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Strong Headwinds Ahead: Highlights of the 35 Annual Chapman University Economic Forecast

Anderson Center for Economic Research

Chapman University
Argyros School of Business and Economics

Press Release

A. Gary Anderson Center for Economic Research

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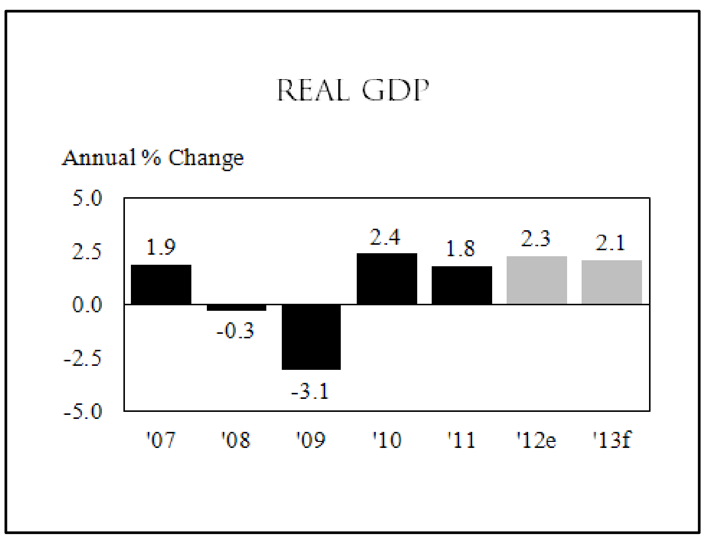
Strong Headwinds Ahead

Orange, CA – The A. Gary Anderson Center for Economic Research at Chapman University released today the results of its 35th annual economic forecast for the U.S., California and Orange County. The forecast was presented to about 1,500 Orange County business leaders at a conference held at the Segerstrom Center for the Arts, Costa Mesa. Following are highlights of the forecasts.

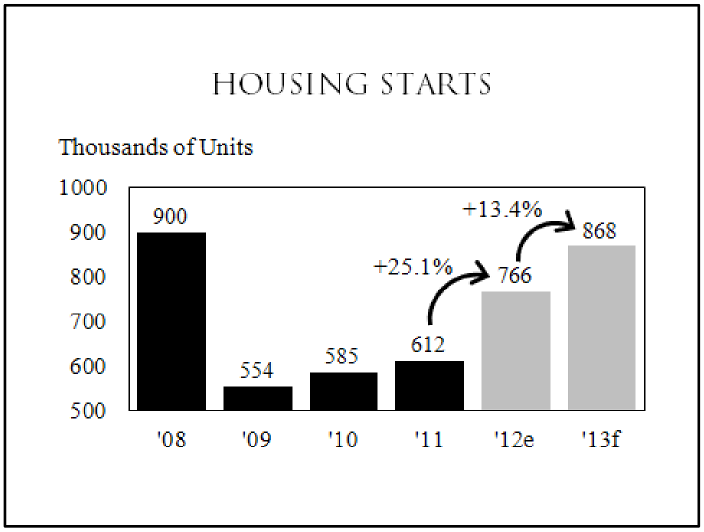
2013 U.S. Forecast



- The Chapman model points to a continuation of the recovery for a fourth straight year in 2013. Overall growth will remain weak, however, with real GDP forecasted to increase at a relatively slow rate of 2.1 percent.
- With the recovery too fragile to withstand a sharply contractionary fiscal policy, we believe government will moderate the impact of the $500 to $600 billion fiscal cliff facing the nation. But we still see reduced government spending and higher taxes cutting spending by at least $200 billion. While such a reduction in the deficit will have long-term benefits, it will negatively impact economic growth in 2013.

- Another negative hit will come from net exports. We are forecasting a decline of $18 billion in real net exports next year.

- At our Forecast Update last June, we made an early call for a housing recovery in 2013. Since that time, more trends have emerged that signal our early call for a strong housing turnaround was correct. We are now calling for housing starts to increase from 765,000 units in 2012 to 868,000 units in 2013—an increase of 13.4 percent.



  In terms of impact on real GDP, "residential structures," a component of gross private investment, is forecasted to increase $70 billion or 18.5 percent. Even better is that the housing sector is an engine of growth that we believe will be with us for some time beyond 2013.

- We also expect strong growth in nonresidential investment. The capacity utilization rate is nearing 80 percent, indicating that manufacturers need additional plant and equipment. Our forecast calls for real nonresidential investment growth of 8.0 percent in 2013, which represents an additional $120 billion in spending.

- The positive growth in residential and nonresidential investment that we are forecasting basically offsets our expectations of the spending declines associated with contractionary fiscal policy and weak global growth. It's the "Big Gorilla"—consumer spending—that will make the difference in bringing about a continuation of the recovery.

  Our forecast model points to a 1.8 percent increase in real consumer spending, which translates to roughly $170 billion. Despite higher taxes hitting households' pocketbooks, the return of housing appreciation, increasing household net worth and rising consumer confidence all suggest increasing willingness on the part of consumers to spend. In addition, although the personal savings rate has been declining, there is room for it to drop a bit more to offset the impact of increasing tax rates in 2013.

- Continued slow economic growth points to slight upward pressure on interest rates. We expect an increase of about one-half percent in short-term rates, such as the 90-day treasury bill, and an increase of about one percent in long-term rates, such as the 10-year treasury bill. The resulting widening in the interest rate spread (difference between long-and short-term rates) is a strong and reliable indicator that buttresses our call for continued recovery.

2013 California and Orange County Forecasts:

- Fueled by job growth in the leisure & hospitality, professional & business, and health care sectors, California and Orange County's overall job growth accelerated in the second and third quarter of 2012. But, in spite of three consecutive years of positive employment growth, total payroll employment is well below its pre-recession highs in both California and Orange County.

- Only leisure & hospitality and education & health services sectors show employment levels exceeding the pre-recession highs. Construction, trade & transportation and manufacturing are well under water. Even professional & business services, which added about 14,000 jobs during the recovery period, is below its pre-recession employment level by about 22,000 jobs.

ORANGE COUNTY EMPLOYMENT & PAYROLL LOSSES

	Change in Jobs 07:4 to 12:2	Average Annual Pay ($)	Change in Payrolls (In Million $)
Construction	-34,800	61,360	-2,135
Trade, Transportation & Utilities	-33,167	51,220	-1,699
Manufacturing	-23,434	67,132	-1,573
Financial Activities	-15,133	97,656	-1,478
Professional & Business Services	-21,767	65,520	-1,426
State & Local Government	-10,234	52,806	-540
Information	-6,767	78,208	-529
Other Services	-3,167	29,380	-93
Federal Government	-467	72,852	-34
Leisure & Hospitality	5,800	21,476	125
Education & Health Services	15,000	53,768	807
Total Nonfarm	**-128,234**	**56,472**	**-8,577**

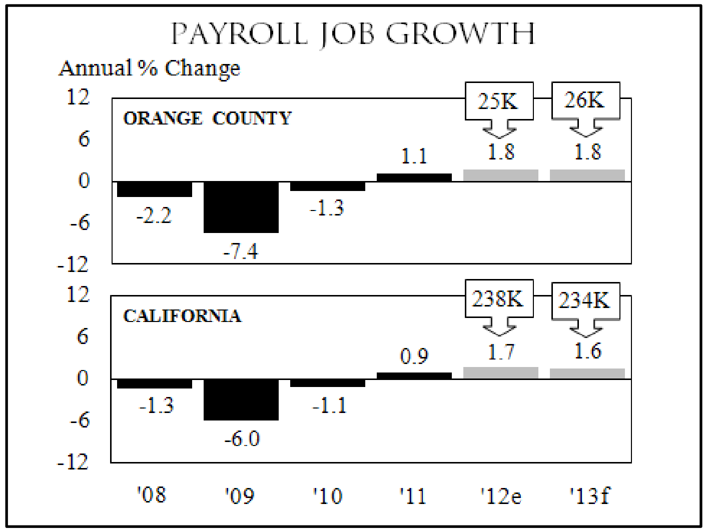
- The total wage and salary received by all workers in the county decreased by a whopping $8.6 billion since the beginning of recession in the fourth quarter of 2007. A similar analysis points to a decline of about $57.0 billion in total wage and salary compensation in California over the same time period..

- There are clear signs that California and Orange County economies will be facing headwinds in the coming year. Higher taxes—sales, income and payroll—are the primary concern. And an anticipated slowdown in the global economic growth may cut into California's export growth.

- On the bright side, the Anderson Center's California Consumer Sentiment Index increased to 94.2 in the third quarter of 2012, a level not seen since the third quarter of 2007. An uptick in job creation, a lower unemployment rate, a stronger stock market and stable to higher home prices are all serving to improve consumers' sentiment.

- Another positive development is the rebound in construction spending. The total value of housing permits has been steadily increasing since the low of 2009. Hence, construction spending, which is derived from the moving average of total permit valuation over the last two years, is projected to grow by 10.0 percent in Orange County in 2013.

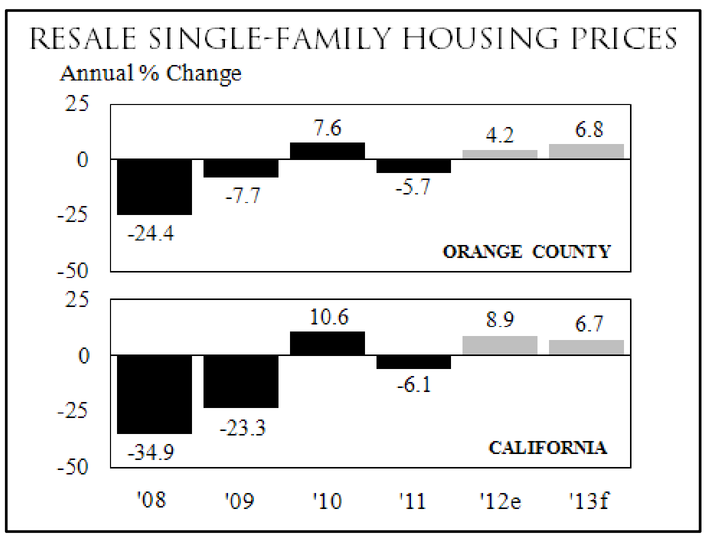
- Overall, our forecast calls for an increase of 1.8 percent in total payroll employment in Orange County in 2013. This represents an average annual gain of 26,000 payroll jobs. California's payroll employment is also forecasted to increase by 1.6 percent or a gain of 234,000 jobs.



- The sharp improvement in affordability and rapid increases in rents are tilting the home purchase versus the rent decision towards purchase. This, in part, explains why home buying activity picked up steam in 2012. The increase in sales is welcome news and is helping to reduce inventory of unsold homes. Steady improvement is reflected by the number of months it would take to sell the existing inventory of unsold homes at the current sales rate.

- Recent statistics regarding shadow inventory, foreclosures and notices of default are all encouraging. Notices of defaults that are prelude to short sales and foreclosures activity have declined sharply in the third quarter of 2012 compared to a year ago. In fact, Orange County's notices of default is currently the lowest in Southern California and showed the sharpest decline in the third quarter of 2012 and is also at its lowest level since the beginning of the housing slump.

- Our projection of continued albeit weak improvement in the job market is a positive factor influencing home prices. But the fact that growth will be tepid limits home price appreciation in 2013. Overall, our forecast calls for Orange County home prices, measured by the median price of a single-family housing unit as reported by the California Association of Realtors, to increase by 4.2 percent in 2012 followed by an increase of 6.8 percent in 2013.



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 in order to encourage the faculty and students at Chapman University to engage in economic and business research of high quality, and to disseminate the results of this research to the community.

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