THE CHAPMAN UNIVERSITY ECONOMIC FORECAST UPDATE

Orange, CA—The A. Gary Anderson Center for Economic Research at Chapman University released today updates of the 2017 forecasts for the U.S., California and Orange County that were issued last December at its 39th Annual Economic Forecast Conference. The updated forecasts take into account more accurate historical economic information that is now available, especially for 2016, as well as the economic trends that have emerged during the first half of this year.

Dr. Jim Doti presented the forecast update to Orange County business and community leaders at the University’s Musco Center for the Arts.

Following is a summary of his presentation. A more detailed analysis and forecasts are included in the enclosed Economic & Business Review.

2017 U.S. FORECAST UPDATE

Overview:

President Trump has voiced his goal to push economic growth up to 3 percent. To consider whether such a goal is achievable, one needs to examine the two components of long-run real GDP growth: jobs and productivity. Job growth, for the foreseeable future, will be constrained by low unemployment as well as projected declines in the working-age population. We believe that a realistic expectation of long-run real GDP growth is 1.6 percent—not the 3 percent growth that President Trump is seeking.

Any prospects for increasing productivity would come from tax reform or regulatory reform. The passage of any significant legislation, however, is in doubt. Since 1966, the average turnover in House seats for the mid-term elections during the first term of a presidency is ~27
seats. This historical record points to a likely narrowing of the Republican majority in 2018. Given that expectation, the Democrats will do all they can to block any major legislation proposed by President Trump. As a result, we are not including any fiscal stimulus assumptions in this forecast update.

The other possible source of economic expansion is monetary policy. But there is no question that the Fed is in a tightening mode, as reflected by the increasing funds rate and a recent slowdown in money supply (M2) growth. We see an additional fed funds rate increase in September, which will cause the interest rate spread (the difference between long- and short-term rates) to narrow to 100 basis points. While that narrowing isn’t enough to suggest a recession is imminent, it does point to weakness in the ongoing recovery.

Our forecast update calls for real GDP growth of 2.3 percent in 2017. While this represents a pickup from the 1.6 percent growth registered in 2016, it is not the kind of growth that will fuel strong inflationary pressure. For a recovery that is one of the longest on record at eight years old, that is good news.

**Highlights:**

- With household net worth continuing to climb, consumer spending is forecasted to increase from 2.7 percent in 2016 to 2.9 percent in 2017.

- Capacity utilization is starting to pick up, pointing to additional investment spending this year. Higher investment spending will also be fueled by housing starts, forecasted to grow at a respectable rate of 10.8 percent.

- The balance of trade is forecasted to be pushed deeper in the red, a result, in part, of the declining value of the U.S. dollar.

- Housing appreciation, after dropping back to 5.6 percent in 2016, is forecasted to pick up to 6.6 percent.

- Inflation, as measured by the year-to-year change in the personal consumption expenditures price index, less food and energy, is forecasted to remain constant at 1.7 percent through year-end.

- Long-term interest rates, like the 10-year treasury bond, are forecasted to remain at current levels. But increases in the fed funds rate will push up other short-term interest rates. We see the 90-day treasury bill increasing about 50 basis points by year-end.
2017 CALIFORNIA FORECAST UPDATE

Overview:
Between 2013 and 2016, California job growth, on an annual basis, outpaced U.S. growth by about one percent per year. Looking at the quarterly data, however, reveals that the gap in job creation between the state and nation narrowed appreciably in 2016. Most of this narrowing was brought about by a sharp drop in information services jobs in Silicon Valley and declining job growth in the construction sector.

We believe the construction slowdown is temporary and expect a pick-up through year-end.

The fall in high tech, however, will continue to be a dominant force, leading to a slowdown in California’s overall economy. The average annual pay for an information services worker in California is $131,000 versus $59,500 for all workers. So information services job losses have a much greater impact on aggregate income and California state tax revenue. These job losses appear to be related to the fact that Silicon Valley housing prices are among the highest in the nation. Workers are relocating to other technology hubs located in regions where housing is relatively more affordable. (This is discussed in more detail in the article on pages 22-24 of the Review.)

As can be seen in the table at the right, the impact of these Silicon Valley job losses will override the positive impacts of California’s other major engines of economic growth. Our forecast calls for California payroll job growth slowing from 2.6 percent in 2016 to 2.1 percent in 2017.

Highlights
- In addition to real GDP growth in the U.S., the state’s economy will also be propped up by growth in U.S. imports. In the first quarter of this year, the most rapid import growth was from Mexico (7.3 percent), China (5.9 percent), and Japan (4.7 percent)—all well above the
3.7 average for all imports. These rising imports are supporting job growth in transportation and warehousing and professional and business services.

- While construction activity was dampened early in the year, the low supply of unsold resale homes in California will help fuel a pick-up in residential permits through year end. Our forecast calls for permit growth of 4.4 percent in 2017, significantly higher than the 0.8 percent growth reported for 2016.

- While the low supply of homes will boost permit activity, this shortage, coupled with higher mortgage rates, is exacerbating the state’s housing affordability problem. California’s home price-to-income ratio is currently 5.8 versus a ratio of 3.3 for the nation.

- California’s home prices will continue climbing in 2017. Our forecast calls for housing appreciation of 6.5 percent versus 5.5 percent in 2016.

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2017 ORANGE COUNTY FORECAST UPDATE

Overview

Like California, Orange County’s job growth has been outpacing the nation but dropped sharply over the last year. Unlike California, the county’s downdraft is related mainly to construction.

Over the last five years, construction has been a major engine of growth in Orange County. It now appears, however, that construction will experience little, if any, growth for the next several years.
Residential building permits increased 10.9 percent in 2016, but are forecasted to increase at a lower 3.9 percent in 2017, bringing the total numbers of permits to 12,600.

Given current demographic trends in Orange County, we do not see housing production much higher than current levels. In fact, our findings suggest a demand of only 11,600 housing starts annually through the year 2020. The major reason for this is a projected population increase of only 0.4 percent per year between 2015 and 2020, with most of that growth occurring in the 65 and over age cohorts rather than from millennial first-time homebuyers. These demographic trends place an upper lid on residential construction.

These trends also constrain future job growth. Because of Orange County’s extremely tight labor market, where unemployment has reached a low of 3.2 percent, any future job increases will not likely come from the involuntarily unemployed returning to work. New entrants to the labor force may add to the supply. But that doesn’t look promising, given the projected graying of Orange County’s population.
New entrants to Orange County’s workforce will not come from people moving to the county. While net immigration has been increasing since 2013, net domestic out-migration to other states has grown even faster, almost completely cancelling out the higher immigration.

Our forecast for overall Orange County job growth is 1.5 percent—the slowest rate of growth since the recovery began in 2009. It is also lower than our forecasts for job growth in the U.S. and California.

**Highlights**

- Orange County’s home price-to-income ratio is currently 8.6, well above the 5.8 and 3.3 ratios for California and the U.S. respectively, reported in the previous section. While Orange County’s high home prices are difficult to justify, our model points to continued housing appreciation of 6.2 percent in 2017.

- Last December, we expressed our belief that Orange County housing prices are in “bubble” territory. Eventually, longer-run economic and demographic forces will lead to a price correction. Current trends strongly suggest that it won’t happen this year.
Prior to past periods when housing prices dropped, several indicators gave off warning signals. The median numbers of days a home was on the market and the supply of homes on the market both picked up. Another warning of declining home prices was that the interest rate spread turned negative. At present, none of those warning signals is in sight.

- The market return for Orange County apartments and offices has declined to near the 10-year treasury bond rate, suggesting a decline in investment in new construction. We see total building permit valuation dropping from a 10.1 percent annual growth in 2016 to 4.5 percent in 2017.
ABOUT THE ANDERSON CENTER FOR ECONOMIC RESEARCH

The A. Gary Anderson Center for Economic Research (ACER) was established in 1978 to provide data, facilities and support to encourage the faculty and students to engage in economic and business research of high quality, and to widely disseminate the results.

**ANNUAL SCHEDULE OF CONFERENCES AND PRESS RELEASES**

| JANUARY  | Economic Forecast Conference for the Inland Empire  
|          | California Purchasing Managers Survey |
| MARCH    | California Consumer Sentiment Survey |
| APRIL    | California Purchasing Managers Survey |
| JUNE     | Economic Forecast Update Conference for the U.S., California, and Orange County  
|          | California Consumer Sentiment Survey |
| JULY     | California Purchasing Managers Survey |
| SEPTEMBER | California Consumer Sentiment Survey |
| OCTOBER | California Purchasing Managers Survey |
| DECEMBER | California Consumer Sentiment Survey  
|          | Economic Forecast Conference for the U.S., California and Orange County |