

# The Economic Outlook

For the Nation and the State

*Where are we  
in the Economic Cycle ...?*

January 14, 2015



Mark Schniepp  
Director

**.... and what does that mean for 2015 ?**

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- Where are interest rates going ?  
... the stock market ?
- What about the national economy ?  
-- is it tiring out ?
- Where does California fit in ?  
-- is the state keeping up ?
- What can we expect by the end of 2015 ?

## Major stories for 2015

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- Oil and gasoline prices tumble
- Interest rates at record lows ..... ?
- Inflation less than 2 percent ?  
But what about all the stimulus a few yrs back?
- Why we are in an economic expansion
- Where is the growth in California, and  
what about ..... the drought ?
- Why housing remains a problem

## the New Normal

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- Definition:
  - a previously unfamiliar or atypical situation that has become standard, usual, or expected
- Slower growth in the economy
  - How conditions are now as good as they get . . .
  - So stop whining....

# Americans Overwhelmingly Pessimistic About Economy

*New GW Battleground Poll also examines 2014 campaign tactics.*

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THE GEORGE WASHINGTON UNIVERSITY

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WASHINGTON, DC

December 18, 2014

Americans continue to hold strong negative views about the state of the economy and a grim outlook for the next generation's financial prospects, according to a [George Washington University Battleground Poll](#) released Thursday.

Voters are uncertain about the direction of the economy: 77 percent of poll respondents are at least somewhat worried about current economic conditions, 31 percent of respondents think the economy is getting worse and another 25 percent say that the economy is poor and staying the same. Just 11 percent say the economy is good and staying the same and 30 percent believe the economy is getting better.

December 18, 2014 at the GWU website

## the New Normal

- Definition:
  - a previously unfamiliar or atypical situation that has become standard, usual, or expected
- Slower growth in the economy
  - How conditions are now is as good as it gets . . .
  - So stop whining....
- Low interest rates are here to stay
- Strengthening dollar
- A fickle housing market
- change

# Social & Economic Changes

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- We are seeing gradual change more frequently and it's redefining normal . ....
- Due to Global influences
  - Manufacturing going abroad
  - Shift in oil production
  - Geopolitical risks
- But mostly as a result of
  - **Technology and Demographics**
  - The aging baby boomer generation, and Generation Y now becoming more economically relevant

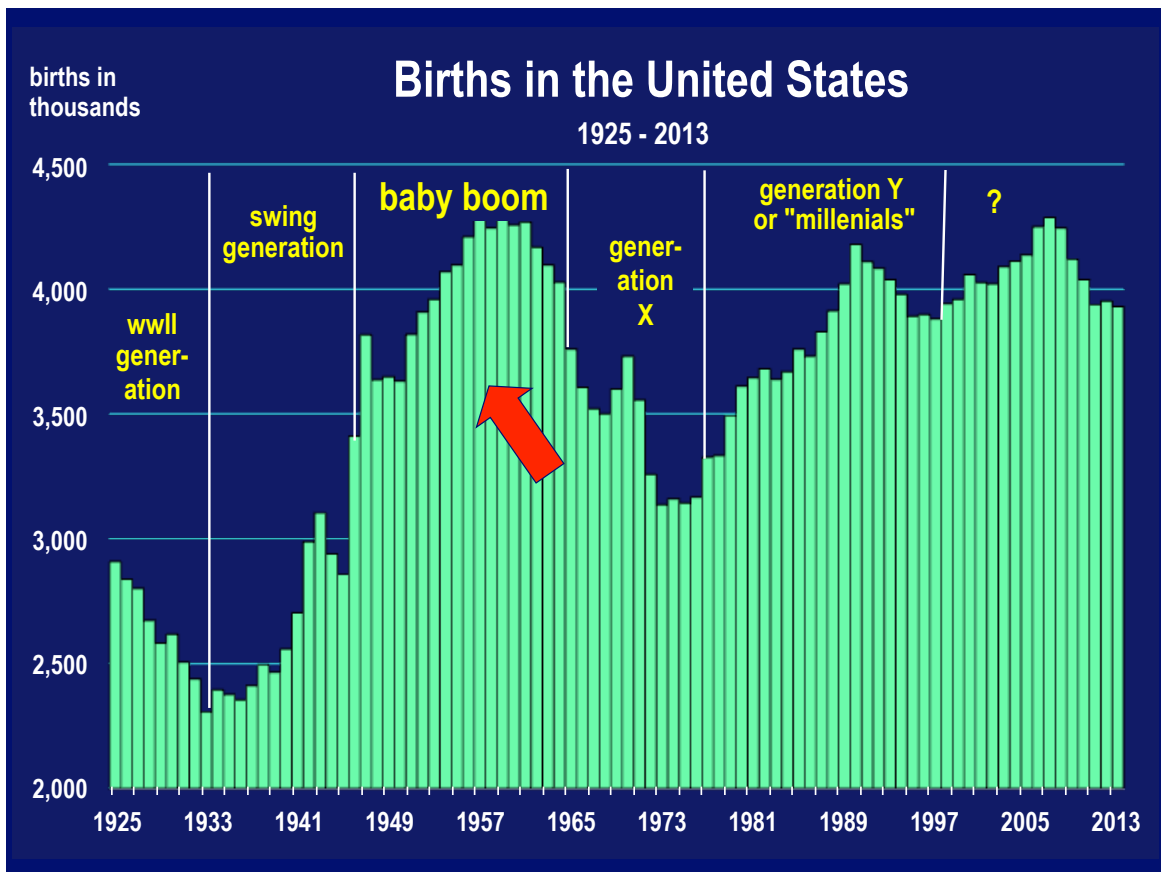
# Social & Economic Changes

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- Who was Kathleen Casey ?
- 76 million for the next 19 years . . . .
- Grew up in the 50s and 60s and was a prominent socio-economic force in America
- Explosion of school construction in 50s
- Toys: Barbie, GI Joe
- Social changes of the 60s and 70s
  - the Drug Culture and Rock Music explosion of the 60s
  - Civil rights movement and the Environmental movement
- Boomers were the spendthrift consumers

# Social & Economic Changes

- Housing booms of the 70s and 80s
- Personal computer boom of the 80s and 90s
- They invented
  - the internet in the 90s, which ultimately led to a 3,000 point advance in the Nasdaq and the tech bust in 2001
  - Viagra in 1998
- The housing bubble in 2004 – 2007
- The technology boom of the new milenium and insatiable demand for electronics and gadgets
- Boomers are now growing old .....



December 14, 2014

## It's All Over The last boom

MUNICH – Carlos Barrio  
northwest of Honolulu  
“baby boom” to do s  
and even irritating  
up. But what does

## The Youngest Baby Boomers Turn 50

This massive generation is now on the cusp of retirement, which has implications for the entire country.



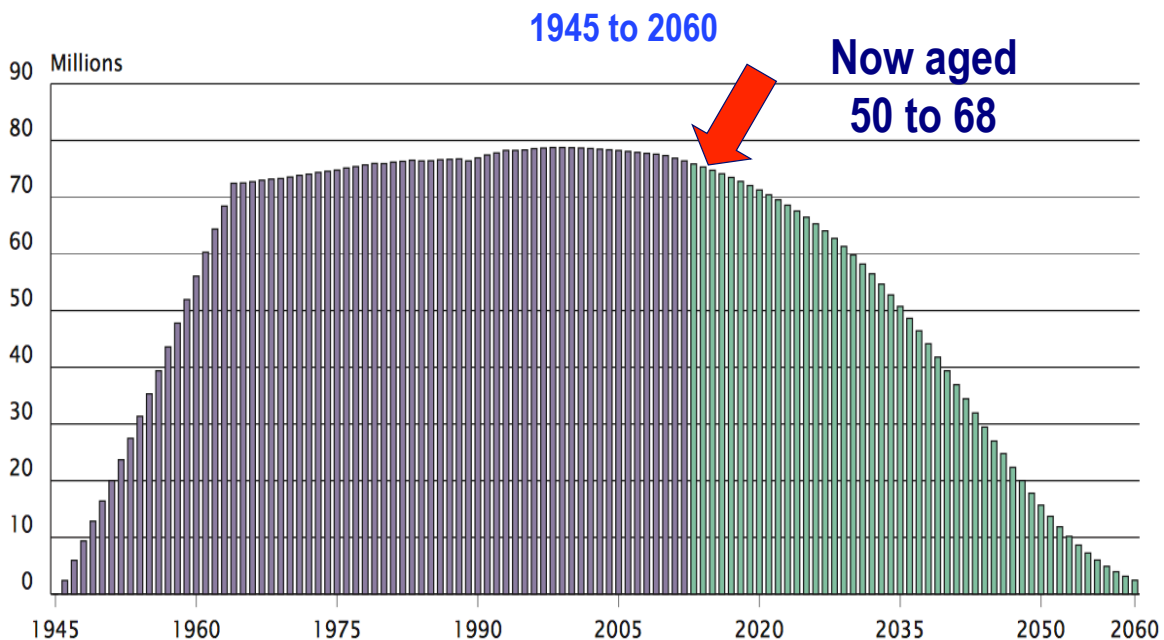
The youngest Baby Boomers are celebrating this milestone at a time when the typical life span is increasing and retirement is being pushed back.

The youngest baby boomers are turning 50 in 2014. The oldest baby boomers started turning 65 back in 2011, and many of them have already retired. The aging of this massive generation born between 1946 and 1964 will have significant implications for the entire country, according to a series of recent Census Bureau reports. Here's a look at the baby boomers as they begin to enter their retirement years:

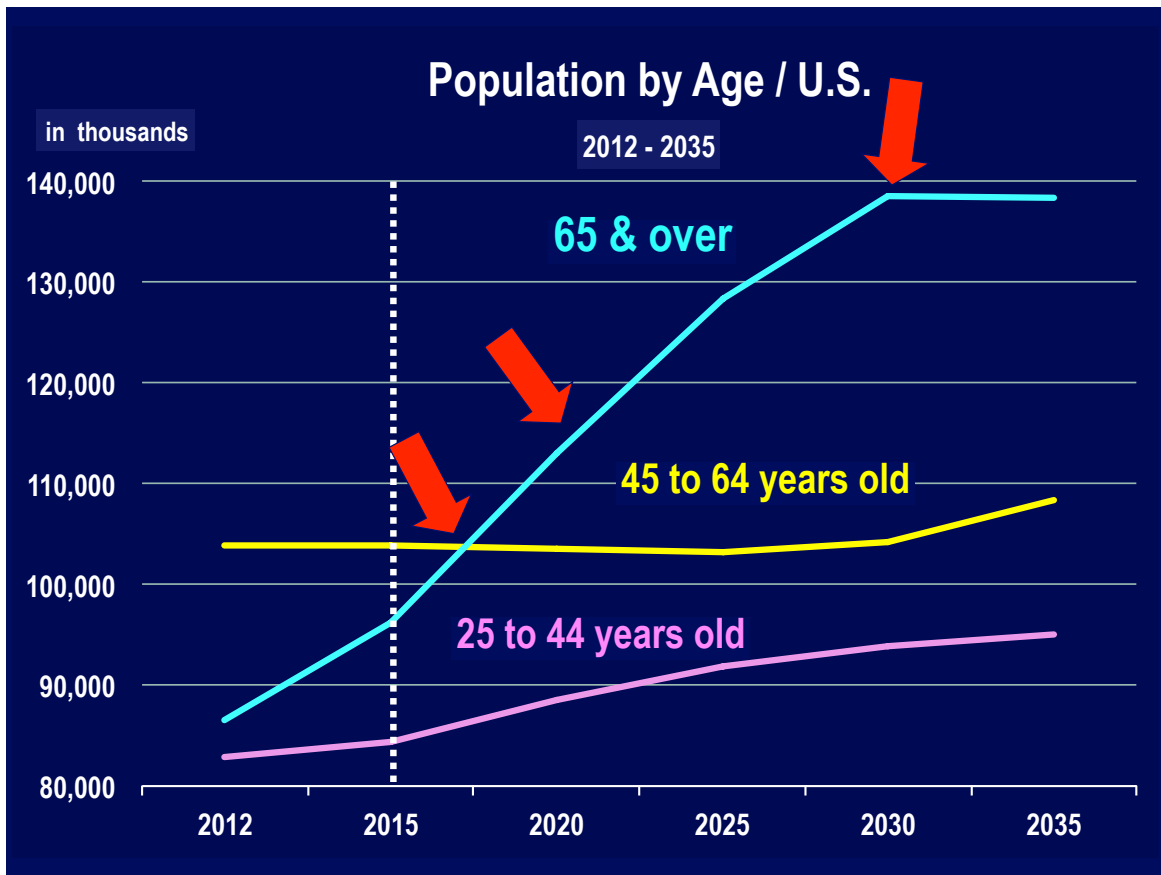
US  
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[December 2014 articles online](#)

## The Baby Boom Population



U.S. Census Bureau / Purple bars estimated; green bars projected

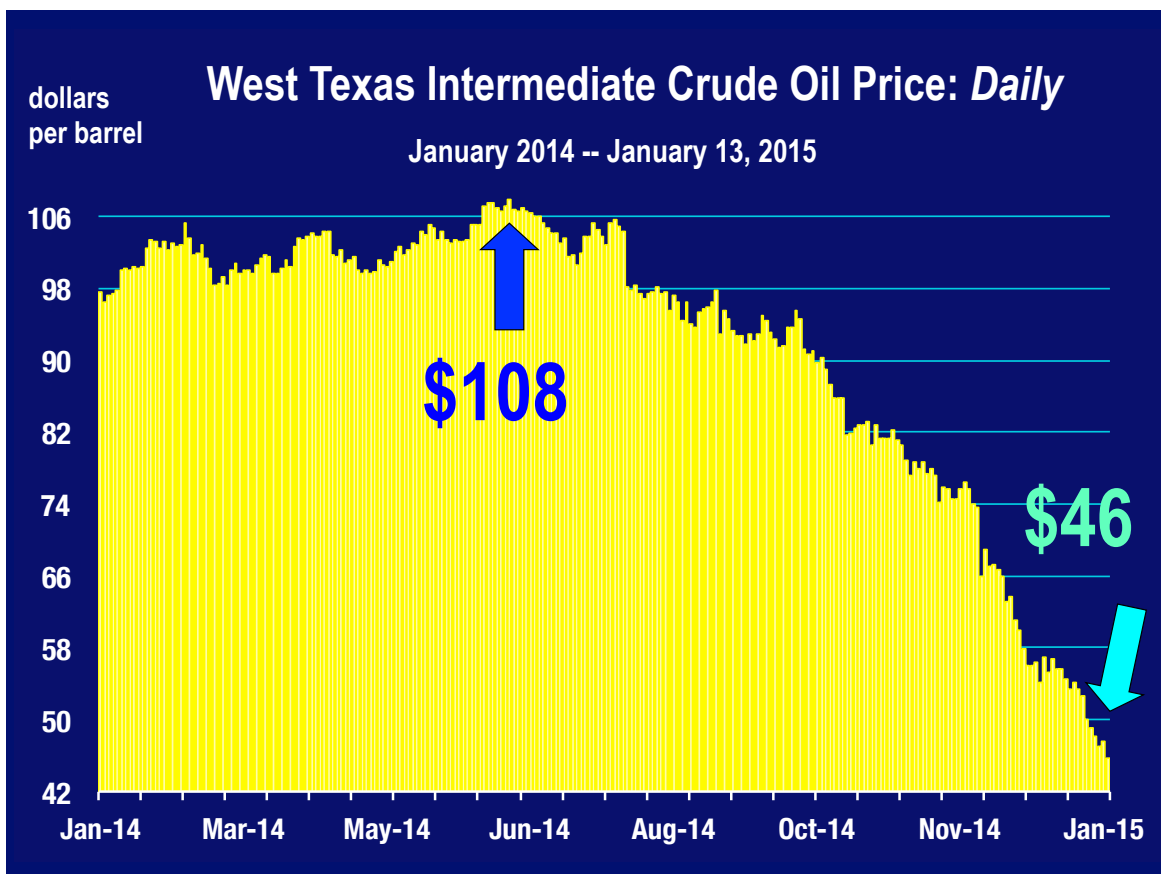


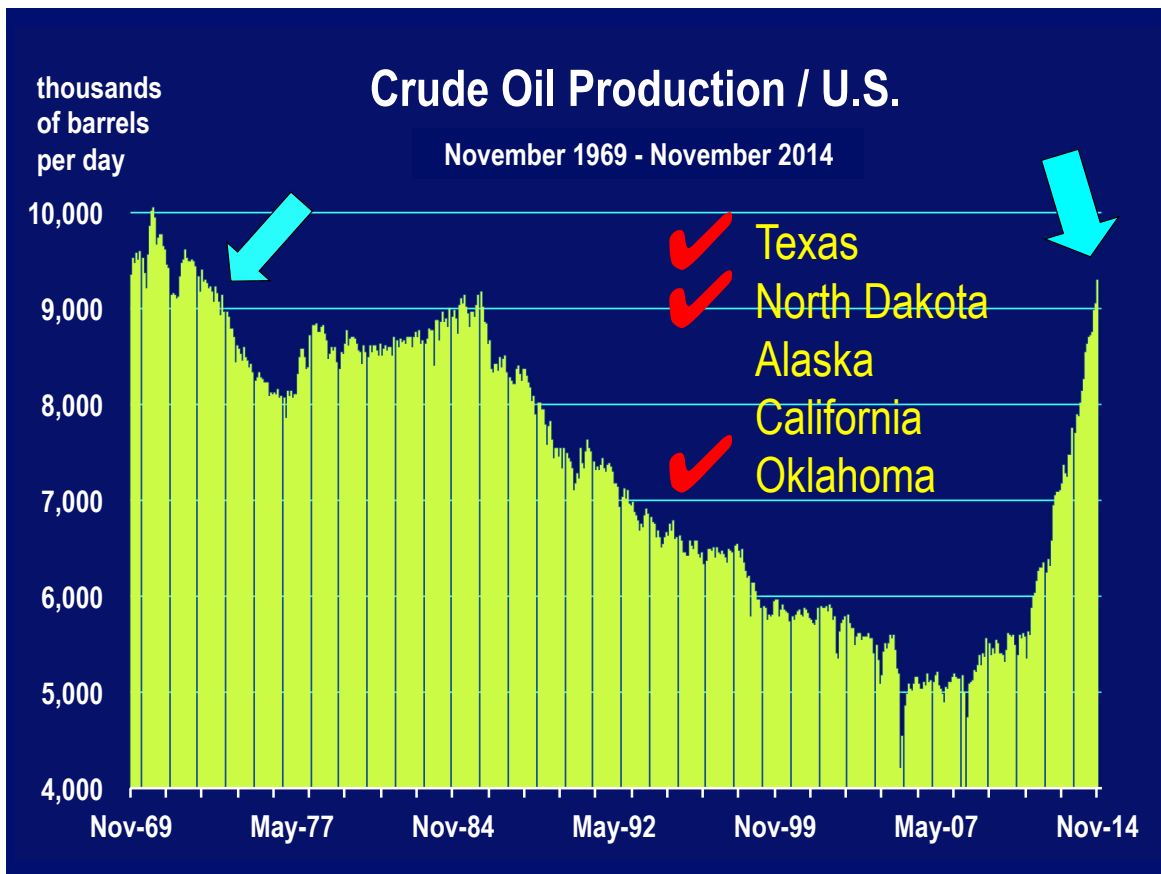
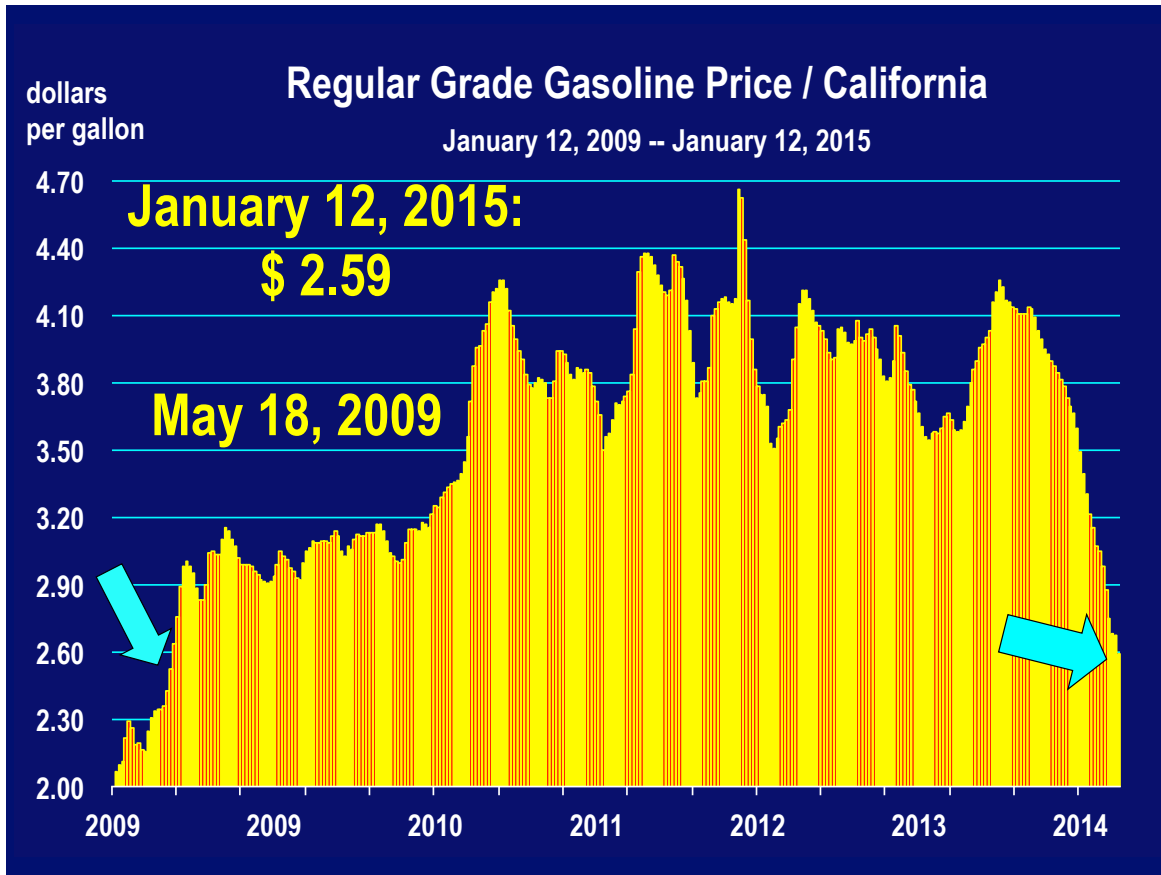
## What do Boomer's want

- They don't want to hear themselves called senior citizens, or "old"
- They don't want to stop working
  - 74 percent of boomers say they'll never retire
  - Entrepreneurial endeavors
- A home without parents, kids, or grandkids
  - 83 percent said they don't want to share their home
- Exercise, and looking good doing it
  - spandex biking gear and yoga pants that don't make them look ridiculous
  - Extreme sports (river rafting, paragliding, skydiving)

# What do Boomer's want

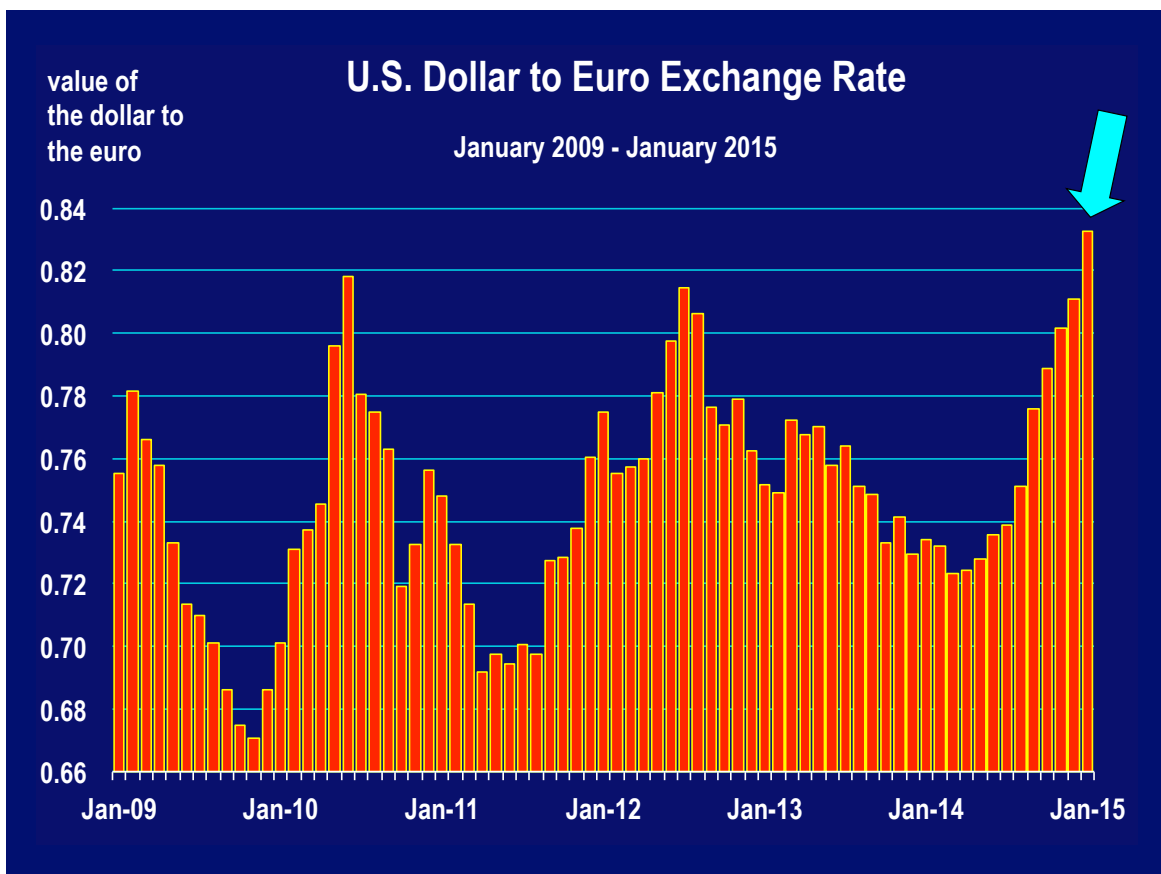
- Travel and recreation tailored to the over 50 crowd
  - **Experiential vacations**
  - **Biking, hiking, cruise ships, exotic classes**
- Senior friendly communities, (close to transportation, stores and services)
  - **But not a traditional retirement community**
- Music and concerts
- Smart technologies, especially re: healthcare
  - **Hip and knee replacements**
  - **Social media**
  - **Robots, drones, other gadgets**





# Why are gasoline prices collapsing ?

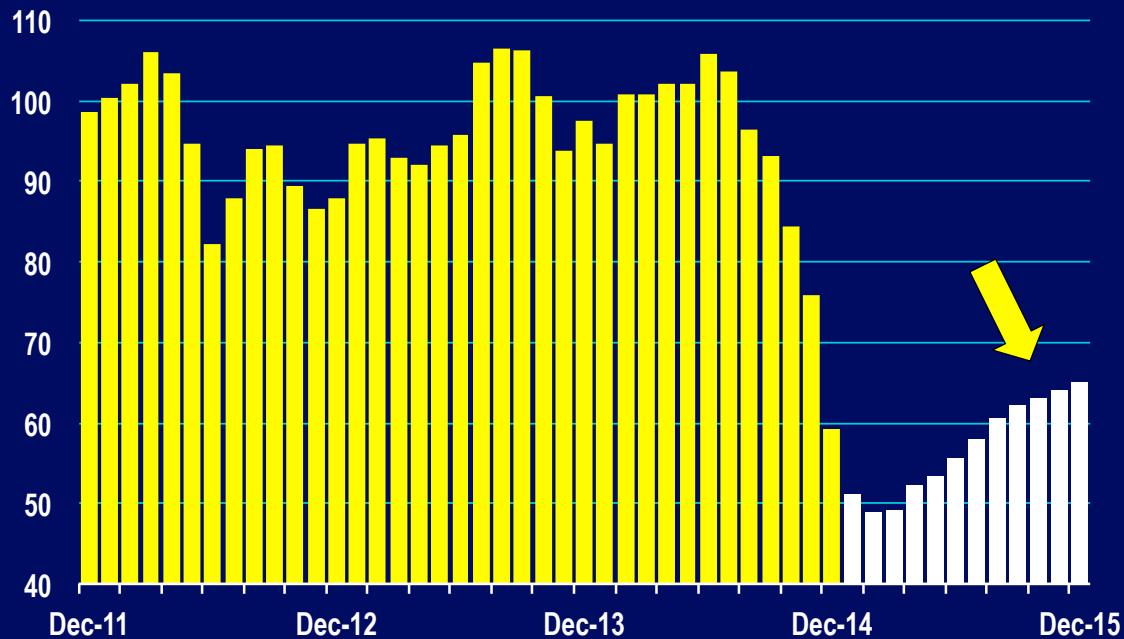
- (1) U.S. oil production has sharply increased
  - Domestic oil refiners import less foreign oil
- (2) World oil demand has softened and demand growth in 2015 is weaker than expected
- (3) The U.S. dollar has strengthened
  - The value of oil relative to the dollar has weakened
- (4) Cheaper gasoline standards in winter months
- (5) No hurricanes and refinery shutdowns



dollars  
per barrel

## West Texas Intermediate Crude Oil Price: Monthly

December 2011 - December 2015

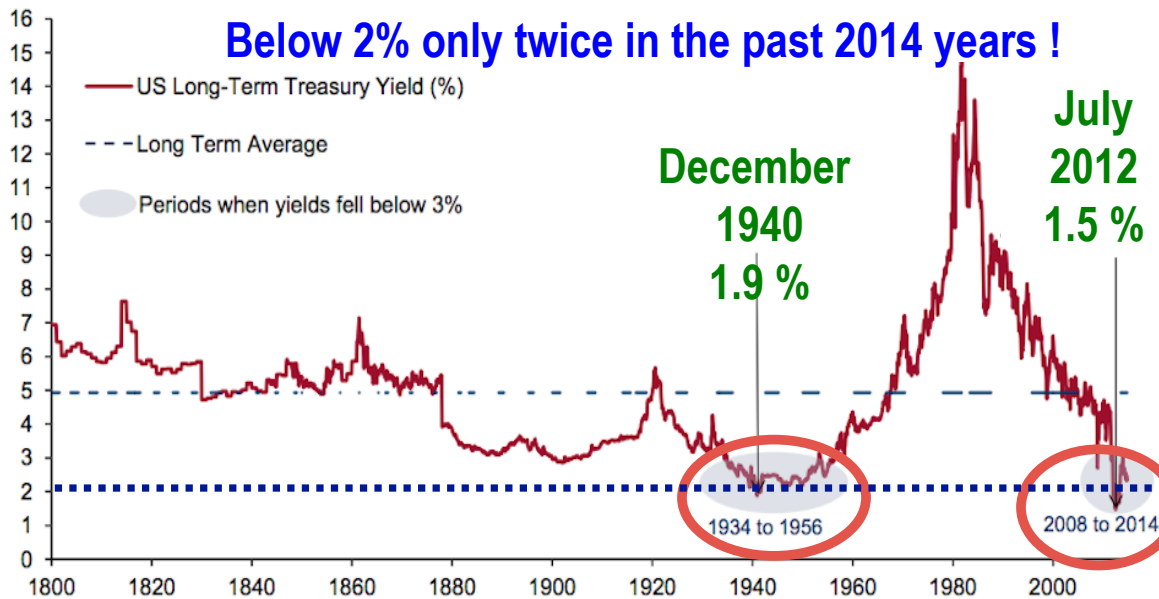


Source: U.S. Energy Information Administration

## The Economic Evidence

- The recovery is now long over;
- Most of the economic indicators including employment are at unprecedented levels
- Growth has accelerated
  - Consumer spending, Hiring, Investment spending.....
- Confidence in the economy has been fully restored
  - U.S. businesses are especially upbeat, consistent with an economy that is expanding well above its potential
- The 10 year Treasury Bond yield closed yesterday at 1.89 percent, third lowest level in 214 years..... !

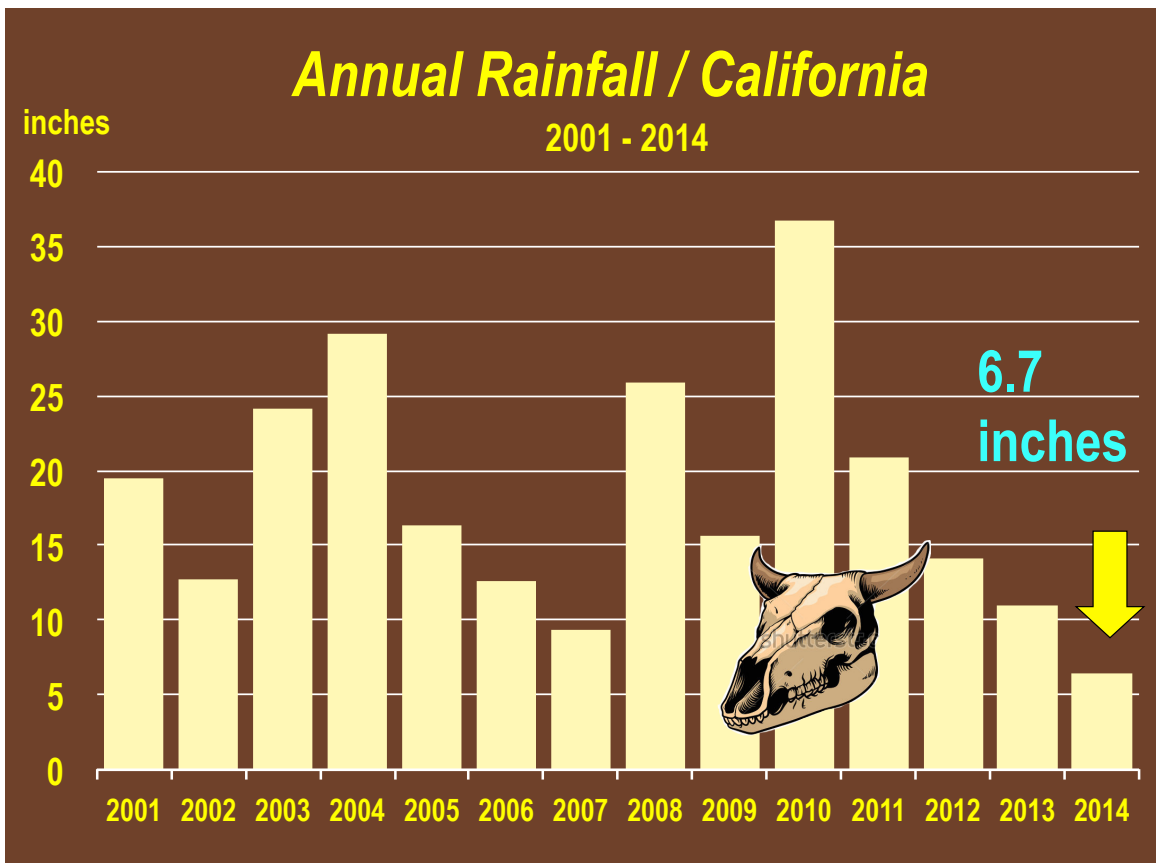
## Long Term U.S. Treasury Yield 1800 - 2014



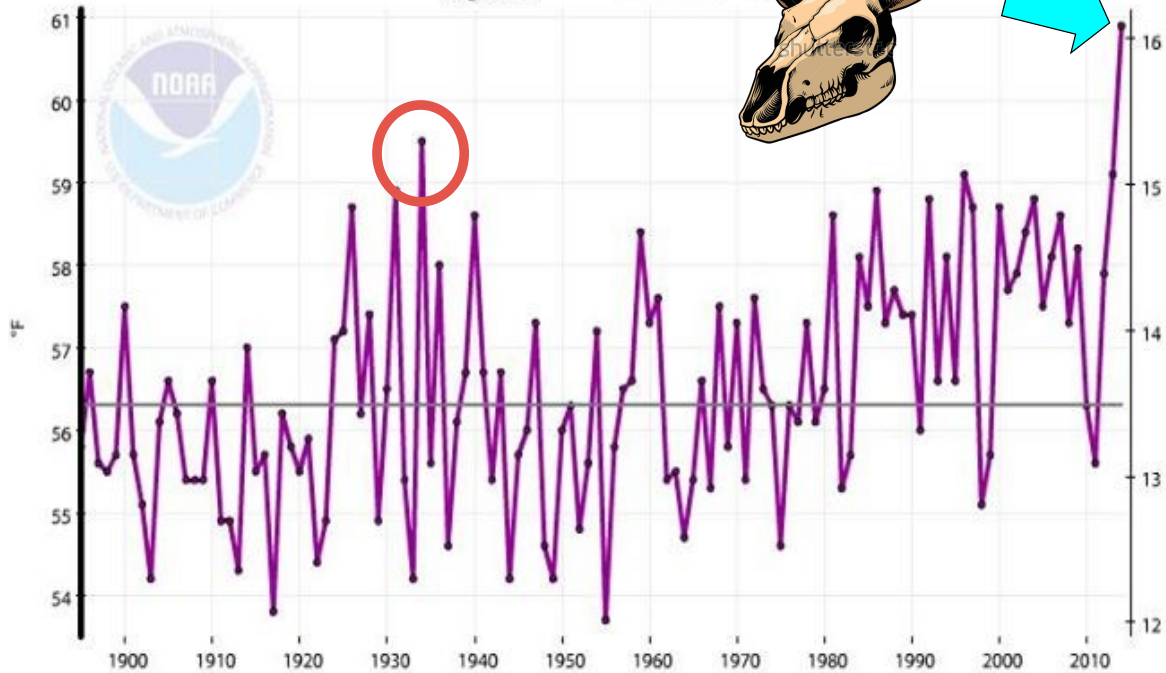
<http://www.businessinsider.com/us-treasury-yields-at-historic-lows-2014-11>

## More Evidence

- World economic events are troubling including the international economic environment . . .
  - But investors are discounting the turmoil
- The stock market is just off it's all time record level
- The **California economy** is out-performing most of the rest of the nation, and the **Bay Area** economy is out-performing most of the world
- The California Drought . . . . is less discussed these days because of recent rains . . .



# California Average Temperature 1900 - 2014

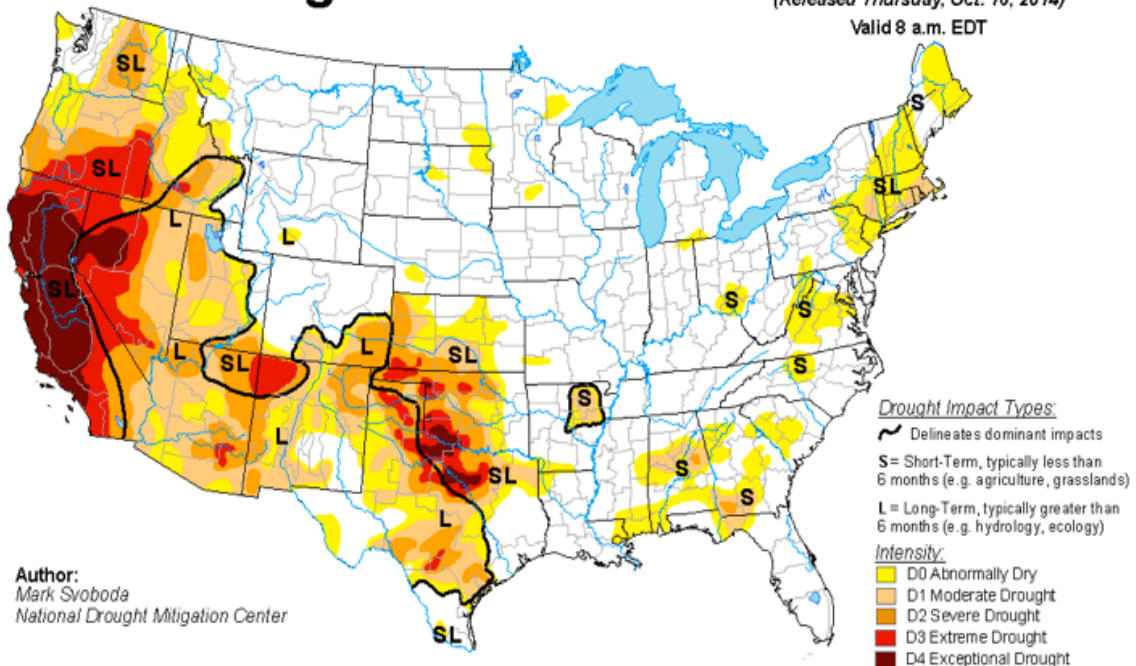


## U.S. Drought Monitor

October 14, 2014

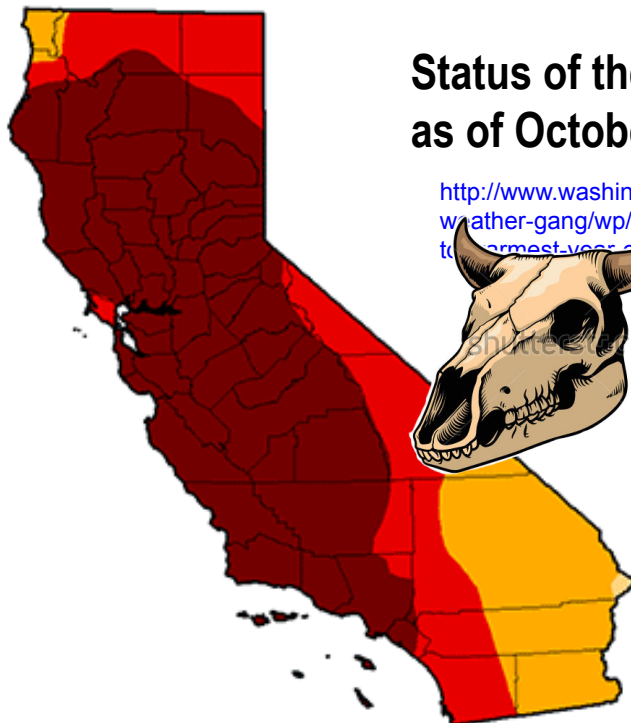
(Released Thursday, Oct. 16, 2014)

Valid 8 a.m. EDT



Author:  
Mark Svoboda  
National Drought Mitigation Center

<http://droughtmonitor.unl.edu>



## Status of the Drought in California as of October 14, 2014

<http://www.washingtonpost.com/blogs/capital-weather-gang/wp/2014/08/13/california-on-path-to-warmest-year-on-record-by-far/>

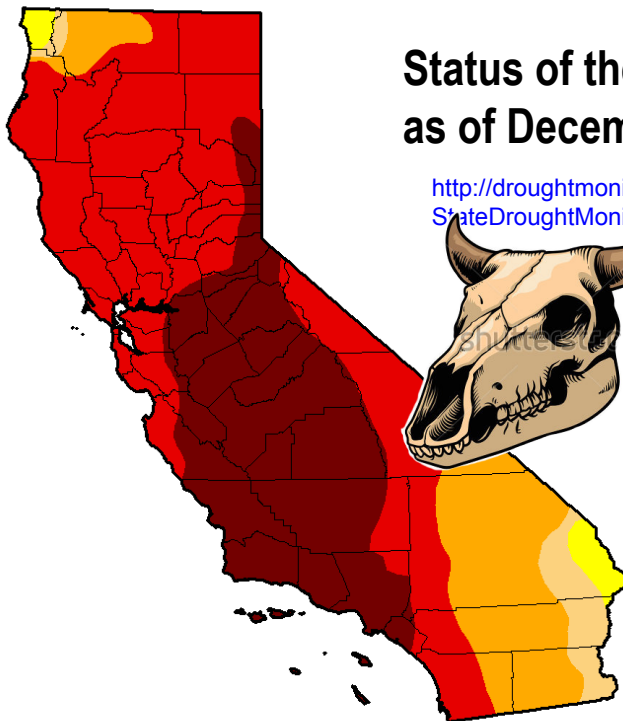
- **65 percent of the state now in “exceptional” drought status**

Intensity:

D0 - Abnormally Dry  
D1 - Moderate Drought  
D2 - Severe Drought

D3 - Extreme Drought  
D4 - Exceptional Drought

Most severe classification



## Status of the Drought in California as of December 31, 2014

<http://droughtmonitor.unl.edu/Home/StateDroughtMonitor.aspx?CA>

- **35 percent of the state now in “exceptional” drought status**
- **Warmest calendar year on record in California**

Most severe classification

# For many, drought has little or no effect

■ Desire lacking for spending on fixes, poll finds

By Bettina Boxall  
Los Angeles Times

LOS ANGELES — Most Californians surveyed say the

environmental protections or large-scale public spending to boost water supplies, a USC Dornsife/Los Angeles Times poll has found.

Although 89 percent characterize the drought as a major problem or crisis, only 16 percent say it has affected them to a ma-

decades — the state's major population centers have largely escaped severe mandatory rationing. Even agriculture, which as California's biggest water user is hit the hardest by drought, has partially compensated for reduced water delivery by pumping more groundwater.

and big spending on water projects.

While Central Valley congressmen and some agribusiness interests have blamed environmental regulations for worsening the water shortages, those polled cited a much broader range of causes. Topping the list was a lack of

"They're really blaming larger forces here," said David Kanevsky of American Viewpoint, the Republican firm that conducted the opinion survey with Greenberg Quinlan Rosner Research, a Democratic firm. "What they don't want to see is quick fixes at the expense of the

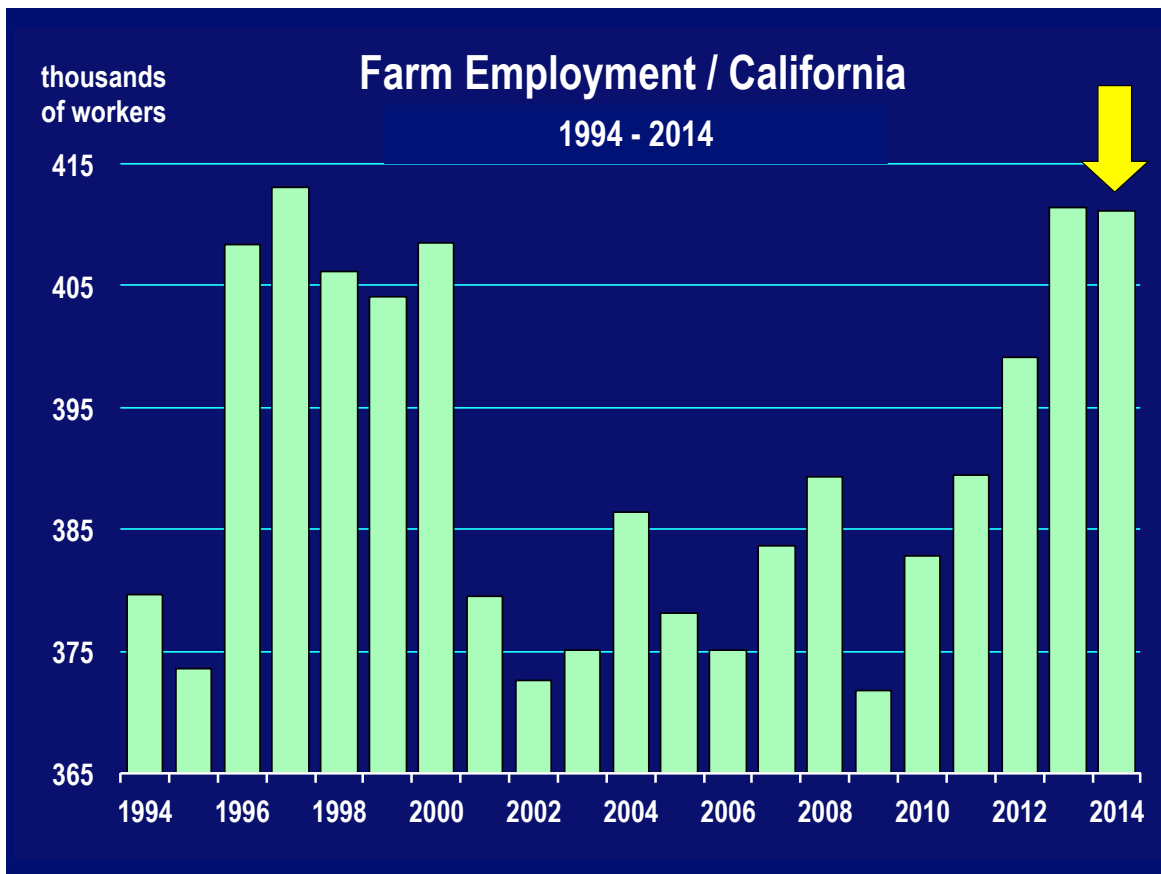
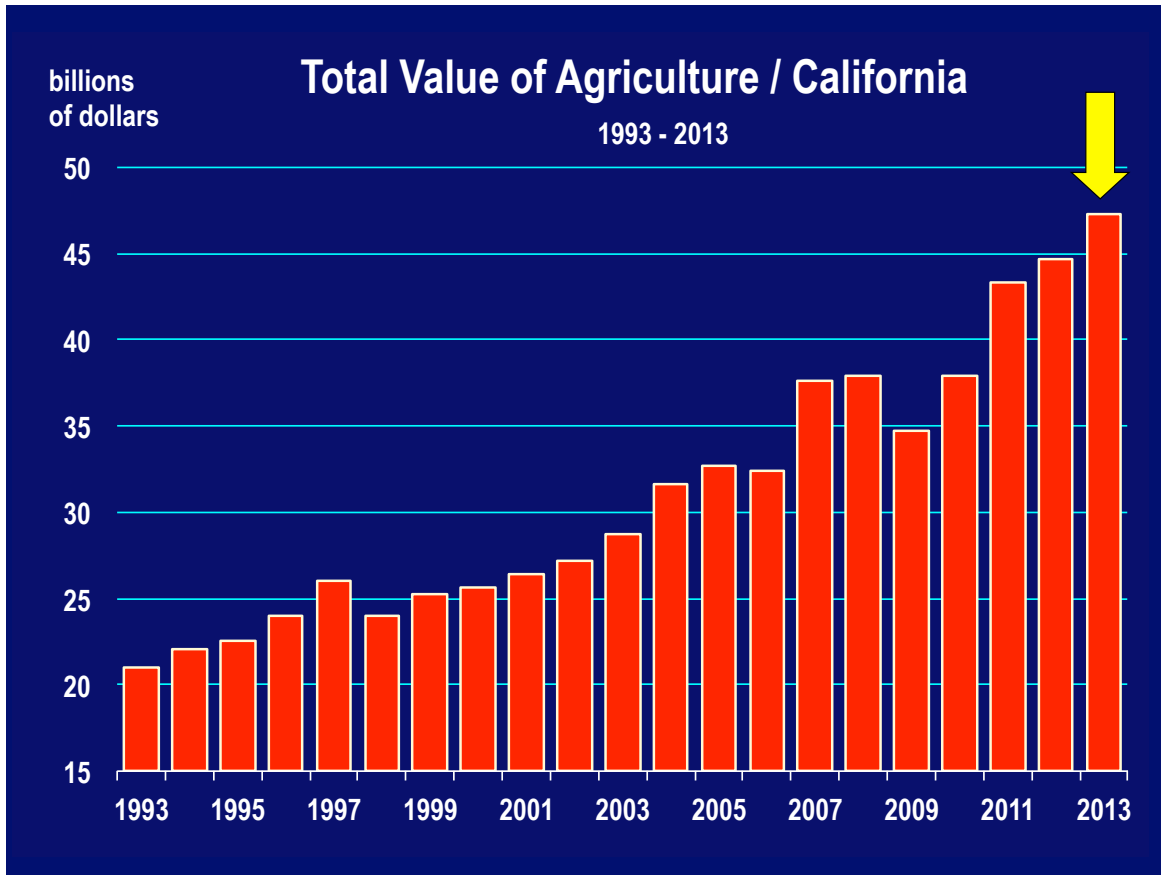
stormwater, increasing underground storage, voluntary conservation and seawater desalination. A smaller percentage, though still a majority, favored building new dams and reservoirs.

But when it comes to paying for the projects, the numbers flipped. Only 36

Ventura County Star,  
July 7, 2014, page 3A

## The California Drought

- 3 full years of drought: 2012, 2013, 2014
- 2014 was the warmest year on record ( since 1895)
- Both extraordinary hot & dry weather
- Lack of precipitation combined with heat accelerates the evaporation of moisture from the ground, and water from reservoirs
- Impacts farming and inland farming counties
- Formal Economic impact to date:
  - \$2.2 billion, mostly in San Joaquin Valley
  - 17,100 farm jobs



# The Economic Cycle



**Where are we ?**

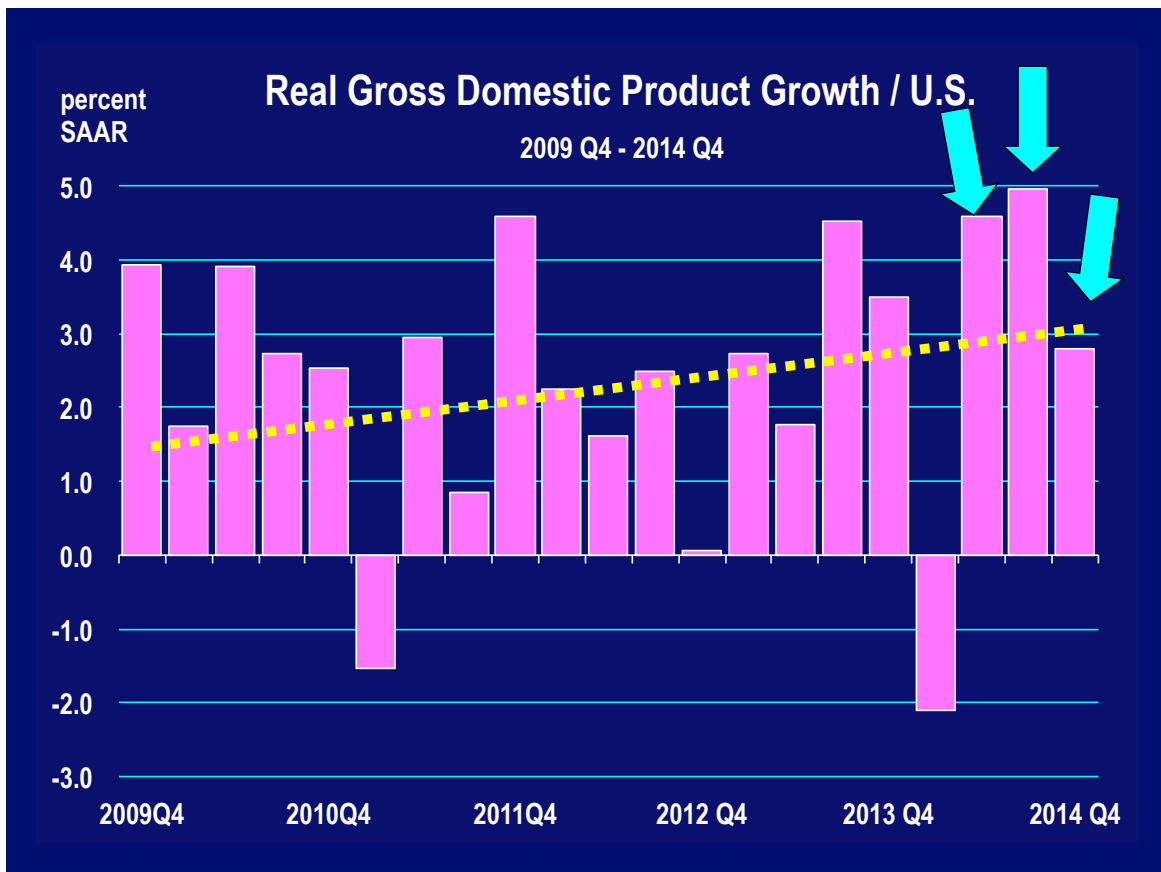
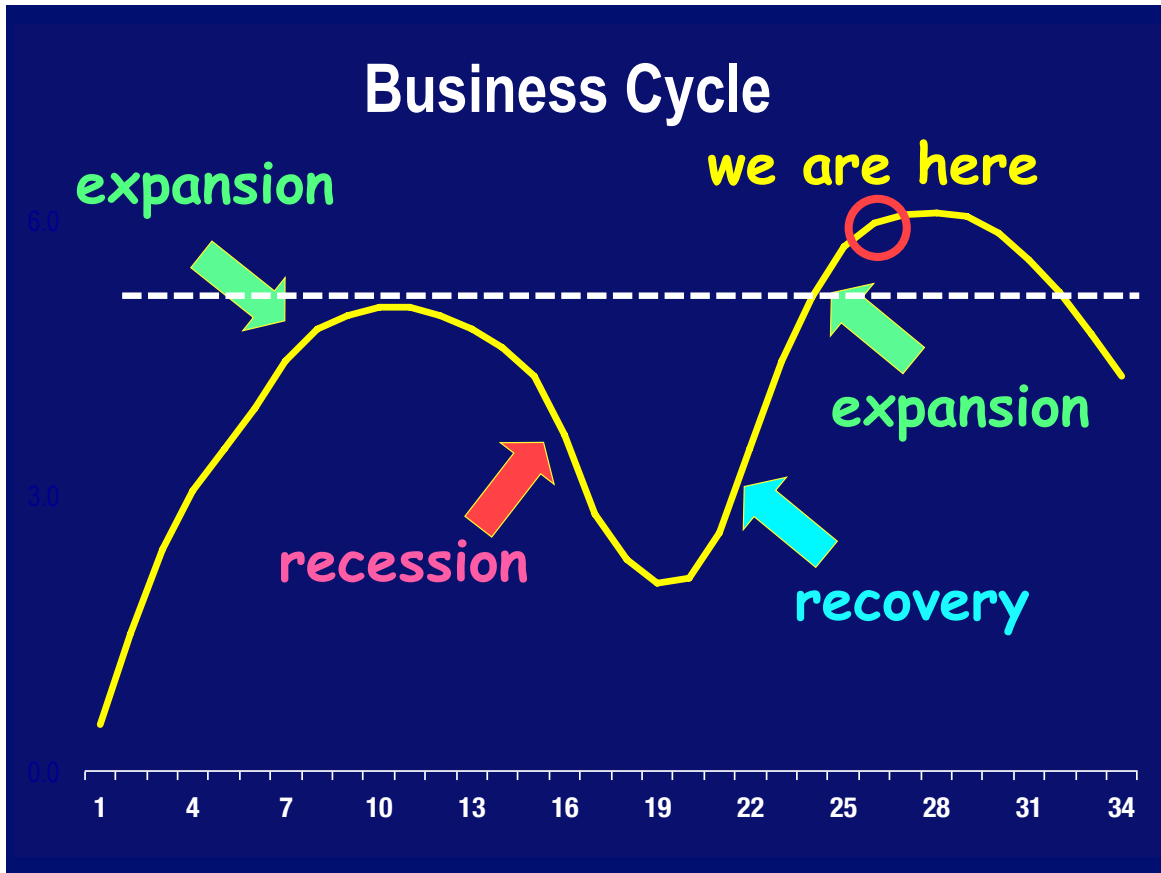
**and, why**

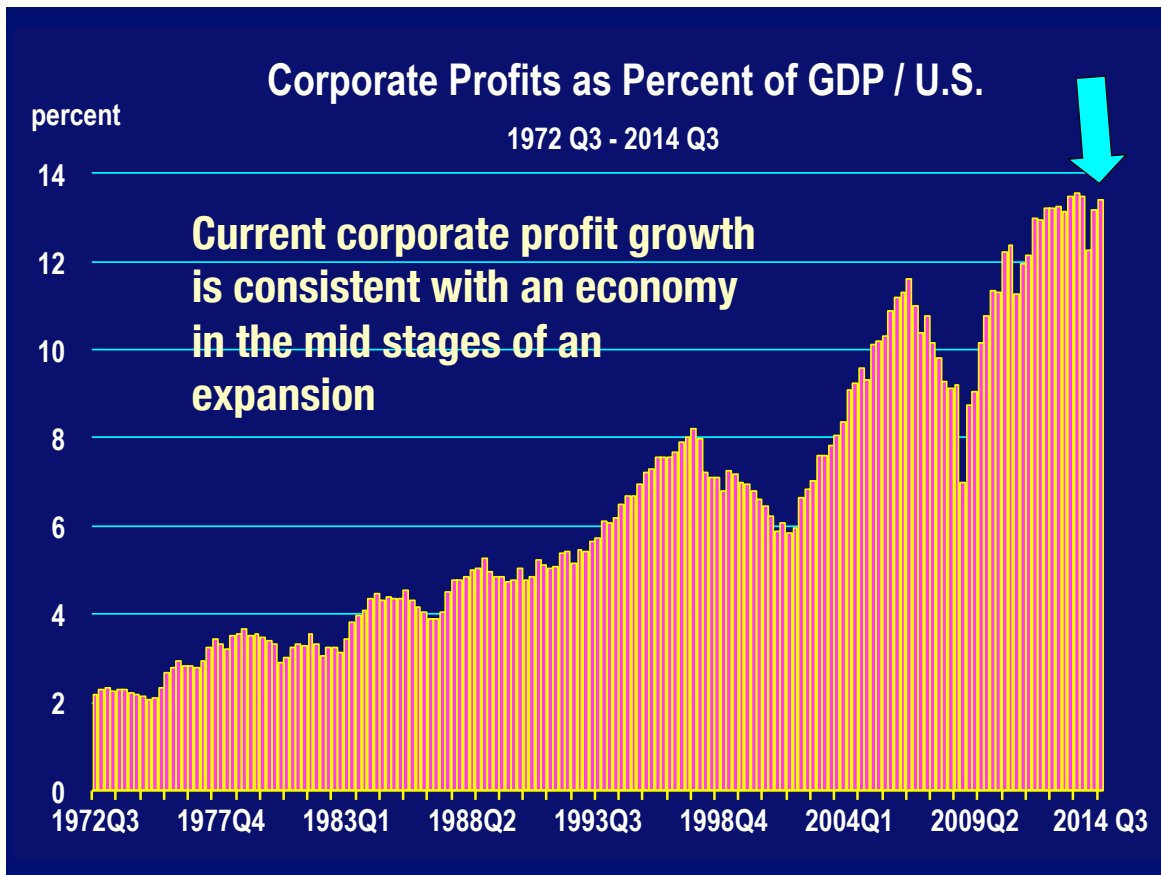
**that's of interest to you**

## Quiz: The economic expansion

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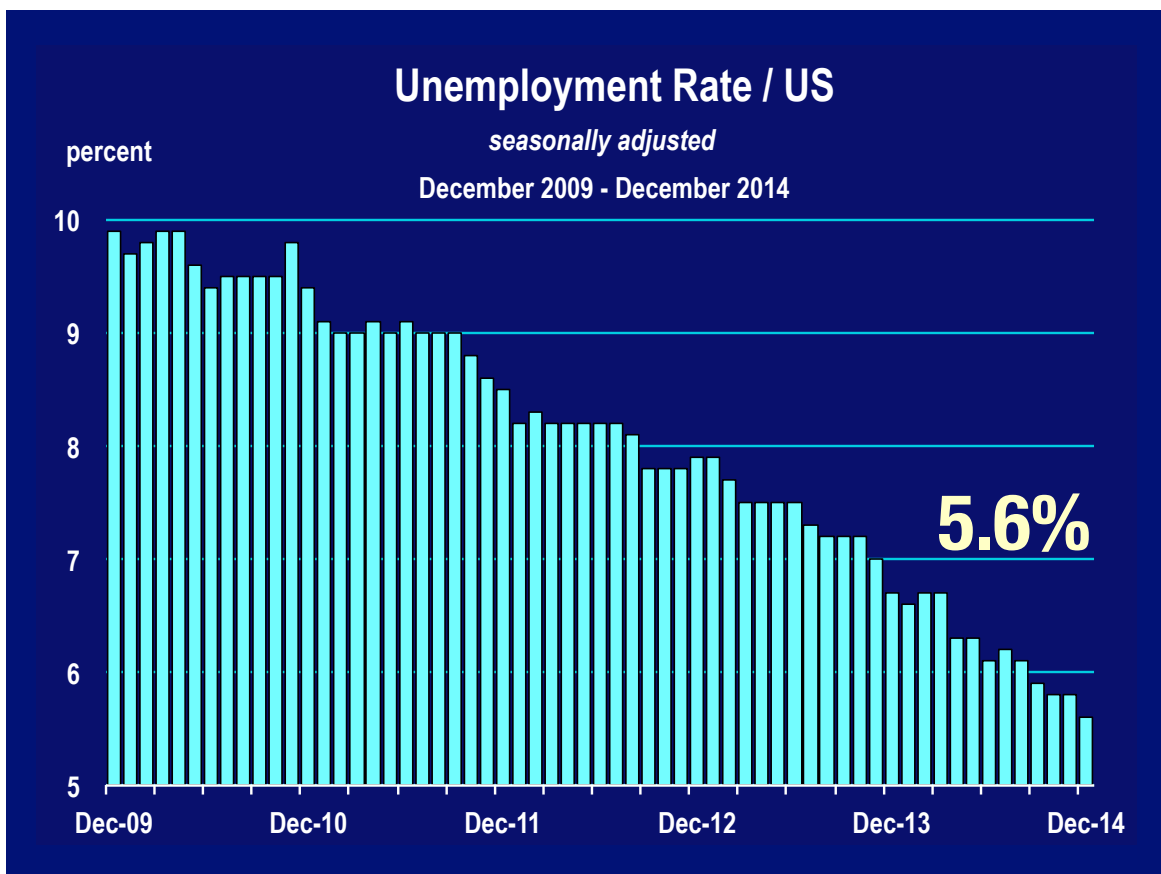
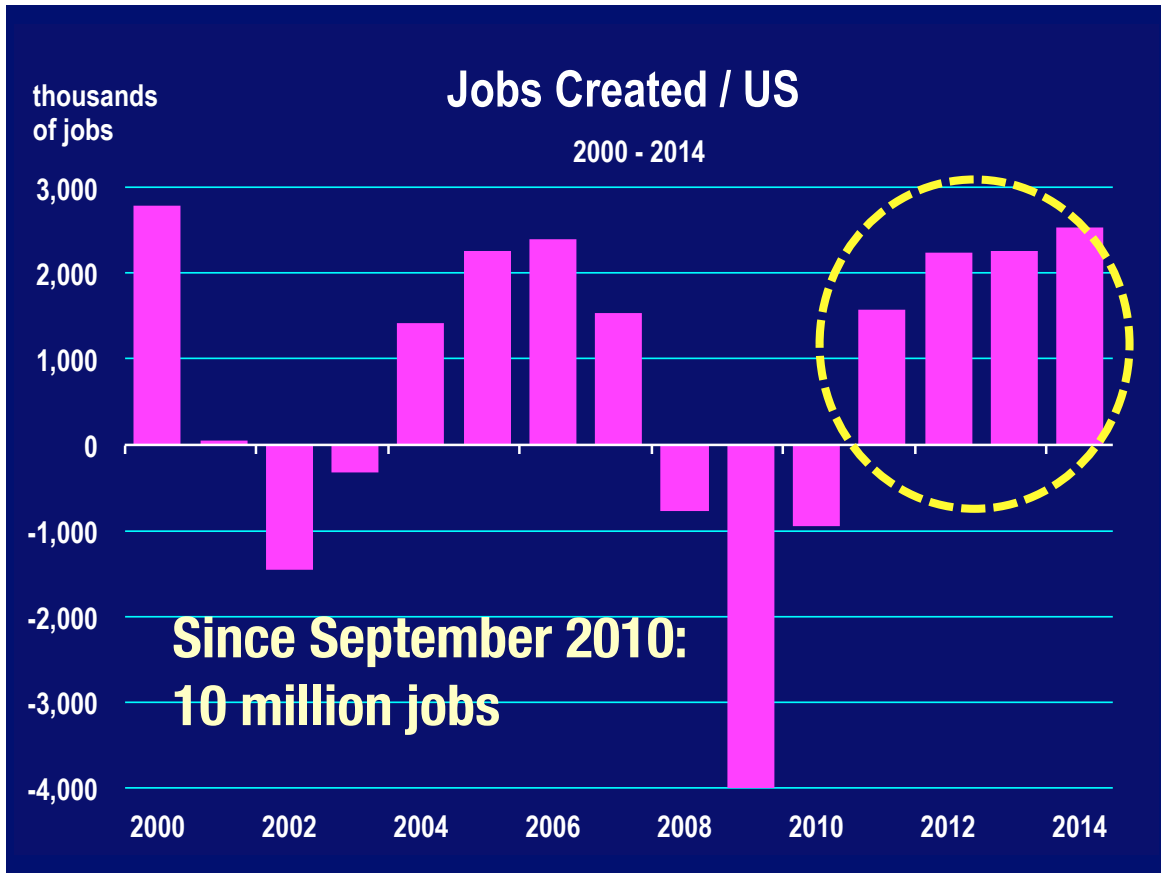
- ✓ (a) is clearly obvious to me now
- (b) is not entirely obvious but the growth in my business is back to normal or nearly so
- (c) is not an expansion for me
- (d) is a big lie
- ✓ (e) shut up

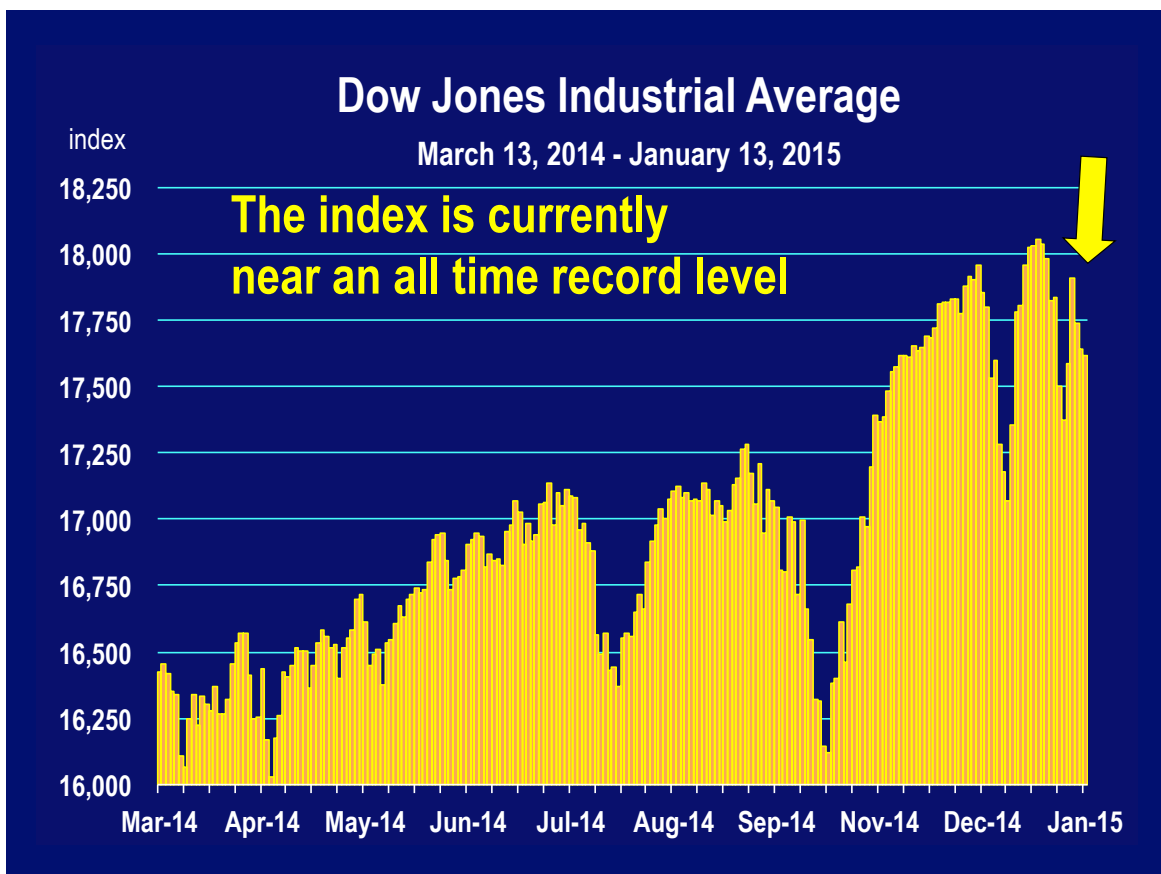
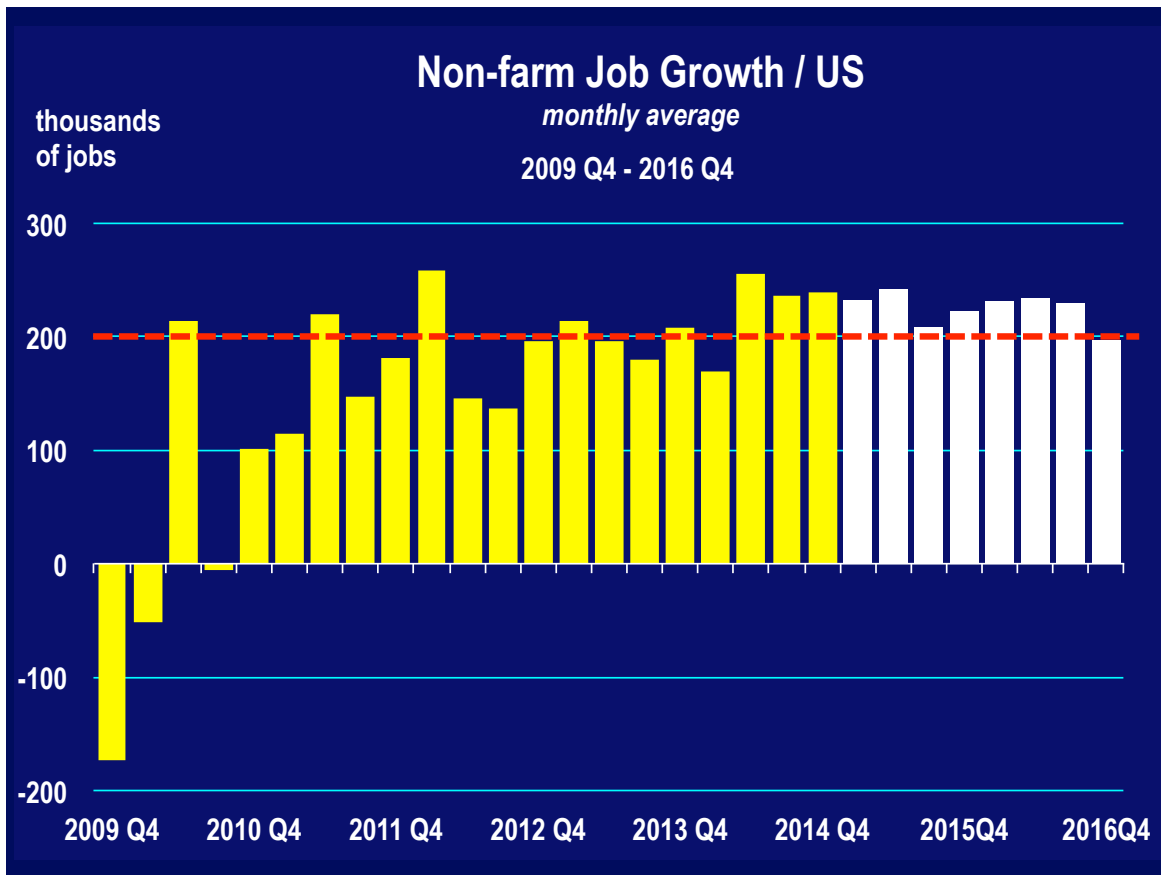




## Why are Corporate Profits Important?

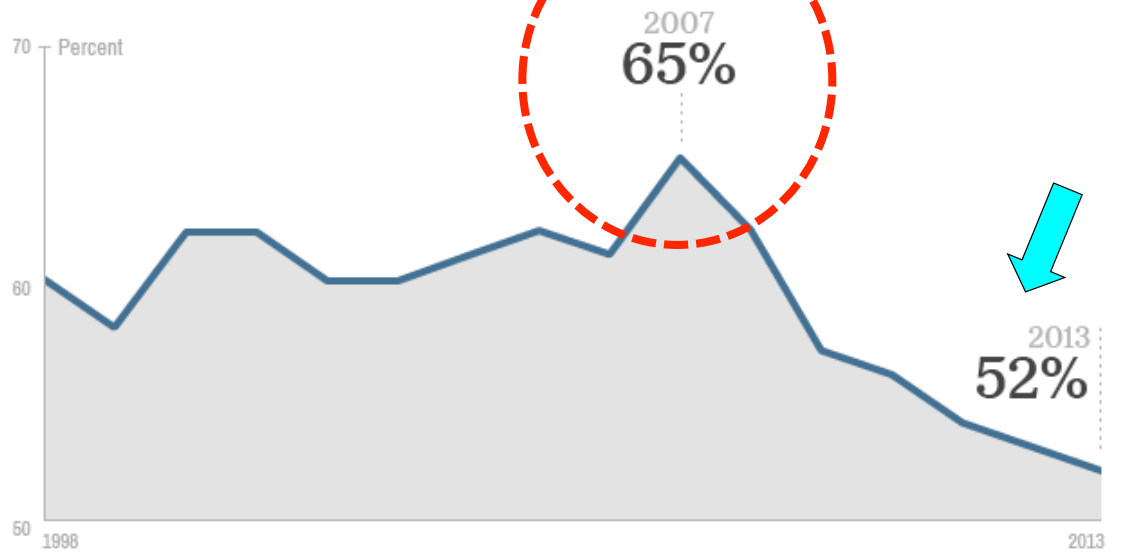
- They drive corporate earnings which are responsible for **higher stock prices**
- Higher stock prices translate into higher levels of **consumer satisfaction**
- Profits are a leading indicator of economic growth, directly correlated with **job growth**
- Profits may be tiring, but **job growth** shows no signs of slowing down





# Half of Americans Participate in Stock Market

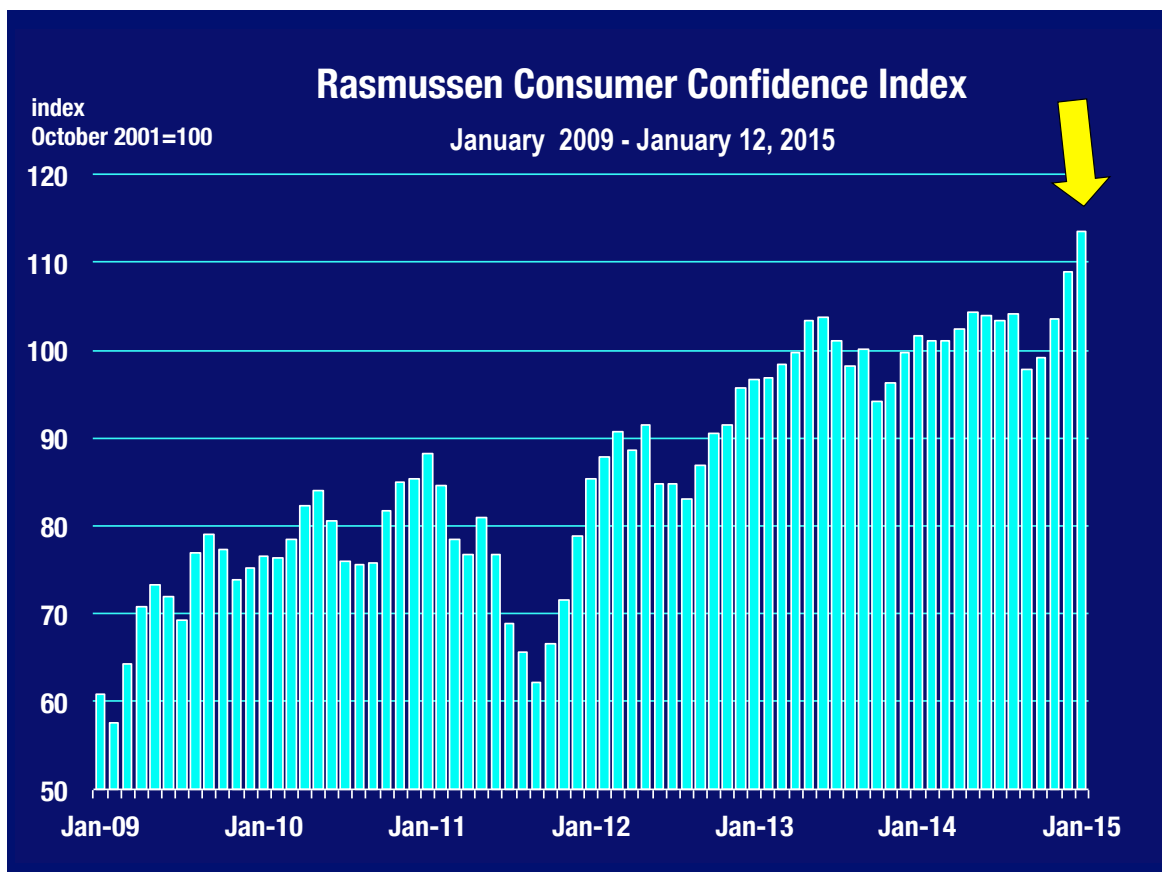
Americans invested in stocks

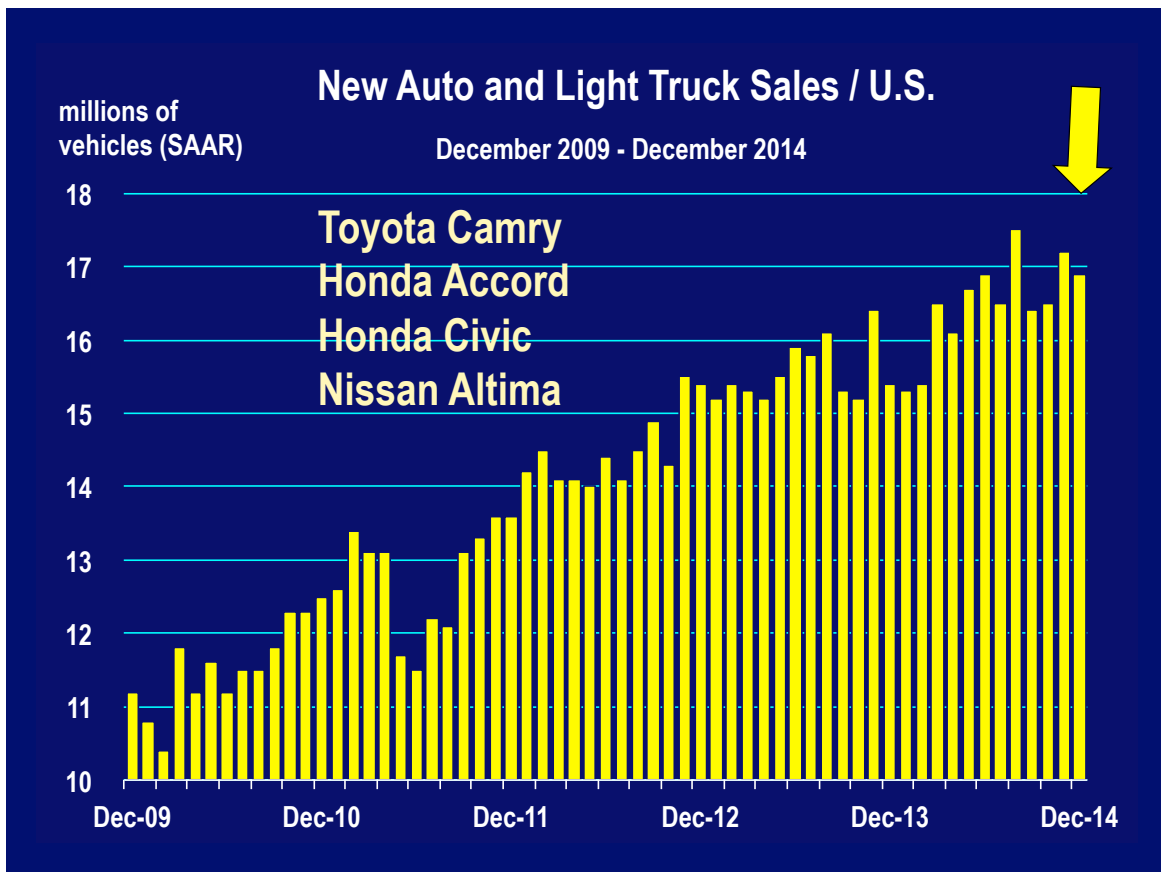
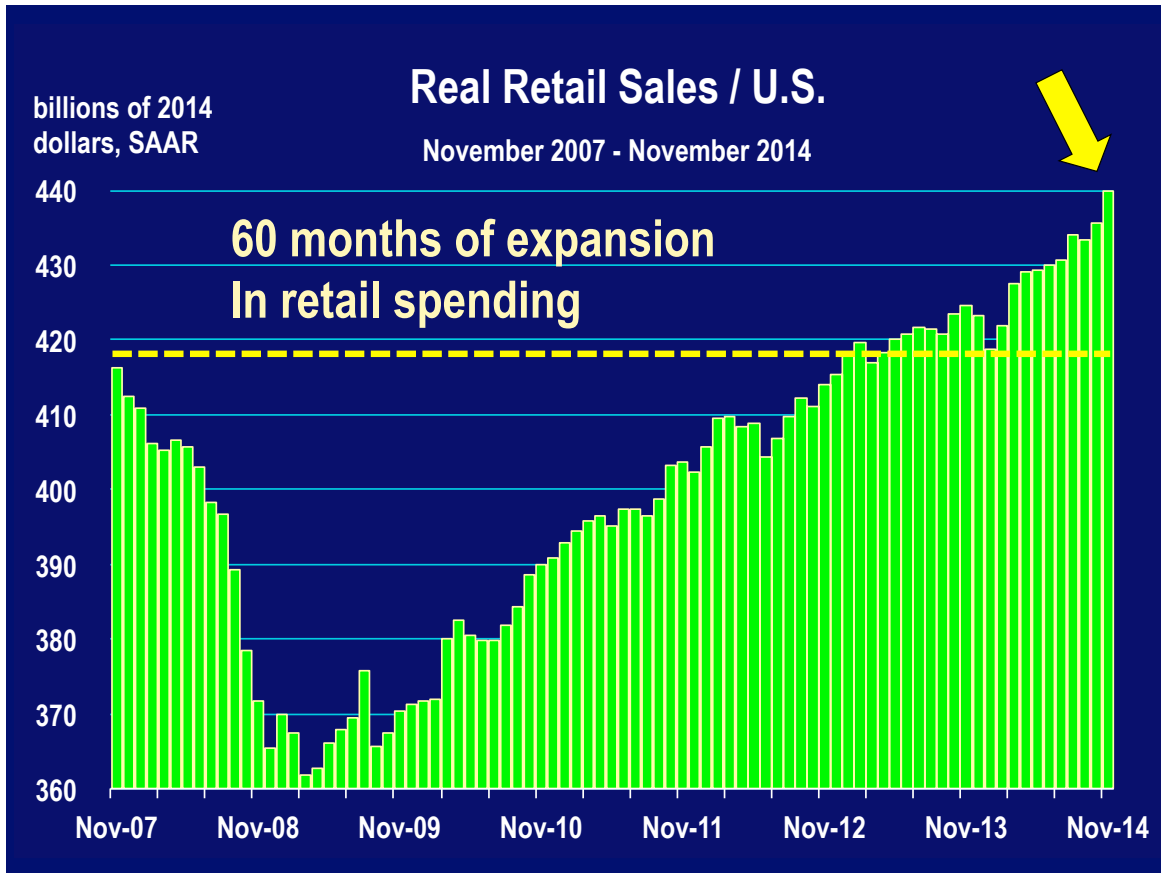


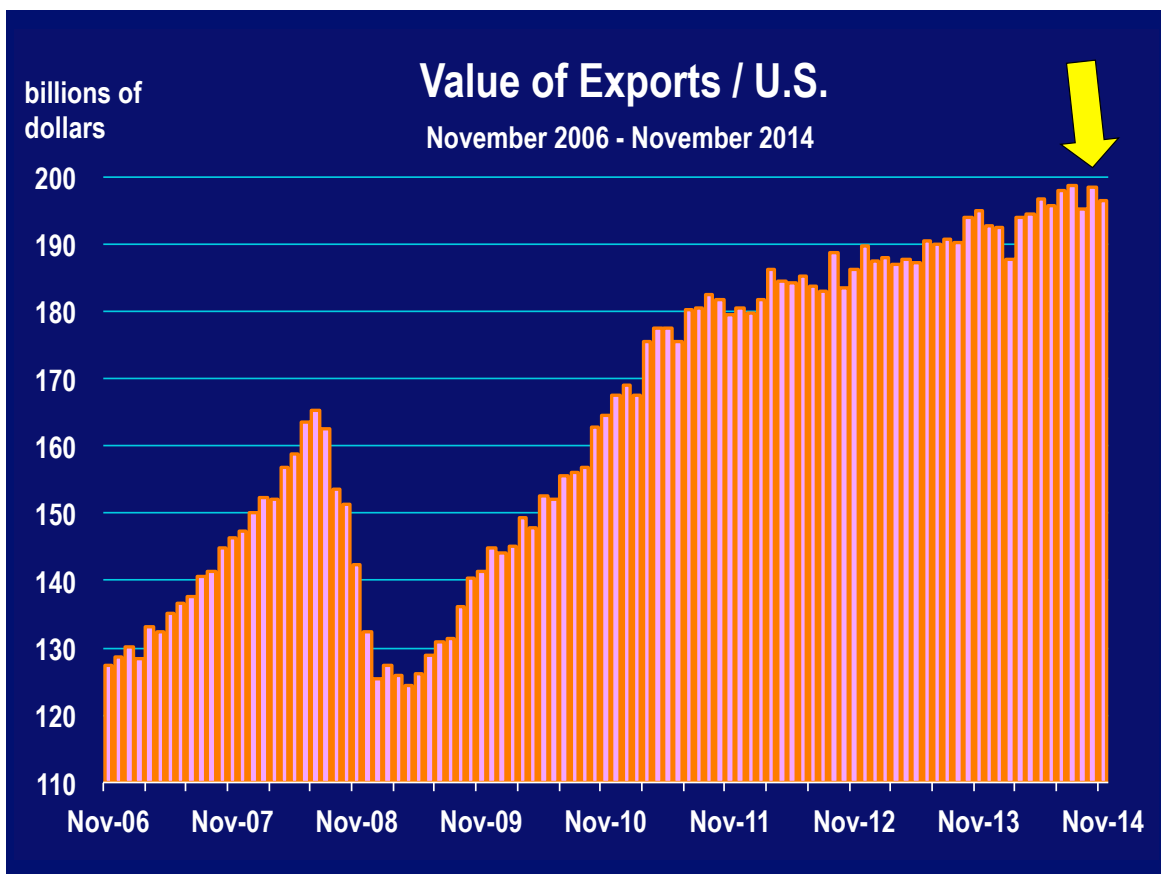
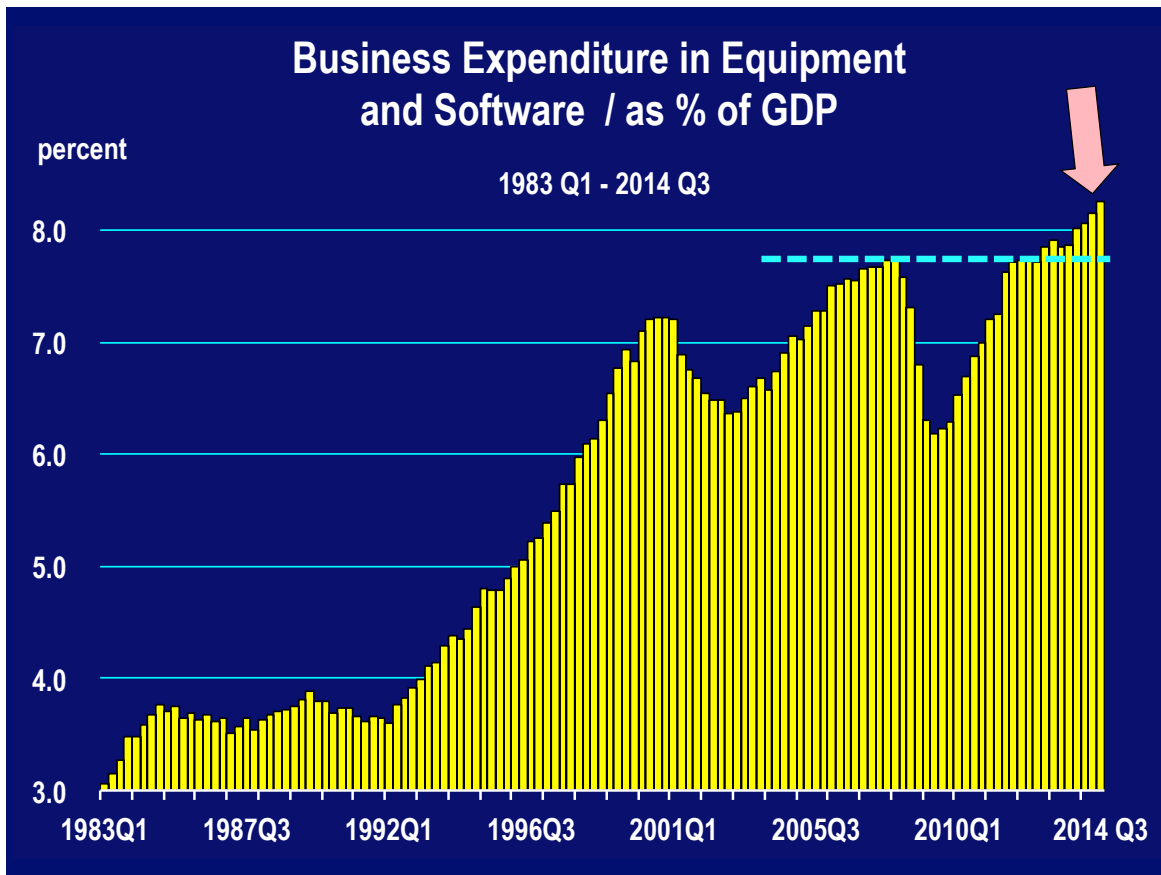
SOURCE: GALLUP

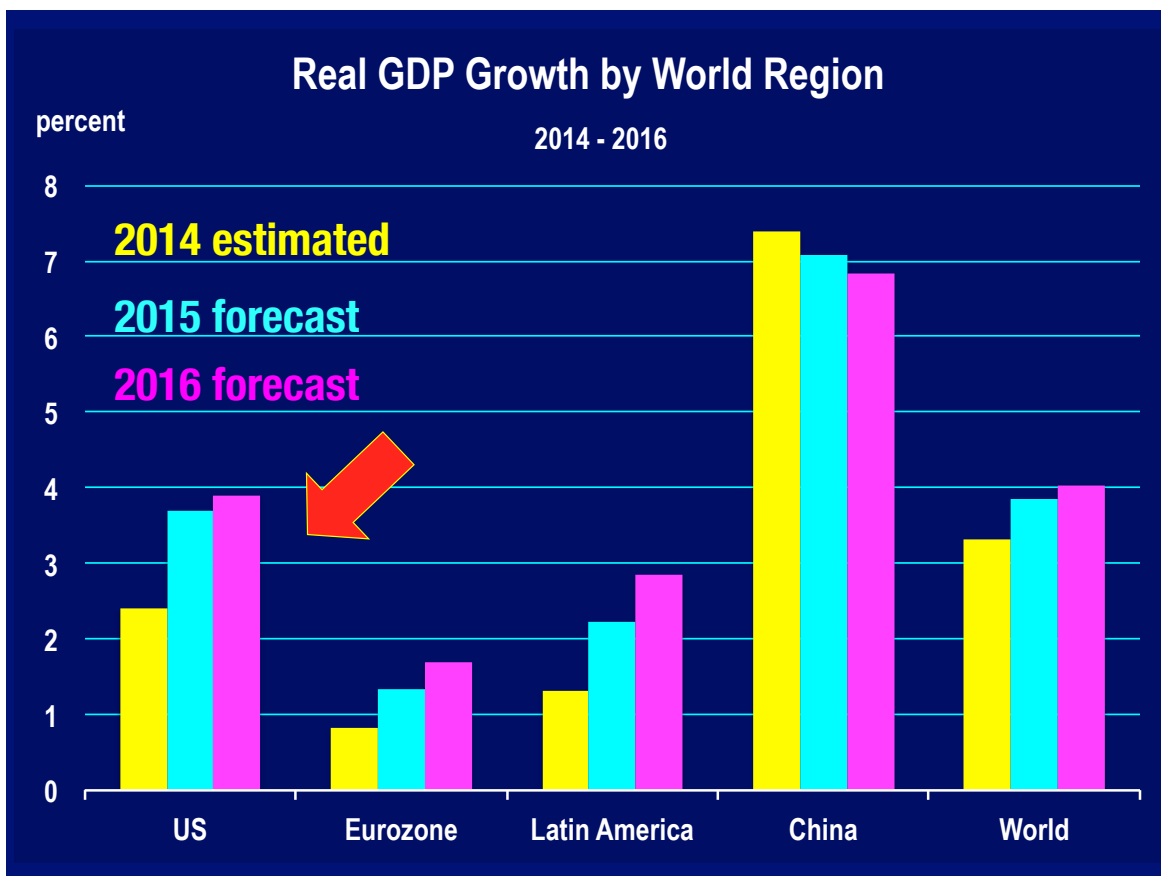
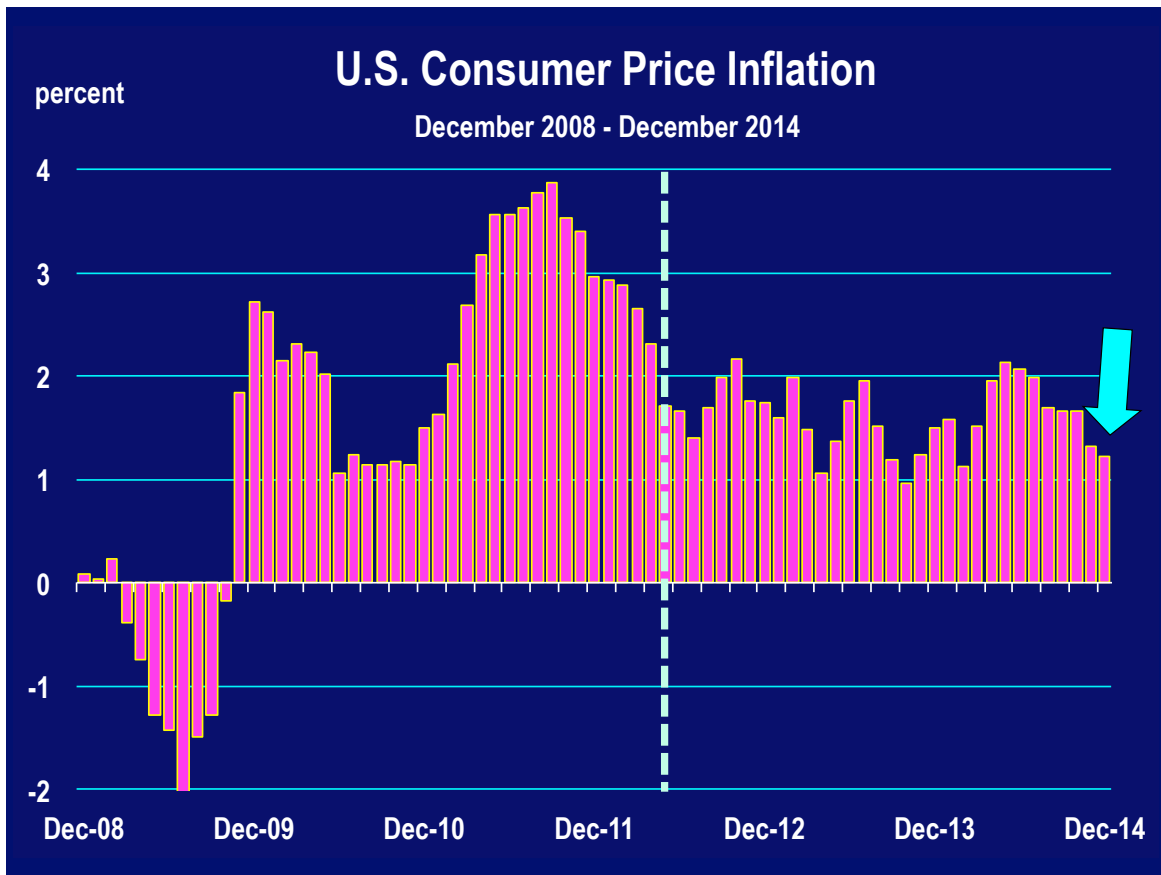
CNN Money online

<http://money.cnn.com/2013/05/09/investing/american-stock-ownership/>









## The U.S. Economy Expanding

- No longer a recovery, . . . . nearing the top
- Nearly all cylinders firing . . . 7 of 8
- Jobs
- Spending
- Business Investment on equipment, software
- Exports
- Even the government sector has stabilized

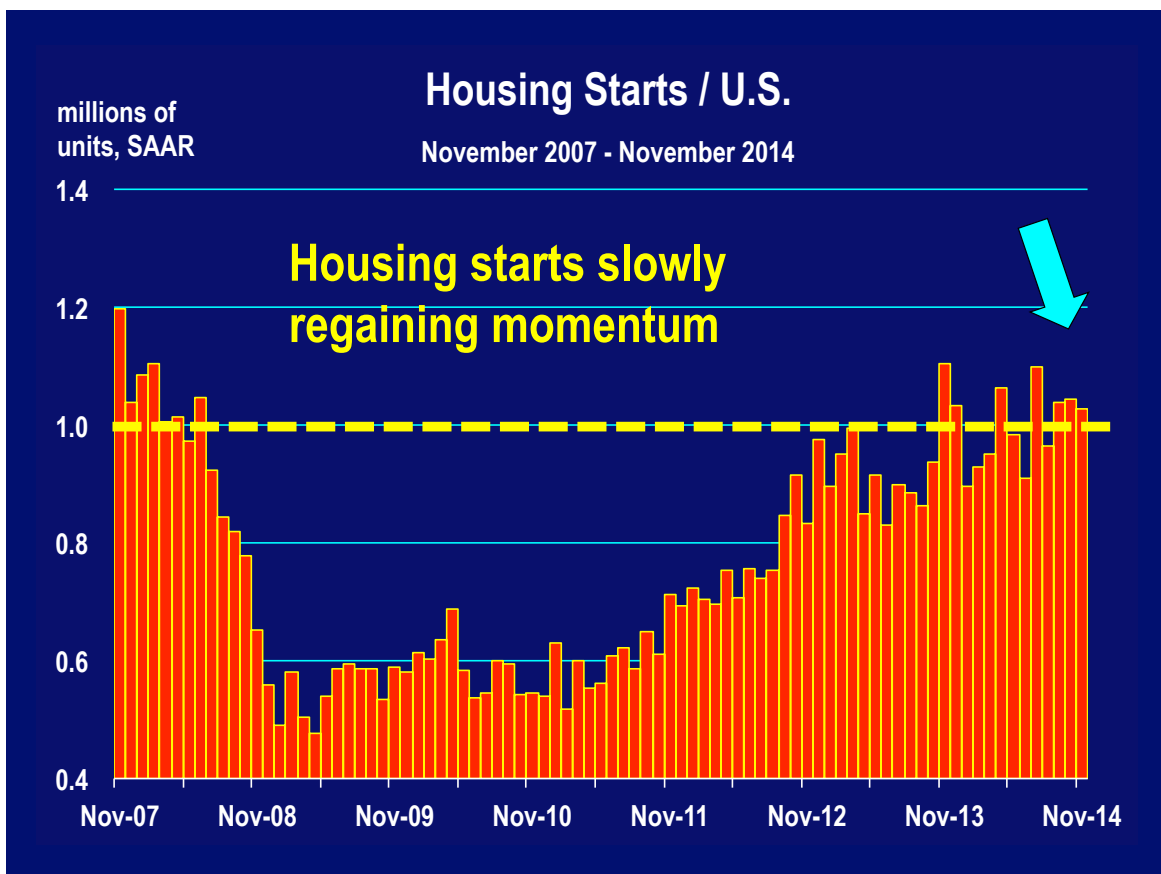
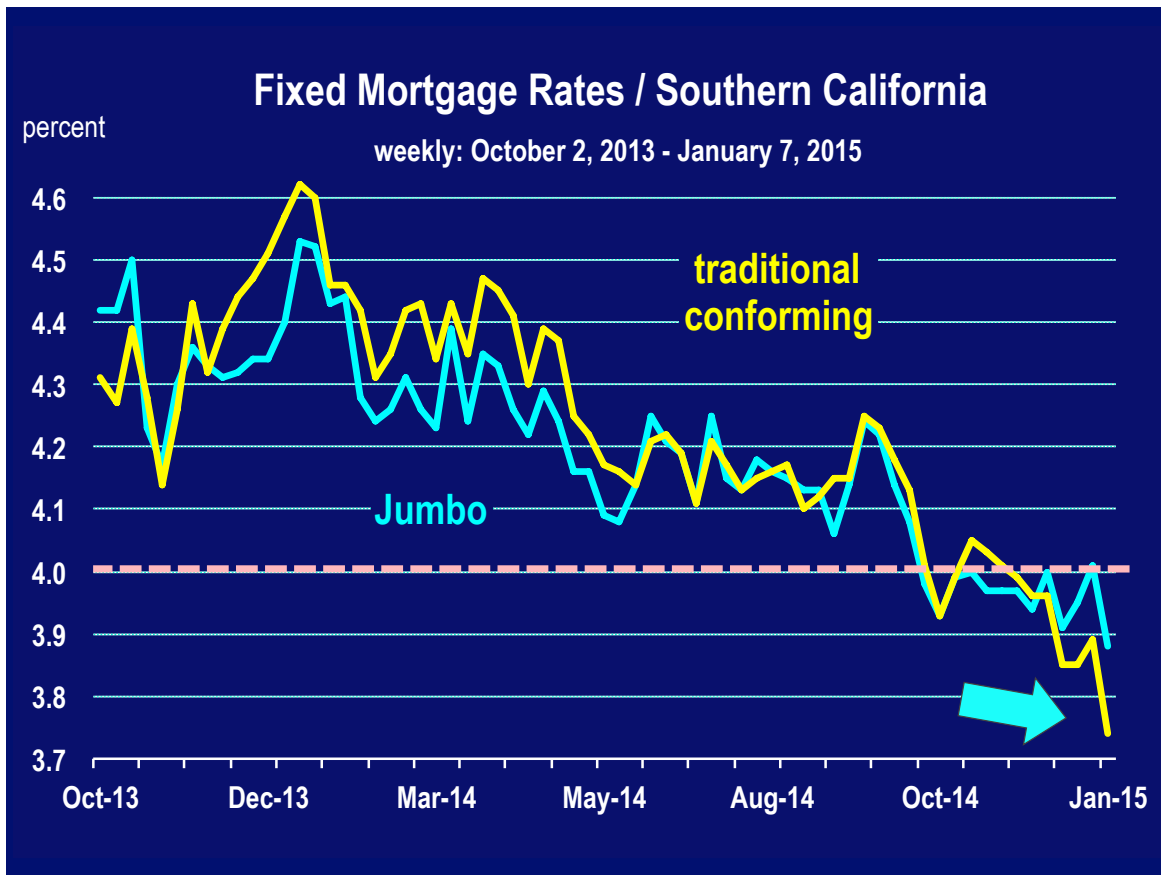
## The U.S. Economy Expanding

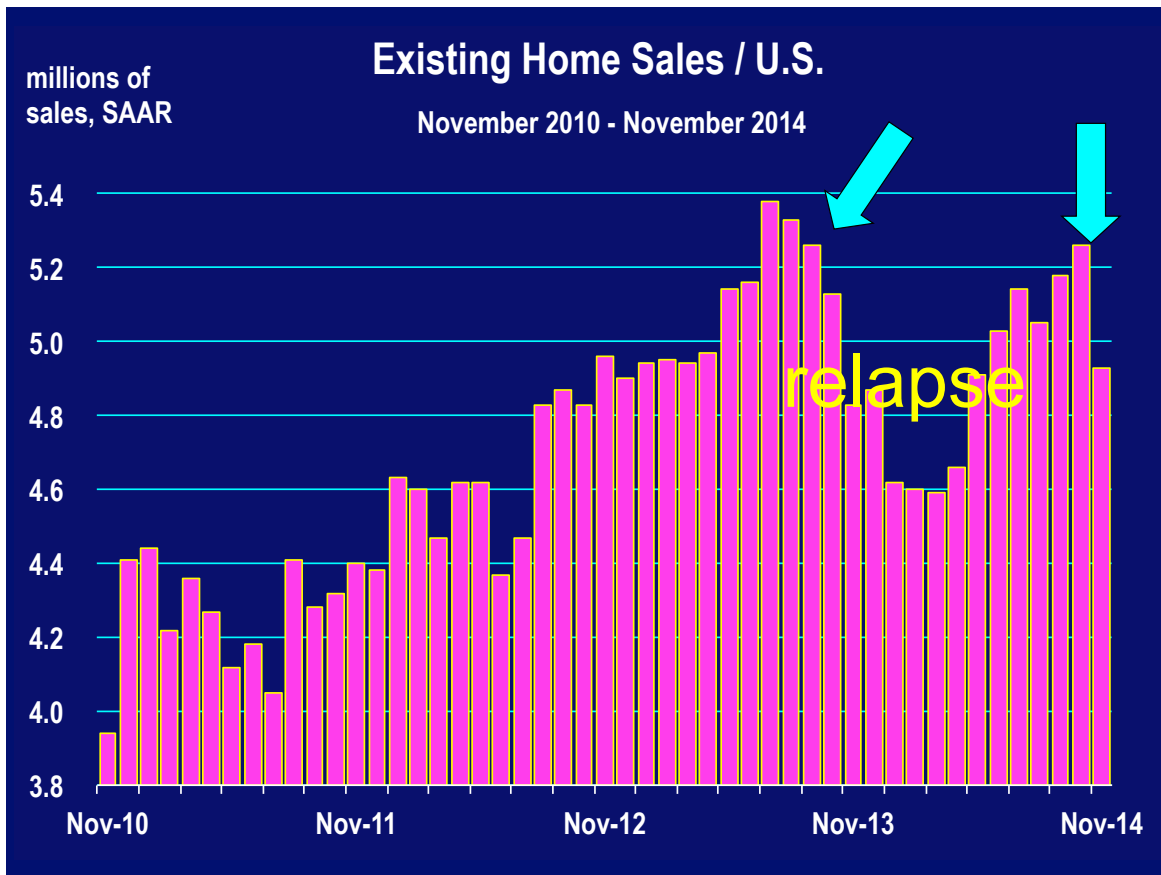
- And finally: Housing.....
  - the sector that remains troubled, impervious to the Fed's interest rate seductions

I'm not  
impressed



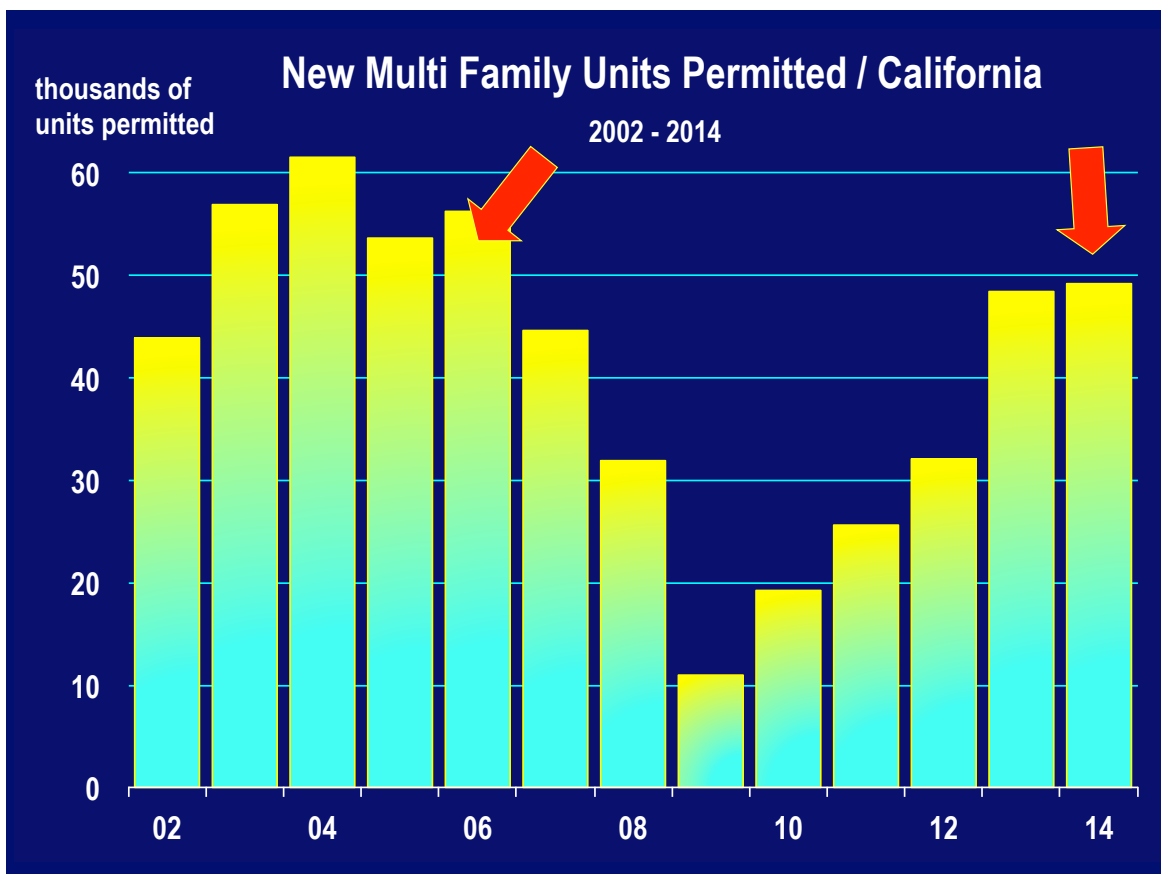
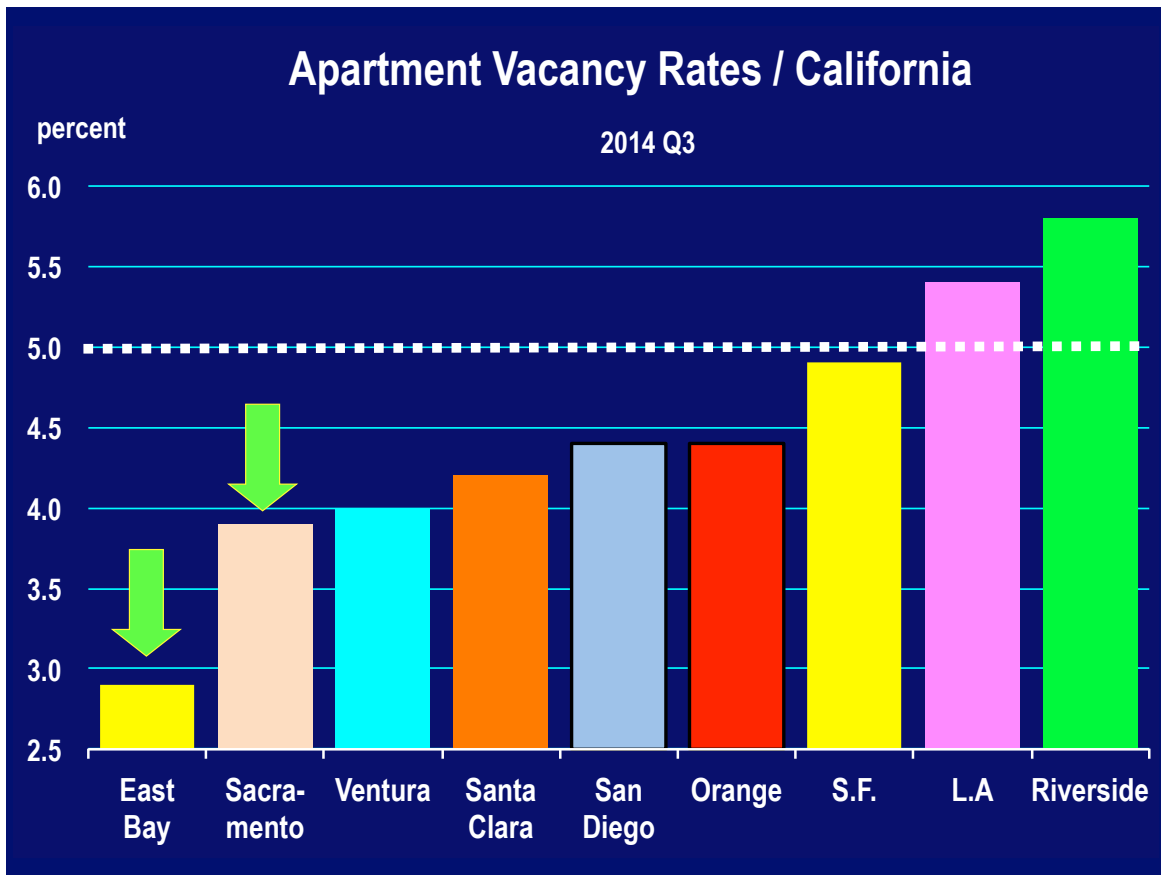
housing the FED





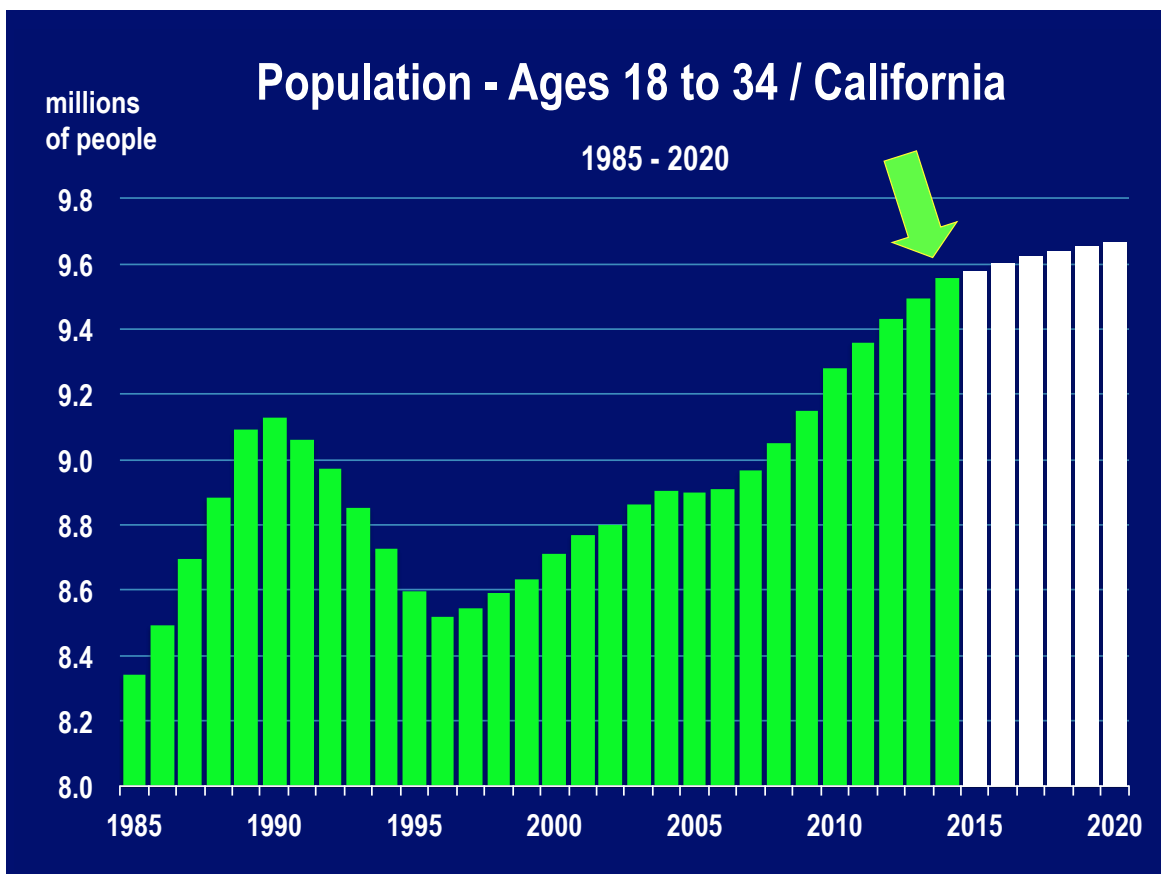
## Quiz: What happened to the Demand for housing?

- (a) We are demanding housing.....  
It's called rental housing
- ✓(b) We like having our 20-something kids live at our house
- ✓(c) We like living with our parents
- (d) We're not sure if we want to buy



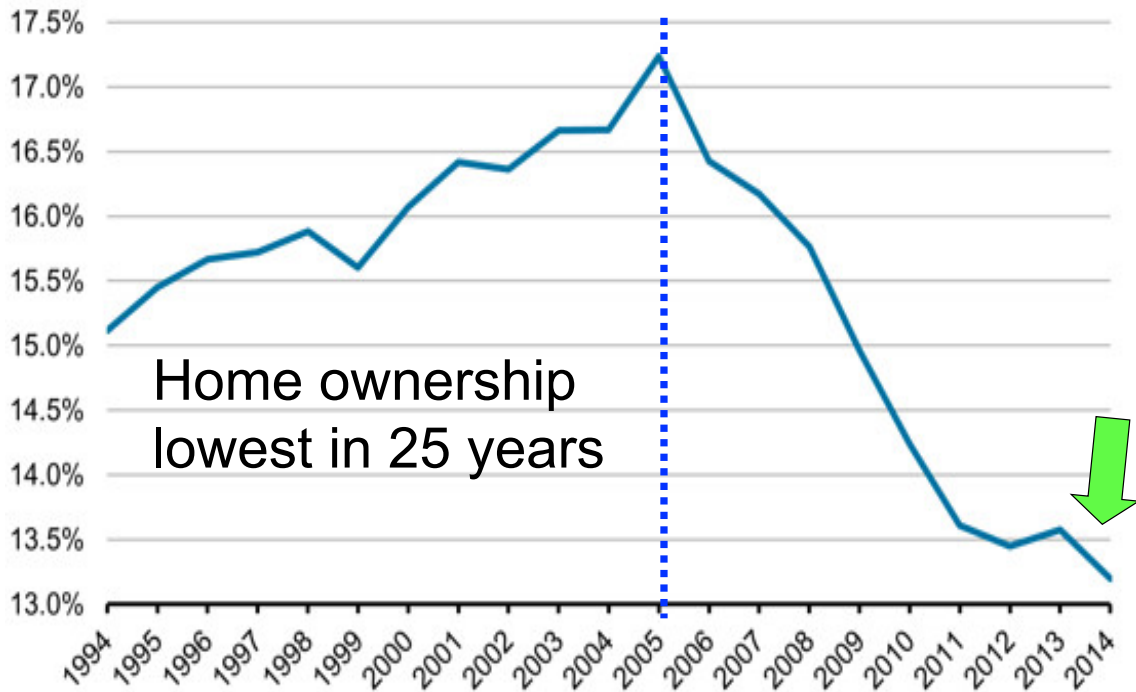
## The weakness in Housing . . . . .

- .... comes from the weakness in housing formation .....
- which is demographically driven, for the most part
- **A stronger economy,**
- **historically low interest rates, and**
- **lower prices --- have not been enough**
- Furthermore, there are new reasons for the lack of household formation . . . .

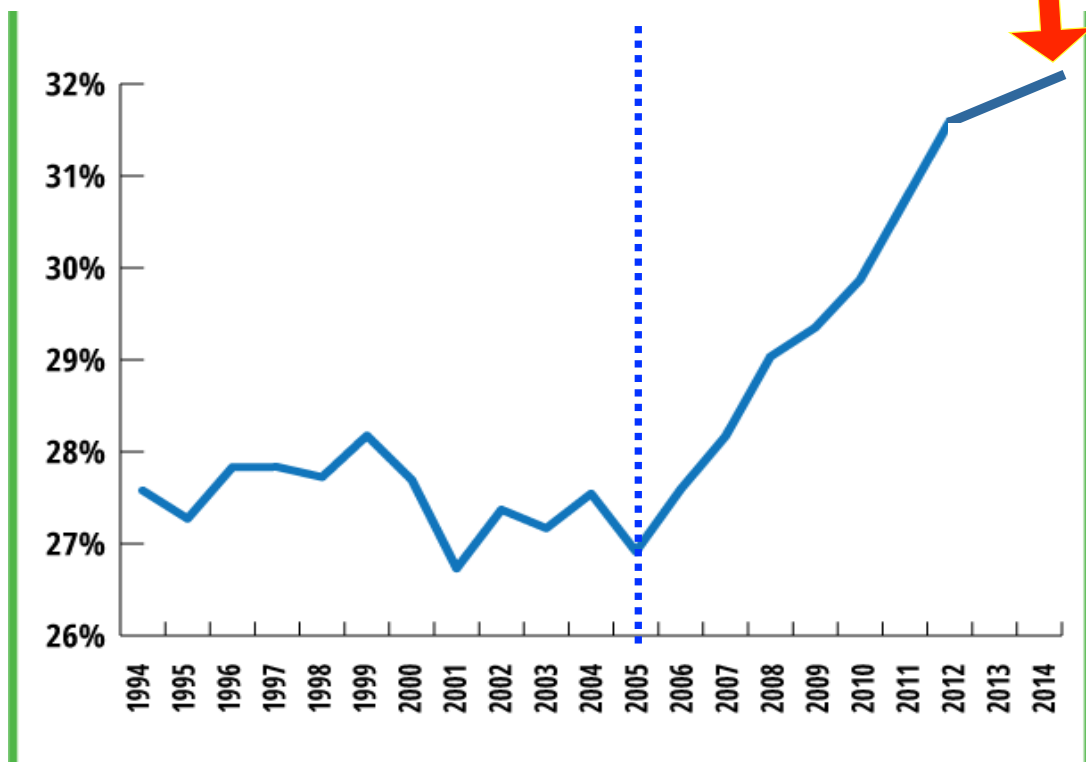


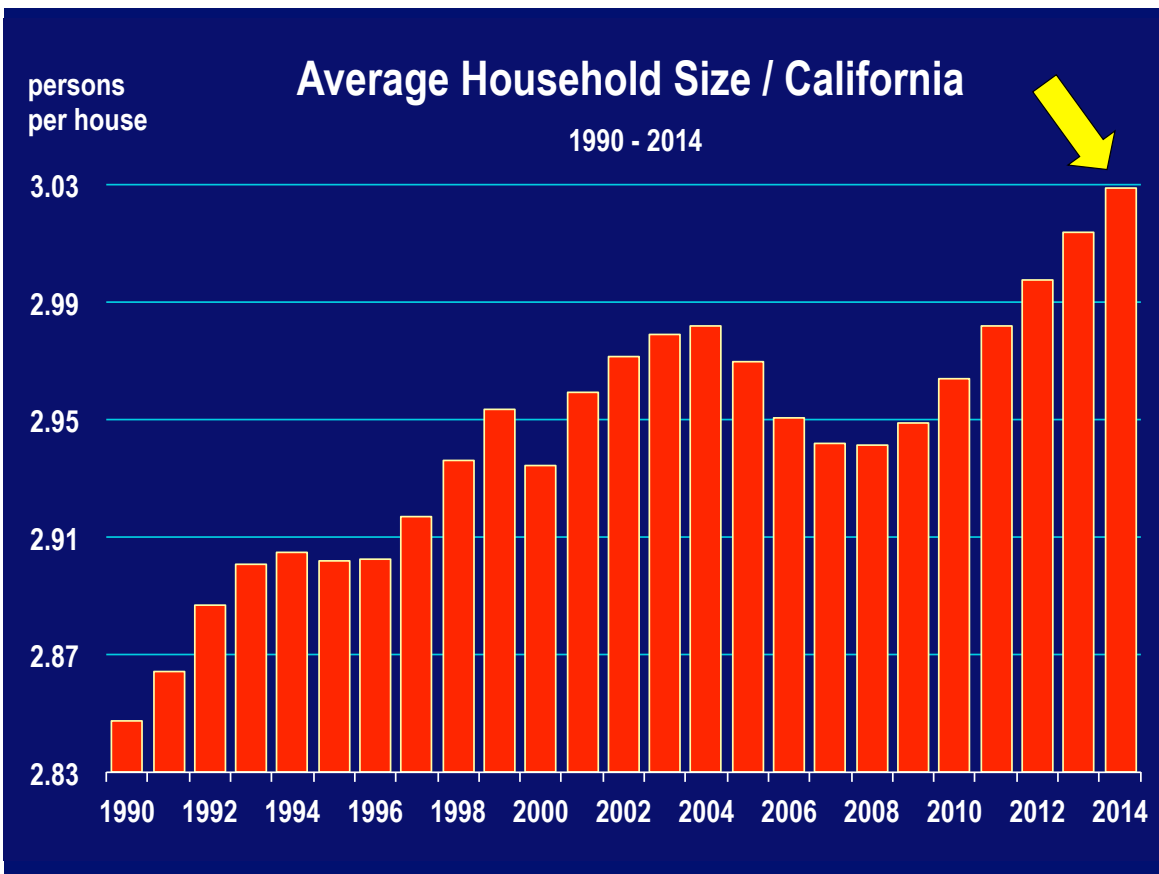
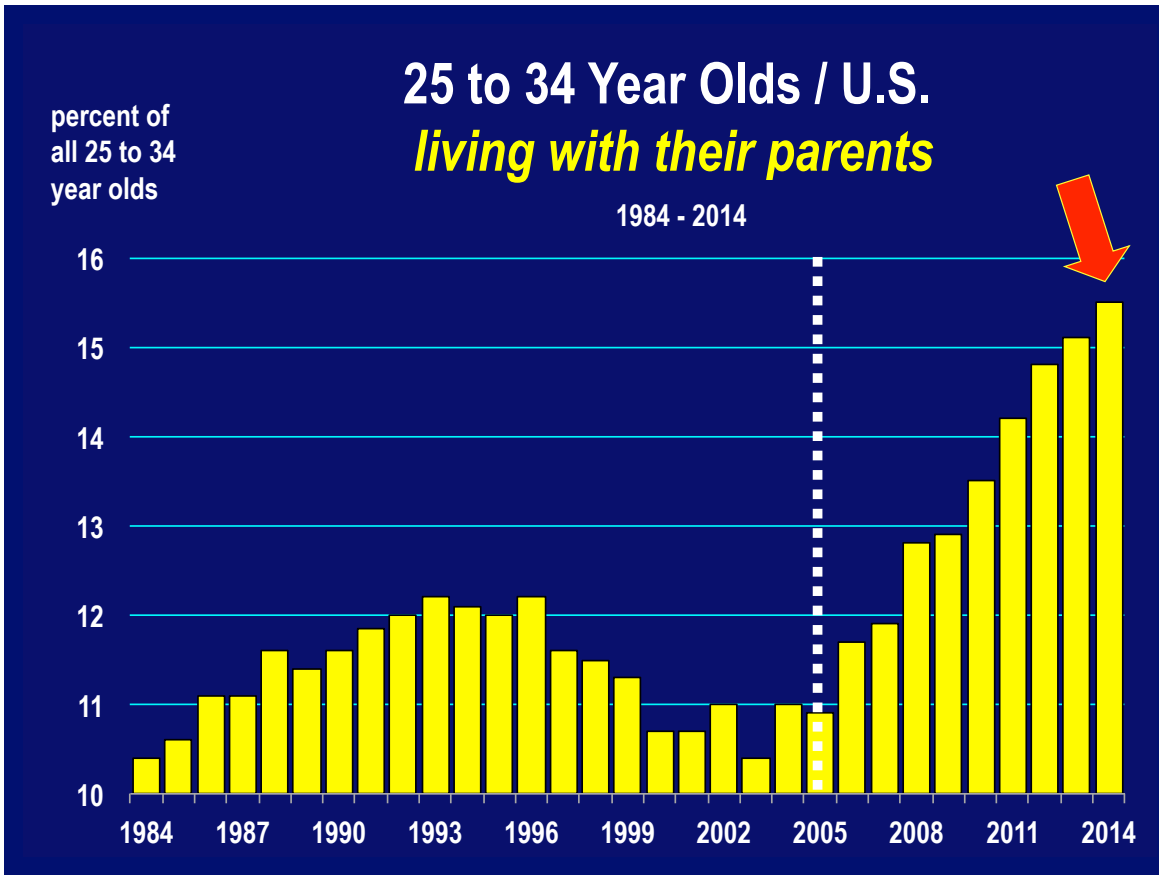
## Generation Y --- Reluctance to Buy ?

*Share of 18 to 34 year olds that own homes*



## 18 to 34 year olds living with their parents

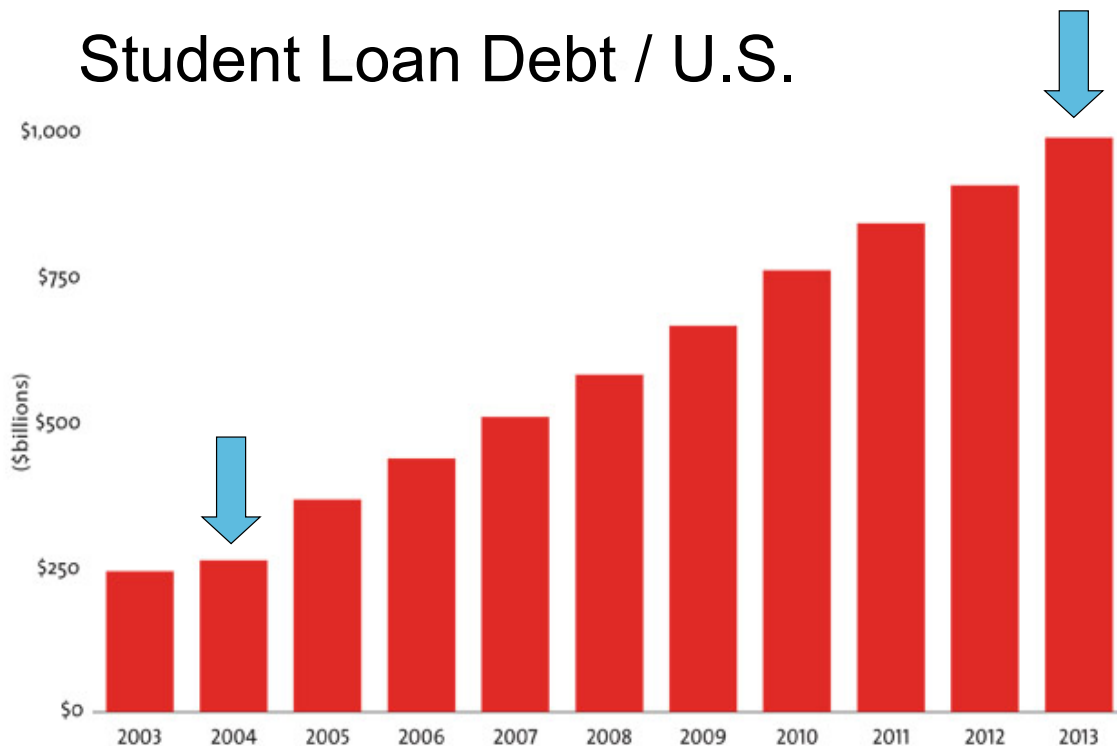




## Why ?

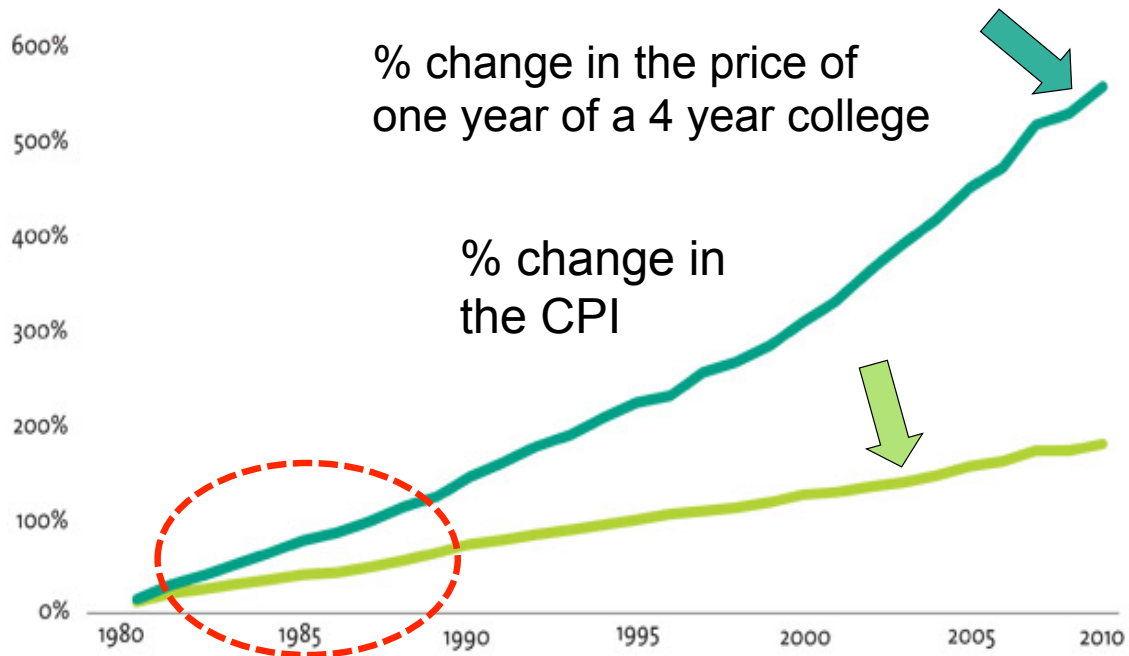
- Jobs have become scarce for 18 to 24 year olds
- Mortgage credit standards tightened and have not loosened up that much, yet . . .
- Student loan debt higher today than ever before
  - **materially impacting FTHB**
  - **\$1.2 trillion today**
  - **more than quadruple the \$250 billion in 2004 !**
  - **interest rates on student loans have doubled**
  - **6 million HHs pay more than \$250/month**

### Student Loan Debt / U.S.

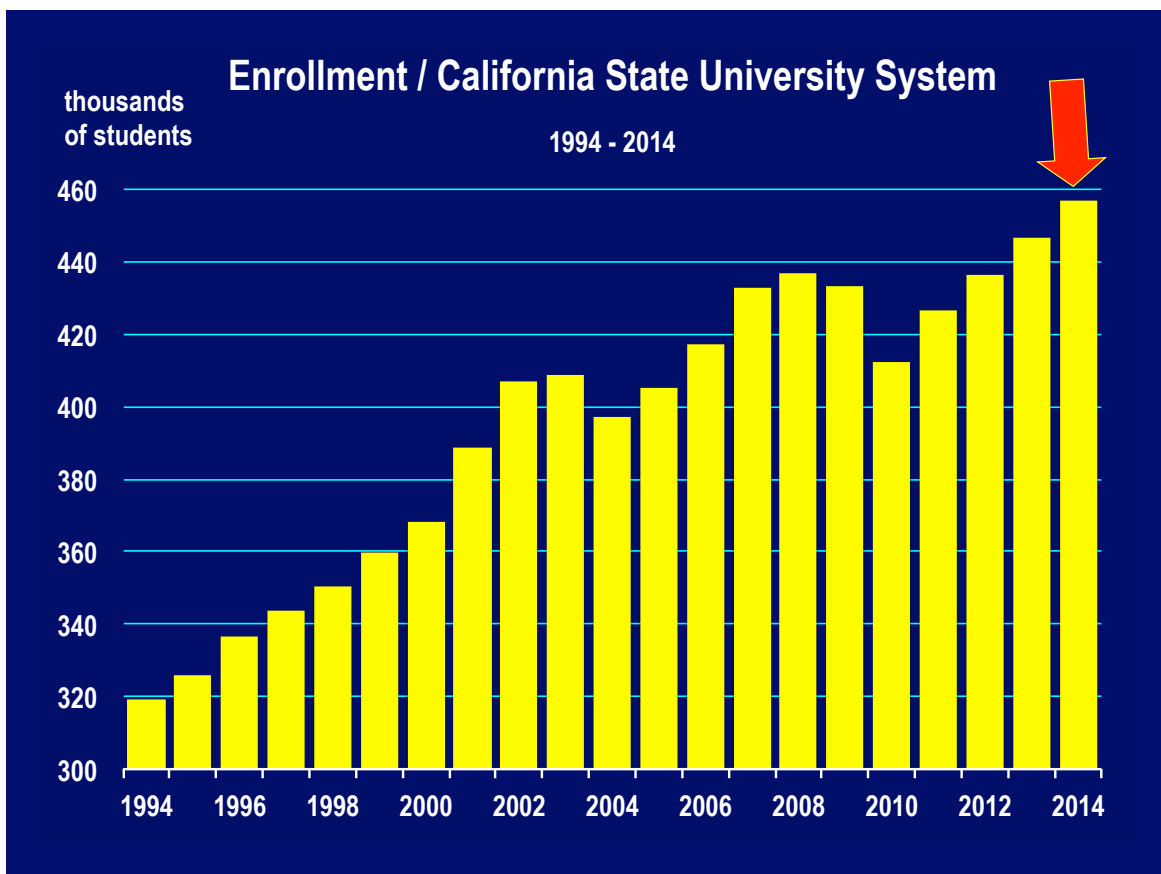


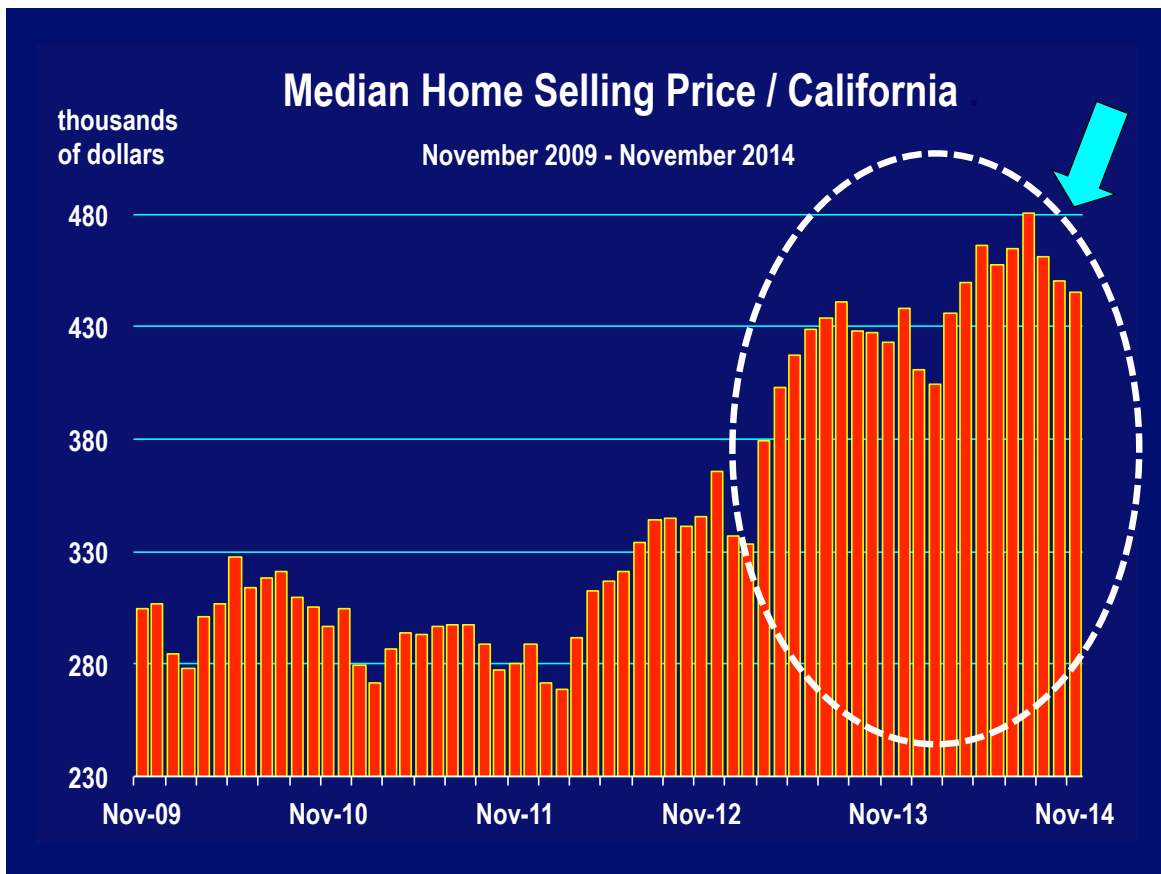
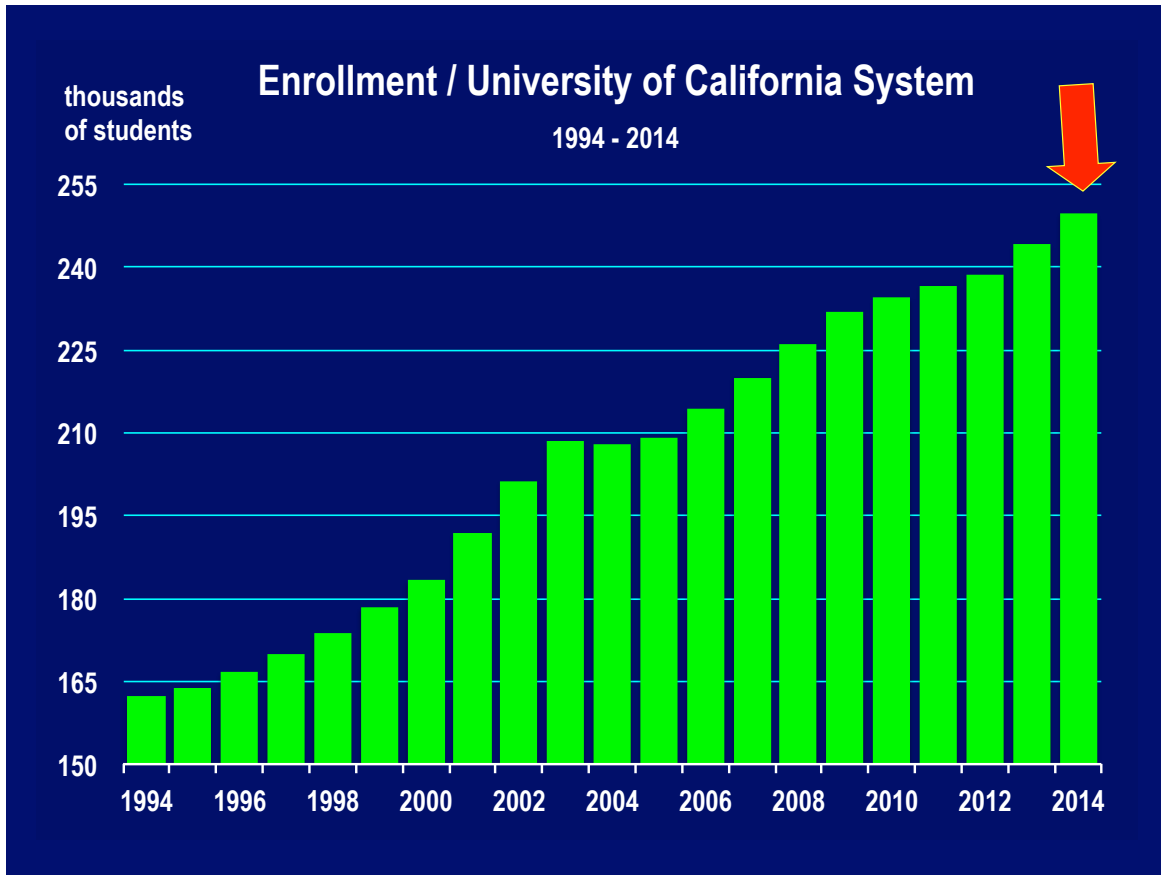
Source: Federal Reserve Bank

# Cost of College vs CPI / U.S



Source: Bureau of Labor Statistics,  
National Center for Education Statistics





# The Problem with Housing

- Not responding like the rest of the economy
- Interest rates are at 214 year lows !
- What's different this time around ?
- Buyers are held back by:
  - Lack of inventory
  - Rising prices
  - Student loan debt
  - *changing preferences from owning to renting*
- Obtaining credit still an ordeal



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## Housing market on track for more improvement this year

By Vicki Needham - 01/07/15 03:04 PM EST

The housing market is expected to continue on its road to recovery this year amid stronger jobs and economic growth as well as increasing home prices.

The **National Association of Realtors** (NAR) said Wednesday those factors should contribute to boosting existing-home sales 7.4 percent this year.

ADVERTISEMENT

From saving the Empire State Building during the Great Depression to standing

Meanwhile, median home prices are expected to rise about 4 percent, while new homes sales are slated to jump 37 percent and rents are likely to increase 4 percent, according to the new forecast.

# Solutions for Housing

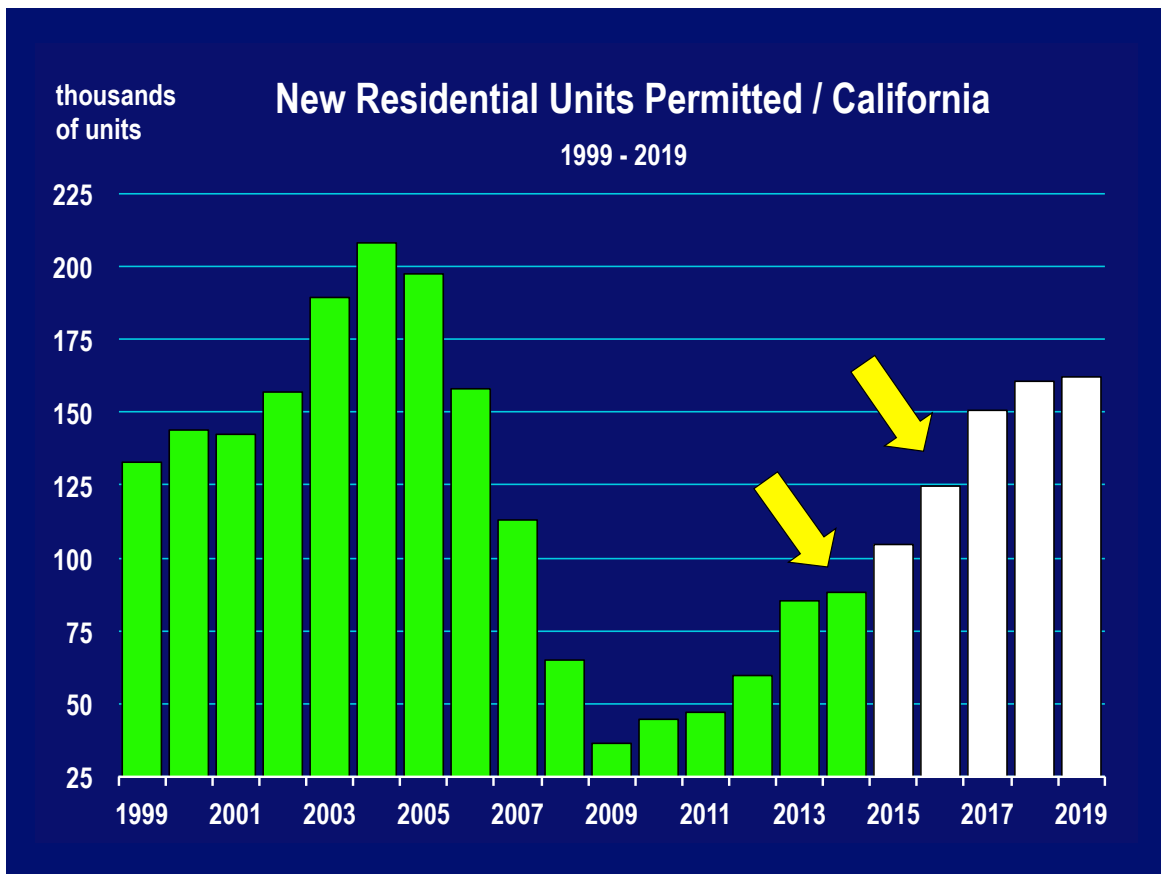
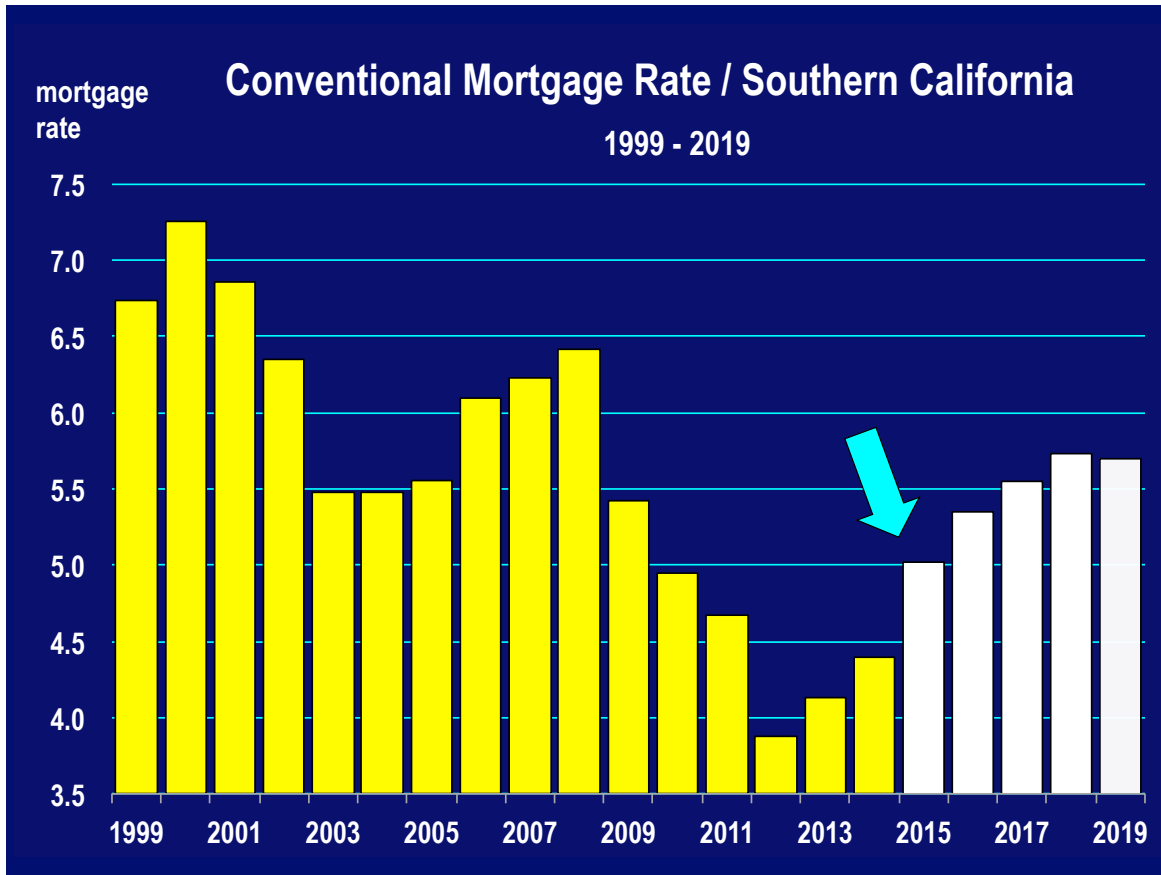
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- lending criteria conditions are set to change materially in 2015
  - Down payments will not be necessary
  - Stated income loans may be back
  - Lower credit scores will be needed
- The economy is reaching full employment with accelerating job creation throughout the U.S. over the last 6 months . . . pushing into 2015
- higher wages and salaries will qualify more potential homeowners

## What to Expect for the Housing Market / next 12 months

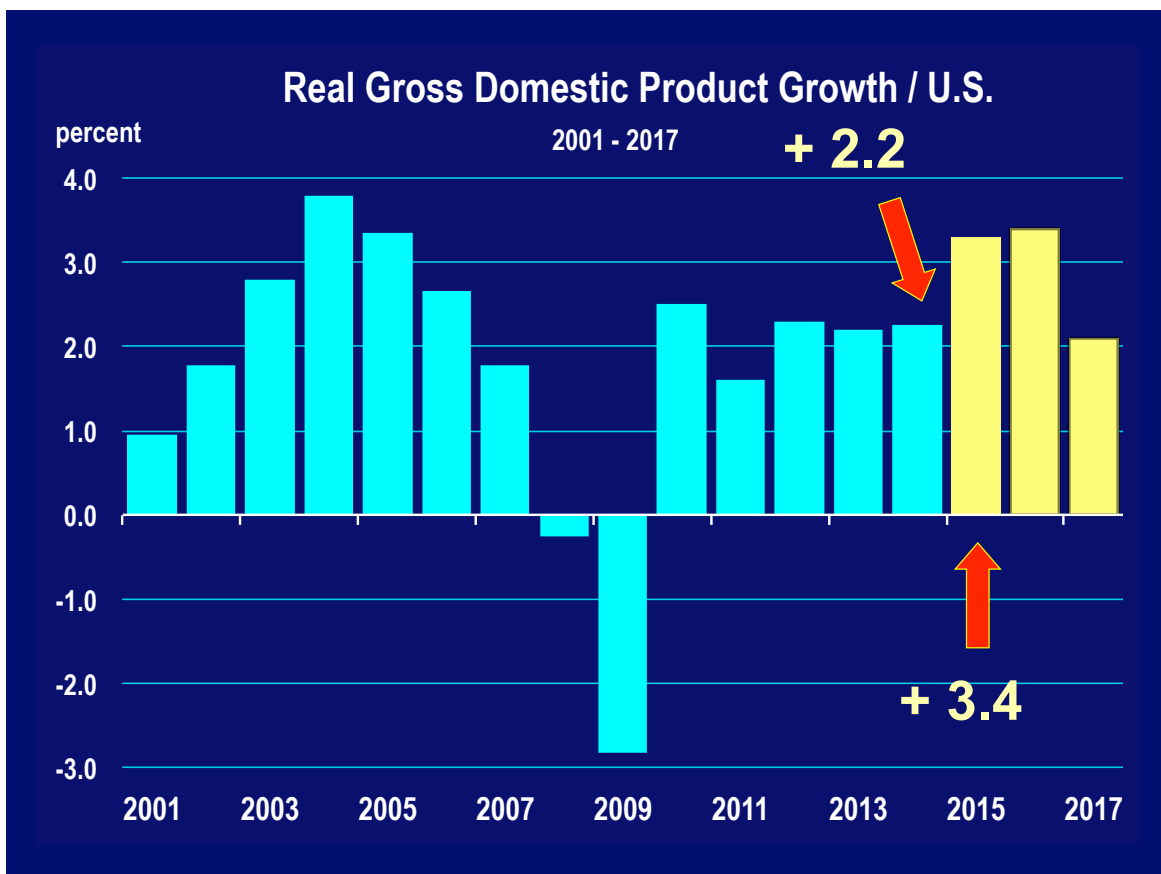
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- Interest rates should move gradually higher
- However, the expansion continues;  
2015 may be the best year of the cycle
- Housing demand should strengthen  
and inventory will increase
- What's a likely scenario for interest rates  
over the next year or two ?



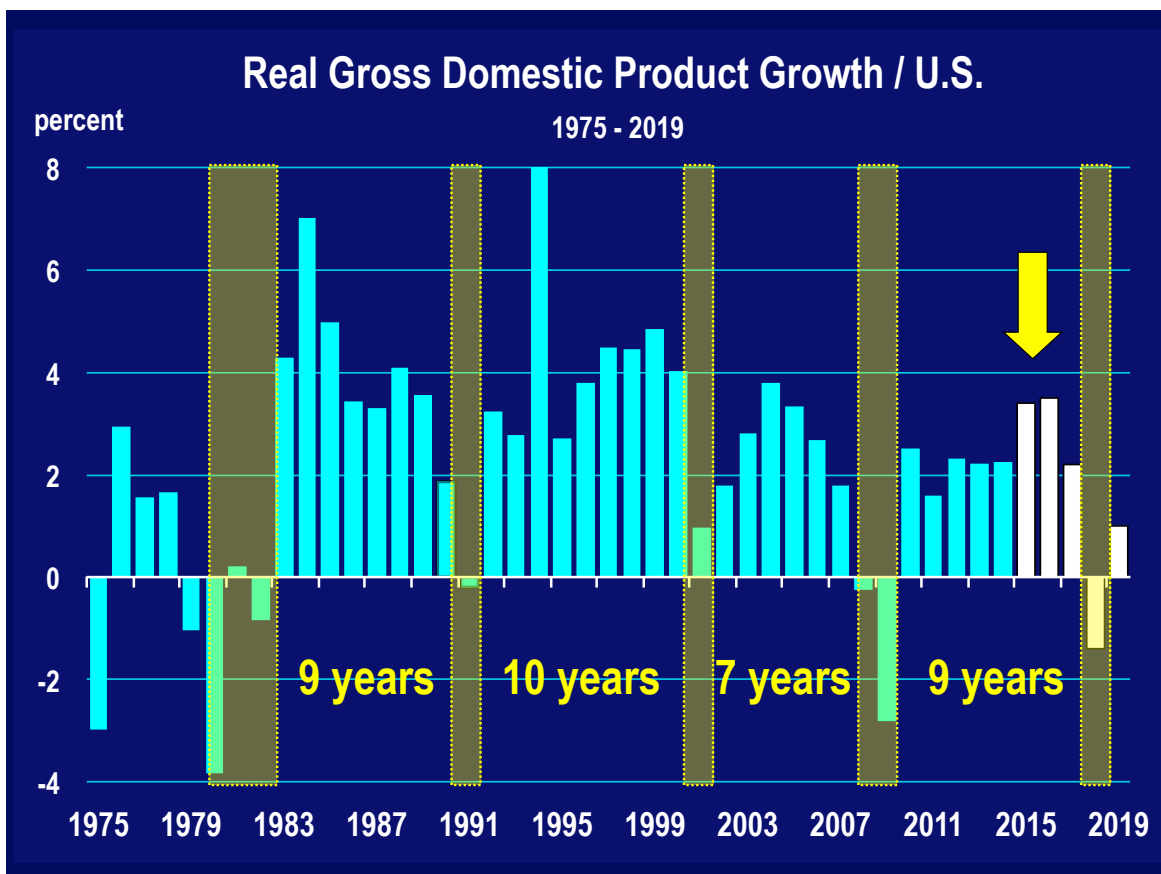
# U.S. Economic Summary

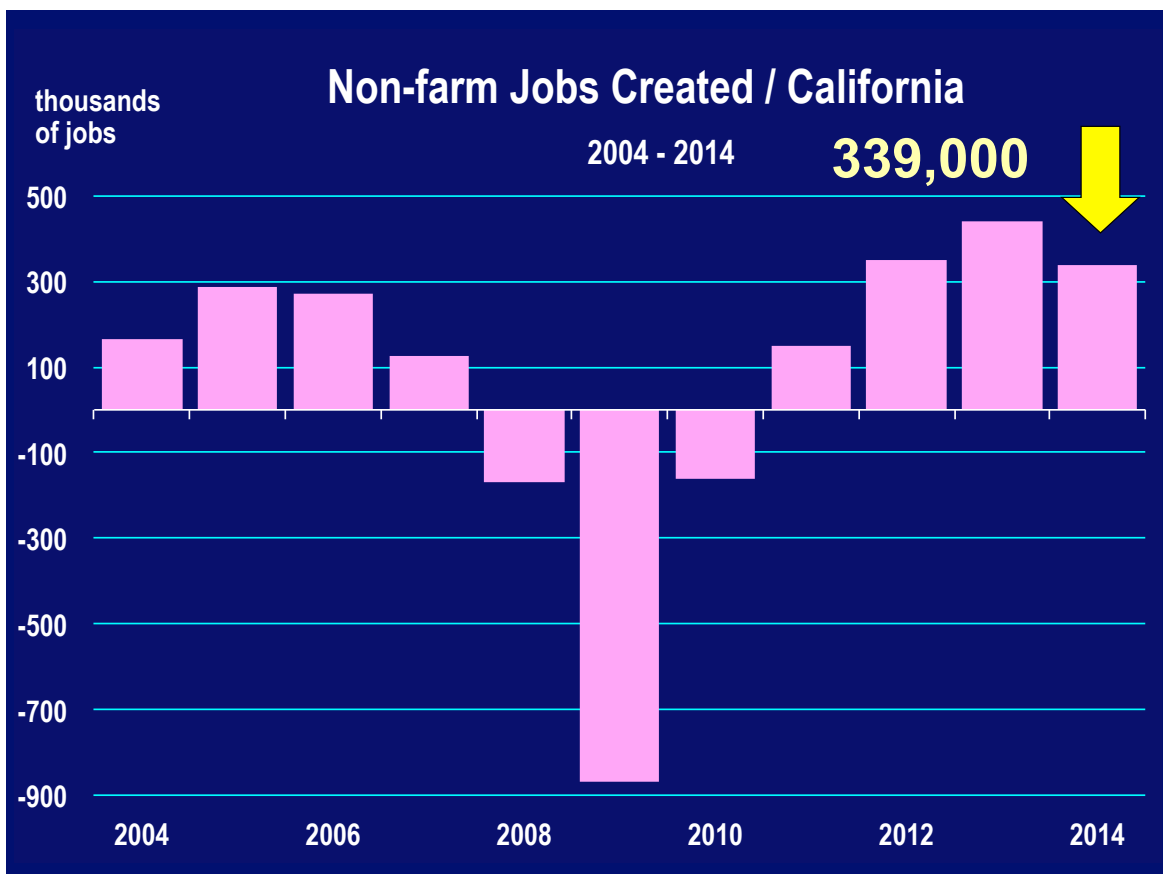
- The recovery is over. We are now experiencing the expansion phase of the business cycle
- unemployment rates are falling, and moving toward full employment by the end of 2015
- Most economic indicators are rising at rates consistent with a healthy economy
- The only laggard sector is housing
- Keep in mind that we are 5+ years on the plus side of the economic cycle . . . .



# When is the Next Recession ?

- Well . . . .  
It's too far away to predict with any confidence
- But statistically, it would occur in 2018

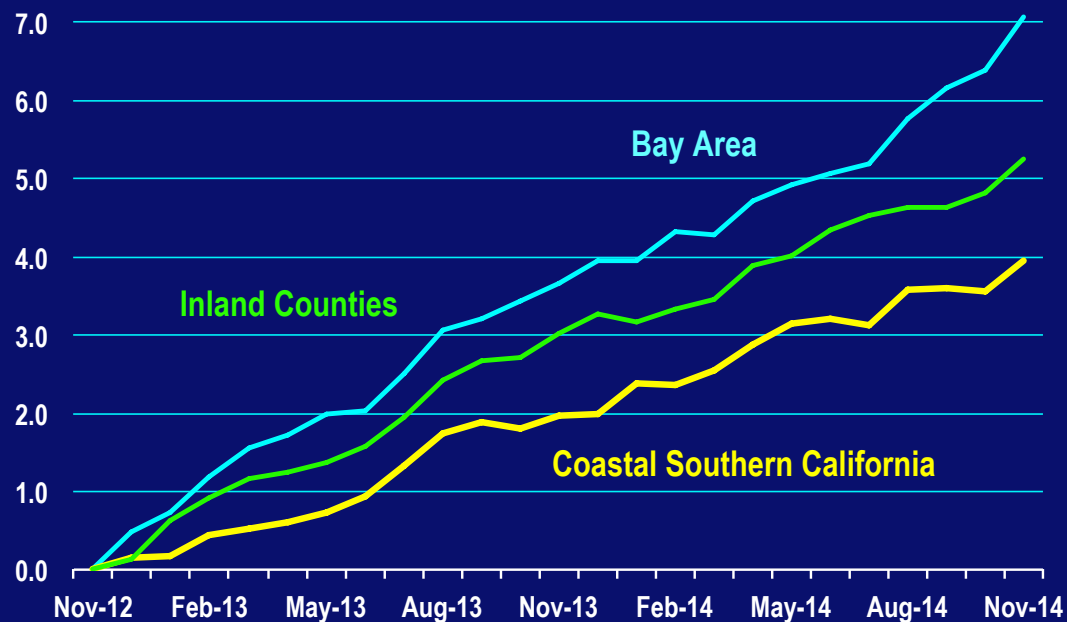




percent change  
in non-farm  
employment

## Cumulative Job Growth by Region

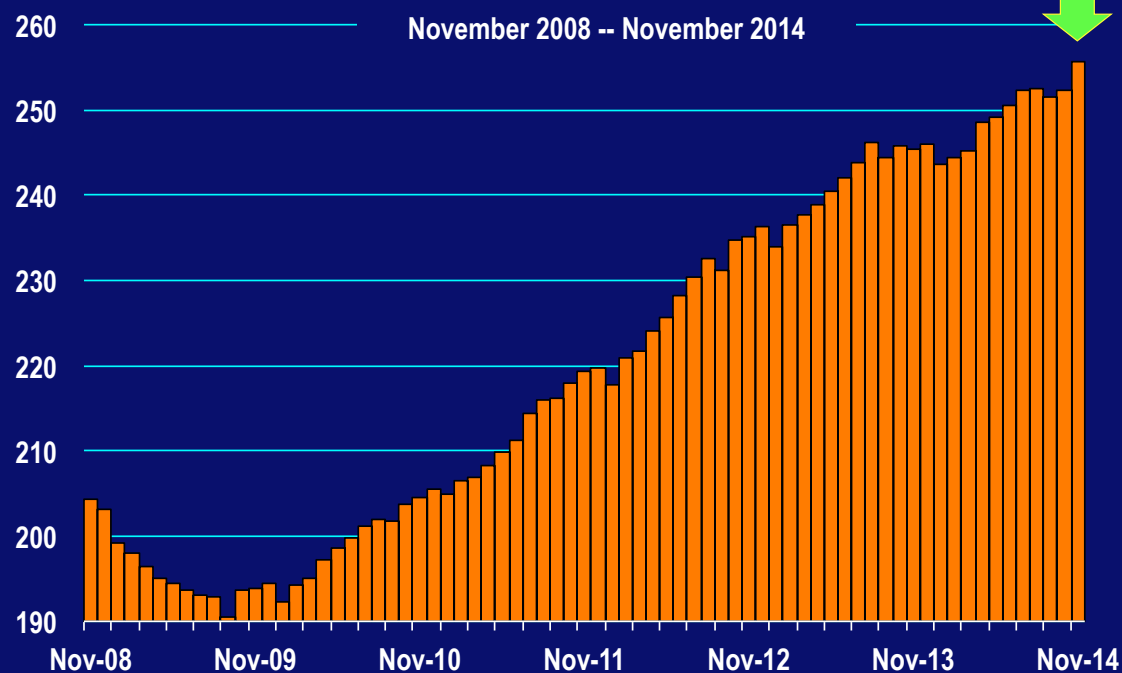
November 2012 - November 2014

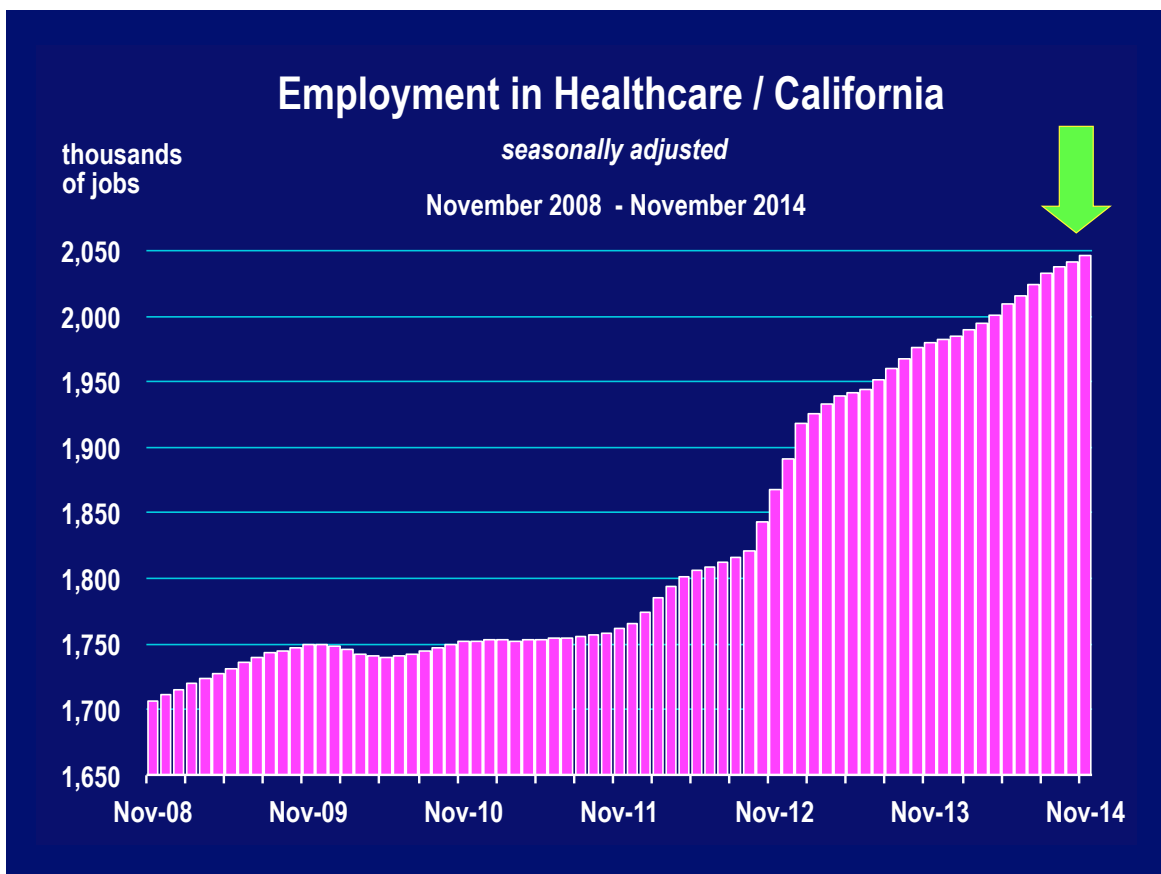
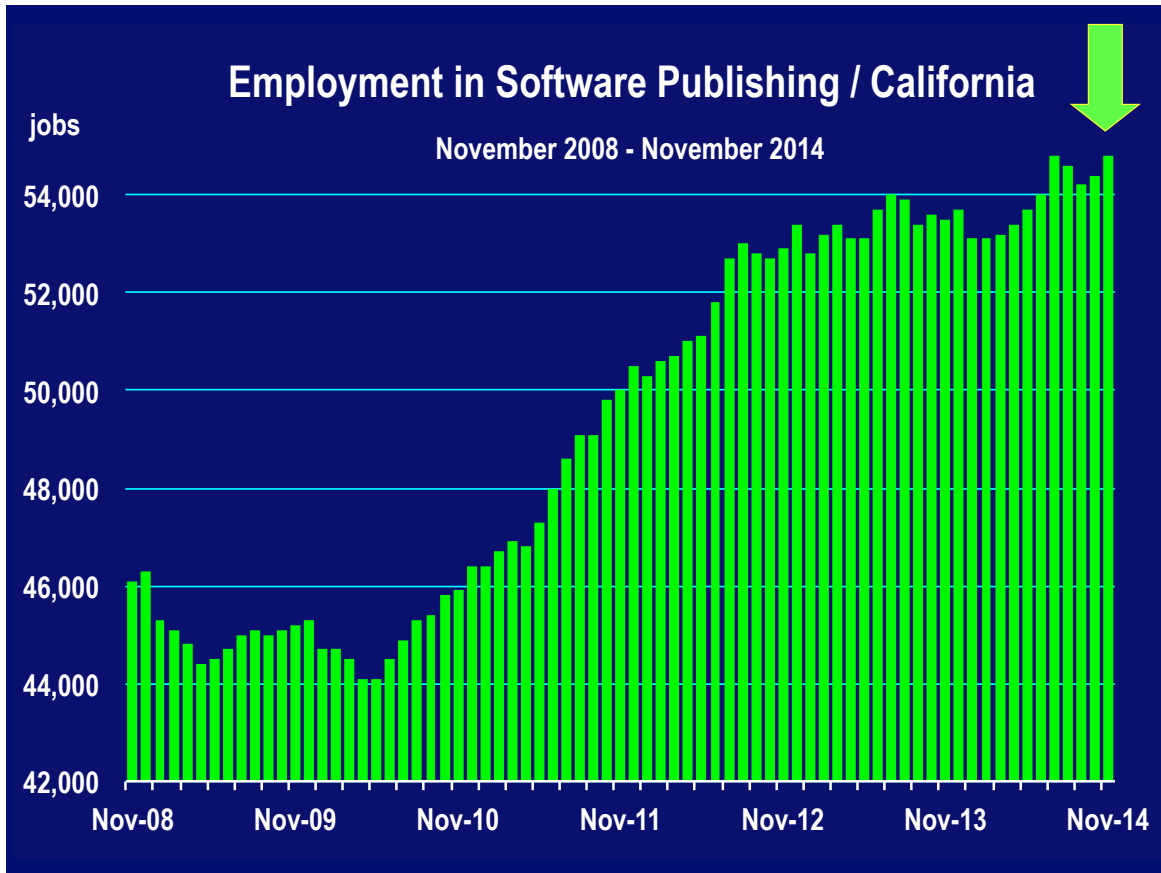


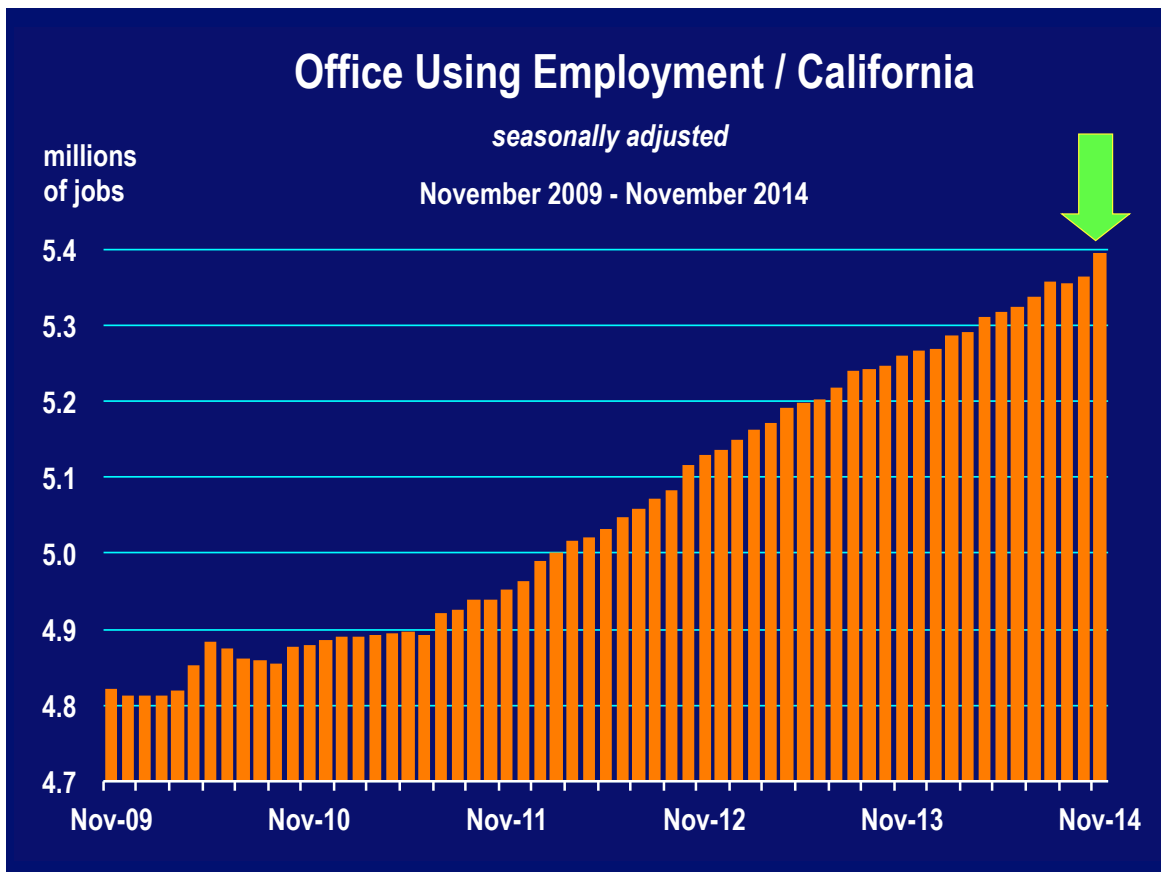
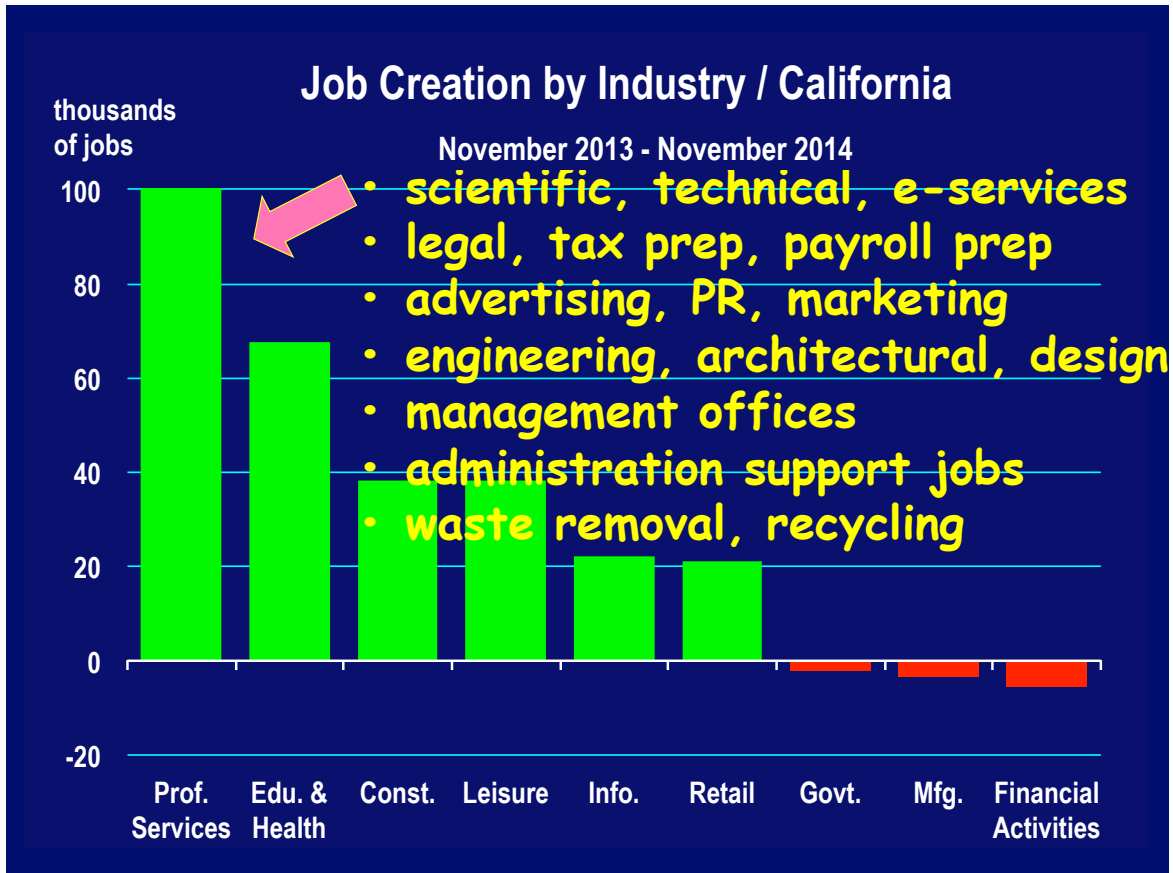
## Employment in Computer Systems Design California

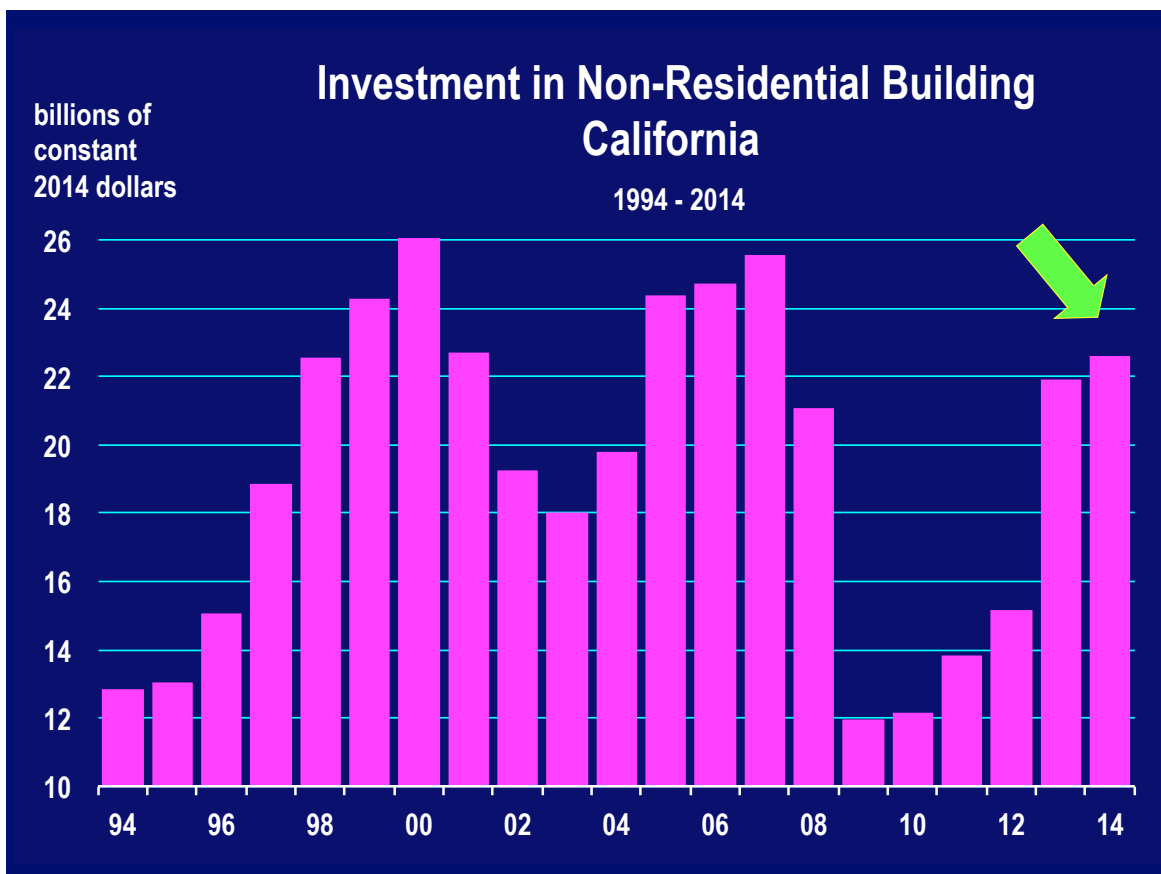
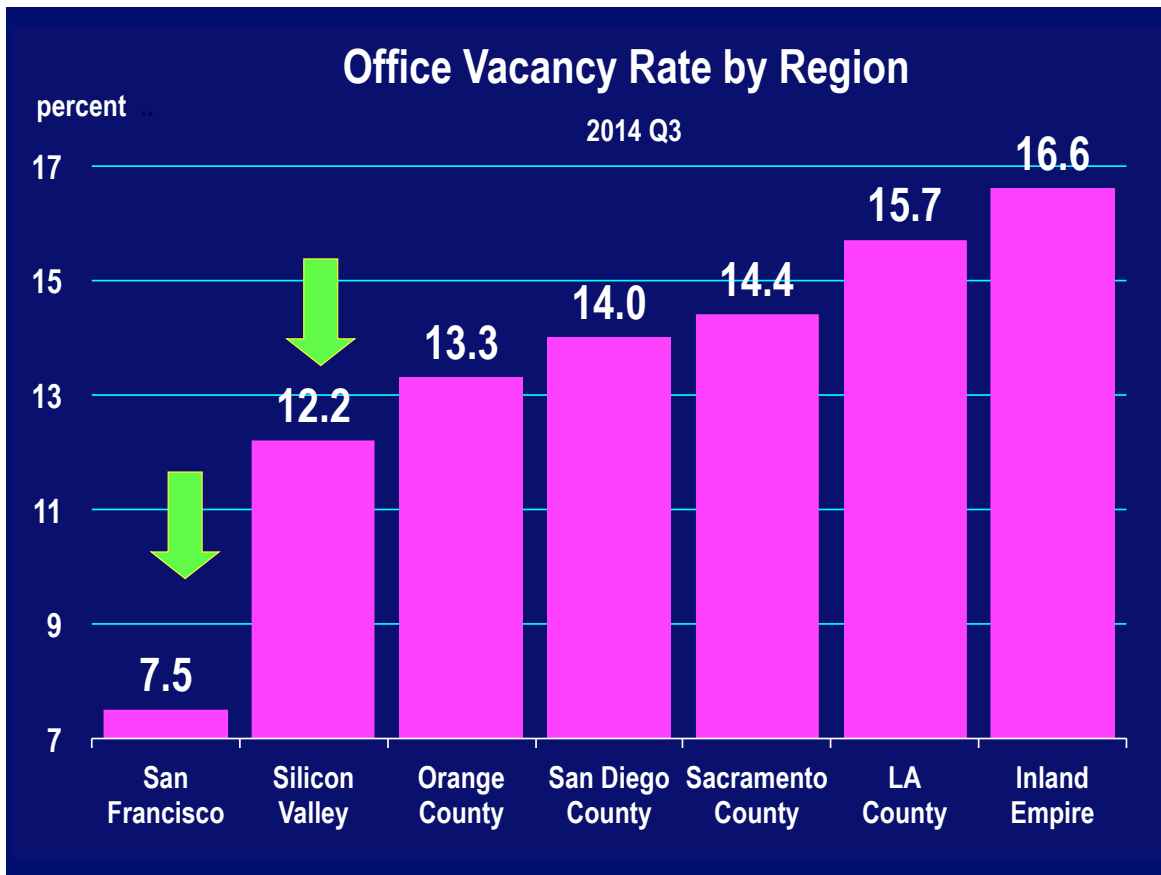
thousands  
of jobs

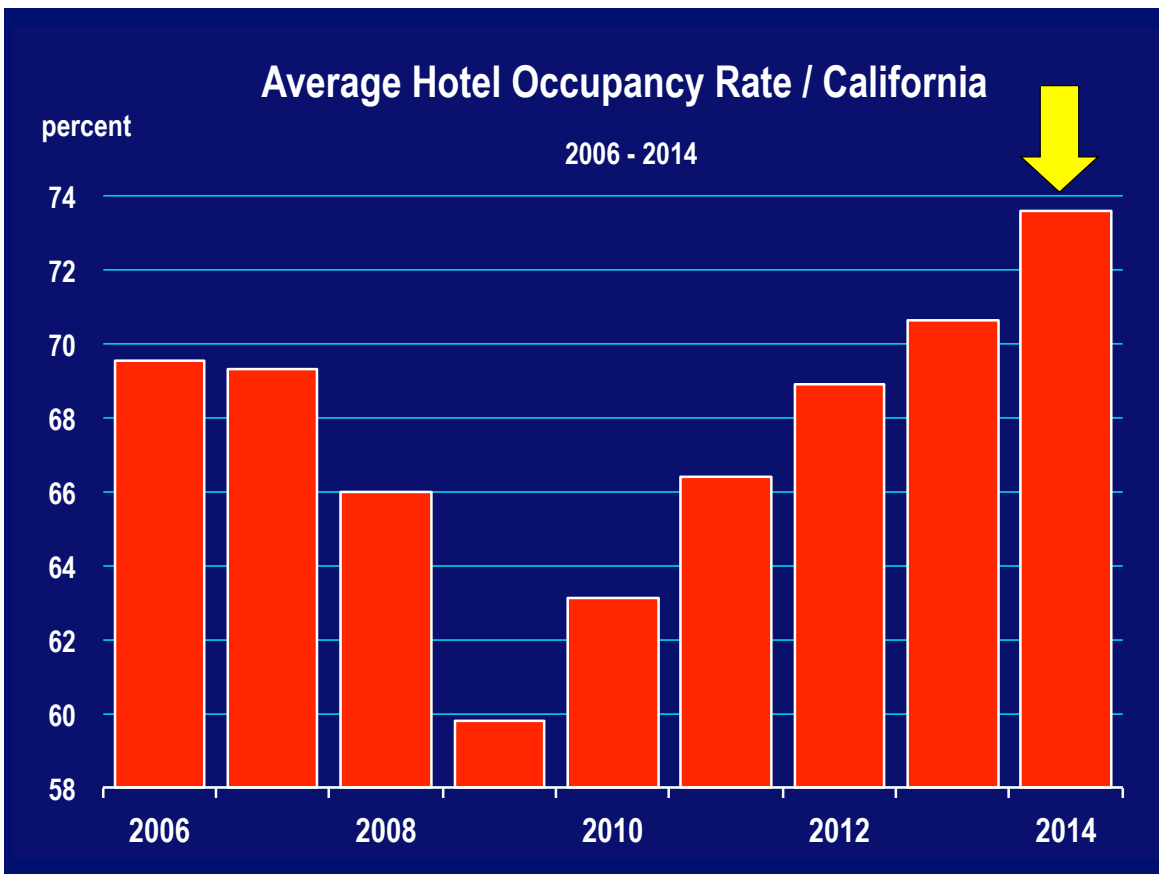
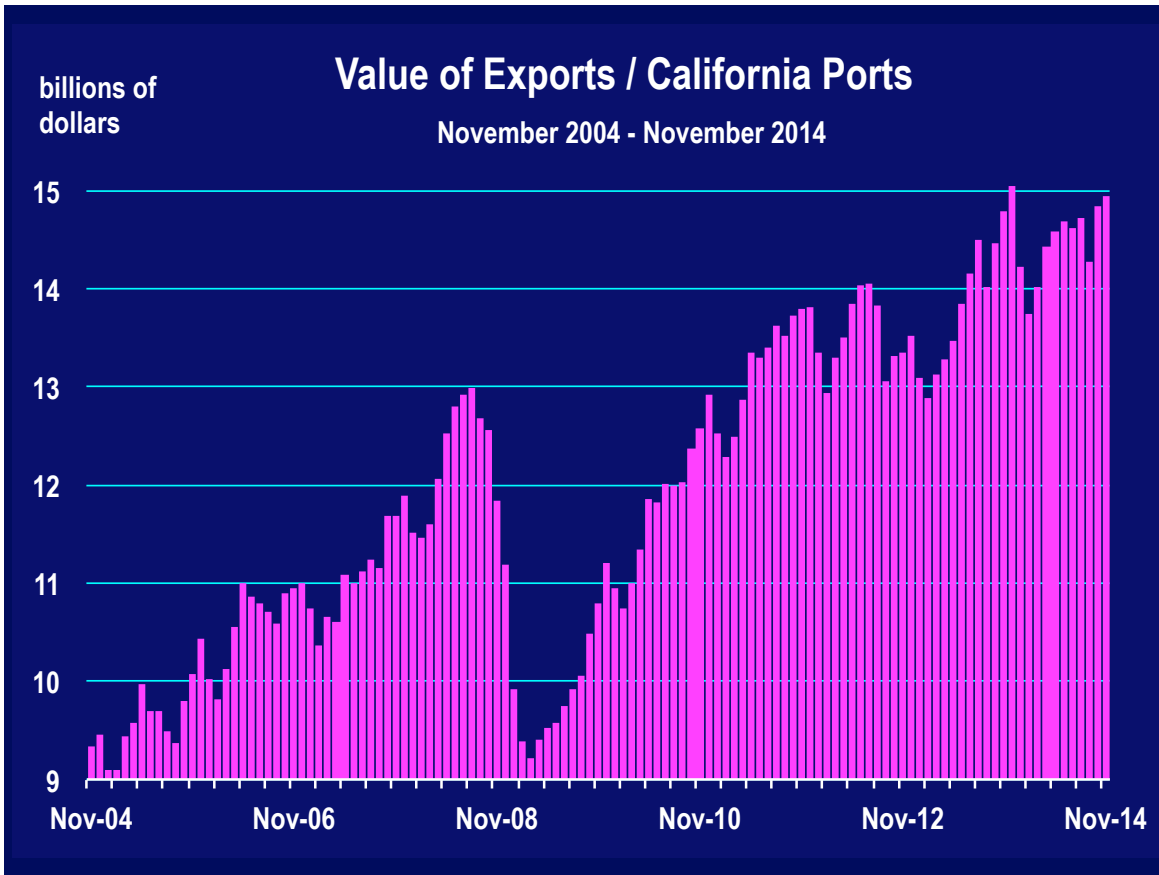
November 2008 -- November 2014





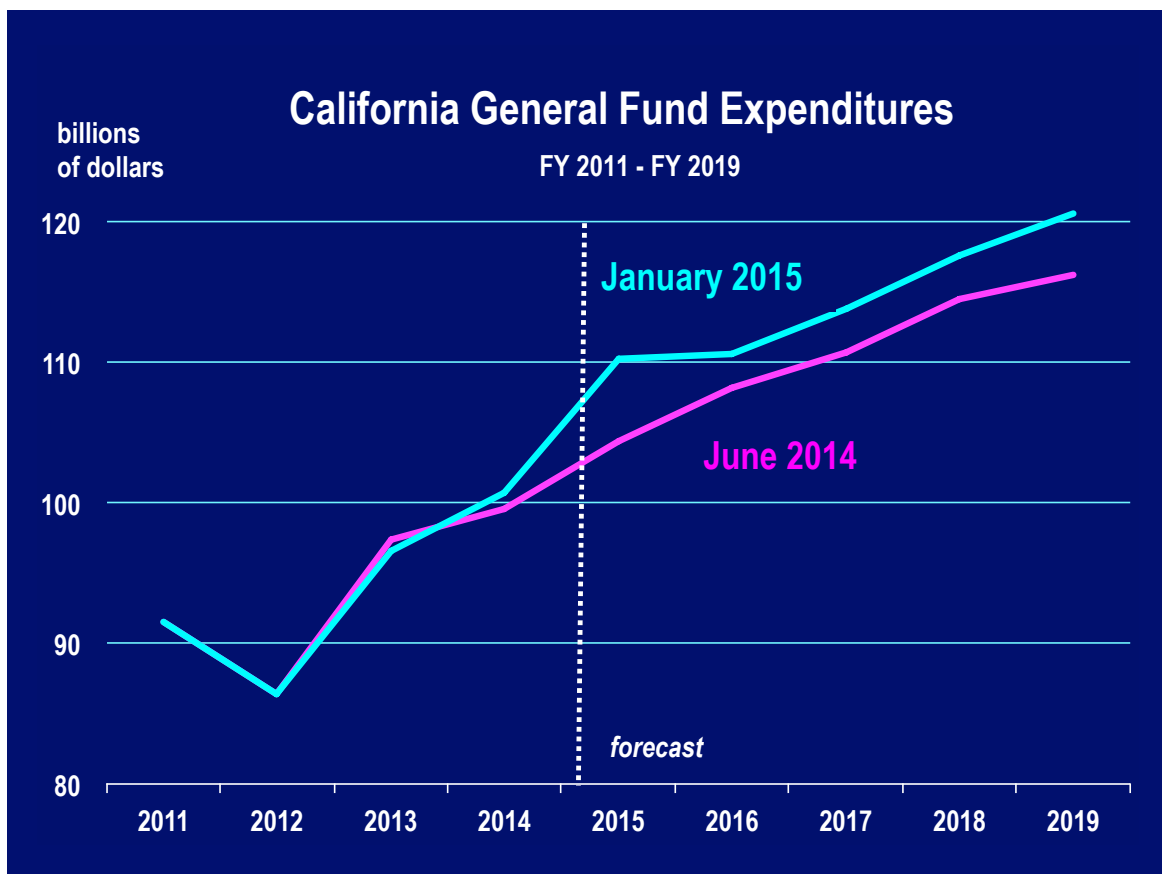


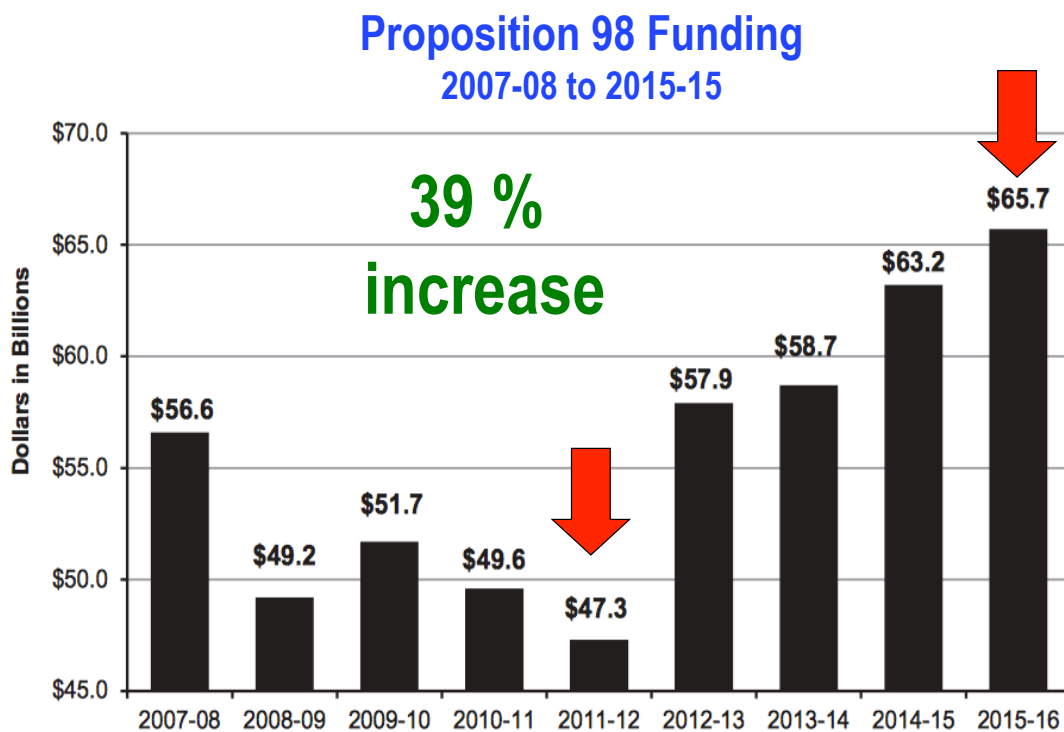
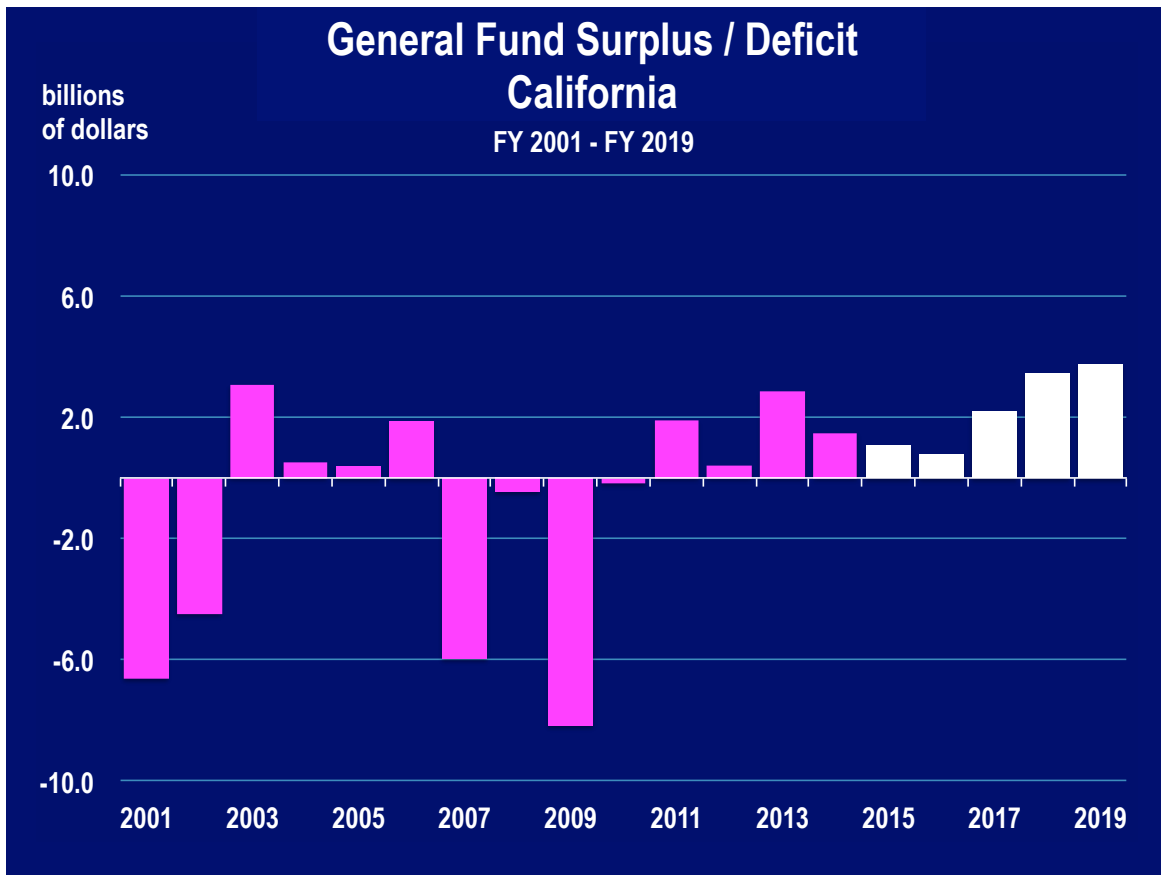




# California Budget

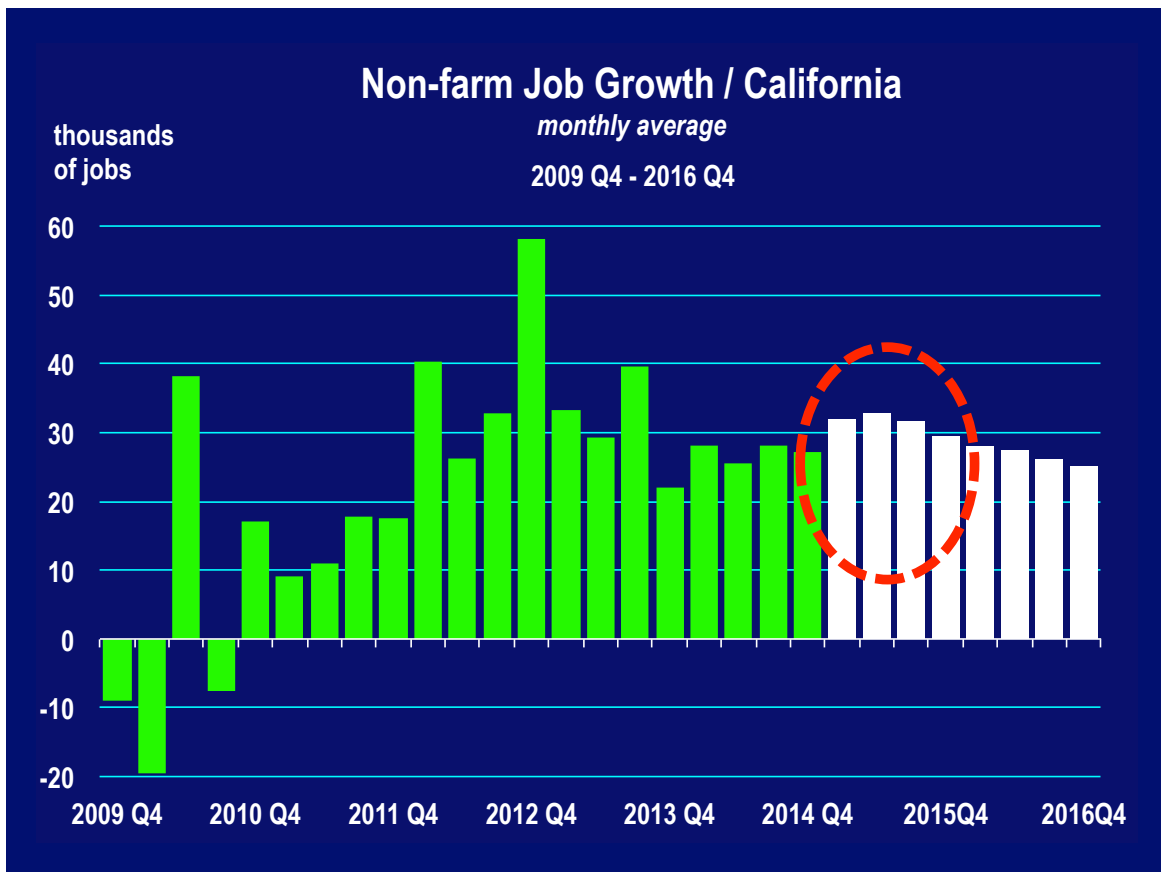
- A strengthening state economy is continuing to push revenues higher
- Under Prop 98, most of those revenues are dedicated to K-12 schools and community colleges
- the 2015-16 year is the last full year for Prop 30 revenues
  - the sales tax rate of 1/4 % expires at end of 2016
- Budget appears sound through 2016, but all bets are off thereafter
  - Prop 30 sunsets at the end of 2018
  - recession probability looms. . . .



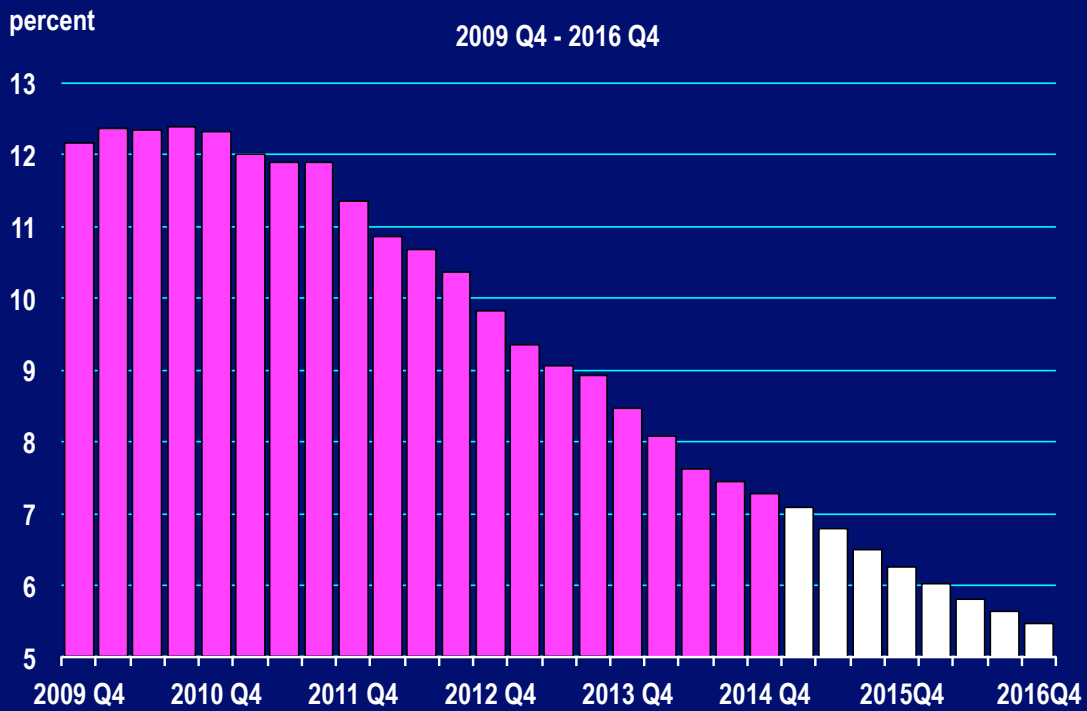


2015-16 Governor's Budget / January 9, 2015

# The 2015 Forecast



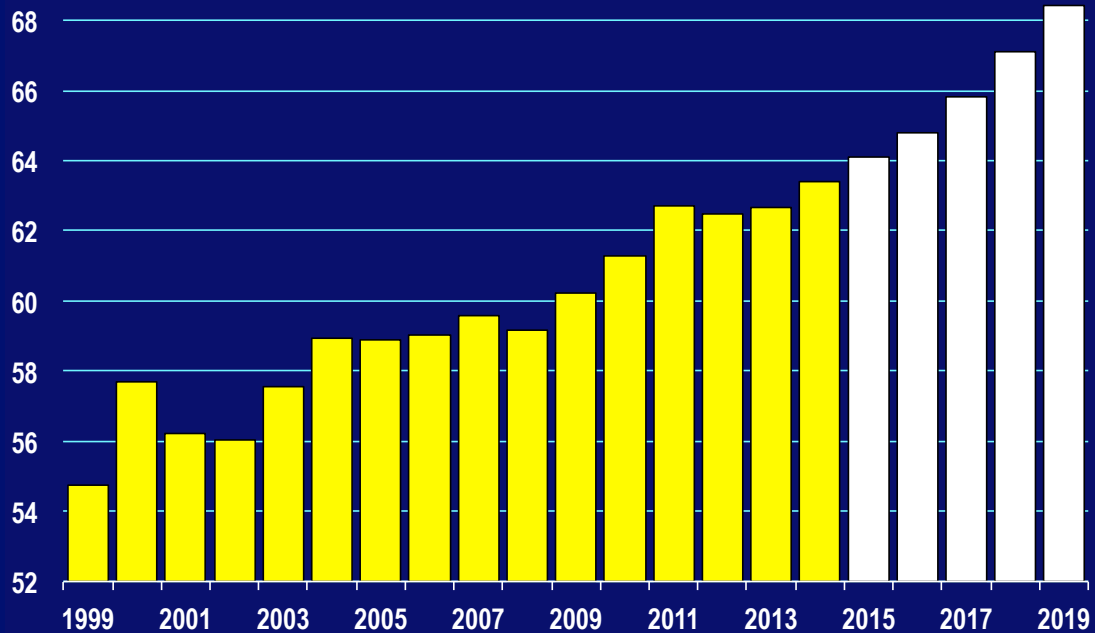
## Unemployment Rate / California



## Real Average Salary per Worker / California

thousands of  
2014 dollars  
per person

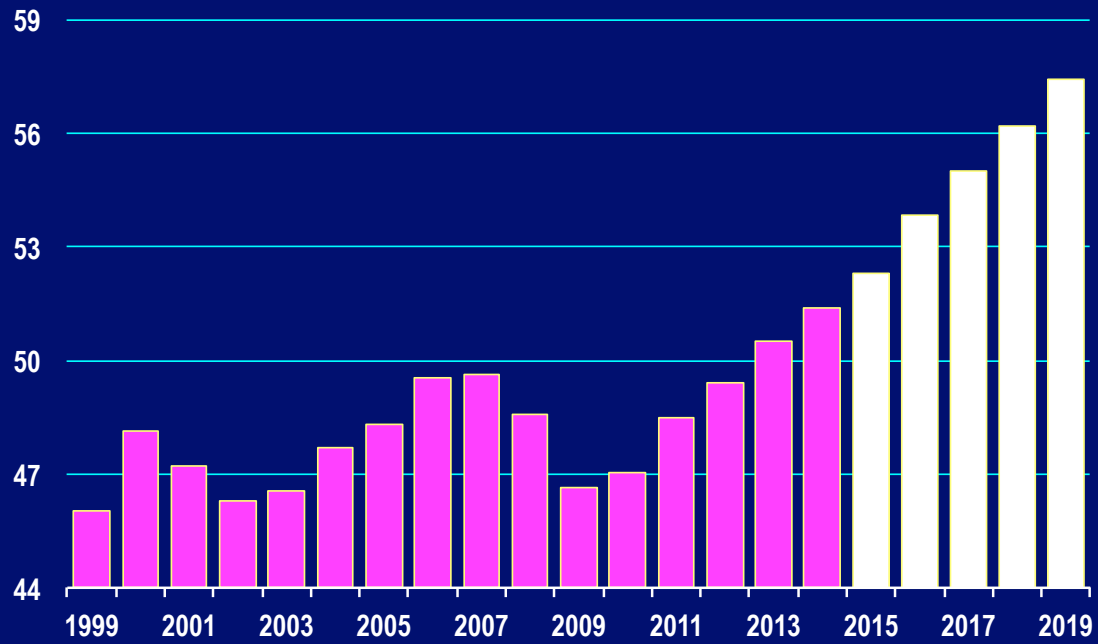
1999- 2019



thousands of  
2014 dollars

## Real Per Capita Personal Income / California

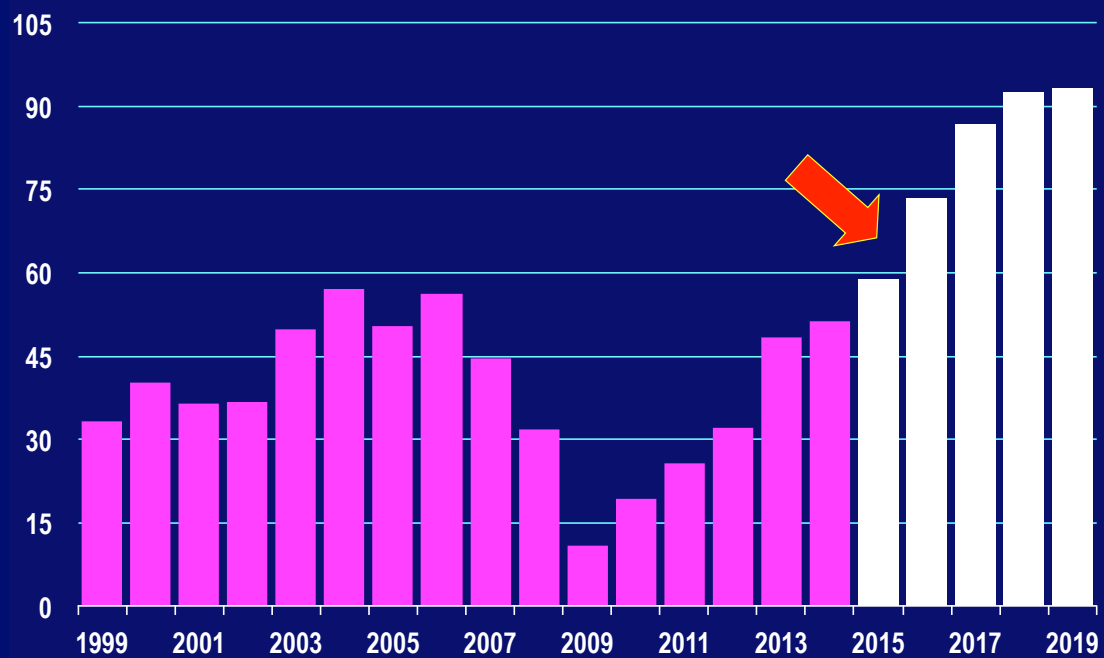
1999 - 2019

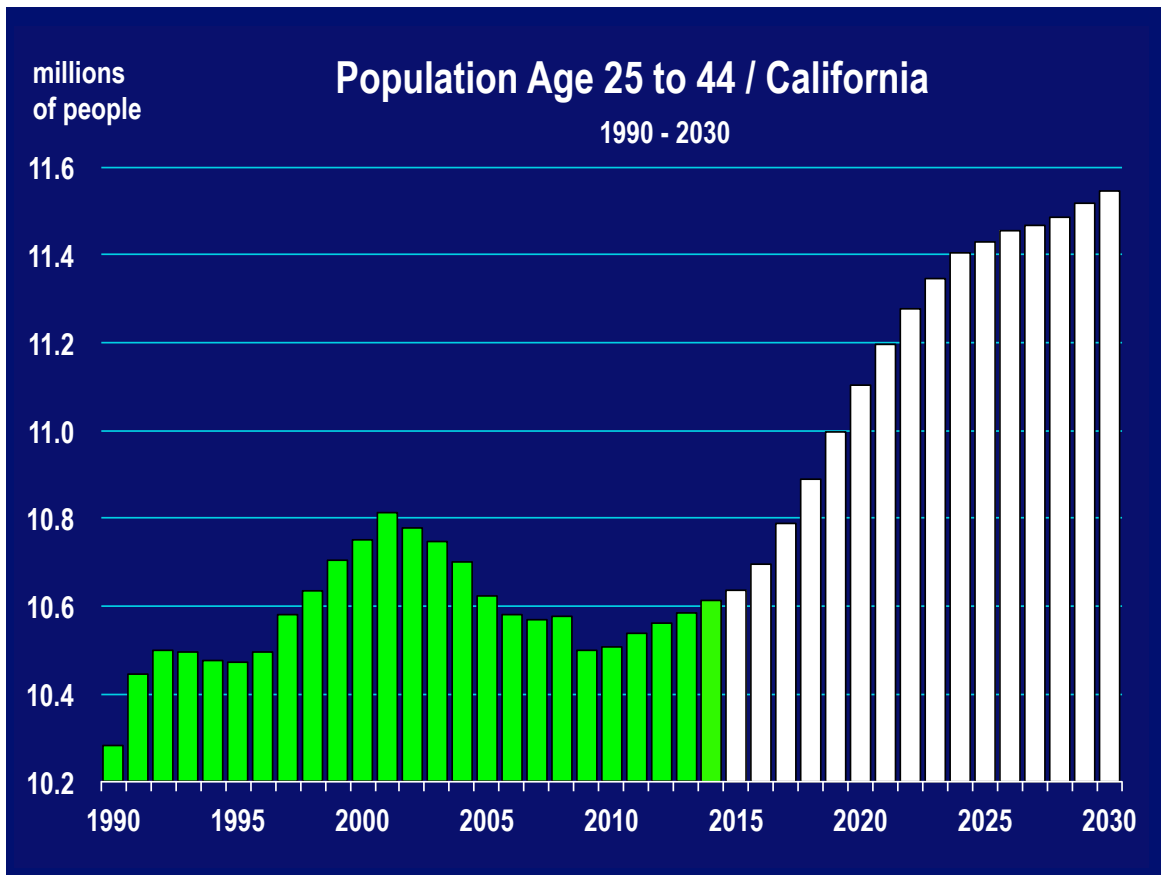


thousands  
of units

## New Multi-family Units / California

1999 - 2019





The outlook generally appears clear



## What you can expect in 2015-2016

- Another 2 years of economic expansion
- Perhaps the best years of the cycle
- No recession in sight
- More hiring, especially of skilled workers
- Rising salaries for skilled workers
- Plan that trip to France, now
- A clear outlook

Economic Outlook 2015

The Nation and California

**Thank you**