

# The California Growth Spurt Continues to Roll On, But for How Long?

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## Introduction

In the California Report of late, we have been following two trends. First, California unemployment rates, particularly in the largest job markets in the State are extremely low. Therefore, it follows that the rate of hiring should slow down. Not only has that not happened, but the rate of hiring for non-farm payroll jobs has increased by 0.2% from 2018's hiring rate. However, the growth in the labor force and the growth in total employment, which includes non-payroll and agricultural jobs, has slowed dramatically. Those data indicate that the March benchmark revision will temper the payroll job growth somewhat, but the trend ought not to change. Second, the pace of growth in the U.S. is slowing. GDP in the second quarter of 2019 came in at only 2.0% and in the first quarter the 3.1% growth was supported by unsold goods (inventory accumulation). Not so in California. GDP growth in the first seven months of the year was running at a 4% annual rate and July was 3.3% – higher than July 2018. Again, the numbers are perhaps a little high and will be revised, but they still raise the question as to why

the disconnect? The answer is found in the growth areas in the state. California is outperforming the U.S. for the same reason it has over the last decade; productivity gains through the employment of labor augmenting technology.

Nevertheless, with recession in the air and a slowing U.S. and world economy, at some point in the future something will have to give. We look to the latter part of next year for that to happen; about the time the U.S. growth rates dip below 1%. At present, and in spite of the trade tensions between the United States and China, the economic news is positive. For example, the July county-wide unemployment rates from Marin to Santa Clara are below 2.8%, from Sonoma through the East Bay below 3.5%, and in Southern California, Orange County and San Diego are at or below the U.S. rate of 3.7%. To be sure, Los Angeles and the inland regions are not doing as well by this measure but, economic prosperity has clearly become the norm in California today. In this California Report we review the output, employment, and housing numbers and present the prospects for the coming 2 ½ years.

### Employment Retrospective

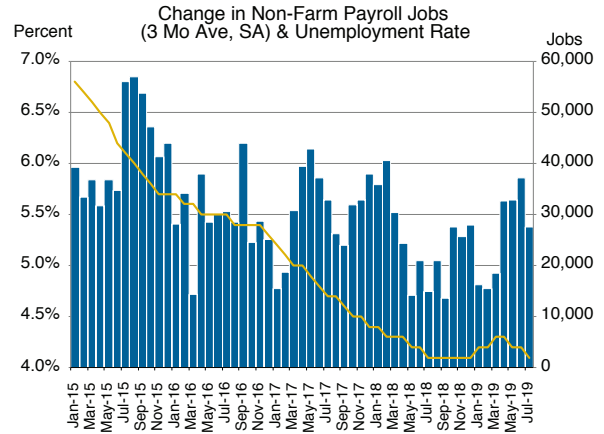
After bumping up to 4.3%, the unemployment rate moved back down to 4.1% – very much in the neighborhood of full employment. Part of this was due to a reduction in the labor force from a seasonally adjusted 19.5 million to 19.3 million. It is likely that the higher number was a measurement error rather than the lower number being representative of 200K more discouraged workers, as labor demand in the State has remained strong. After a slowing last year to a monthly average of 23,000 net new non-farm payroll jobs, hiring increased to an average of 26,600 net new jobs per month through the first seven months of this year (Chart 1).

The household survey which measures the number of people employed in the State has decreased over the last few months, albeit more slowly than the labor force. Again, our expectation, particularly in light of the enterprise survey non-farm payroll employment numbers, is that this is a measurement error rather than an actual trend (Chart 2). Thus, we expect both series to show some revision with the decrease in the number of people employed being revised away and the number of non-farm payroll jobs a little lower than reported.

Job growth in the State has been across most sectors. Of the top five sectors growing at a rate faster than 3% over the last twelve months, four (construction, professional and scientific services, information, and transportation warehousing and utilities) have an average wage that is at or higher than the median and one (health care and social services) lower. These differences in sectoral growth have a profound impact on State GDP and have been driving GDP growth faster than the U.S.

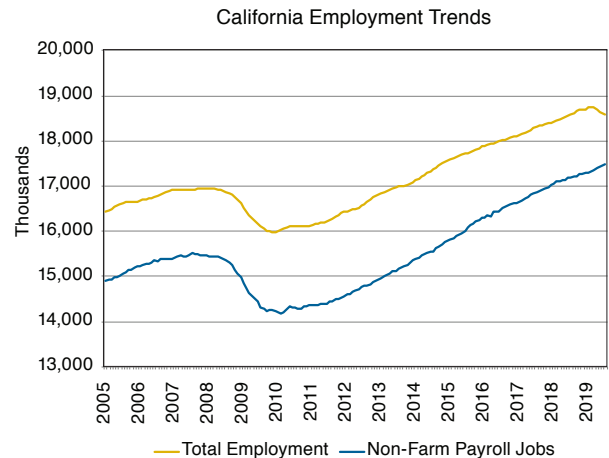
Healthy labor markets in California are also geographically widespread (Chart 4). In the second half of 2018, the inland parts of the State—the Inland Empire and the San Joaquin Valley – continue to score impressive gains, as did each of the four Bay Area Regions and San Diego. Los Angeles and Orange counties are growing at rates that are not significantly different from the U.S. rates.

Chart 1



Source: EDD.ca.gov

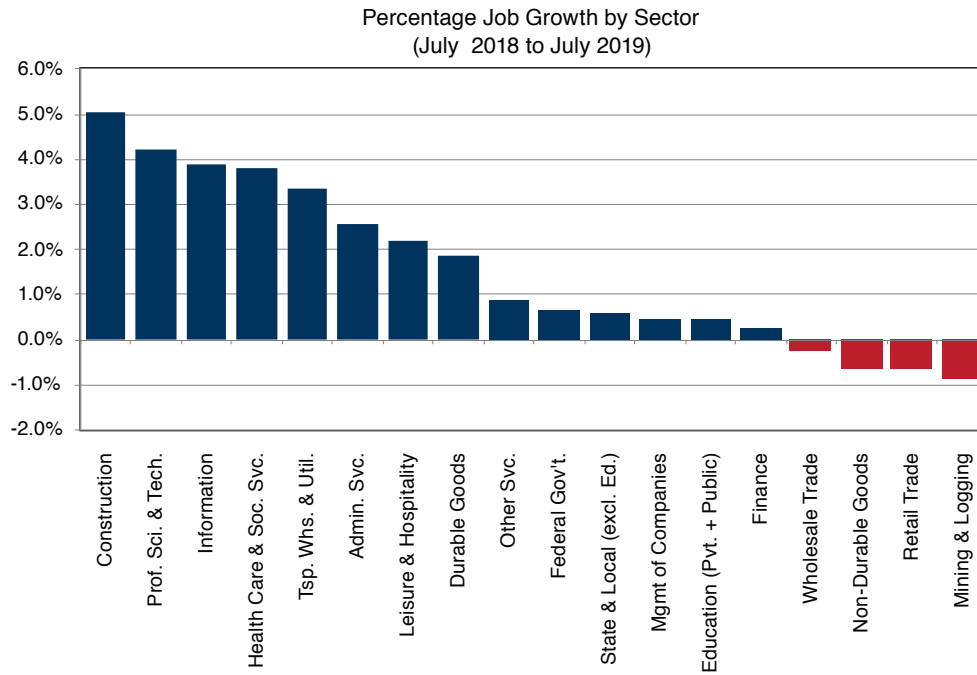
Chart 2



Source: EDD.ca.gov

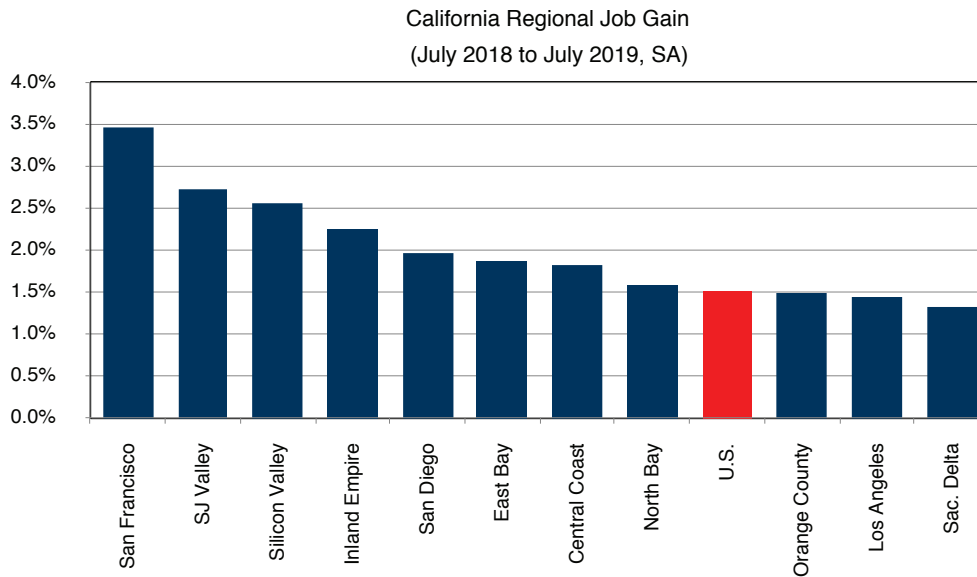
THE CALIFORNIA GROWTH SPURT CONTINUES TO ROLL ON, BUT FOR HOW LONG?

Chart 3



Source: EDD.ca.gov, UCLA Anderson Forecast

Chart 4

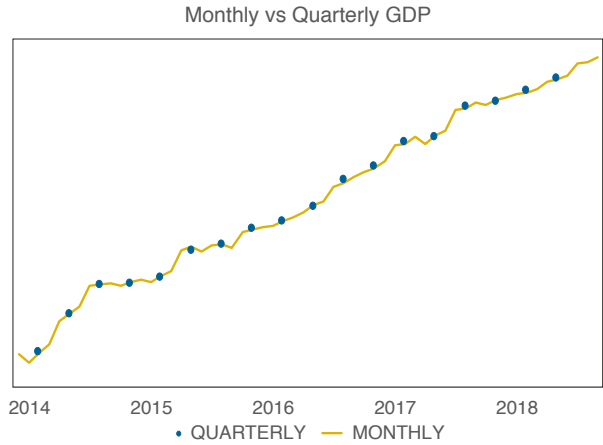


Source: EDD.ca.gov, UCLA Anderson Forecast

UCLA Anderson Forecast Monthly GDP Metric

The UCLA Anderson Forecast measure of monthly GDP for the State shows continued growth. Chart 5 is a plot of the quarterly GDP data from the U.S. Bureau of Economic Analysis. The solid line is the UCLA Anderson Forecast Monthly GDP Metric. As can be seen from the chart, it follows the quarterly numbers closely, but it has the advantage of being contemporaneously and available 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. While it shows a slowing of those growth rates, it is only a slowing to 3.3% from the previous 4%.

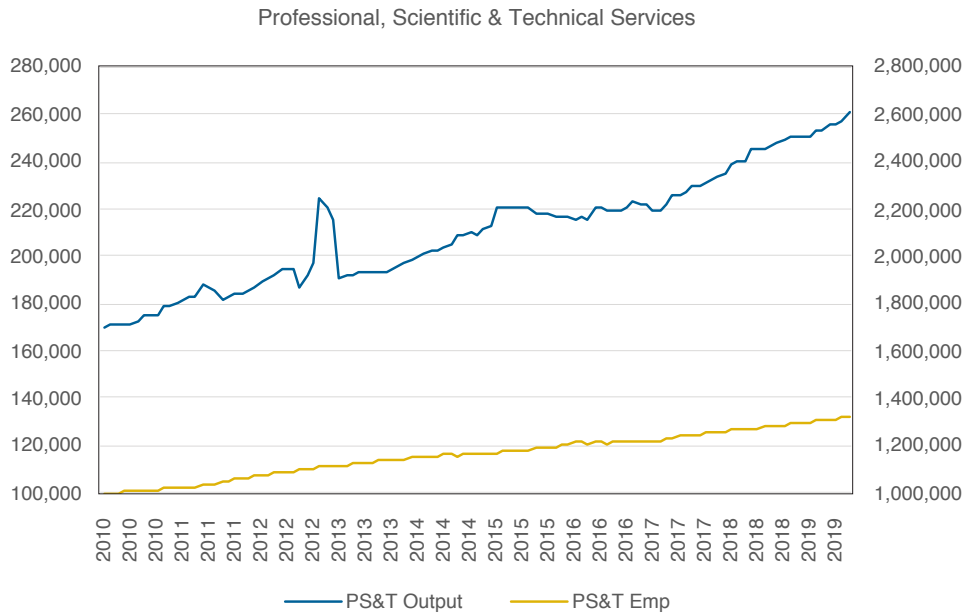
Chart 5



Why is the California economy growing faster than the rest of the nation? The answer lies in the sectors that are experi-

Source: BEA.gov, UCLA Anderson Forecast

Chart 6

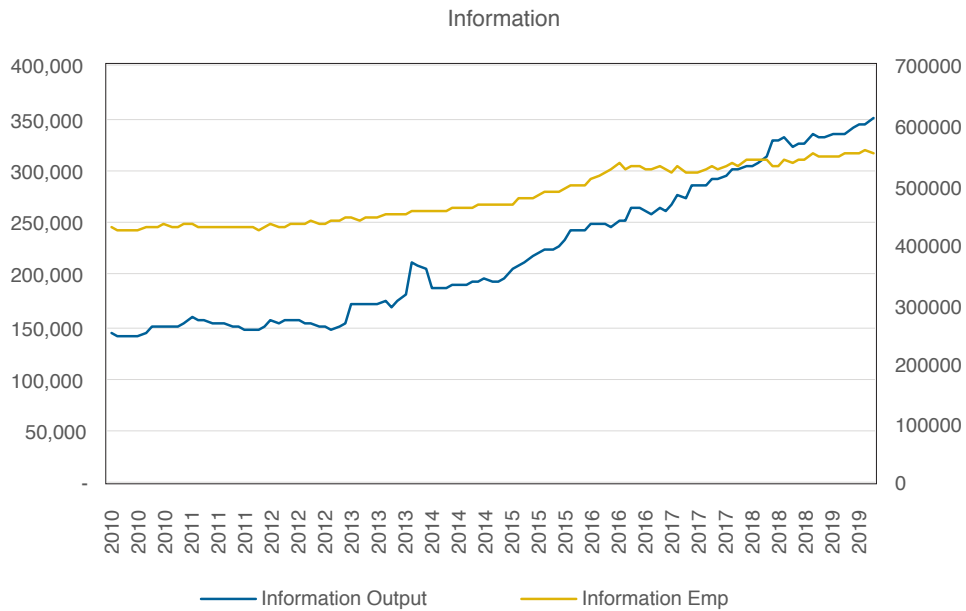


Source: UCLA Anderson Forecast

encing the most growth. The second fastest growing sector over the last twelve months was professional, scientific and technical services. Chart 6 shows the growth in output compared to the growth in employment. Though the scales are different they are proportional to each other. Clearly output is growing much faster than employment, indicating productivity gains in this sector. The same is true with the other sector dominated by technology – information (Chart 7). It is in this sector that the penetration of technology into the entertainment industry is evident, and this sector has been growing at just under 4% over the last year.

However, seeming non-tech sectors also show dramatic productivity growth in the State. In Chart 8, output and employment in durable goods manufacturing is plotted. Over the past 12 months (July 2018 to July 2019) manufacturing output grew at 3.8%. At the same time, employment grew by only 1.9% resulting in a productivity improvement of nearly 2% per annum. Robots apparently are augmenting worker activities in the building of durable things in the State. And in the retail sector, employment is falling. Nevertheless, output is increasing, reflecting the dramatic increase in retail productivity from online Retail (Chart 9).

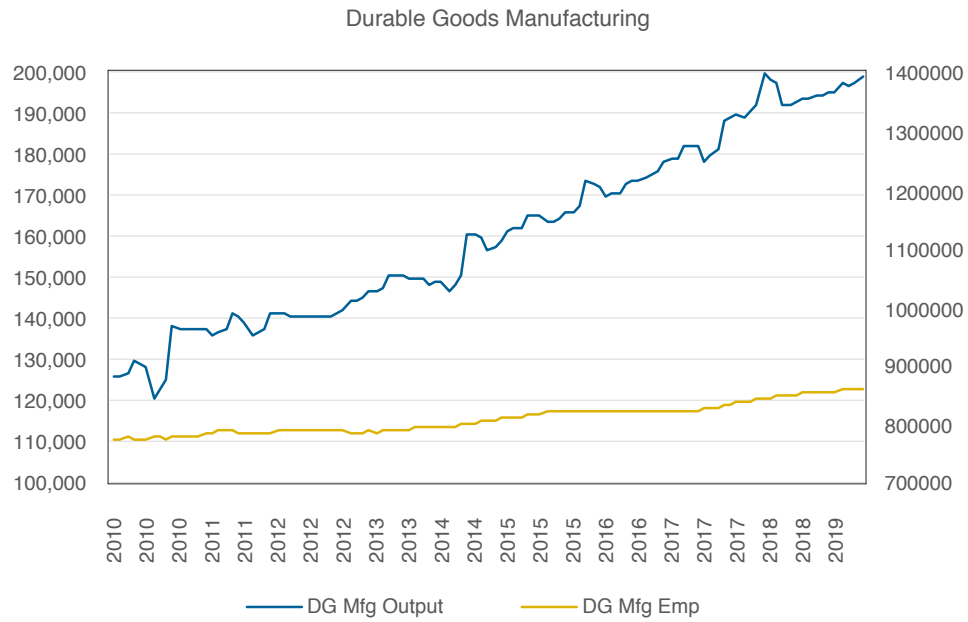
Chart 7



Source: UCLA Anderson Forecast

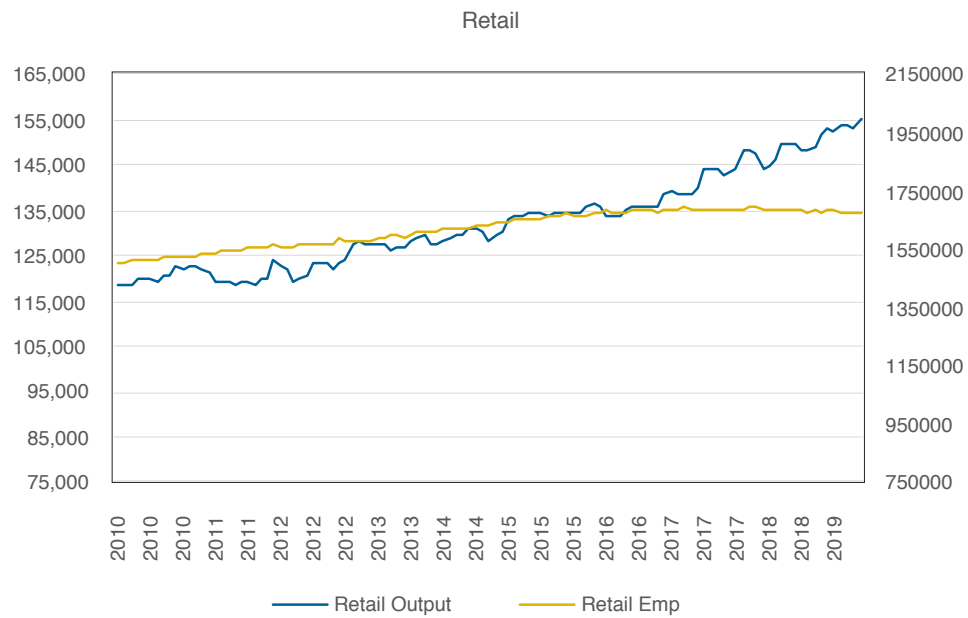
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Chart 8



Source: UCLA Anderson Forecast

Chart 9

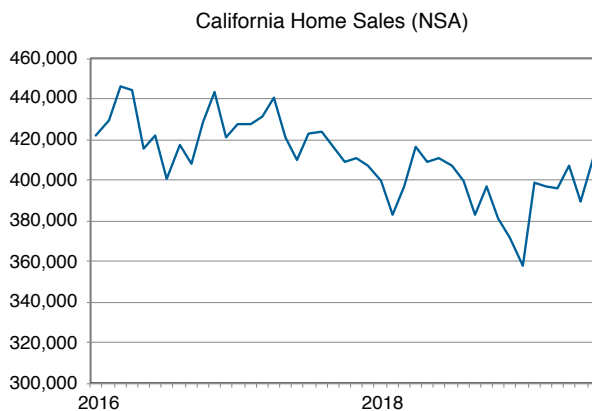


Source: UCLA Anderson Forecast

## Housing Market Retrospective

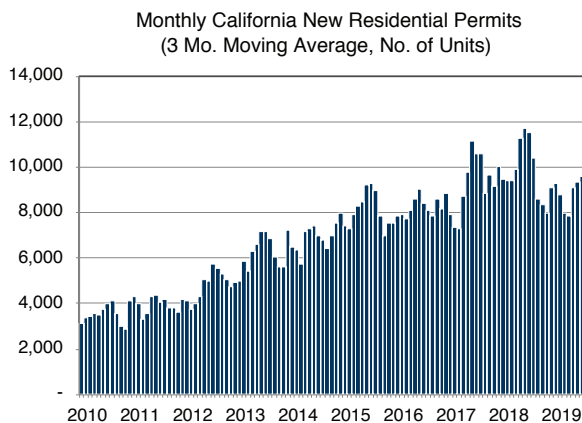
In the last California report, we presented an analysis of California’s soft housing market and attributed the softness to expectations of slower price appreciation and possible interest rate cuts. Although interest rates cuts are still forecast, the eight-month softness in housing markets seems to be over. Pushing against the expectations of future price reductions has been the aforementioned robustness in the State’s job growth. The firming of the market is seen in a return of the volume of home sales at about the average recent long-run average. However, during the peak buying season the volume of sales should be higher (Chart 10). Along with increased sales has been a firming in median prices as well as a firming in the same-house sale price index S&P Core Logic Case/Shiller.

Chart 10



Source: California Association of Realtors

Chart 11



Source: U.S. Department of Census

Nevertheless, there is little long-run price appreciation, and nervousness about the near-term future of housing markets continues to depress residential construction. The number of permits issued during the three months ending April 2019 was 16% below that of a year earlier. The annual rate of building over the three months ending July 2019 bumped up from the 95K for the three months ending in April to 115K. When one considers the fact that some of these permits were for rebuilding homes lost in natural disasters, the State has clearly fallen behind in home production relative to population growth and future needs, and this is not expected to change any time soon. Our forecast is for a modest increase in the level of building until the U.S. economy begins to soften next year, followed by a slow recovery of home building in 2021.

## The Forecast (with William Yu)

The U.S. forecast update in September represents very modest changes to the outlook since the previous update last June. Weakness in housing as well as the slowing U.S. economy is reflected in a more modest growth rate in the U.S. in late 2020 in the present forecast. As a consequence, we expect California’s average unemployment rate to rise to an average of 5.1% in the fourth quarter of 2020. For the entire years 2020 and 2021 we expect average unemployment rates of 4.6%.

Our forecast for 2019, 2020 and 2021 is for total employment growth rates to be 0.8%, 1.7% and 1.2%. Payroll jobs are expected to grow at a 1.6%, 1.1% and 0.9% rate respectively. This reflects the stronger growth in payrolls over the last year, even while total employment growth was weaker. Real personal income growth is forecast to be 1.3%, 1.7% and 1.9% 2019, 2020 and 2021 respectively. 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. Homebuilding will be lower by about 11,000 units per year by the end of the 2021 than previously forecast as a consequence of the current weak housing market and the slowdown in late 2020. Needless to say, weakness in home building, even with the new eased regulations and zoning, means that the prospect for the private sector building out of the housing affordability problem over the next three years is nil.