

# THE BEACON OUTLOOK CALIFORNIA



Winter 2024

Sean Windle, Research Manager

## HIGHLIGHTS

### Despite Headwinds, No Recession In Sight

Although California's massive budget deficit has reinvigorated fears of a recession, Beacon Economics sees slower growth in 2024, but not a contraction.

### Employment U-Turn

Not long ago, California had too many jobs for too few workers; today, interest rate hikes have cooled the labor market and the number of job seekers and job openings has converged.

### Demand For Housing In California Continues

On a quarterly basis, Beacon Economics expects California home prices to surpass their pandemic peak by the midpoint of 2024.

## KEY INDICATORS

1.04  
Million

### **\$58 Billion – Budget Bust**

The Legislative Analyst's Office is projecting a three-year \$58 billion budget shortfall through 2024-25.

6.4%

### **7.6% - Home Price Growth Accelerates**

California home prices rose 7.6% year-over-year in October.

-\$2.3  
Million

### **36% - Weak Home Sales Continue**

California home sales continue to fall and are 36% below the pre-pandemic peak in February 2020.

-\$2.3  
Million

### **4.8% - Unemployment Ticks Up**

The unemployment rate in California was 4.8% in October, up from 4.1% a year earlier.

# OVERVIEW

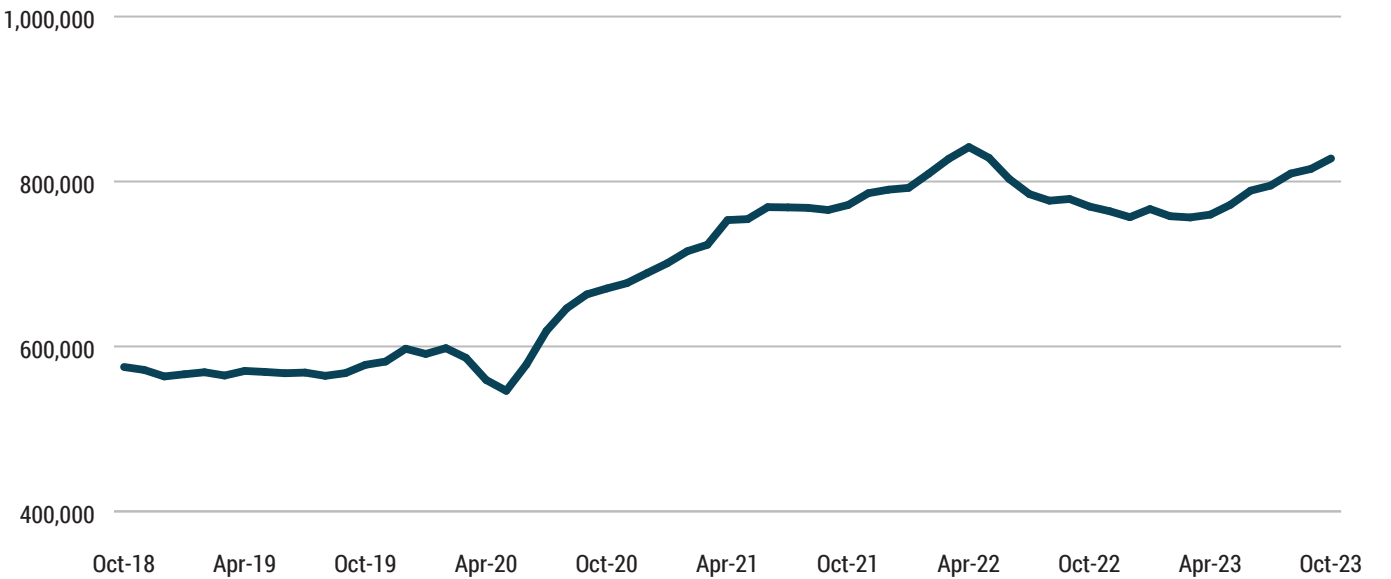
After 29 months of post-pandemic jobs growth dating back to April 2021, employment growth in California was flat in September and declined in October. Unemployment is rising, and California consumers and businesses are dialing back spending. Home sales continue to decline amid rising mortgage rates, accelerating home price growth to levels seen during the peak of the pandemic housing market. The cooler labor market has already negatively impacted the state budget, with officials projecting budget shortfalls on the magnitude of the Great Recession in 2008.

These economic and budget headwinds have occurred despite the economy not falling into a recession. While Beacon Economics does not expect an economic calamity to materialize in California, we expect slower growth in 2024. In fact, in its December fiscal outlook, the California Legislative Analyst’s Office (LAO) declared that the California economy is in a ‘downturn’.

## HOME PRICES NEARLY BACK TO PRE-PANDEMIC PEAK

After nine straight months of year-over-year declines stretching back to October 2022, the median sale price for an existing single-family home in California returned to growth in July, rising 1.3%. Since then, price growth has accelerated, reaching 7.6% year-over-year in October 2023, the most recent month of data available. Currently, home prices are 38.5% above the pre-pandemic peak in February 2020, and 1.6% below the pandemic peak in March 2022. On a quarterly basis, Beacon Economics expects home prices to surpass the pandemic peak by mid 2024.

### MEDIAN SALE PRICE FOR SINGLE-FAMILY HOMES



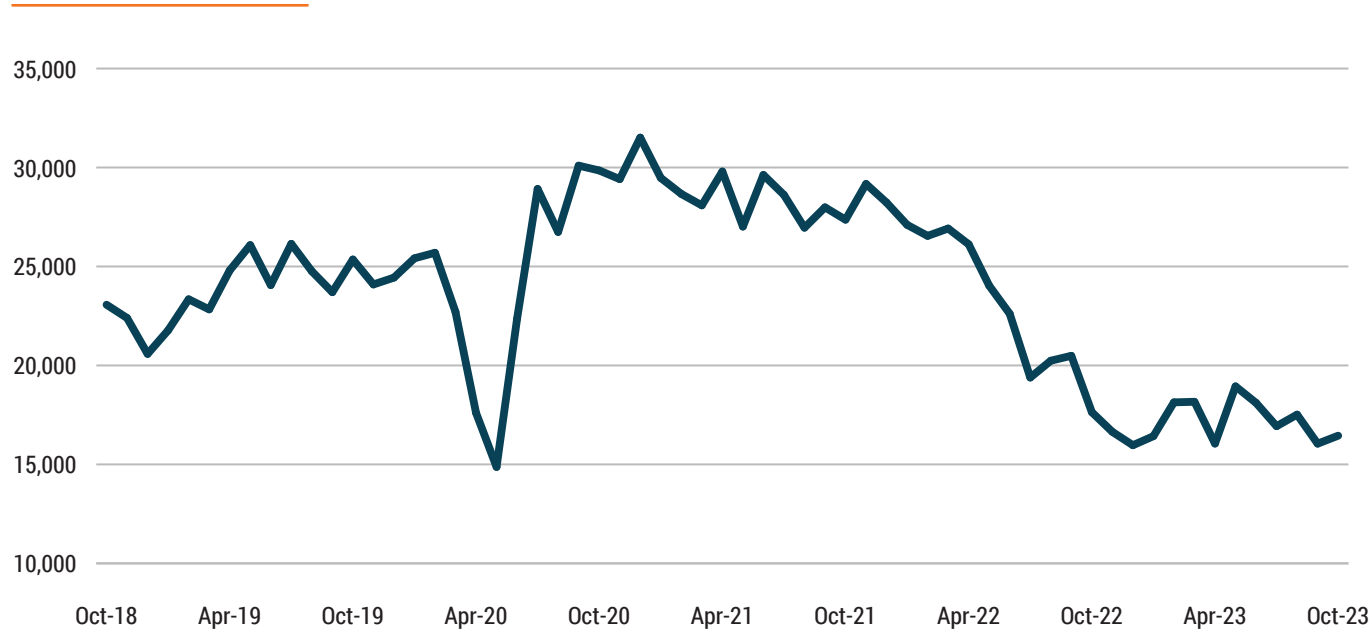
Source: Redfin; Analysis by Beacon Economics



# HOME SALES CONTINUE TO FALL, BUT APPEAR TO BE BOTTOMING OUT

On a year-over-year basis, as of October 2023, seasonally adjusted existing single-family home sales have declined 26 consecutive months, dating back to September 2021. Rapidly rising interest rates have further exacerbated California’s chronic housing shortage, as homeowners locked into historically low mortgage rates are either unwilling or financially unable to sell. However, home sales appear to be reaching a trough. In October, home sales fell 6.7%, marking the first single-digit year-over-year decline since April 2022. While home sales are expected to remain weak heading into 2024, Beacon Economics expects the beginnings of a housing market thaw in the latter half of the year as mortgage rates begin leveling off.

## SINGLE-FAMILY HOME SALES



Source: Redfin; Analysis by Beacon Economics

# JOBS GROWTH AT AN INFLECTION POINT

California total nonfarm employment has grown 17.9% since the trough of the pandemic; however, employment declined 0.2% year-over-year in October, the latest data available. Furthermore, on a quarterly basis, employment has declined in each month going back to July. Similarly, the state’s unemployment rate increased to 4.8% in October, up from 4.1% a year earlier.

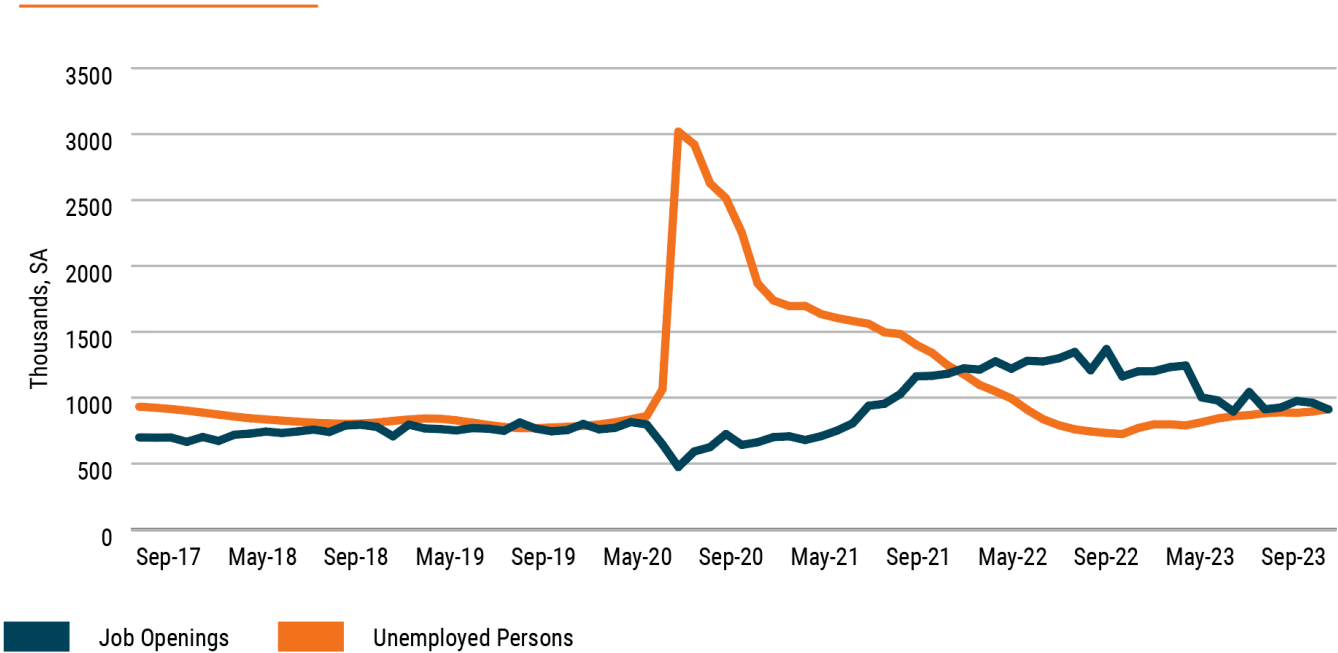
## CALIFORNIA RESIDENTIAL BUILDING FAILING TO KEEP PACE WITH EMPLOYMENT

|                          | October 2023 | Change Since<br>May 2020 | Change Since<br>October 2022 |
|--------------------------|--------------|--------------------------|------------------------------|
| Total Nonfarm Employment | 18,442,100   | 17.9%                    | -0.2%                        |
| Unemployment Rate        | 4.8%         | -10.9pp                  | +0.7pp                       |

Source: California Employment Development Department, U.S. Census Bureau; Analysis by Beacon Economics

During the peak of California’s labor market in July 2022, there were roughly 2 job openings for every unemployed worker. Since then, however, the number of job openings and job seekers has converged. In September 2023, there were an estimated 911,000 job openings and 913,500 job seekers, yielding a ratio of 1.003. A ratio of 1 means there is 1 job opening for every unemployed person. The cooling labor market is a lagged response to interest rate hikes during the past year and a half.

### CALIFORNIA JOB OPENINGS AND UNEMPLOYED PERSONS



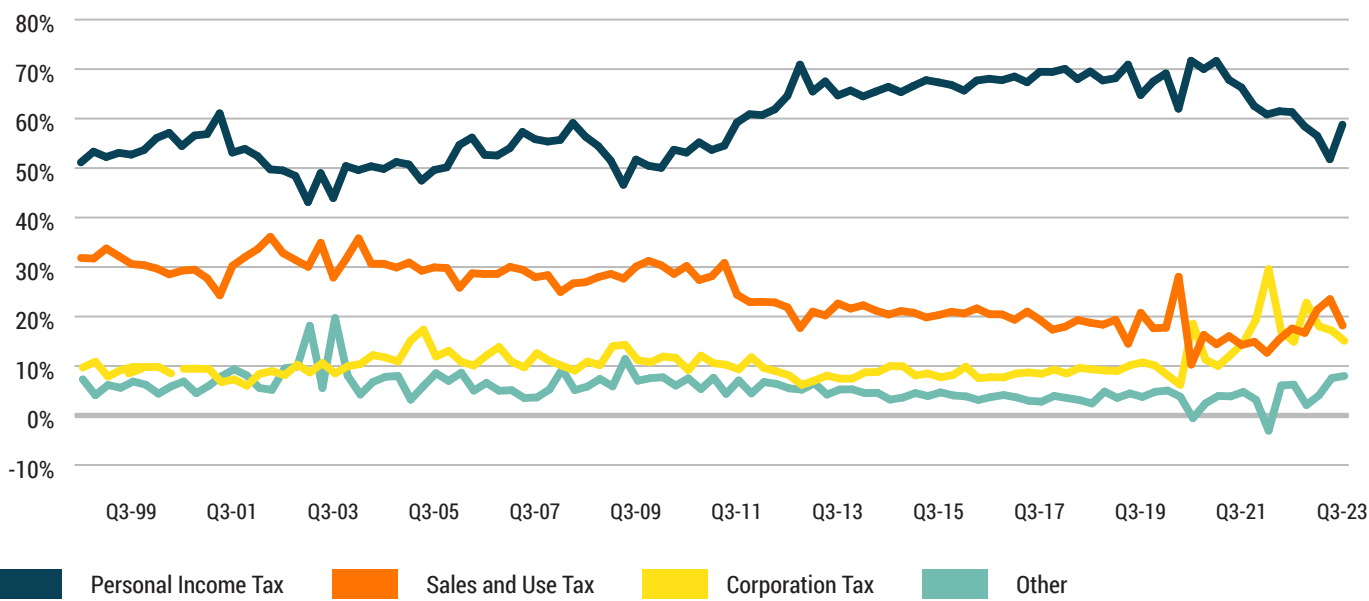
Source: Bureau of Labor Statistics; Analysis by Beacon Economics

# \$58 BILLION BUDGET DEFICIT PROJECTED THROUGH 2024-25

A bleaker budget outlook is taking shape in Sacramento as various postponed tax payments came in significantly weaker than expected, and as economic headwinds take their toll on state revenues. The nonpartisan Legislative Analyst’s Office (LAO) estimates a budget shortfall of \$26 billion for fiscal year (FY) 2022-23, with a cumulative three-year budget shortfall of \$58 billion through the next two fiscal years.

California is heavily dependent on personal income tax, which accounts for well over half of major general fund money, and which includes volatile capital gains. According to Governor Newsom’s revised 2023-24 budget proposal released in May, the top 1% of income earners paid about half of all personal income taxes in 2021, with more than 11% of all personal income tax coming from capital gains during the same year.

## CALIFORNIA REVENUE RELIES HEAVILY ON PERSONAL INCOME TAX



Source: California State Controller; Analysis by Beacon Economics

The one-two punch of persistent inflation and the Fed's rapid pace of rate increases has raised borrowing costs and cooled investment, spurring a significant downturn in U.S. stock indices in 2022 after three years of gains. Tighter credit and the cooling labor market have also reduced income tax withholdings from low- and middle-income earners as businesses have less money available to hire additional workers and expand operations. The LAO estimates that the portion of personal income taxes collected directly from employee paychecks was down 2% over the last twelve months compared to the preceding year.

What's more, monetary tightening has hit startups and the technology sector especially hard, which are segments of the economy that have an outsized importance to California. And despite above-average growth in consumer prices, sales tax revenues have declined, falling 6.6% and 1.7% year-over-year in the second and third quarters of 2023. Moving forward, the LAO is watching for weakness to shift somewhat from personal income tax to sales tax and corporate tax in 2023-24 as the labor market continues to cool.

## CALIFORNIA FORECAST

### CALIFORNIA FORECAST - KEY INDICATORS

|                                  | <i>Current</i>   | <i>Forecast</i> |           |           |           |
|----------------------------------|------------------|-----------------|-----------|-----------|-----------|
|                                  | <b>Q3-23</b>     | Q4-23F          | Q1-24F    | Q2-24F    | Q3-24F    |
| Nonfarm Payrolls (000s, SA)      | <b>18,104</b>    | 18,292          | 18,318    | 18,331    | 18,345    |
| Unemployment Rate (% , SA)       | <b>4.6</b>       | 4.7             | 4.8       | 4.9       | 5         |
| Real GDP (Millions 2012\$, SAAR) | <b>3,031,125</b> | 3,046,713       | 3,065,500 | 3,086,366 | 3,102,421 |
| Home Prices (\$, SA)             | <b>694,774</b>   | 697,310         | 694,674   | 700,694   | 710,527   |

|                                  | <i>Forecast</i> |           |           |           |           |
|----------------------------------|-----------------|-----------|-----------|-----------|-----------|
|                                  | Q4-24F          | Q1-25F    | Q2-25F    | Q3-25F    | Q4-25F    |
| Nonfarm Payrolls (000s, SA)      | 18,359          | 18,391    | 18,442    | 18,504    | 18,570    |
| Unemployment Rate (% , SA)       | 5.1             | 5.1       | 5         | 4.9       | 4.7       |
| Real GDP (Millions 2012\$, SAAR) | 3,117,880       | 3,136,101 | 3,157,283 | 3,180,970 | 3,204,507 |
| Home Prices (\$, SA)             | 716,658         | 727,804   | 738,971   | 749,659   | 759,611   |

Source: U.S. Bureau of Economic Analysis, U.S. Bureau of Labor Statistics, CoreLogic; Forecast by Beacon Economics