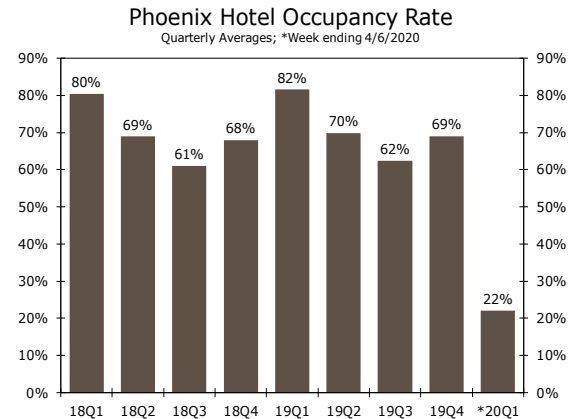


Figure 4



Source: U.S. Department of Labor, STR and Wells Fargo Securities

Federal Spending Will Cushion the Downturn

Arizona’s large manufacturing sector may fare somewhat better in this downturn, as a large portion is tied to defense spending. The federal government is the largest employer in many areas of the state, which home to numerous defense contractors and military installations that rely on federal spending—notably aerospace products and parts manufacturers. Some manufacturers are even stepping up hiring to produce sorely needed personal protective equipment (PPE) for healthcare workers. Honeywell recently announced it is adding 500 new jobs to its Phoenix aerospace facility in order to ramp up production of N95 protective masks as well as other PPE.

Conversely, Arizona’s large computer & electronics manufacturing sector may be disproportionately exposed to supply chain disruptions from the COVID-19 outbreak in China and across the globe in general. Specifically, the state has a sizable semiconductor manufacturing cluster, which directly employs roughly 23,000, the fourth highest total of any state. Intel, ON Semiconductor, Microchip Technology and NXP Semiconductor each have major fabrication plants

Arizona receives a lot of federal funding.

in Chandler. While state officials have deemed the semiconductor manufacturing industry as essential and many producers remain operational, travel restrictions and factory closures in China, Japan and South Korea may disrupt supply chains in the short term. Longer term, demand for semiconductors is likely to come under pressure from the deep global recession resulting from the COVID-19 shutdowns. Overall, manufacturing payrolls are likely to decline about 8% this year.

Somewhat surprisingly, the state’s massive healthcare sector has not proven immune to job cuts. Normally, healthcare, which is chronically short of workers, continues to add jobs during a recession. While there has been a massive effort to build out emergency surge capacity, many non-emergency and elective services have been put on hold to free up healthcare resources. Medical and dental practices have temporarily shuttered or drastically reduced operations and the lack of elective surgeries has led to layoffs throughout the medical supply chain. Healthcare & social assistance employs roughly 13.6% of Arizona’s workforce, more than any other major industry. Once there is sufficient evidence that the virus is contained, non-emergency services should resume fairly quickly. With social distancing guidelines remaining in place for a while, however, employment will likely not regain its pre-recession level for a year or more.

Arizona has a massive healthcare sector.

The state’s massive healthcare ecosystem is one of the reasons Arizona is so popular with retirees. The state’s population increased 1.7% in 2019, the third fastest pace of any state. Arizona also saw a net influx of roughly 91,000 movers from other states, many of which were retirees attracted by the favorable climate, low cost of living and abundance of healthcare facilities. Since 2013, the population of those 65 or older age has grown at a 4.3% annual rate, faster than any other age cohort. Furthermore, Tucson is one of the fastest growing retirement enclaves in the country. Over 20% of the metro’s population is 65 years or older, compared to 16% nationwide. Retiree inflows will slow this year, as stay-at-home orders make it difficult to shop for a new home. The recession and volatile financial markets should also cause many retirees to hold off relocating until they can more easily sell their current home.

Arizona’s economy is certainly feeling the impact of the COVID-19 outbreak and efforts put in place to contain it. The University of Washington’s Institute for Health Metrics and Evaluation estimates the growth in the virus will top in about two weeks and then decrease steadily through late May. That means social distancing and stay-at-home orders are likely to remain in place for some time, and we expect the unemployment rate to rise to around 11.5%. Leisure & hospitality, retail trade, business and household services and healthcare will be impacted the most. Once evidence of containment emerges, businesses will gradually begin to open and the recovery should commence. That said, it will be some time before the state regains the momentum it had headed into the crisis.

It will take time for Arizona to recover.

Figure 5

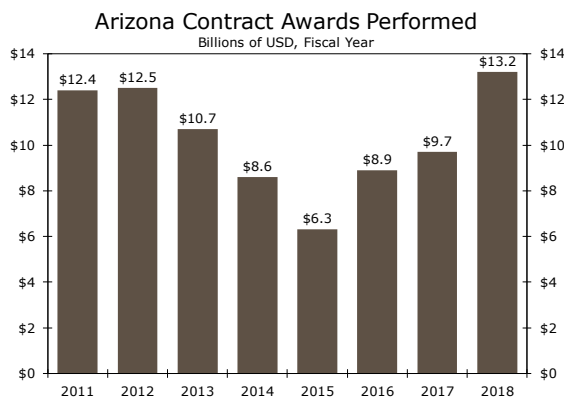
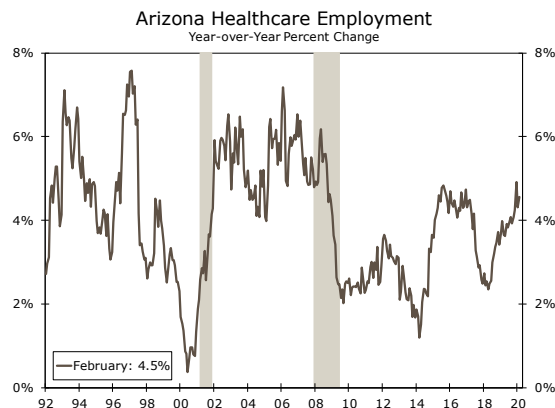


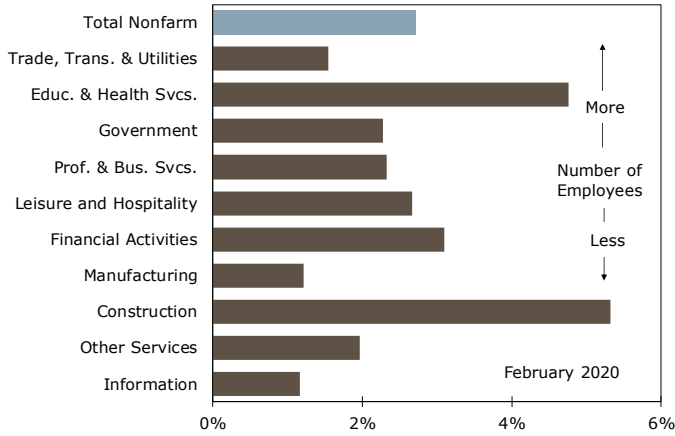
Figure 6



Source: U.S. Department of Defense, U.S. Department of Labor and Wells Fargo Securities

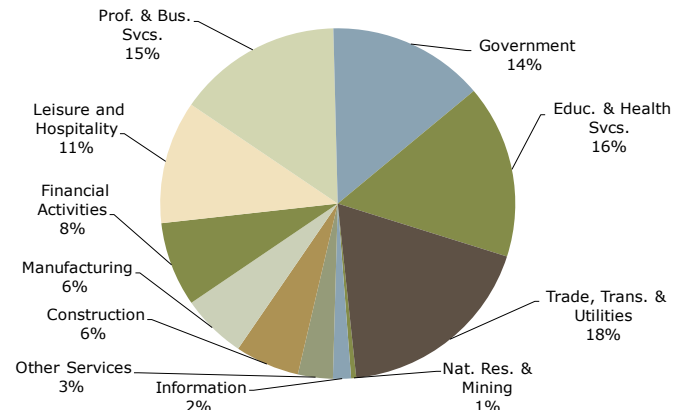
Arizona Employment Growth By Industry

Year-over-Year Percent Change of 3-MMA



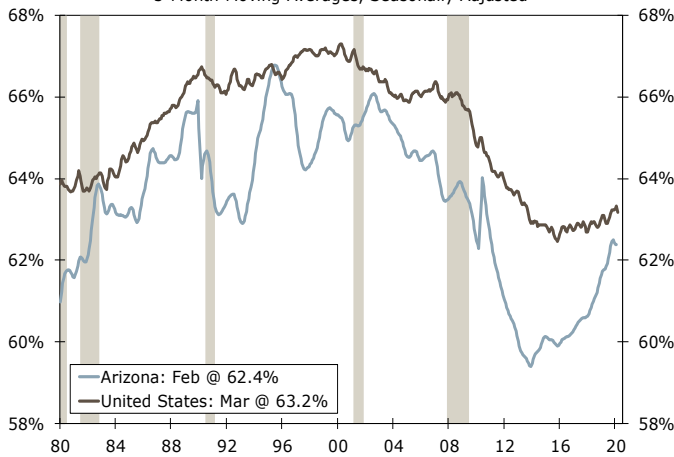
Arizona Employment Composition

February 2020



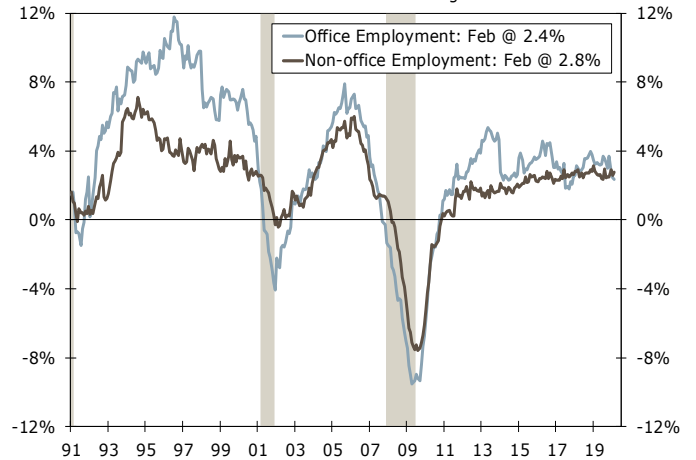
Arizona Labor Force Participation Rate

3-Month Moving Averages, Seasonally Adjusted



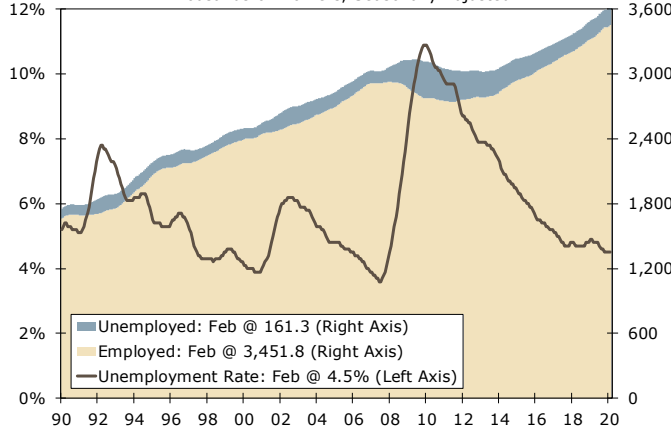
Arizona Office Employment Growth

Year-over-Year Percent Change



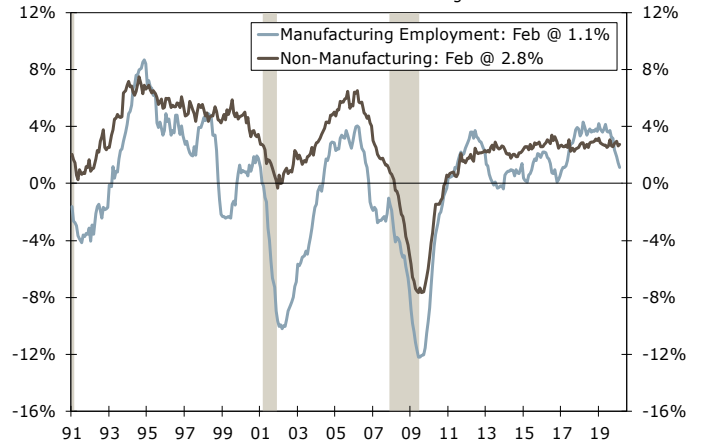
Arizona Labor Force

Thousands of Workers, Seasonally Adjusted



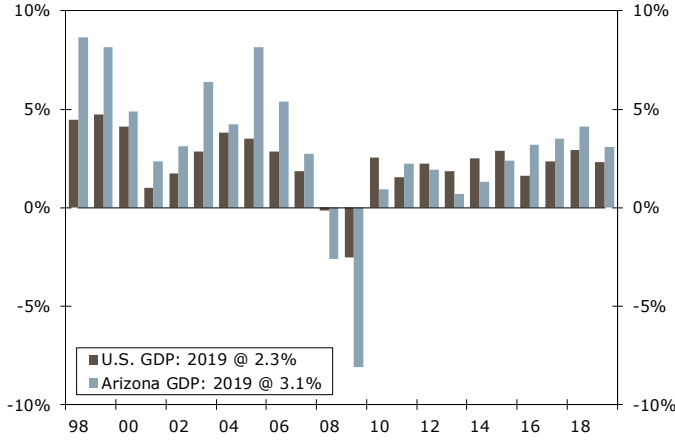
Arizona Manufacturing Employment Growth

Year-over-Year Percent Change

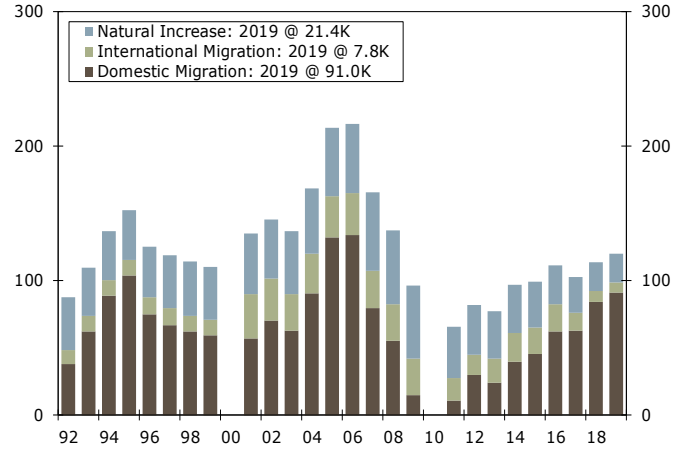


Source: U.S. Department of Labor and Wells Fargo Securities

Arizona Gross State Product & U.S. GDP
 Year-over-Year Percent Change

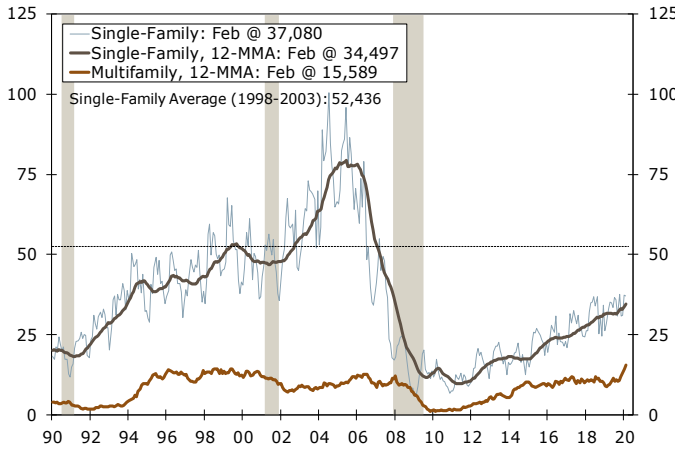


Components of Population Change: Arizona
 In Thousands



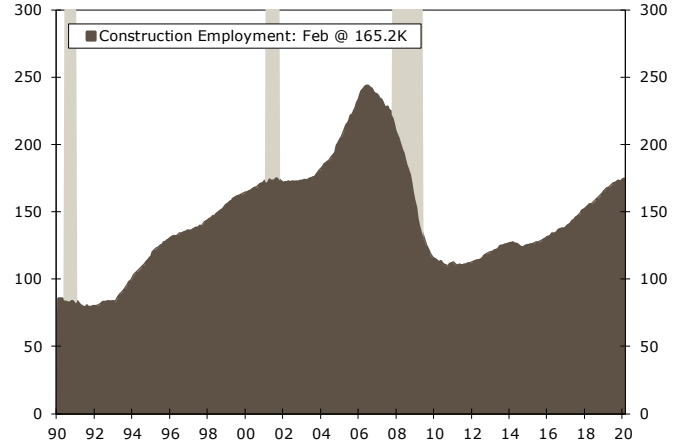
Arizona Housing Permits

Thousands of Permits, Seasonally Adjusted Annual Rate



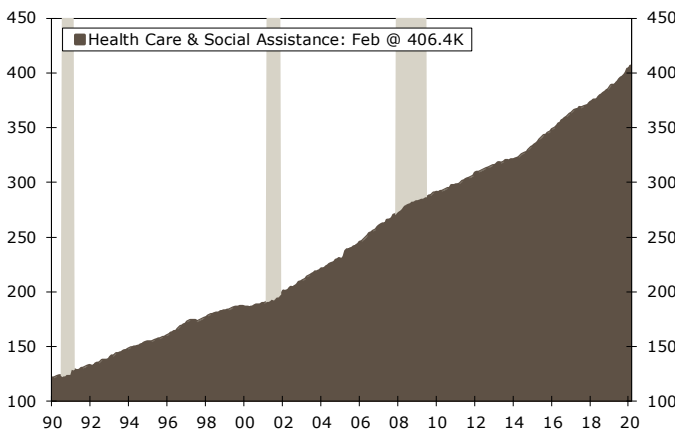
Arizona Construction Employment

Thousands



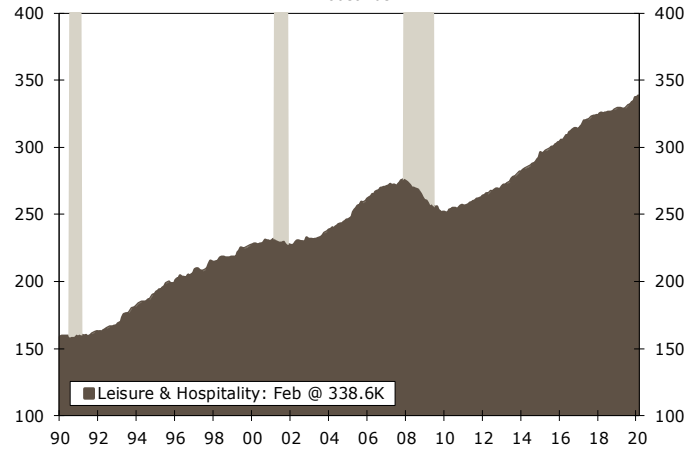
Arizona Health Care Employment

Thousands



Arizona Leisure & Hospitality Employment

Thousands



Source: U.S. Department of Commerce, U.S. Department of Labor and Wells Fargo Securities

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