California Economic Forecast

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RECENT ECONOMIC MOMENTUM POINTS TOWARD BRIGHTER 2012

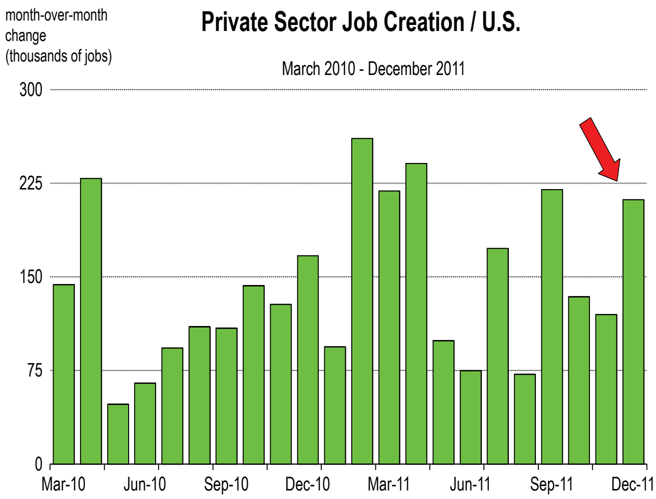
by Mark Schniepp

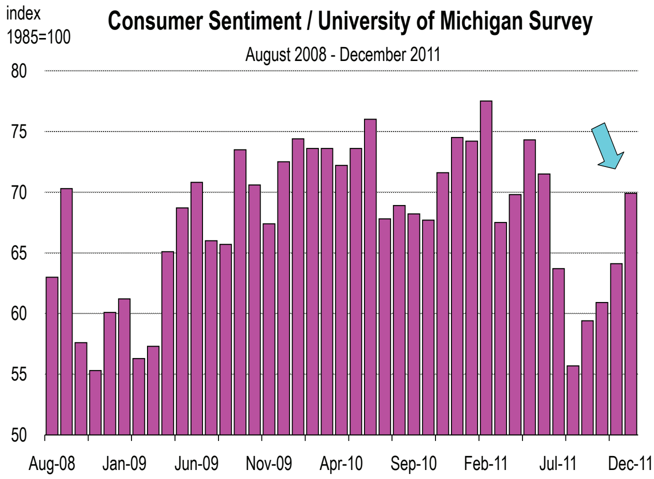
Recent evidence points to the possibility of an accelerating recovery which would upwardly revise our forecast for economic growth in 2012. Though we reported this same behavior of the economy in January 2011 when momentum was clearly building, there is more broad based participation among the economic indicators this year, including consumer sentiment. This leads us to believe the recovery has become more durable.

Job Creation is Finally Coming Around

The best news on the economy is the rise in employment. The 200,000 increase in jobs in December was better than expected and the largest since September. The unemployment rate fell to 8.5 percent, the lowest level in nearly 2 years. The U.S. economy created 1.6 million jobs in 2011, an improvement from just less than a million jobs created in 2010.

The major retail chains were up 3.4 percent in December, and Holiday spending in November and December was up between 4 and 5 percent according to early industry reports. The auto sector is coming back, and sales during 2011 were at their highest level since the first half of 2008.

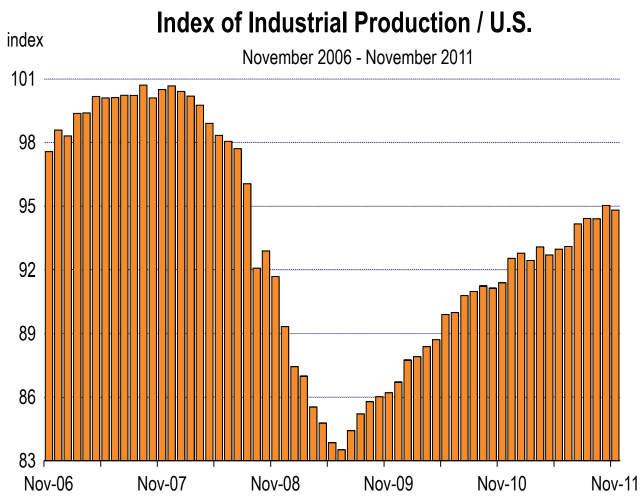




Consumer sentiment has clearly improved since October. It began 2011 by rising to a multi-year high, but fears about a number of economic problems that arose during the first half of the year caused sentiment to tumble during the spring and summer. The better than expected retail spending reports in November and December validate the more optimistic psychology of consumers.

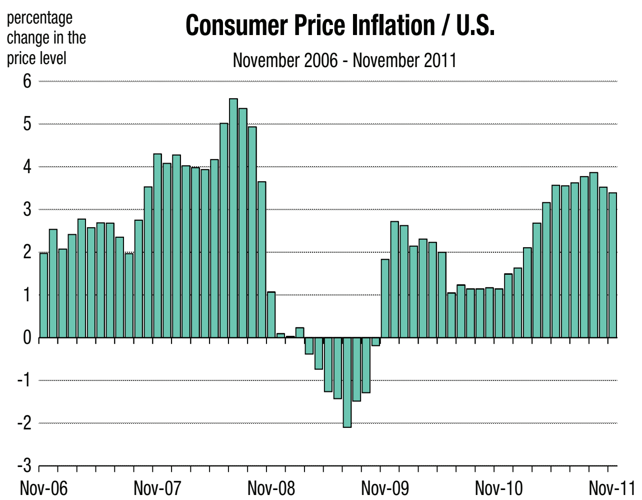
Other Indicators

- New jobless claims for unemployment insurance are falling sharply.
- Construction spending was up again in November, adding to a string of positive reports over the last few months of 2011.
- November industrial production unexpectedly fell, but the December report will be positive because manufacturing output and employment were solidly higher in December.
- Expansions in manufacturing are being reported by many regions of the country, including California. The Chapman University index of manufacturing for Orange County shows continued expansion of output there.



- The Dow rose 5.5 percent in 2011. The S&P 500 index was perfectly flat, with no net gain for the year. The Nasdaq composite was off 1.8 percent, but it has rallied sharply during the first week of January.

- Inflation is under control. The headline rate in November was slightly negative (meaning that the general price level declined between October and November). The annualized rate for the first 11 months of 2011 is 3.2 percent. Excluding food and the volatile energy sector (that includes gasoline), the core inflation rate is running at 1.8 percent. If Iran backs off of its current threats to block the Straight of Hormuz, oil prices will decidedly fall and that will put downward pressure on the inflation rate.



Housing

Still dragged down by foreclosures, falling home prices and virtually no new construction, the housing market remains stagnant in many regions of the country. In California, home sales were about even with 2010, and distress has clearly declined, but the shadow inventory of foreclosures remains troublesome, leaving housing unlikely to contribute much to economic growth in 2012.

The housing slump is nearly over. Housing construction has moved higher for apartment buildings throughout the country including California. Housing will become a clear source of growth in 2013.

Housing will show some improvement in 2012 because particular fundamentals will help to move this sector forward. To date, the high rates of 2009 and 2010 vacancy of homes have been reduced through absorption. Mortgage rates are the lowest on record and credit conditions are slowly improving. However, the best predictor of the housing market is the labor market. And with employment finally picking up, an improved housing market will follow.

Employment Now and Prospects Going Forward

Private sector job growth was up 212,000 in December. Job growth was broad based across nearly all sectors, and notably, manufacturing jobs were up by 23,000. For all of 2011, the private sector created 1.9 million jobs in the nation.

If this can be maintained, the rate of unemployment will continue to contract in 2012, and falling unemployment will bolster confidence in the economy and the sustainability of the recovery.

Businesses have curtailed their layoffs. Over the last few months, businesses are now hiring again. Provided they don't lose confidence in the economy or in the federal government this year, the private sector is forecast to create between 2.1 and 2.2 million jobs in 2012. That's an average of 175,000 to 200,000 new jobs per month.

For California, the forecast adds 215,000 new jobs in 2012, or about 18,000 per month.

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