

# The 2020 Recession in the Golden State

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March 2020 Interim Forecast

As the U.S. economy moved into a recession this month, it looks like California, once again, will bear a heavy share of the contraction. In 1990 it was the aerospace industry, in 2001 the tech industry, and in 2008 residential construction; each of which were sectors that California was proportionately more exposed than the rest of the nation. Now it is the turn of three more sectors with heavy concentration in the Golden State; transportation and warehousing, agriculture, and leisure and hospitality. The exposure to transportation and warehousing stems from the fact that the ports of California carry much of the goods coming in from Asia, and they are not coming in. California is a major tourist destination, particularly from Asia, and the aircraft are not flying across the Pacific. And agriculture, hard hit by the trade wars, now finds that there are no ships nor appropriate containers to

move the latest harvest out to market. These, overlaid on a U.S. forecast of a two-quarter recession, results in four quarters of job loss and three quarters of real income losses in the State.

Employment is expected to contract by -0.7% in 2020 with the 2nd and 3rd quarters contracting at an annual rate of 2.6%. The unemployment rate will rise to 6.3% by the end of this year and expected to continue to increase into 2021 with an average for 2021 of 6.6%. By the first quarter of 2021 of the year California is expected to lose over 280K payroll jobs with over 1/3 of those in leisure and hospitality and transportation and warehousing. The expectation is for 2021 to be a slow recovery year and 2022 a year of growth once again.

A summary of the outlook for California:

	Q1	Q2	Q3	Q4
Annual rate of real personal income growth in 2020:	1.5%	-2.3%	-1.8	-0.5
Annual rate of employment growth in 2020:	-0.5%	-2.6%	-2.6	-0.3%
Unemployment Rate:	4.2%	5.3%	6.1%	6.3%
	2020	2020	2020	
Annual real personal income growth:	0.1%	0.1%	1.6%	
Annual rate of employment growth:	-0.7%	-0.2%	0.8%	
Annual Average Unemployment Rate:	5.5%	6.6%	6.5%	

# Trade Wars, Epidemic: Big News and Small Impact

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IT'S ANOTHER TEQUILA SUNRISE  
THIS OLD WORLD STILL LOOKS THE SAME  
ANOTHER FRAME

DON HENLEY & GLENN FREY, TEQUILA SUNRISE, 1973

## Introduction

Prior to the outbreak of the COVID19 epidemic we were optimistic about the California economy. The unemployment rate in December was 3.9% and in many coastal counties sub 3%. Though trade wars had taken their toll on the logistics industry, income growth in the State was higher than in the US and the recently signed Phase One trade agreement between the US and China signaled an end, at least for now, of the trade war. That has now changed. Supply chains are interrupted and trans-Pacific travel has ground to a standstill. The epidemic is on, and how long it lasts and how severe it become is an open question. Meanwhile, government response is mixed. The US Center for Disease Control on February 27 called it a “serious public health threat<sup>1</sup>,” while the President took issue with this assessment. The key to incorporating this event into our near-term forecast is to realizing that however the epidemic evolves, it is in its early stages. Thus, more is unknown than known. Nevertheless, the strength with which the California economy entered the current decade provides a buffer, particularly for relatively short-term interruptions in supply chains and travel. In this California report we review how the impact of the epidemic,

as we know it today, is incorporated into the forecast, the latest trends in employment and State GDP and finish with a summary of the current forecast. In short, like the March 2020 US forecast, the first three quarters of 2020 will be weaker than previously thought. The largest impact will be in the second quarter, one short month away. By the last quarter of the year a recovery will be underway and by 2022 we expect the economy to be more-or-less at the same levels it would have been absent this event.

## The Vulnerable Sectors

In thinking through the potential negative impact of a world-wide epidemic of COVID19, we focus on the consumer sectors. Specifically, the interruption of trade will impact transportation and warehousing, and retail and wholesale trade. The interruption of travel will impact international tourism. There ought to be an impact on manufacturing and some provision of services other than these, however they will be derivative and it is difficult to ascertain the magnitude at this point in time. There will also be an increased demand for health care services and personal care services, though estimating that is also problematic.

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1. <https://www.cdc.gov/mmwr/volumes/69/wr/mm6908e1.htm>

An estimate of the economic impact of SARS cited in William Yu, “Predicting the impact of the coronavirus on the global economy,” UCLA Anderson

When events such as targeted tariffs and epidemics occur, it is always a challenge to pin down the impact before they have run their course. In this forecast we have made a “best estimate” from what we know from the run of the tariffs thus far and from our examination of SARS and MERS outbreaks. The US forecast, which now incorporates those, is folded into the California forecast. In addition to the national impact, transportation, warehousing and trade are proportionately more vulnerable in California, as the seaports and airports of the State provide the gateway to Asia. We have adjusted the California forecast for these as described below.

Since the heating up of the trade war with China at the end of 2017, goods movement through the ports of California, both exports and imports, have declined (Chart 1). The same pattern of decline holds for air cargo through LAX (Chart 2) and through SFO (not shown). Though the Phase 1 agreement was signed, and trade tensions should ease, the outbreak of COVID19 mitigates against any increase in goods movement until the last quarter of the year. Indeed, the interruption in supply chains and the increased health scrutiny of ships and their crews coming into the ports would indicate a further decline in the near term should be expected.

International passenger traffic growth stalled early in 2019 as China advised its citizens against travel to the U.S. and U.S. visa approvals became more difficult to obtain in many locations. With the advent of COVID19, traffic has plummeted. This is not only true with trans-Pacific traffic, but also with domestic traffic. Though we do not have data on February load factors, and United and Jet Blue are offering reassuring words, the impact has only begun domestically.

Indeed, Jet Blue has now suspended change fees for those with concerns about the virus. Historically, a scare from an accident or the outbreak of a disease has had a temporary impact on airline load factors. For this reason, we are assuming that domestic travel will return to trend in the fourth quarter of this year as well.

Folding these into the forecast for California requires an estimate of the initial impact and the path to recovery. Our estimate, based on the limited data from SARS and MERS is a 1.8% decline in leisure and hospitality employment and in transportation and warehousing employment. To be sure, this is just a swag. There is insufficient data to make a statistically based adjustment to the forecast. The “swag” has an implicit assumption on the reaction of people to the news of the outbreak, governmental action around the world, the severity of the outbreak, and the duration of the outbreak. We make no claim to be experts in any of these areas. What the “swag” does illustrate is the kind of pattern that might be expected as the path of the COVID19 epidemic plays out.

Chart 4 shows how the growth of one vulnerable sector, retail and wholesale trade, changes under our assumptions. In the December forecast we had a decline in growth in this sector after adjusting for seasonal factors due to the slower growth in the US economy forecast for the latter part of this year. In the current forecast, the sector contracts much more rapidly and then rebounds in the fourth quarter. The rebound is simply the recovery of retail and wholesale trade as supply chains return to normal and Walmart shoppers become shoppers once again.

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2. Forecast, March 2020, is -0.07%. SARS was in 2002 before China was much integrated in the global economy. China's GDP is 9 times what it was in 2002. We have taken the SARS estimate by a little less than half of that multiple to California GDP and assigned it to the above three sectors for this exercise.



## Employment Retrospective

California has an unemployment rate of 3.9 percent and it has held for several months. With such low unemployment, particularly in the parts of the State that have been growing extraordinarily fast during this expansion, one would expect the new additions to payroll employment to be at a slower rate than in the nation as a whole. But, this has not been so. Payroll jobs grew at a 1.79 percent rate from December 2018 to December 2019, and the U.S. outside of California grew at a 1.35 percent rate. Moreover, job growth is not slowing down. The average monthly increase in 2019 was more than 10 percent higher than that in 2018 for over 300K net new payroll jobs in the State (Chart 5).

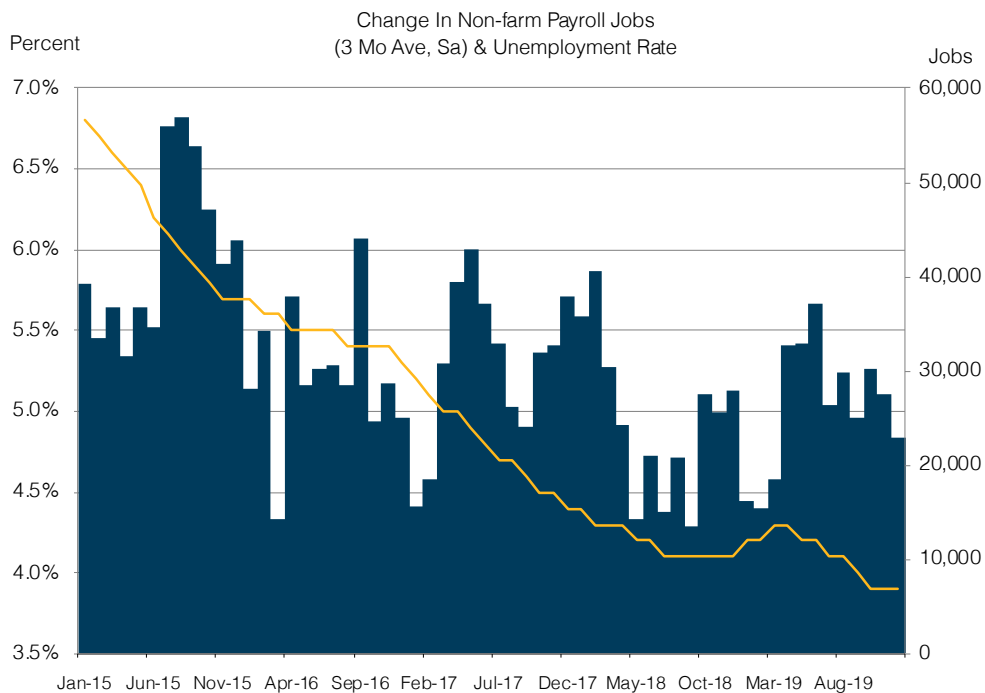
In overall terms, 18.8 million Californians were employed in December. This represents an 11 percent gain over the previous peak employment just prior to the Great Recession (Chart 6). Although these numbers will be revised with the March employment release, if the US benchmark is any indication, that will affect earlier employment estimates more than the later ones.

Although overall job growth in the State has been remained robust, the high value-added sectors; information, profes-

sional and business services, and construction, grew at a smaller percentage over the year, and in particular, over the last quarter of the year. Growth in the lower value-added sectors of health care and social services, administrative services, and private education, is now leading job growth (Chart 7). While health care employment may grow over the coming months due to the outbreak of COVID19, and government employment due to the decennial census, our expectation is for slower growth in transportation, warehousing and leisure and hospitality. These sectors along with professional and business services, information and manufacturing tend to drive higher GDP growth rates in the State. Thus, when we add it up, low unemployment rates, slowing growth due to the nascent epidemic, and slower growth due to the shift in growth sectors yields a slower GDP and employment growth for 2020 than we had previously forecast.

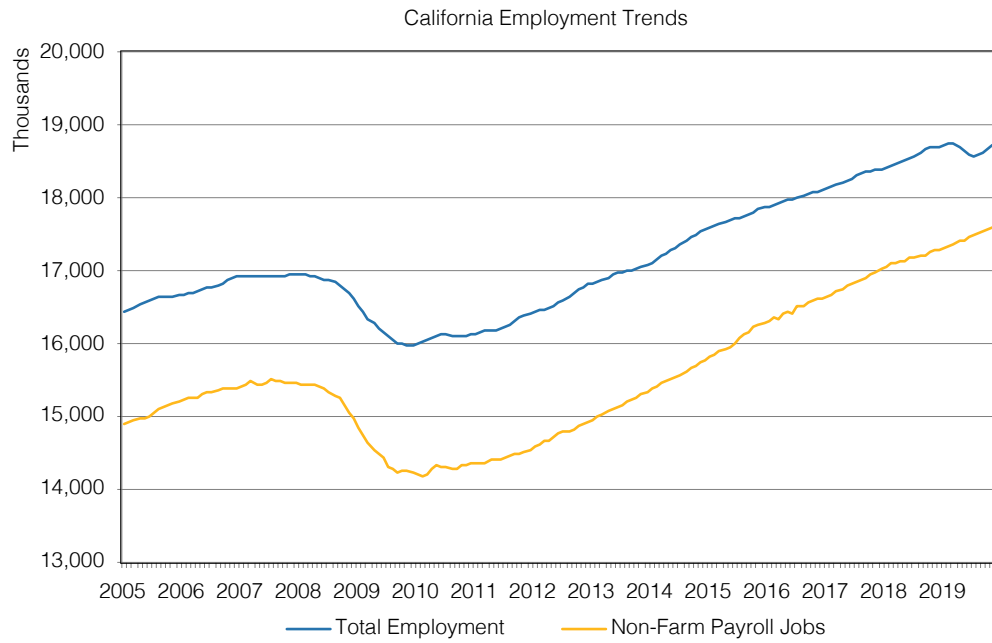
Nevertheless, the healthy labor markets in California are geographically widespread (Chart 8). In the last twelve months, only the counties in the Sacramento Delta grew slower than the U.S. Even the great state of Jefferson which has seen population declines and a relatively moribund economy (the northernmost counties in the State) is now growing faster. Notably, San Francisco, Silicon Valley, the

Chart 5



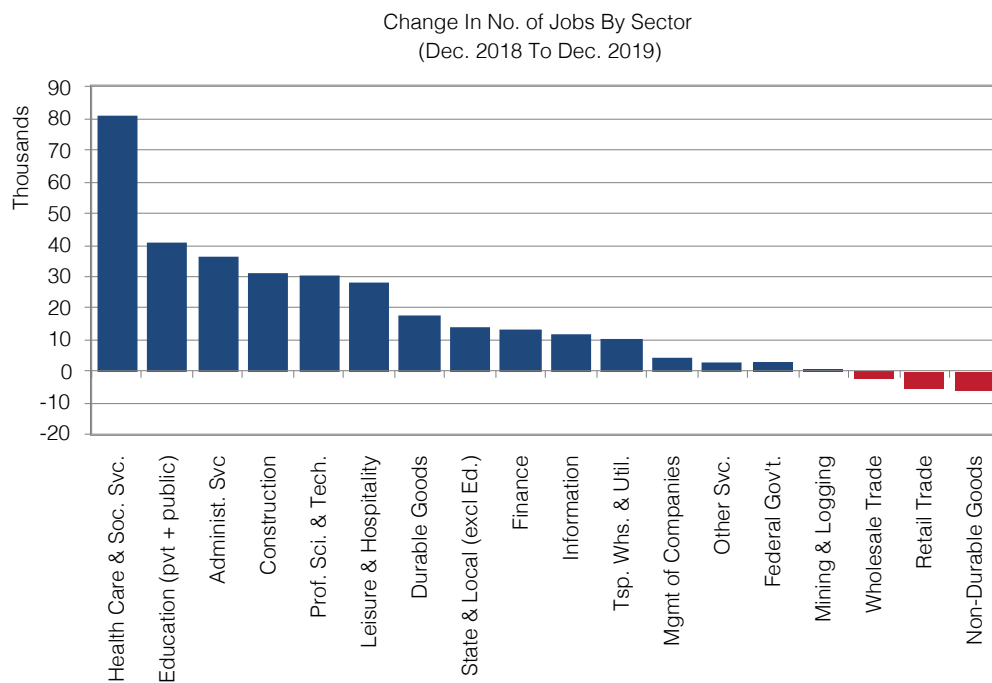
Source: EDD.ca.gov

Chart 6



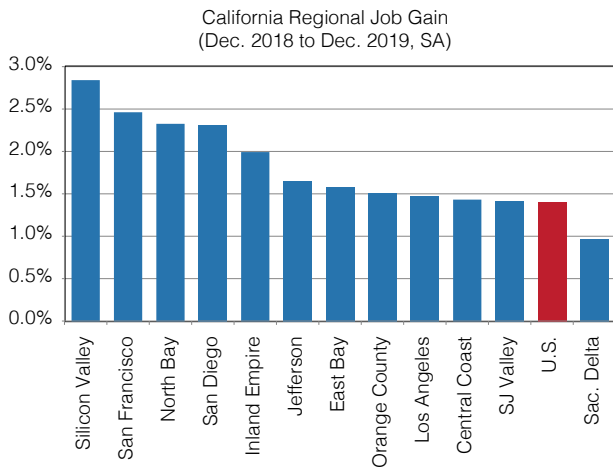
Source: EDD.ca.gov

Chart 7



Source: EDD.ca.gov, UCLA Anderson Forecast

Chart 8



Source: EDD.ca.gov, UCLA Anderson Forecast

North Bay, San Diego and the Inland Empire saw 2 percent or greater growth in payroll jobs in 2019. The first four grew at 1 percent or more faster than non-California U.S. payroll employment and the Inland Empire at more than ½ percent faster. While Bay Area dynamism still leads the State, there is significant growth to the south and east as well.

## Anderson Forecast Monthly GDP Metric

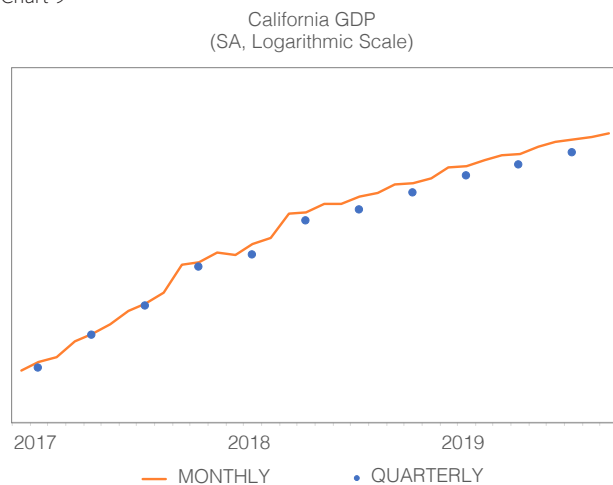
The Anderson Forecast measure of monthly GDP for the State shows continued, but slowing growth. (Chart 9) The solid line is the Anderson Forecast Monthly GDP Metric and the circles are the quarterly GDP estimates from the US Bureau of Economic Analysis. The UCLA Anderson Forecast metric is contemporaneous and is available shortly after the end of each month, unlike the quarterly BEA numbers which arrive with a considerable lag. The chart is in logarithmic scale, which means that straight lines represent constant rates of change. There is a clear flattening of the slope of the monthly line reflecting the slowing of the California economy from 3.5% growth rate to 2.1% growth measured from December 2018 to December 2019.

The quarterly growth of the California economy from Q4 2018 to Q4 2019 is estimated to be at 2.2 percent. This is 0.1 percent below the estimated US growth rate, though sta-

tistically the same. The faster growing California economy ground to a halt in December as the trade wars took their toll. This is suggestive of a further contraction the first half of this year with the interruptions in international travel and tourism and international trade in goods as the COVID19 plays out. Although we expect the technology sectors to begin growing again later in the year, it portends a slow growth year for the State. Real personal income growth which is highly correlated with changes in State government personal income tax revenue should slow to 1.3 percent and real taxable sales to 0.1 percent for the year. These declines in growth rates are historically associated with a decline in State general fund revenue. The half-full glass stems from the fact that this slowdown will be spread over the end of the current fiscal year and the beginning of the next. Our expectation is for an uptick in real personal income and real taxable sales in the final three quarters of the 2020/2021 fiscal year.

The reason for the slower California GDP growth lies in a shift in the sectors in which growth is occurring. This is illustrated with two sub-sectors of Professional and Business Services. Chart 6 shows the output of Professional, Scientific and Technical Services, a high value-added sector. The scales are in the same proportion to each other. As employment grows so does output, but at a faster rate. Some of this is due to increases in productivity and some to increases in hours. In the most recent few months (to the right on the chart) employment growth slows. The decline in output with approximately the same number of jobs is a consequence of

Chart 9



Source: BEA.gov, UCLA Anderson Forecast

declining hours worked in this sub-sector. Chart 7 shows the same two series, output and employment, for administrative services. In it one observes an increase in employment in recent months and an increase in output. However, the two are growing at approximately the same rate. Thus, employment in the sector grows, but the rate of growth of output (part of State GDP) grows more slowly than a similar increase in employment in higher value-added sectors.

## The Forecast

The U.S. forecast update in March represents a significant change to the pattern of economic activity since the previous update last December. The advent of the COVID19 worldwide epidemic's impact on supply chains and on transportation has created additional weakness in the California economy. While the numbers at this point do not indicate an overall recession, some sectors will be adversely affected. To be completely up-front about the forecast, we do not have substantial enough data on these kinds of events to be more definitive, and therefore there is elevated risk in the forecast. The increase in the unemployment rate for the end

of 2020 and the beginning of 2021 is a consequence of the slower growth during this period. It is followed by a rebound in economic growth and hiring in 2021. For the entire years 2020, 2021 and 2022 we expect average unemployment rates of 4.4%, 4.5% and 4.3% respectively.

Our forecast for 2020, 2021 and 2022 is for total employment growth rates to be 0.5%, 1.0% and 0.8%. Payroll jobs are expected to grow at a 1.0%, 1.0% and 0.9% rate respectively. This reflects the weaker growth in payrolls and in total employment over the last year as the weaker economy takes its toll. Real personal income growth is forecast to be 1.3%, 1.7% and 1.7% in 2020, 2021 and 2022. The continued growth in real personal income in 2020 is reflective of the changing mix of employment in California and tight labor markets in high wage occupations. In spite of the weaker economy, the continued robust demand for housing coupled with lower interest rates leads to little change in the forecast for homebuilding. Our expectation is for 117K net new units in 2020. Needless to say, this level of home building, means that the prospect for the private sector building out of the housing affordability problem over the next three years is nil.