Press Release

Chapman University

A. Gary Anderson Center for Economic Research

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CHAPMAN UNIVERSITY
INLAND EMPIRE ECONOMIC FORECAST

Orange, CA—The A. Gary Anderson Center for Economic Research at Chapman University released today its 2017 economic forecasts for the U.S., California and Inland Empire. Dr. Jim Doti presented the forecasts to Inland Empire business leaders at a conference held at the Riverside Convention Center.

Following is a summary of Dr. Doti's presentation. A more detailed analysis and forecasts are included in the enclosed *Inland Empire Economic Forecast*.

2017 U.S. FORECAST

Overview:

President-elect Trump's campaign proposals will change our nation's economic landscape. In the long-run, "Trumpenomics" is likely to bring about regulatory reform, tax cuts, increased spending on defense and infrastructure, and some sort of Obamacare "fix." Trumpenomics in the short-run points to the reversal of executive orders, loosened bank regulations and expectations of inflation.

With tax cuts and increased spending looming, the Federal Reserve Board is likely to be more resolute than ever about raising the federal funds rate, which is likely, in turn, to push up other short-term interest rates. If that were to narrow the difference between short- and long-term rates, it may be a warning of recession. Every recession has been preceded by the interest rate spread (the difference between the 10-year T-bond and the 90-day T-bill) falling below zero.

There is no reason to believe that the interest rate spread will turn negative in 2017. Not only do these findings rule out a recessionary call, but we are forecasting that the recovery will pick up steam, with real GDP growth increasing from 1.7 percent in 2016 to 2.4 percent in 2017.

Highlights:

- Payroll employment is forecasted to increase 1.8 percent in 2017—slightly higher than the 1.7 percent growth registered in 2016. This sustained job growth, coupled with higher wage gains, will push consumer spending higher.

  In addition, sharp increases in household wealth, fueled by stock market gains and rising home prices, will help spur higher consumer spending.

Real GDP

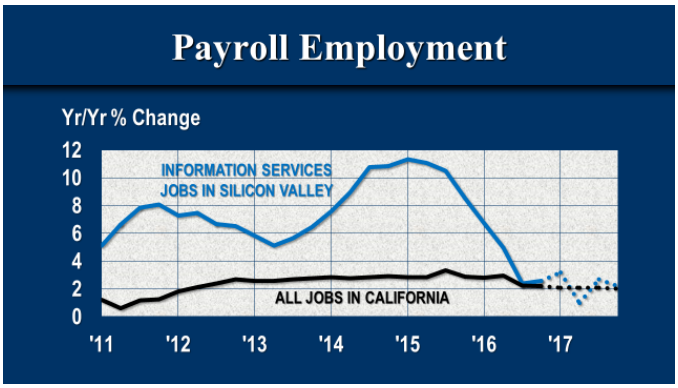
	Weight	Annual % Change 2016e	Annual % Change 2017f	Impact on Real GDP
Real Consumption	0.69	2.7%	3.1%	↑
Real Investment	0.17	–2.0%	1.8%	↑
Real Government Purchases	0.17	0.9%	0.5%	↓
Real Net Exports	–0.03	–1.7%	–6.5%	↓
Real GDP	1.00	1.7%	2.4%	

- Investment in mining exploration and wells dropped sharply from $123 billion in 2015:1 to $42 billion in 2016:3. We believe this sector has now bottomed out, and the lifting of its drag on the overall economy has helped real GDP growth gain momentum.
- Higher investment spending will also be fueled by a pickup in housing starts. That increase will lead to 1.2 million housing starts in 2017—the highest since the recovery began but still below the pre-recession high of 2.1 million housing starts in 2005.
- Despite the projected increase in residential construction, home price appreciation is forecasted to slow from 5.5 percent in 2016 to 5.0 percent in 2017.
- Inflation, as measured by the year-to-year change in the personal consumption expenditures price index, less food and energy, is forecasted to be on the rise by mid-2017, increasing from 1.7 to 1.9 percent by year-end.
- Both short-and long-term interest rates are forecasted to increase about 50 basis points by the end of 2017, keeping the interest rate spread positive at about 200 basis points.

2017 California Forecast

Overview:

Since 2017, California has outperformed the nation in job growth. That is due, in large part, to the Silicon Valley's disproportionately high growth in job numbers and wage/salary levels in the high-paying information services sector. But growth in those jobs has dropped back sharply since early last year, and a number of factors suggest a continuing downward spiral, albeit at a slower rate. This Silicon Valley slowdown will have a significant impact on the state's overall economy.



Another factor expected to constrain job growth in California this year is a slowdown in construction, with total building permit valuation declining from a 4.1 percent growth rate in 2016 to 3.2 percent in 2017.

Our Chapman model suggests that these negative forces will be offset, in part, by stronger growth in real GDP and imports into California. While imports are subtracted from U.S. real GDP growth, they serve as a positive proxy for the extensive trade and distribution services in California. Barring any Trump-induced changes in trade pacts and tariffs, at least in 2017, the recent depreciation in exchange rate values points to a pickup in imports flowing through California from the state's major markets, China, Mexico, Japan and Canada.

Our forecast calls for employment growth in the state to slow from 2.6 percent in 2016 to 2.1 percent in 2017. While we see California job growth slowing to 2.1 percent, this will still outpace our U.S. forecast of 1.8 percent job growth.

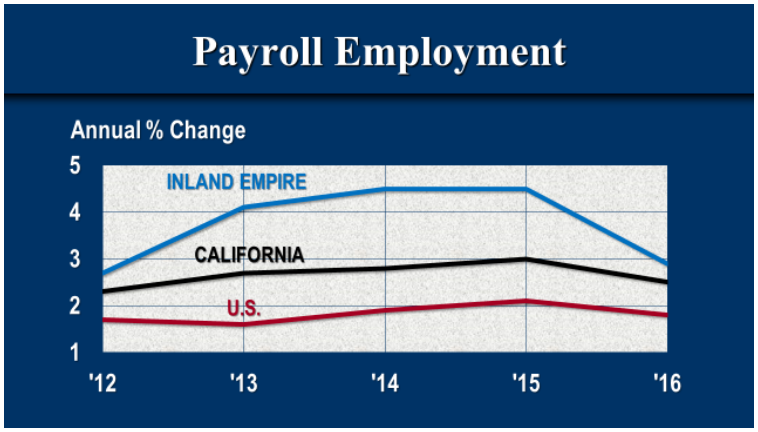
Highlights:

- Construction has been a major engine of economic growth in the state since the beginning of the recovery. Annual housing construction has increased sharply from 36,000 units in 2009 to 94,000 in 2016—a 14.5 percent average annual rate of increase.
- Despite this rapid increase in housing construction, the supply is still tight. Population demographics point to the need for 98,000 new units annually between 2015 and 2020, close to the actual number of housing starts occurring annually since 2015.
- Housing affordability in California has hovered around an index of 90 for the last few years, suggesting that median family income is 90 percent of what is required to purchase a median-priced home. If our forecasts for mortgage rates and housing appreciation in the state are on target, housing affordability will decline from an index of 95 to 84 by the end of this year.
- Another factor that has been and will continue to impact the California economy is migration trends. People are "voting with their feet" and moving outside the state. From 2010 to 2014, California lost 88,000 citizens as compared with Texas and Florida that both gained more than 100,000.

2017 INLAND EMPIRE FORECAST

Overview

From 2012 to 2015, annual job growth in the Inland Empire was about 50 percent higher than in California and double that of the U.S. In 2016, however, Inland Empire job growth dropped sharply relative to the state and nation.

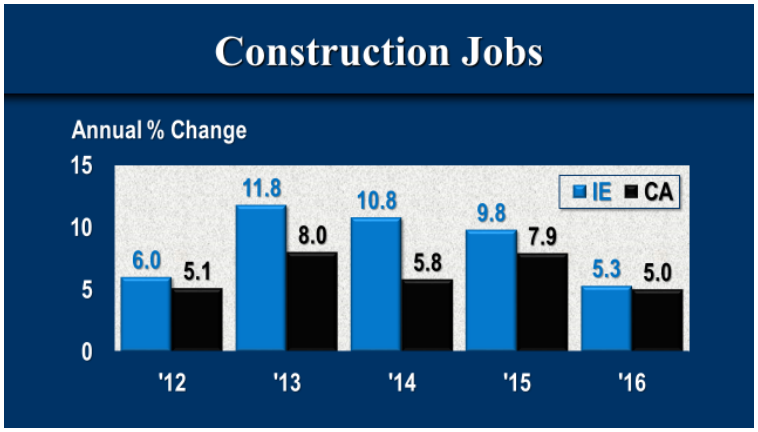


The 2016 drop in the Inland Empire's job growth was broad-based and hit virtually every major employment sector. Particularly hard hit in the Inland Empire relative to California were the construction, professional & business services and leisure and hospitality sectors.

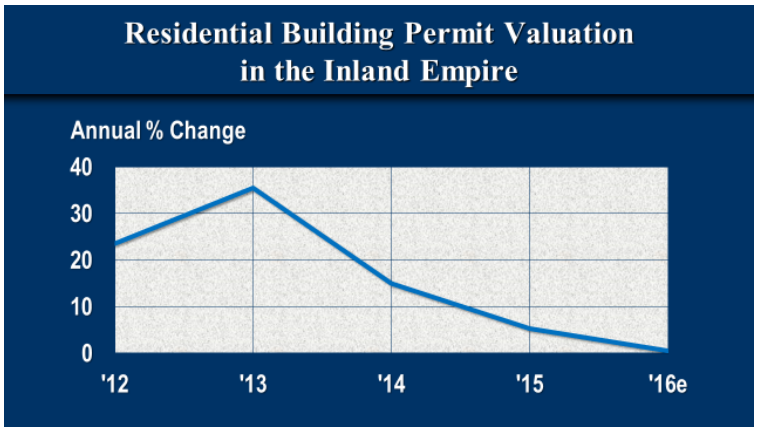
Swing in Rates of Job Growth

	Inland Empire			California		
	2015	2016	Swing	2015	2016	Swing
Construction	9.8%	5.3%	–4.5%	7.9%	5.0%	–2.9%
Trade, Transp. & Utilities	5.6%	3.5%	–2.1%	2.6%	2.0%	–0.6%
Financial Activities	2.3%	0.5%	–1.8%	2.0%	1.6%	–0.4%
Prof. & Business Services	3.6%	0.2%	–3.4%	2.9%	3.2%	+0.3%
Education & Health	5.2%	3.5%	–1.7%	3.8%	3.8%	+0.0%
Leisure & Hospitality	4.6%	1.1%	–3.5%	4.1%	3.7%	–0.4%
Total Payroll Employment	4.5%	2.9%	–1.7%	3.0%	2.6%	–0.4%

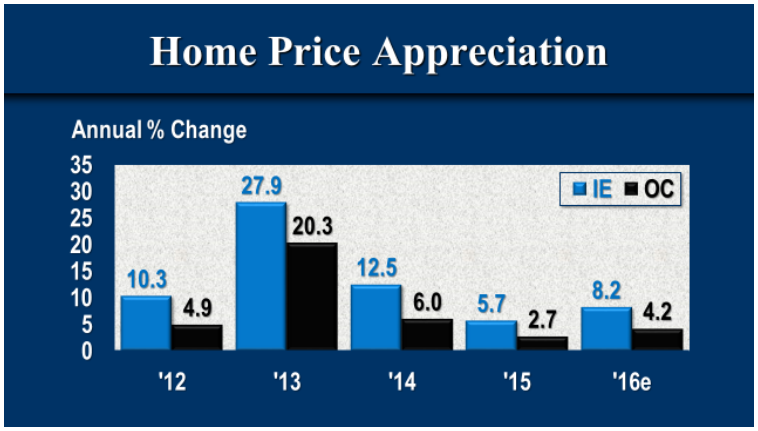
It appears that jobs in the construction sector have experienced the sharpest decline in growth. After peaking at an annualized growth rate of 11.8 percent in 2013, construction jobs fell back to 5.3 percent growth in 2016, only marginally higher than the U.S. growth rate.



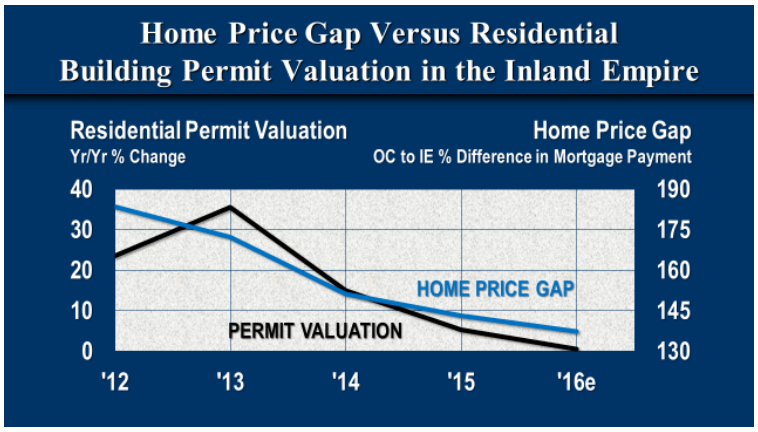
That decline mirrors a sharp drop in residential building permit valuation in the Inland Empire. Since peaking at 35.5 percent annualized growth in 2013, total building permit valuation has fallen to 0.6 percent in 2016.



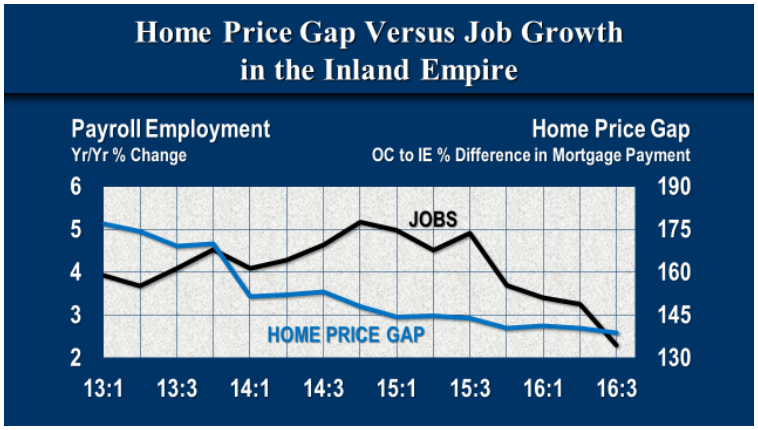
We believe the major reason for the pull back in the Inland Empire's job growth is because of housing appreciation that has greatly outpaced that of other areas, particularly Orange County.



As the housing price gap between the Inland Empire and Orange County (percentage difference in mortgage payments) has diminished, so too has permit valuation.

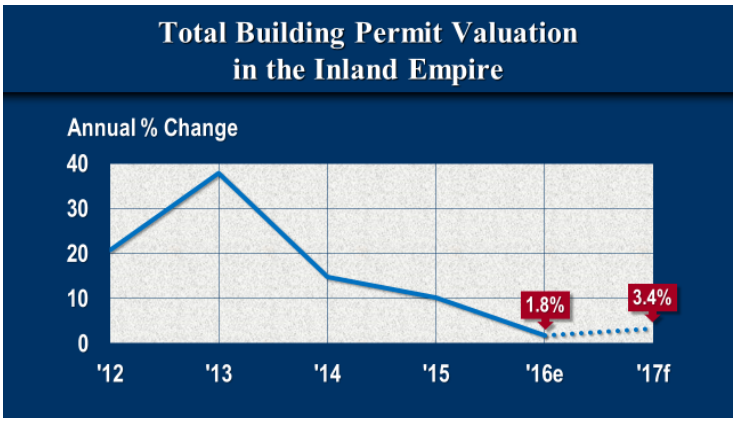


Overall job growth in the Inland Empire dropped sharply from 5 percent in the third quarter of 2015 to 2.3 percent one year later.

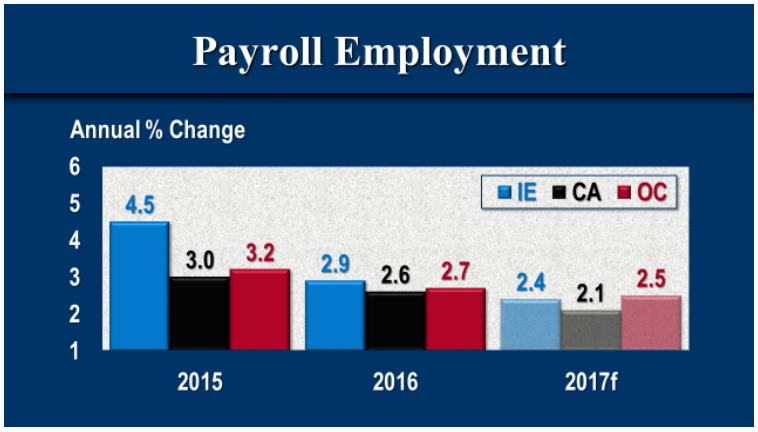


Since the Inland Empire still serves as a bedroom community for Orange County, housing price comparisons for the two counties are important considerations for where people decide to live. For example, in 2013, the average mortgage payment on a median-priced home as a percent of median family income in the Inland Empire was 15 percent versus a much higher 30 percent in Orange County. That difference was likely large enough to convince workers to brave that brutal commute on the 91 Freeway. But over the 2012-13 period, housing appreciation in the Inland Empire soared 65 percent as compared to 36 percent in Orange County. As a result, the gap in the average mortgage payment to income ratio between the counties narrowed. Not surprisingly, job growth in the Inland Empire of 4.5 percent in both 2014 and 2015, which was almost double that of Orange County, dropped sharply in 2016 to 2.9 percent, only slightly higher than Orange County's growth rate of 2.7 percent.

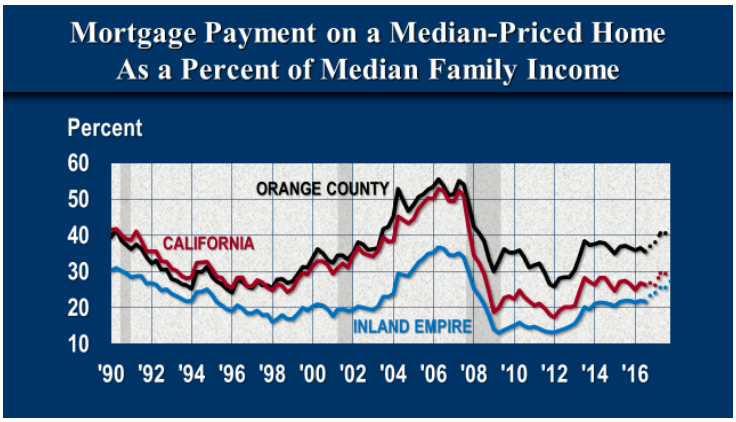
Our 2017 forecast calls for a mild pickup in both residential and nonresidential building permit valuation, though nowhere near the growth rates registered between 2015 and 2015.



Although construction activity is projected to pick up a bit in 2017, the lagged effects of the construction downturn will continue to keep a lid on overall job growth in the Inland Empire. Our forecast calls for job growth of 2.9 percent in 2016 to drop back to 2.4 percent in 2017.



Rising home prices coupled with higher mortgage rates will reduce housing affordability in the Inland Empire. The mortgage payment on a median-priced home as a percentage of median family income will hit 30 percent in 2017. Although that is nowhere near the heights of 50 percent and above reached prior to the recession, it does represent a marked rise from the 17 percent low in 2012.



ABOUT THE ANDERSON CENTER FOR ECONOMIC RESEARCH

The A. Gary Anderson Center for Economic Research (ACER) was established in 1979 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 Conferences for the Inland Empire
- California Purchasing Managers Survey

FEBRUARY
- California Leading Employment Indicator

MARCH
- California Consumer Sentiment Survey

APRIL
- California Purchasing Managers Survey

MAY
- California Leading Employment Indicator

JUNE
- Economic Forecast Update Conference for the U.S., California, and Orange County
- California Consumer Sentiment Survey

JULY
- California Purchasing Managers Survey

AUGUST
- California Leading Employment Indicator

SEPTEMBER
- California Consumer Sentiment Survey

OCTOBER
- California Purchasing Managers Survey

NOVEMBER
- California Leading Employment Indicator

DECEMBER
- California Consumer Sentiment Survey
- Economic Forecast Conference for the U.S., California and Orange County