Alliance Bank OF ARIZONA®

Arizona

Regional Intelligence Report

APRIL 2022

Prepared by Beacon Economics, LLC
Presented by Alliance Bank of Arizona

Economic Outlook: Arizona

Overview

The pandemic recession and recovery ended in the final half of 2021. As far as business cycles go, this one was truly unique—it was the deepest ever, and shortest in length, and followed by one of the most rapid recoveries ever seen. This was a supply-shock-driven recession without the typical longer-term consequences that come from, for example, an asset-bubble-collapse-driven demand shock as what drove the Great Recession. While growth in Arizona has slowed, the state has a larger economy at the end of 2021 than it did in 2019.

Still, excessive consumer demand is driving inflationary pressures in the U.S. This can be seen in the strong growth in overall consumer spending—growing faster than GDP growth overall since 2017—with no slowing seen. A history of periods when consumer spending grows faster than output have always ended ugly, as the Great Recession can attest to.

How sustained will inflation be? The Federal Reserve seems to be suggesting that a few rate hikes and the unsnarling of supply chains will quickly reduce the rate of price growth, and so far, the bond markets appear to be buying it. But a careful empirical analysis of the history of prices suggests that other factors play an important role, including the Federal deficit, wage growth, and of course the money supply, which lies at the heart of monetary theory. Given the current tightness of U.S. labor markets, the lack of conversation about closing the Federal deficit points to continued inflationary pressure.

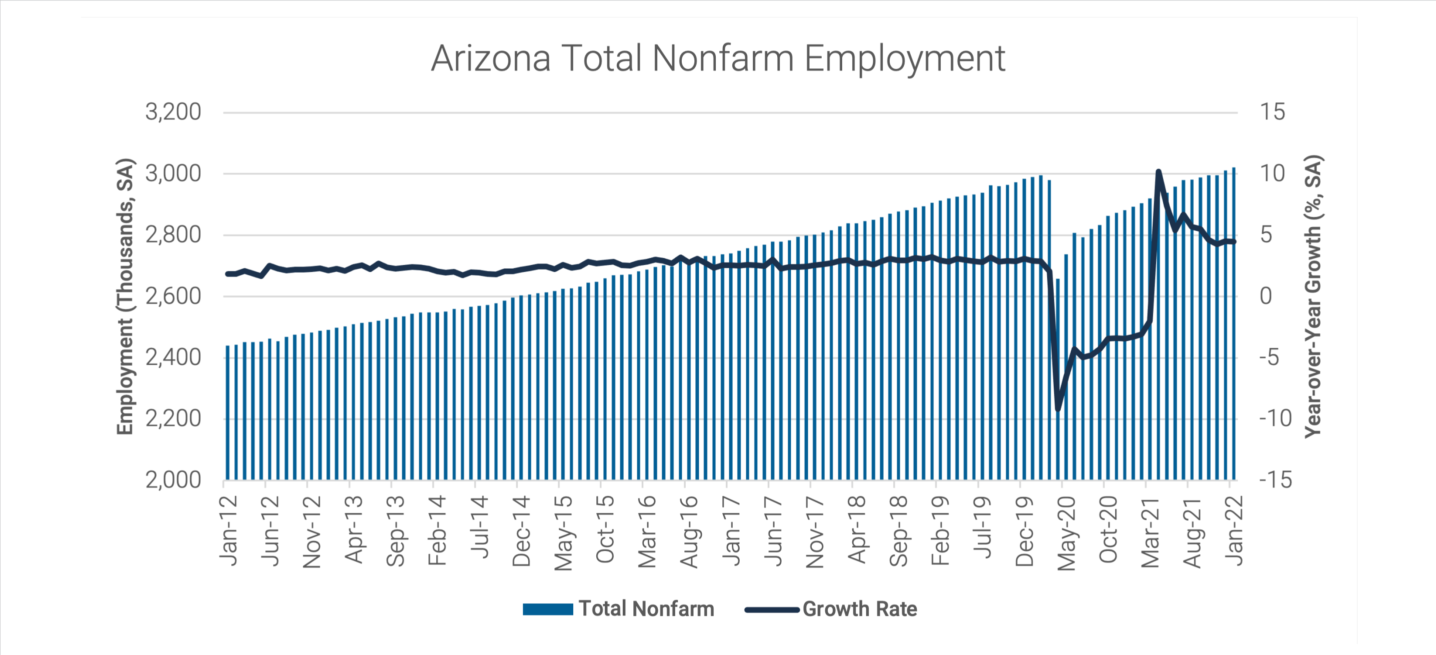
Regional Employment

Arizona's labor market has continued to steadily recover from the COVID-19 pandemic, adding 364,100 jobs since it hit bottom in April 2020. Total payroll employment is 0.8% (or 25,400 jobs) above the pre-pandemic peak in February 2020.

Unemployment rates have also improved from 2020's highs. In Arizona, the unemployment rate is now 3.7%, the lowest rate for the state since just before the Great Recession. Arizona's labor force has also expanded, increasing by 57,200 workers since February 2020, a 1.7% increase. While Arizona has seen its labor force expand since the beginning of the pandemic, other parts of the nation have not, with the labor force in the U.S. still 0.5% below pre-pandemic levels.

While state payrolls have increased overall since the beginning of the pandemic, growth has been mixed at the industry level. The surge in e-commerce has helped boost payrolls in Arizona's Transportation, Warehousing, and Utilities sector by 21.7% (or roughly 26,900 jobs) since February 2020. Other sectors with sizeable increase in payrolls over this period were Retail Trade (6.2% or 20,400 jobs), Financial Activities (5.0% or 11,700 jobs), Wholesale Trade (3.6% or 3,600 jobs), Construction (2.8% or 4,900 jobs), and Manufacturing (2.4% or 4,300 jobs).

The largest job losses in Arizona have been concentrated in the Government sector, with 20,000 fewer workers compared to February 2020, a 4.7% decline. Other significant job losses have occurred in Administrative Support (-7.2% or 18,400 jobs), Leisure and Hospitality (-4.5% or 15,500 jobs), and Education and Health Care (-1.7% or 8,000 jobs). These were some of the sectors most impacted by government health mandates and consumer reservations due to COVID-19.



Source: U.S. Bureau of Labor Statistics

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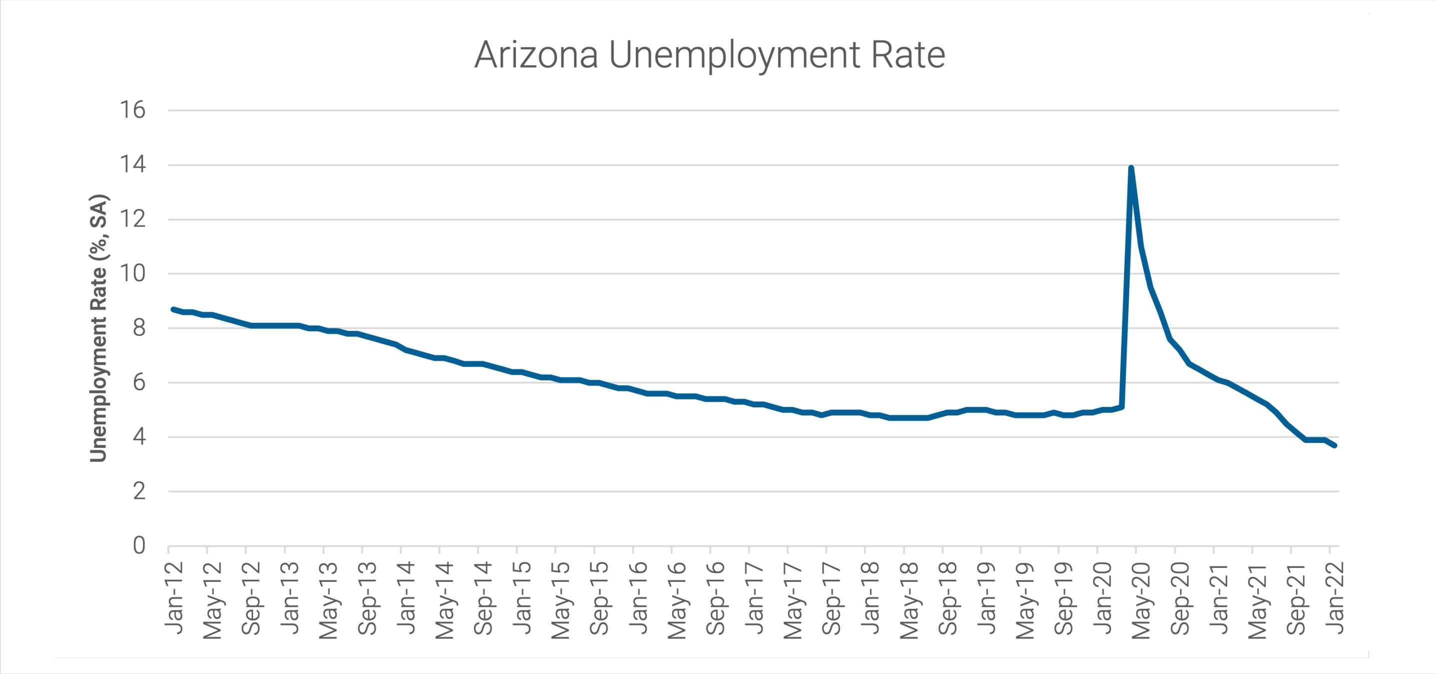


Source: U.S. Bureau of Labor Statistics

INDUSTRY EMPLOYMENT: ARIZONA

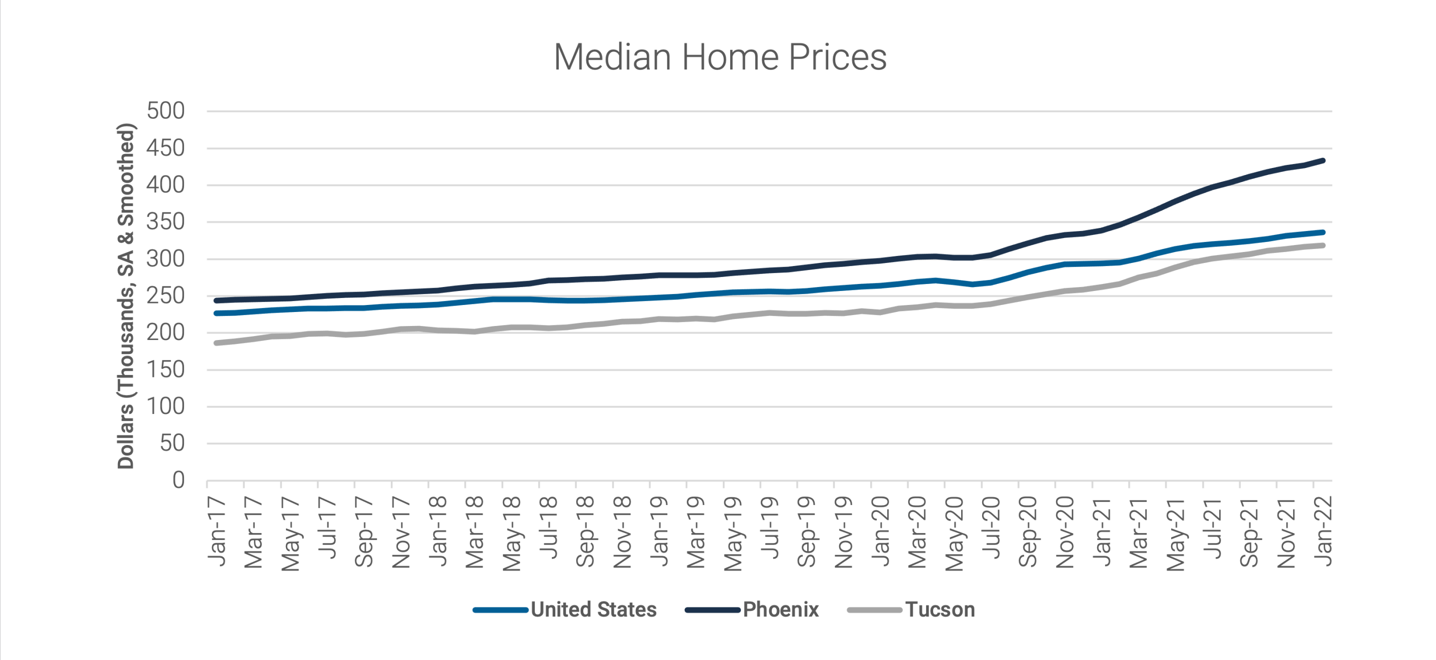
Sector	Jan-22 Emp. (000s)	Chg. Since Feb-20 (%)	Chg. Since Feb-20 (000s)
Transport, Warehouse, Utilities	150.7	21.7	26.9
Retail Trade	348.2	6.2	20.4
Financial Activities	245.5	5.0	11.7
Wholesale Trade	103.7	3.6	3.6
Construction	180.7	2.8	4.9
Manufacturing	184.7	2.4	4.3
Other Services	94.7	-0.2	-0.2
Professional/Business	448.7	-0.4	-1.9
Information	48.9	-1.6	-0.8
Education/Health	469.5	-1.7	-8.0
Leisure and Hospitality	325.6	-4.5	-15.5
Government	406.7	-4.7	-20.0
Admin Support	236.8	-7.2	-18.4
Total Nonfarm	3021.6	0.8	25.4

Source: U.S. Bureau of Labor Statistics

Residential Real Estate

The housing market was by far the strongest spot of Arizona's economy in 2021. Strong performance is likely driven by three factors. First, typical homebuyers (higher-income earners) have been less affected by the labor market downturn. Second, mortgage rates are at historically low levels, spurring purchase activity. Third, inventories are near historic lows. These factors have pushed offers far over the asking price even as buyers waive inspections and other contingencies in an attempt to get a leg up on the competition.

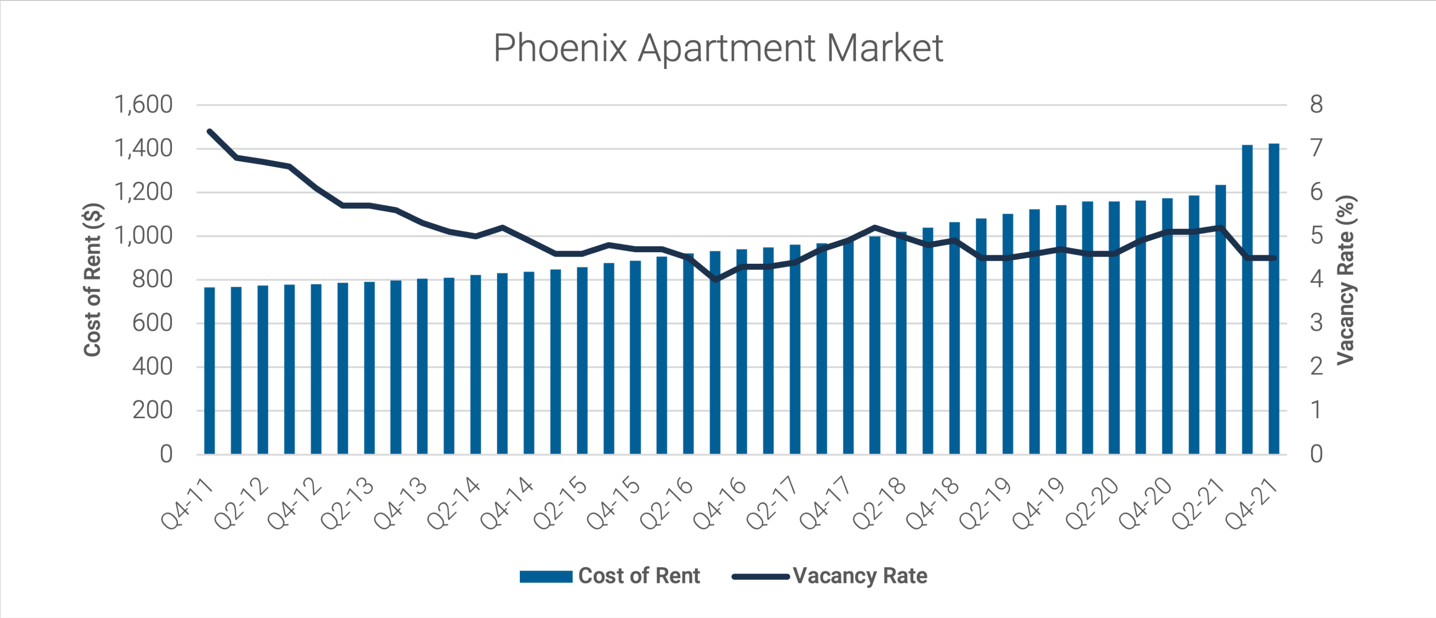
With this backdrop, home prices in Arizona continue to increase rapidly. From January 2021 to January 2022, the median home price rose 28% in Phoenix, reaching $433,599. In Tucson, the median home price rose to $318,245 in January 2022, a 21.3% increase from a year earlier. Home prices in Phoenix and Tucson grew at a faster pace compared to the U.S., where median prices rose by 14.4% over the same period.



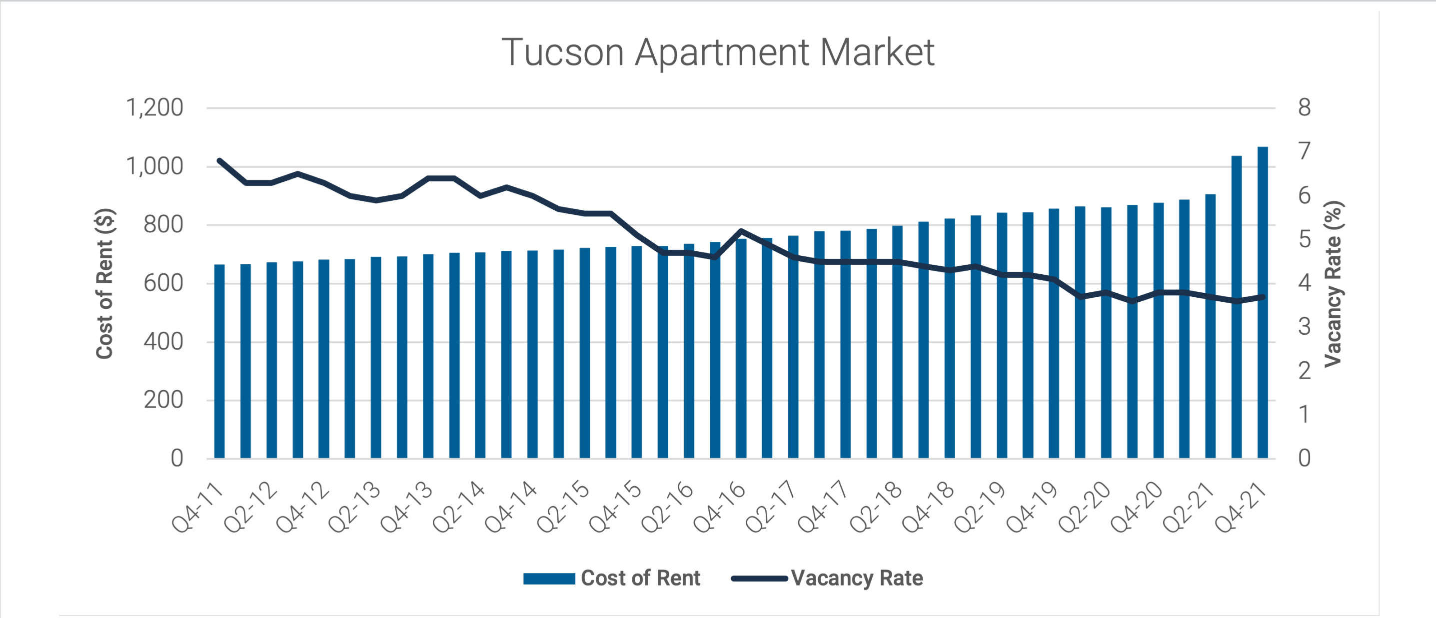
Source: Zillow

Economic stimulus and low interest rates have increased demand for housing throughout Arizona; however, supply has not increased to meet these demands. In 2021, there were an average of 18,875 units for sale per month in Phoenix, 15.9% below 2020 levels and 30.6% below 2019 levels. In Tucson, there were an average of 3,299 units for sale per month in 2021; this is 18.9% below 2020 levels and 32.2% below 2019 levels. While housing supply remains constrained in the state, the specter of higher interest rates will weigh on price appreciation in 2022.

Demand for apartment units has also surged over the past year in Arizona. In Phoenix, the apartment vacancy rate fell to 4.5%, a 0.6 percentage-point decrease from a year ago. Vacancy rates for apartment units also declined in Tucson over this period, at 3.7%, down 0.1 percentage points from a year earlier. In addition, the average asking rent grew by 21.2% in Phoenix and by 21.8% in Tucson. This pace of growth puts the Phoenix and Tucson metropolitan areas well ahead of the 11.9% growth in the U.S. over the same period. Despite the significant price appreciation over the last year, asking rents in Phoenix ($1,423) and Tucson ($1,068) are still lower compared to the U.S. ($1,635).



Source: REIS (Moody's Analytics)



Source: REIS (Moody's Analytics)

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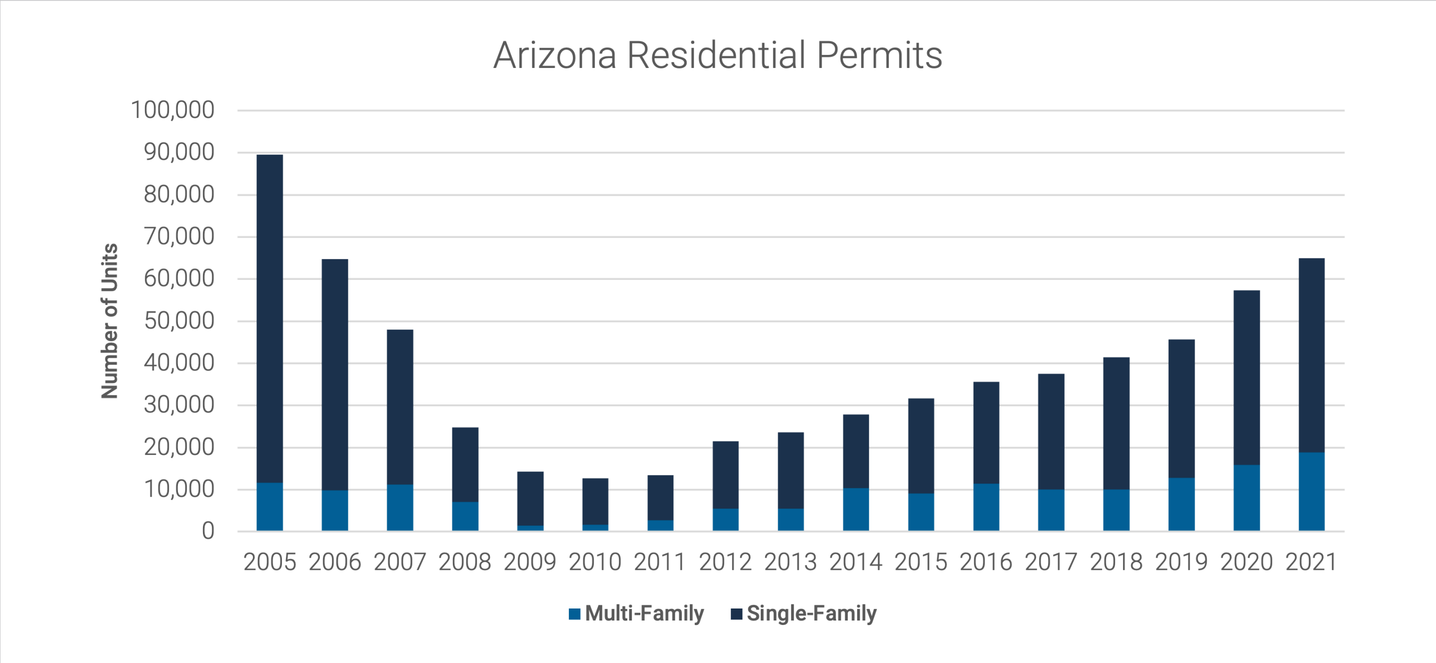
Construction permit activity has increased over the last year in Arizona. In 2021, residential permitting activity in Arizona is up 13.3% over 2020 levels. This growth is being fueled by an 11.2% increase in single-family permitting and an 18.8% increase in multi-family permitting.



Source: Construction Industry Research Board (CIRB)

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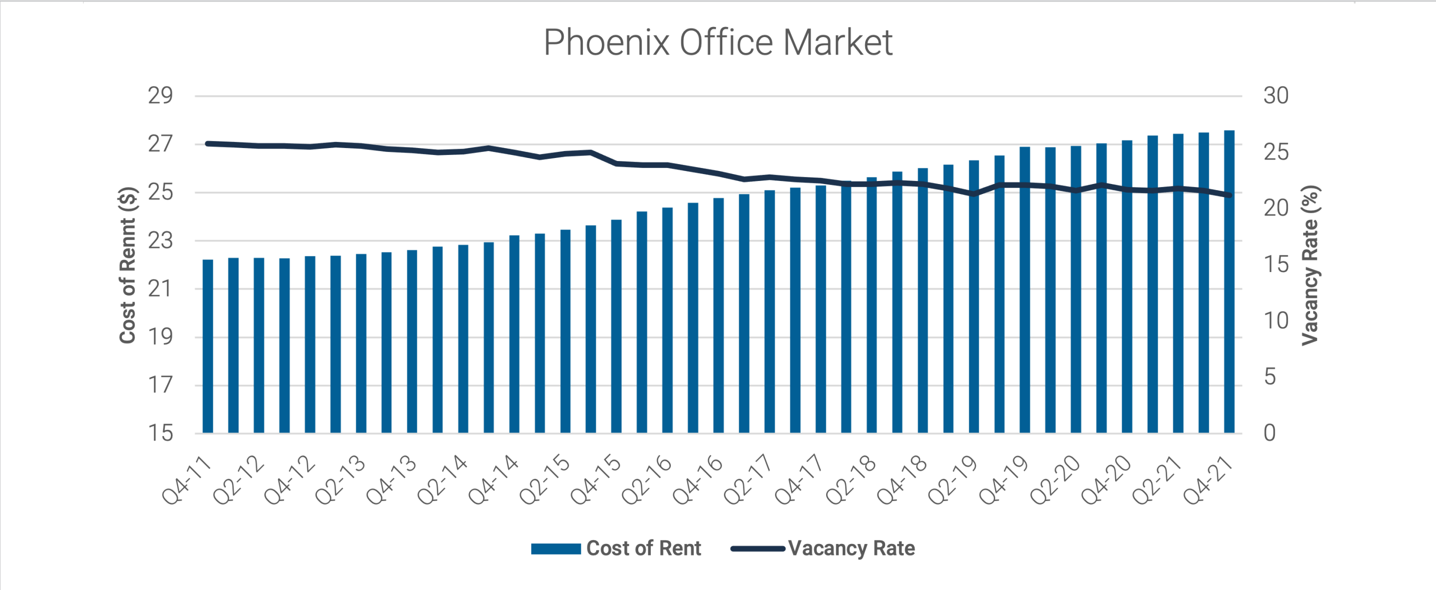
Commercial Real Estate

With more companies returning to normal operations, demand for office properties has grown over the last year in Arizona. In Phoenix, the office vacancy rate hit 21.2% in the fourth quarter of 2021, down 0.5 percentage points from a year earlier. Vacancy rates for office properties also declined in Tucson over this period, at 22.5%, down 2.5 percentage points from a year earlier. The average asking rent expanded by 1.5% in Phoenix and by 3.2% in Tucson, outpacing the 0.2% decline in asking rents in the U.S. over this period.



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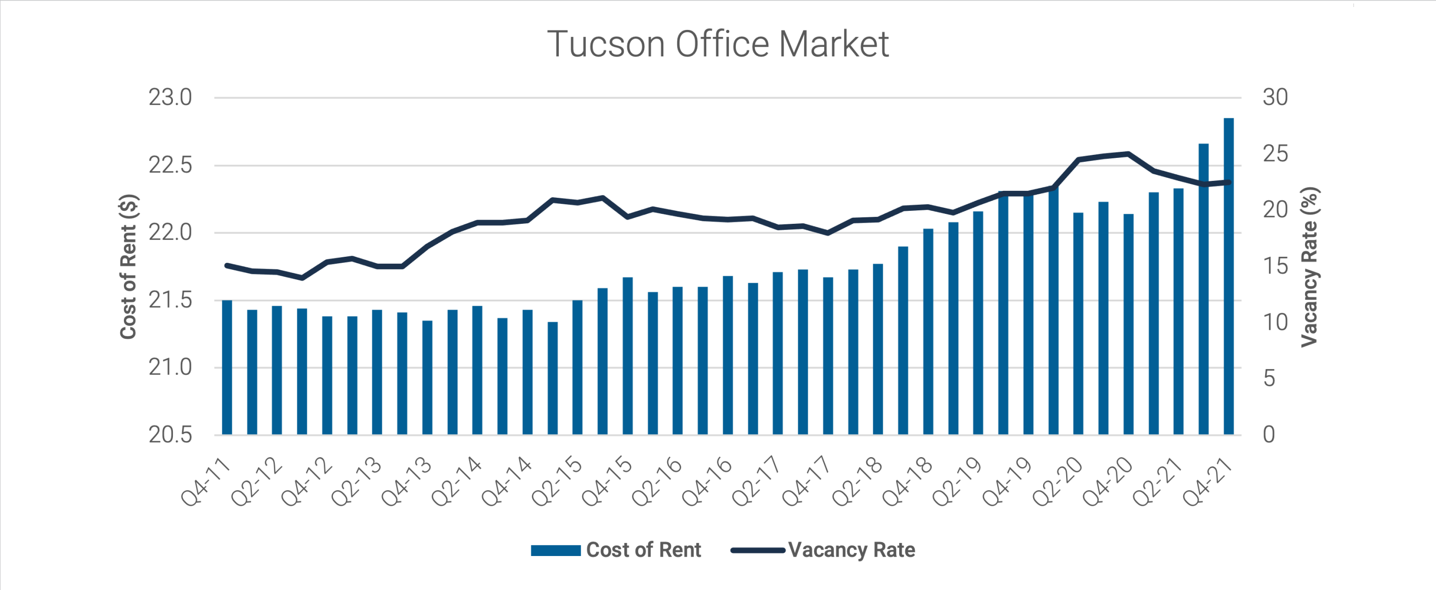
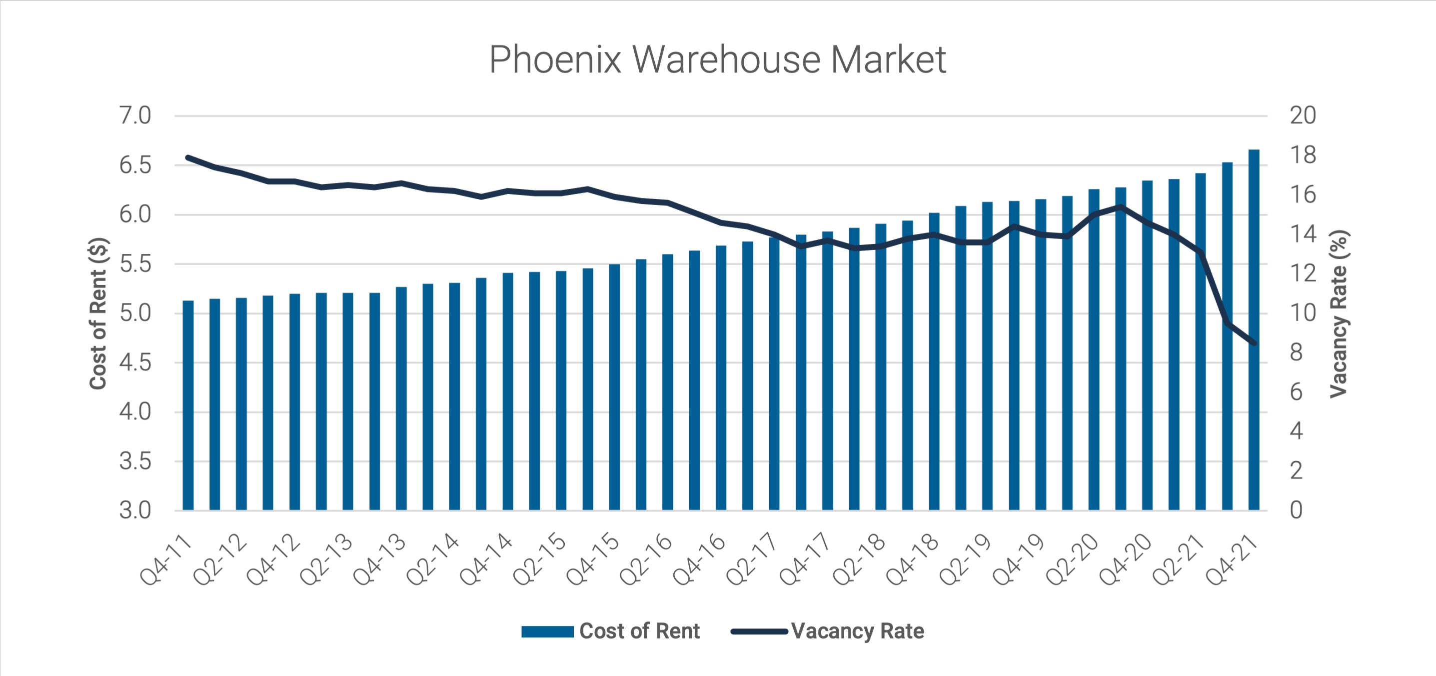


Source: REIS (Moody's Analytics)

Demand for retail space in Arizona has stabilized over the last year. In Phoenix, the retail vacancy rate hit 9.6% in the fourth quarter of 2021, down 0.1 percentage points from a year earlier. Vacancy rates for retail properties also declined in Tucson over this period, at 9.6%, down 0.6 percentage points from a year earlier. The average asking rent declined 0.5% in Phoenix and increased by 0.7% in Tucson, putting Arizona in line with the 0.1% increase in asking rents in the U.S.



Source: REIS (Moody's Analytics)

The increase in demand for e-commerce has increased demand for warehouse space in Arizona. In Phoenix, the warehouse vacancy rate dropped to 8.5% in the fourth quarter of 2021, down 6.1 percentage points from a year earlier. Vacancy rates for warehouse properties also declined in Tucson over this period, at 10.3%, down 5.4 percentage points from a year earlier. The average asking rent grew 4.9% in Phoenix and by 4.8% in Tucson, matching the growth in the U.S. over this period.

Demand for flex/research and development (R&D) properties has been more resilient relative to office and retail space in Arizona. In Phoenix, the vacancy rate for flex/R&D properties fell to 8.8% in the fourth quarter of 2021, a 4.3 percentage-point decline from a year earlier.

Prepared By Beacon Economics

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