UCLA Anderson Forecast Predicts Soft but Turbulent Landing for National Economy

September 28 2006

In its third quarterly report of 2006, the UCLA Anderson Forecast says that while "the U.S. economy appears to have seamlessly downshifted to a soft landing (and) we are not forecasting a recession … the economy is about to get bumpy as the housing market continues to deteriorate."

The Forecast calls for a sustained period of 1.5-2.0 percent growth. In California, the housing market continues to soften and real estate employment has gone from an "engine of growth" to "a drag on growth in 2006." In the absence of a recession, however, statewide home prices are unlikely to experience significant declines.

The Forecast calls for a sustained period of 1.5-2.0 percent growth. In California, the housing market continues to soften and real estate employment has gone from an "engine of growth" to "a drag on growth in 2006." In the absence of a recession, however, statewide home prices are unlikely to experience significant declines.

The National Forecast

UCLA Anderson Forecast Senior Economist David Shulman says that the national economy is about to enter a period of several quarters of sluggish growth with "inflation above the comfort level." As a result, the Federal Reserve can be expected to cut the funds rate to 4.5 percent and unemployment will rise, while economic sectors related to real estate will decline. Strength in business investment and trade, coupled with a bottoming of the housing market, will eventually strengthen the economy, which will bounce back to a 3-4 percent growth rate by 2008. The Forecast calls for real GDP growth averaging 1.8 percent in the three quarters beginning with the third quarter of 2006.

The report titled "Soft Landing with Turbulence Ahead" notes that home sales are off 12 percent and housing starts off 26 percent from their respective peaks, making it clear that the housing market is in a major cyclical decline. "It is only a matter of time," Shulman writes, "before nominal home prices are down on a year-over-year basis."

The California Forecast

The California Forecast, authored by economist Ryan Ratcliff, says that the state's real estate sectors will continue their 2006 decline — without major declines in other sectors.

This distinction is significant, since it implies a slowdown instead of a recession. Historically, recessions in California have had major job loss in at least two sectors, such as construction and manufacturing. Without recession-sized job losses, a significant decline in statewide home prices is unlikely. However, a few regions where new construction is a significant share of overall sales may see some price declines, since builders historically have been more willing to lower prices than owners.

According to Ratcliff, building permits will continue to decline, bottoming out in 2008 as activity returns to levels seen in 2000. The drop in building activity will continue to weaken the construction sector, which will lose around 100,000 jobs through the life of the forecast, which runs until fourth quarter 2008. The financial activities sector will suffer a slowdown overall due to real estate-related declines. Nominal home prices in the state will stay flat through 2008, though real prices will fall.

In a California companion piece titled "2005: The Year the Tortoise Won the Race, Whither California Home Prices," Forecast director Edward Leamer again makes the case that the real estate sector is a volume cycle and not a price cycle. As a result, the real declines in this area will be in total volume and not real estate prices. He argues that volume produces the activity which contributes to GDP (and GSP), and declines in volume often lead to layoffs of construction workers and lowered real estate commissions.

Leamer expects home prices five years from now to be about the same as they are today, though lower in real terms by 15-20 percent. Meanwhile, housing's contributions to GDP will be very weak, with building, finance and real estate commissions suffering significant declines.

Source: UCLA