AVENU
INSIGHTS & ANALYTICS

Economic Outlook

January 2021

Avenu in partnership with the UCLA Anderson Forecast collaborates to provide both micro and macro level views of the economic health of California at the state and local levels. The following economic information has been provided by our colleagues at UCLA Anderson Forecast.

UCLAAnderson
FORECAST

Please mark your calendars for our next quarterly joint economic presentation which will take place on **February 23rd at 9:00 AM Pacific.** Meeting invitations will go out the first week of February.

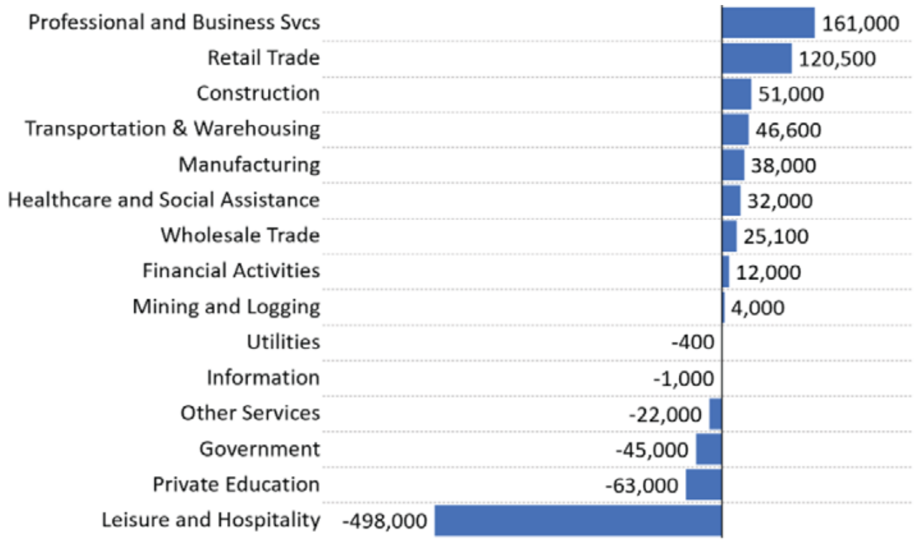
Economic Update:

More fiscal aid and the release of pent-up demand following mass vaccinations promise a bright future by mid-2021. But the current situation is increasingly grim.

After the COVID-19 pandemic reached the U.S., the Anderson Forecast's March report was followed by two downward revisions, and the June and September releases charted the pandemic's impact on the California and national economies. The December forecast offers hope of a robust recovery from the current recession, based on the assumption that mass vaccinations would clear a path toward a new, productive normalcy for many industries. However, that good news is tempered by predictions of a rough winter, as economic growth remains stalled by measures intended to prevent rising spread of virus cases until vaccines become widely available.

- The UCLA Anderson Forecast is projecting 3.9% real GDP growth in 2021, with upside risk now that Democrats will control the Presidency and both houses of Congress. Depending on size and extent, additional fiscal relief and a potential infrastructure package could push growth above 4% this year, as well as raise growth in 2022.
- The current situation, however, is increasingly grim. The Jobs Report for December shows a decline of 140,000 jobs (nonfarm payroll employment), with losses concentrated in leisure and hospitality, private education, and government. Gains occurred in professional and business services, retail trade, construction, transportation and warehousing, and manufacturing. (See Exhibits 1 and 2).
- There is little indication that core PCE inflation will increase and remain above the Fed's target of 2% any time soon. We don't foresee an increase in the Fed Funds Rate until at least mid-2023. An earlier increase would suggest a faster and more robust recovery.
- There are two downside risks to our forecast. The first is political instability. The second is additional virus mutations. Either could significantly set back the recovery.

Exhibit 1. Change in Net Jobs by Sector, December 2020



Source: U.S. Bureau of Labor Statistics, Employment Situation Report, January 8, 2021

Exhibit 2. U.S. Nonfarm Payroll Employment since 2018

Source: U.S. Bureau of Labor Statistics and St. Louis FRED

The National Forecast

A year ago, the idea that recovery from a national recession would depend on mass vaccinations ending a pandemic was not on most economists' minds. But that's the scenario today, as the nation considers how to inoculate the population against COVID-19. The reopening of the economy is directly related to the population's ability to safely return to work.

UCLA Anderson Forecast report senior economist Leo Feler, anticipates two more quarters of slow growth — seasonally adjusted annual rates of 1.2% for the fourth quarter of 2020 and 1.8% for the first quarter of 2021 — before robust growth of 6% in the second quarter of 2021. After that, growth rates should remain above 3.0% well into 2023. "We expect the economy will reach its previous peak by the end of 2021," Feler writes.

Feler emphasizes that the outlook does not fully reflect the economic misery that so many are experiencing. Currently, 20.5 million Americans are receiving some form of unemployment insurance benefit. Nearly 9% of U.S. residents live in households that are behind on their rent or mortgage payments, 12% live in households where there is not enough food to eat and 34% live in households where it has been difficult to pay for typical household expenses.

But a vaccine would help release pent-up consumer demand over the next year, leading to a strong recovery. The forecast anticipates that a surge in services consumption and continued strength in housing markets will propel the economy forward. Feler expects the housing market to remain hot through at least 2023, with housing starts already at their highest levels since 2007.

Even with a strong recovery beginning in the second quarter of next year, Feler expects only modest core inflation, around 2.1% to 2.2% per year. In addition, the unemployment rate is expected to improve only gradually, remaining above 5% through 2021 before falling to 4% by 2023. And as the economy adjusts to a post-pandemic normal, a few areas of weakness will remain, with more people working from home and more online commerce than before. For better or worse, some parts of the economy will never be the same, Feler suggests.

"Right now, the key issue is how we will make it through to an exuberant spring," Feler writes. "These next few months will be dire, with rising COVID-19 infections, continued physical distancing, and the expiration of social assistance programs. Additional timely fiscal relief would prevent unnecessary hardship and allow the economy to maintain the structural relationships that will help us recover more quickly once vaccines become widely available."

The California Forecast

The COVID-19 pandemic's outsized and unpredictable impact on California is expected to continue, at the very least, for the immediate future.

As Forecast director Jerry Nickelsburg and economist Leila Bengali write, "California has responded, as before, with more restrictive non-pharmaceutical interventions (NPI) via mask mandates, closures and gathering restrictions. We expect that to continue, particularly through the holiday season, as significant traveling by Americans has thus far presaged further increases in COVID cases. We also know that at least three vaccines are in the latter stages of testing and approval. Does this mean that we are out of the woods soon? The answer is maybe."

The economists assume that an elevated number of virus cases will persist and that caution will prevail regarding many traditional holiday activities, including in-store shopping, throughout the winter. "This will mean a weak growth rate through the balance of the year and into early 2021," they write. "For the purposes of our forecast we also assume that a large number of people will have received one of the vaccines by summer, ushering in the beginning of a return to normalcy."

The report notes that 1.37 million non-farm payroll jobs in California have been lost since October 2019. Although there has been a recovery of some of those jobs since April 2020, a handful of sectors will remain the state's weakest economic sectors, bearing the brunt of the state's employment losses: leisure and hospitality, retail and education.

The forecast for the state is that the technology sectors, residential construction and logistics will lead the recovery, and that post-pandemic California will grow faster than the U.S. as a whole, although the state's recovery is expected to begin later.

The economists expect the state's unemployment rate in fourth-quarter 2020 to be 8.9%, and the average unemployment rate to be 6.9% in 2021, followed by 5.2% in 2022 and 4.4% in 2023. They project total employment growth rates of 6.1% in 2021, followed by 3.4% in 2022 and 2.2% in 2023, and non-farm payroll job growth of 3.6%, 3.8% and 2.5% for the same three years.

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