# Anderson Forecast: Sluggish economy continues despite housing market improvements

June 21 2012

In its second quarterly report of 2012, the UCLA Anderson Forecast predicts U.S. GDP and job formation will remain weak in the near-term, mirroring conditions that have prevailed for the last two years.

GDP growth is forecasted to be 2.4 percent by the end of 2013, increasing to 3.4 percent in 2014. The unemployment rate by the end of 2013 should be 7.7 percent. The Forecast assumes the Federal Reserve Bank cannot risk a rate increase, particularly if the nation experiences a projected inflation rate of 1.6 percent.

In California, slow and steady gains are anticipated throughout 2012. More accelerated growth in 2013 and 2014 could see California's unemployment rate decrease to 7.7 percent by the end of 2014, which is within 0.6 percent of the U.S. rate.

## The national forecast

In his June report, UCLA Anderson Forecast director Ed Leamer speculates on the economic factors that will become the engine(s) of growth for the U.S. economy. In an essay titled "Wall Street, K-Street or Main Street? Who Can Save Us?", Leamer suggests that the "distraction" caused by focusing on the financial sector (Wall Street) and the federal government (K-Street) is causing most to miss the "real Main Street problem" — inadequate workforce development for 21st-century labor

markets.

Re-emphasizing themes he has discussed in previous forecasts, Leamer writes, "The solution is workforce development. We need to take a deep breath and accept the fact that two bubbles have disguised the inferior quality of our educational system. Good jobs in the United States in the 21st century will require humans to do things that are not suited to the capabilities of far-away foreigners, robots or microprocessors. We need a workforce that can think creatively and solve the new problems, not merely recall the solutions to old problems."

Leamer's essay notes that there has been no real recovery from the "Great Recession" of 2008–09. In each of the previous 10 recessions, GDP returned to its previous peak within two years. A recovery with exceptional GDP growth requires greater-than-normal employment growth. Payrolls have typically recovered to their previous peaks within two to two-and-a-half years. Given current lags, Leamer says, this recession could take seven or eight.

In a companion piece, UCLA Anderson senior economist David Shulman casts an eye on the nation's housing market. In an essay titled "Rebuilding the Housing Economy," Shulman writes that average home prices have declined by one-third, a searing experience for most homeowners who never believed housing prices would fall. Amid continuing foreclosure activity, with "potential homeowners either unable to meet more stringent purchase requirements or fearful of continued price declines, the homeownership rate declined from a peak of 69 percent in 2004 to 66 percent in 2011 and is forecast to drop to 65 percent by the end of this year."

However, Shulman's analysis suggests the housing market may have bottomed out and that a recovery is underway. Foreclosures appear to have peaked. Existing home sales are on the rise. Shulman says that this

recovery is bolstered by a gradually improving labor market, a rebound in household formations and record-low mortgage rates.

But he warns that the recovery will be "gradual and uneven." The improving job market is far from healthy. Higher down payments and credit score requirements are nullifying some of the stimulative effects of the low interest rates, and the specter of exploding student loan debt will keep potential buyers out of the housing market for years to come.

Housing starts are expected to increase from a very depressed 610,000 units in 2011 to 755,000 units this year, 1.01 million units in 2013, and 1.37 million units in 2014. Although the increase is substantial, the recovery represents a return to a more normal level of activity.

Shulman notes that the "real drama" is coming in multi-family housing, citing the current boom in multi-family construction, which is underpinned by a low vacancy rate (5 percent), rising rents and a flood of institutional money coming into the sector.

## The California forecast

In the California report, senior economist Jerry Nickelsburg looks closely at California's housing market, specifically residential construction, which "first led the decline in employment and economic activity going into the recession and has been at the rear, dragging down potential growth during the recovery." In an essay titled "California Housing Markets: Data, Mirages, and Recovery," Nickelsburg writes that California's unemployment rate rose faster than the nation's, due to 350,000 lost construction jobs.

Is California's housing market ready to turn? Nickelsburg's analysis suggests that California real estate markets are "either still in the trough or still declining toward it. While there is some data giving rise to

optimism, there is no real indication that the housing market is on the cusp of a recovery." However, there is data that leads Nickelsburg to expect that the California housing market will grow more rapidly than the nation's in 2013 and 2014.

"We expect a modest growth in housing starts for the balance of the year at approximately one-quarter of the U.S. rate," Nickelsburg writes. "This will be predominantly multi-family housing. In 2013, we forecast a 40 percent jump in permits, slightly above the U.S. rate, and a dramatic rise to 130,000 permits in 2014 — double the U.S. rate."

The current forecast is for continued slow, steady gains in employment through 2012, with growth expected to increase 1.9 percent in 2012, 1.8 percent in 2013, and 2.5 percent in 2014. Payrolls will grow more slowly, at 1.6 percent, 1.8 percent and 2.4 percent for the three forecast years. The unemployment rate will linger around 10.6 percent through 2012 and average 9.7 percent in 2013, about the same as was forecasted in the March report. The unemployment rate is expected to drop to an average of 8.3 percent in 2014.

With eyes on the California High Speed Rail (CHSRL) as Gov. Jerry Brown and the state Legislature take up issuance of construction bonds approved by the voter passage of Proposition 1A (2008), Nickelsburg and co-author Saurabh Ahluwalia evaluated similar rail development in Japan. Under "project vision and scope" on the CHSRL Authority website, three categories of benefits for the rail project are considered: economic, environmental and community. Nickelsburg and Ahluwalia focused only on the induced economic development benefits in an essay titled "California High-Speed Rail and Economic Lessons from Japan."

Nickelsburg and Ahluwalia find that for Japan, high-speed rail does not seem to have any significant aggregate economic development component. Their results cast doubt on the economic benefit claims for

CHSRL. In a separate study of the Japanese system, they also found that high-speed rail tends to create sprawl as it lowers the cost for commuters and makes more far-flung locations possible bedroom communities. This may be a benefit or detriment, depending on one's viewpoint, they say.

They conclude that "there may be good reasons to invest in CHSRL, including the possibility that CHSRL is the optimal infrastructure investment for a growing population; but the economic argument — the jobs argument — does not seem to stand on solid ground."

For more information on the UCLA Anderson Forecast, visit ucla.in/LDAlng

Provided by University of California, Los Angeles

Citation: Anderson Forecast: Sluggish economy continues despite housing market improvements (2012, June 21) retrieved 20 June 2024 from https://phys.org/news/2012-06-anderson-sluggish-economy-housing.html

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