CALIFORNIA ECONOMIC OUTLOOK

June 2019

Bank of the West Economics

Executive Summary

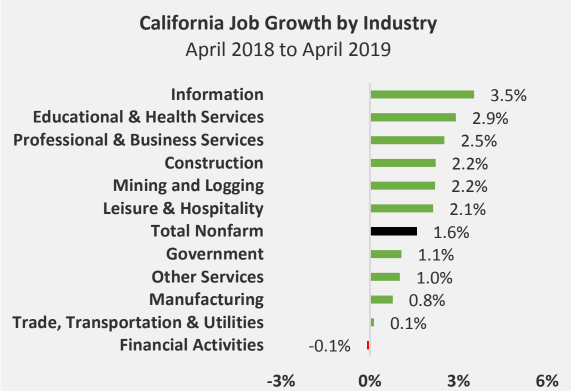
- California's job growth engine is not dead yet, but it is sputtering. California payroll growth has reaccelerated modestly since January. However, California's job growth year-on-year slipped below that of the nation in December 2018, after exceeding U.S. growth for nearly seven years. That underperformance has persisted so far in 2019.
- There's a downside risk to California's economic outlook from the ongoing trade war between the U.S. and China. Agricultural exports from the Central Valley could suffer because they are on the list of goods subject to retaliatory tariffs by China. A study by the University of California, Davis, estimates that higher tariffs could cost major U.S. fruit and nut industries $2.6 billion per year in exports to countries imposing higher tariffs, including China.
- Bay Area tech companies are also in the crosshairs. Higher tariffs mean higher component costs that could ultimately push prices higher for smartphones, tablets, and computers and reduce demand for these products.
- Annual job growth in California has moderated for three consecutive years, and the slowdown is projected to continue through 2020. Job growth is projected to slow to 1.2% in 2019 and manage only a 0.5% gain in 2020, down from 2.0% nonfarm payroll growth in 2018.
- Job growth is forecast to be moderate across all regions in 2019 and 2020 except for the Central Coast where a modest acceleration is expected in 2019. The slowest job growth is forecast in the Southern California region over both years.
- Reflecting persistent labor market underperformance, California's unemployment rate has been gradually rising to 4.3% in April 2019 from an all-time low of 4.1% in July 2018. It is expected to average 4.9% by 2020, the highest level since 2016.
- Housing demand in California remained subdued heading into the spring home buying season, with existing single-family home sales in April declining 0.1% from March and down 4.8% from a year ago. May existing home sales, released earlier this week, showed an improved 2.6% increase from April, but sales are still down 0.6% from a year ago. California existing home sales have declined from a year ago for 13 consecutive months.
- California's home price appreciation is forecast to moderate to more sustainable rates of around 2.0% over the next two years due to decelerating job growth, slowing U.S. and global economies, continued out-migration and weak population growth.
- By limiting the tax break on mortgage interest paid and by capping the amount of state and local taxes (SALT) that homeowners can deduct from their federal taxes, the Tax Cuts and Jobs Act of 2017 is reducing the incentive to own a home.
- According to the National Association of Realtors, limits on the mortgage interest deduction and capping the SALT deduction will result in a reduction in U.S. home values in excess of 10% from where they would be without capping the SALT deduction.
- California homebuyers and home builders have not yet shifted their preferences to lower cost homes in response to the tax deduction limits. The share of home sales above $750,000 was 29.7% in April 2019, up from 29.0% in April 2018 and 25.7% in April 2017.

California Job Growth Firmly Below U.S.

Annual job growth in California fell below that of the nation in December 2018 after exceeding U.S. growth for nearly seven years. While that trend has remained in place so far in 2019, California job growth did pick up modestly to 1.6% in April.

California job gains from a year earlier were positive in most major sectors, with the sturdiest growth in information services (3.5%), education & health services (2.9%) and professional & business services (2.5%). On the other hand, job growth was weakest in financial services (-0.1%), trade, transportation & utilities (+0.1%), and manufacturing (+0.8%). Together, these three slow growth sectors represented a sizable 30% of all jobs in the state in April 2019.

Information Services Jobs Leads the Way



Source: U.S. Bureau of Labor Statistics

Annual job growth in California has moderated for three consecutive years since peaking for this cycle at 3.0% in 2015. The slowdown is projected to continue through 2020 with growth of 1.2% this year and only 0.5% next year. A weaker global economy, rising tariffs, a high cost of living and doing business, elevated and rising home prices and net out-migration will weigh on California's job growth over the next two years.

Sectors expected to have the sharpest slowdown in growth from 2018 to 2020 are construction, information services, and manufacturing.

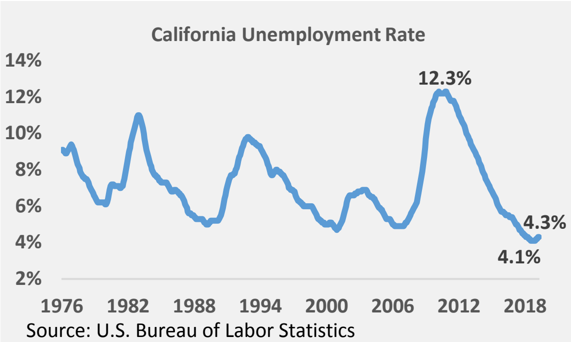
The U.S.-China trade war escalated after President Donald Trump on May 10 announced an increase in the tariff rate to 25% from 10% on $200 billion of Chinese exports to the U.S. beginning on June 1. China retaliated and raised the tariff rate to as high as 25% on $60 billion of U.S. exports to China. Since then the rhetoric has been turned up on both sides and a full-blown trade war cannot be ruled out.

This represents a downside risk to job growth in California as the state conducted more trade with China than any other state in 2018. According to the U.S. Census Bureau, total trade between California and China was nearly $178 billion, with imports of $161.2 billion and exports of $16.3 billion. To the extent that tariffs lead to price increases on the targeted goods and weighs on demand, the result could be less two-way trade between the two countries, with slower job growth in some industries.

California's unemployment rate fell to an all-time low of 4.1% in July 2018 in a series that dates back to January 1976, and stayed there for six months. But with persistently slower job growth, California's unemployment rate began to rise in January 2019 and reached 4.3% by April. This is well-above the U.S. unemployment rate, which has held at a historically low 3.6%.

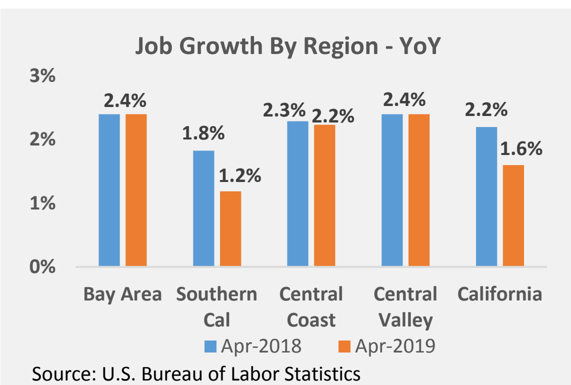
Average monthly job growth in California has slowed from 2.2% in 2017 to 2.0% in 2018 and just 1.5% year-to-date through April in 2019. This deceleration in job growth is projected to continue through 2020, driving the unemployment rate up to 4.5% in 2019 and 4.9% by 2020. Despite the increase, the unemployment rate will remain well-below the long-run California average of 7.3% from 1976 to 2018.

California's Unemployment Rate Is Rising



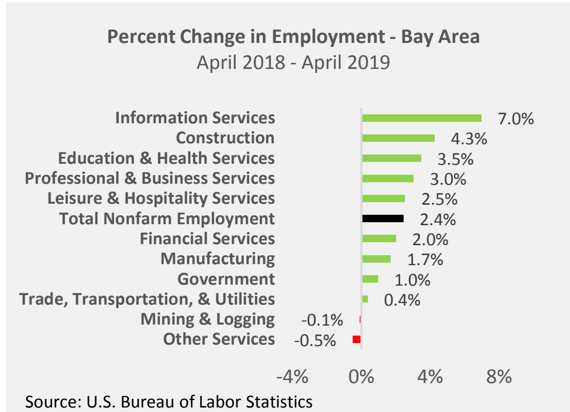
Annual job growth in California has decelerated from 2.2% in April 2018 to 1.6% in April 2019. The slowdown, however, has been primarily due to a sharp deceleration in job growth in Southern California from 1.8% to 1.2% over the same time frame. Indeed, job growth from a year earlier was unchanged in the Bay Area and the Central Valley and fell by just a tenth of a percentage point in the Central Coast.

Job Growth Has Been Resilient in Most Regions



The **Bay Area** labor market continues to outperform most other California regions. Total nonfarm job growth was 2.4% in April from a year earlier. Job gains in the Bay Area remain broad-based with payrolls expanding in nine of the 11 major industry groups, led by information services (+7.0%), construction (+4.3%) and education & health services (+3.5%). Other services (-0.5%) and mining & logging (-0.1%) were the only industry groups to contract and those two sectors represented a meager 3.2% of total employment in April 2019.

Growth in Information Services Remains Robust



San Francisco was once again the leading metro in the region with job growth of 3.6% – a full percentage point above growth in number two Silicon Valley. Conversely, the worst performing metro in the region was Vallejo with flat employment growth.

Bay Area job growth this year is forecast to be a very respectable 2.0% – nearly double statewide growth of 1.2% but down a tenth of a percentage point from 2018. Job growth is expected to slow to a mere 0.6% in 2020. Rising costs are an extension of the strong Bay Area economy and will contribute to slower growth for the remainder of the expansion. Moreover, net migration, which was positive for eight years from 2008 to 2016, became negative in 2017 and is forecast to remain negative through 2020. Fewer people are relocating to the Bay Area and more are leaving because of spiraling costs and congestion.

Bay Area growth could unexpectedly increase because of the influx of cash that will be generated by tech companies going public. Uber, Lyft, Pinterest, and Beyond Meat are already publicly traded and could be joined by Slack and Airbnb, among others. The inflow of cash will increase the demand for homes and could entice sellers to put their homes on the market, putting upward pressure on prices and creating more housing wealth. This in turn could lead to increased consumer spending in the Bay Area via the wealth effect.

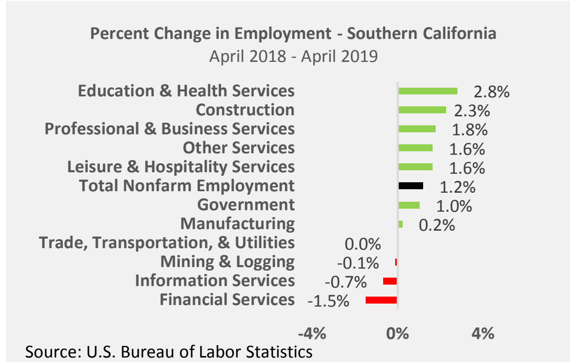
A factor that could weigh on Bay Area growth is the recent announcement by the U.S. government to investigate if Apple, Facebook, and Google (as well as Amazon) are abusing their massive market power. Shares of Facebook fell 7.5% when the news broke, while Alphabet (the parent company of Google) and Apple declined 6.1% and 1.0%, respectively. The ongoing investigation could place more pressure on the stock prices of the large tech companies and compel them to pull back on Bay Area hiring.

The escalation in the U.S.-China trade war puts Bay Area technology companies in the crosshairs because the tariffs, if realized, could be levied on some smartphones, notebooks, and printers. This could lead to price increases on these products which would weigh on demand and slow job growth in the impacted industries.

Furthermore, the Trump administration recently decided to place China's leading telecom giant Huawei on an "entity list" that restricts it from buying hardware, software, and services from U.S. high tech suppliers. This could force Huawei to purchase these components and services from high tech companies outside the U.S. and depress job growth in California.

Recent job growth in **Southern California** is much slower relative to the other regions. Total nonfarm job growth was just 1.2% from a year earlier in April, the only major California region with a sub-2.0% job growth rate. The fastest growing employment sectors were education & health services (+2.8%), construction (+2.3%) and professional & business services (+1.8%). On the other hand, three sectors suffered declines from a year-ago: financial services (-1.5%), information services (-0.7%) and mining & logging (-0.1%). These three sectors were nearly 8.0% of total nonfarm employment in April 2019.

Health Services Lead Southern California's Growth



Source: U.S. Bureau of Labor Statistics

Southern California job growth is forecast to slow to 0.9% in 2019 – less than half of the 2.0% growth recorded last year and moderate to just 0.3% in 2020. High and rising costs will force firms and residents alike to flee Los Angeles and restrict the number of people willing to move to the area. Moreover, the entertainment industry is losing business to North Carolina, Michigan, Georgia, and Louisiana, all of which are spending millions of dollars to attract film production.

As Southern California job growth continues to moderate markedly from the cycle peak of 2.9% in 2015, the unemployment rate is forecast to rise from 4.1% in 2018 to 4.3% in 2019 and 4.8% in 2020. The unemployment rate forecast for both years is still slightly below the state average.

Much like the rest of the state, a downside risk for Southern California is the renewed hostilities in the U.S.-China trade dispute. If the two sides are unable to come to an agreement – Southern California will suffer because around 50% of U.S. trade with China goes through Los Angeles area ports.

For now, the increase in tariffs on Chinese imports may be boosting trade volumes at the Port of Los Angeles as importers race to beat tariffs on an additional $300 billion of Chinese goods imports. The Port of Los Angeles handled 736,466 Twenty-Foot Equivalent Units (TEUs) in April 2019, the busiest April in the Port's 112-year history. Moreover, for the first four months of this year, volumes are up 4.5% from the same period in 2018. Increased tariff rates on imports from and exports to China in the future could impede the flow of goods, however, leading to slower job growth compared to our baseline forecasts.

There are 10,000 dockworkers at the Port of Long Beach who could be impacted by a slowdown in trade. Moreover, a slowdown would affect the entire supply chain from logistic workers to warehouse workers to truckers who move the cargo, leading to possible job losses.

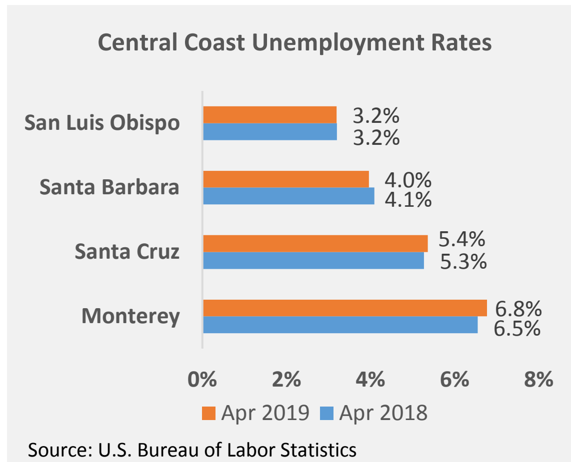
Job growth in the **Central Coast** remains solid. Total nonfarm job growth in the **Central Coast** region rose 2.2% in April from a year earlier, trailing the Central Valley and the Bay Area by two-tenths of a percentage point. The region's job growth was propelled by a robust 3.2% gain in Monterey, followed by a 2.2% increase in Santa Barbara. Below average growth of 1.4% in San Luis Obispo and 1.9% in Santa Cruz held regional employment growth in check.

Regional job gains were particularly impressive in professional & business services (+4.3%), leisure & hospitality (+3.6%), education & health services (+3.3%) and construction (+3.1%). The two sectors that contracted were information services (-1.6%) and other services (-0.1%).

San Luis Obispo had the lowest unemployment rate in the region in April despite having the slowest job growth of any metro during the same month. The metro is well-below full employment and is having a hard time finding qualified workers to fill open jobs, limiting employment gains.

Monterey had by far the highest unemployment rate in the region at 6.8%, followed by Santa Cruz at 5.4%. Moreover, their unemployment rates both increased from a year earlier. The unemployment rate declined in Santa Barbara and was flat at a low 3.2% in San Luis Obispo.

Monterey Unemployment Rate Increasing



Job growth in the Central Coast region is forecast to be 1.6% this year – well-above the California average of 1.2% but below the fastest-growing regions of the Central Valley (2.1%) and the Bay Area (2.0%). Job growth is expected to decelerate to just 0.7% next year as the U.S. and California economies slow. Central Coast out-migration persists and population growth of 0.4% per year through 2020 remains weak relative to the long-term average of 0.7% from 2008 to 2018.

Construction, professional & business services and manufacturing are expected to experience the sharpest slowdowns in growth rates from 2018 to 2020, weighing on overall employment growth in the Central Coast. Accordingly, the unemployment rate –which hit a post-recession low of 4.6% in 2018 – is projected to rise to 5.1% in 2019 and 5.7% in 2020. Despite the modest increases anticipated, the unemployment rate for the Central Coast of California will remain well-below the peak of 11.4% in 2010.

Job growth in the **Central Valley** has been very robust recently. Total nonfarm job growth in April from a year earlier was 2.4%, the fastest pace of any of the four California regions covered in this outlook report. Ten of the 11 major industry sectors had positive growth in April, led by education & health services (+5.1%), construction (+5.0%) and mining & logging (+3.1%). The one sector that shed jobs over the last year was information services (-2.8%).

Central Valley job growth was a robust 2.9% in 2018 – tied with 2015 for the post-recession high and by far the fastest growing region in the state. Job creation is forecast to slow to 2.1% in 2019 and 0.4% in 2020. Weaker population growth – gains of 0.8% and 0.6% are projected for the next two years, below the long-run average of 1.0% from 2008 to 2018 – and a sharp slowdown in in-migration will collectively limit job gains through 2020.

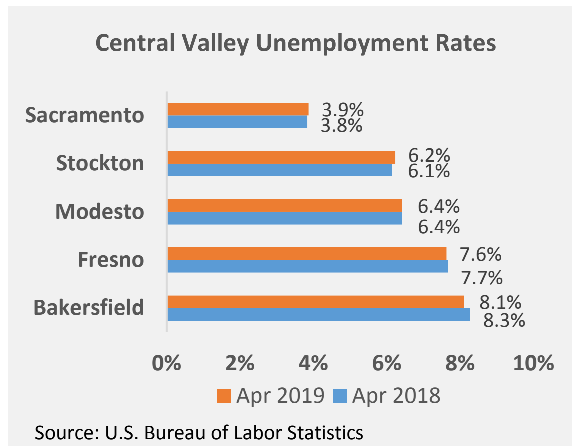
Decelerating growth over the next two years in the fastest-growing sectors of the Central Valley economy in 2018 – oil production, construction, education & health services and professional & business services – will cause total job growth to weaken in the Central Valley.

Oil prices remain the wild card in the outlook for the Central Valley. Prices have fallen from a year earlier for six consecutive months through May and are down by an average of 11.0% per month in 2019. If prices weaken further due to fears of slowing U.S. and global economic growth, a reduction in investment spending on oil wells in the region might ensue, presenting a downside risk to the outlook.

There's also a downside risk to the Central Valley from the retaliatory tariff by China placed on agricultural products. A study by the University of California, Davis, Agricultural Issues Center and Department of Resource Economics estimates that higher tariffs could cost major U.S. fruit and nut industries $2.6 billion per year in exports to countries imposing the higher tariffs. A loss of this magnitude would undoubtedly weigh on job growth in those industries.

Unemployment rates fell from a year earlier in April in the two metros with the highest rates: Bakersfield and Fresno. Continued slack in these two metro labor markets makes it easier for companies to find qualified individuals to fill open positions. In contrast, the unemployment rate increased slightly in Sacramento and Stockton and was unchanged in Modesto.

Mixed Unemployment Rate Performance



The unemployment rate in the Central Valley, which reached a post-recession low of 5.6% in 2018, is expected to rise to 6.0% this year and 6.8% in 2020 in the face of decelerating job and population growth.

The TCJA of 2017 and Home Prices

On December 22, 2017, the most comprehensive tax reform since the Tax Reform Act of 1986 was passed. The Tax Cuts and Jobs Act of 2017 (TCJA) made slight reductions to income tax rates for most individual tax brackets and significantly reduced the income tax rates for corporations. The TCJA also provided a large new tax deduction for owners of pass-through entities and significantly increased the alternative minimum tax (AMT) and estate tax exemptions.

It wasn't all good news for taxpayers, however, as the TCJA eliminated or limited many itemized deductions, including several specific to the housing market:

- **State and local taxes (SALT):** The deduction for state and local taxes was substantially reduced. From 2018-2025, taxpayers can claim a deduction of up to $10,000 for state and local property taxes.
- **Mortgage interest deduction:** The TCJA tightens limits on the mortgage interest deduction. From 2018-2025, it generally allows taxpayers to deduct interest only on mortgage debt of up to $750,000, but the $1 million limit remains for mortgage debt incurred before December 15, 2017.
- **Home equity interest deduction:** The new tax law suspends, in most cases, the deduction for interest on home equity debt from 2018-2025.

TCJA Reduces Incentives for Homeownership

By limiting the tax break on mortgage interest paid to mortgage debt of $750,000 or less and by capping at $10,000 the amount of state and local taxes that homeowners can deduct from their federal taxes, the tax cuts are reducing the incentive to own a home in California. Moreover, because the TCJA nearly doubles the standard deduction that most people take, there will be fewer people who claim the mortgage interest deduction on their income tax returns because the standard deduction will exceed their itemized deductions. This could also reduce the incentive to become a California homeowner.

Housing Markets Most Impacted by TCJA

The biggest impact due to the elimination and limitation of itemized deductions specific to the housing market was expected to occur in states with high home prices and high property taxes such as California, Connecticut and New York. An analysis by the Tax Foundation found that the SALT deduction, prior to the new limits, allowed Californians to reduce their taxable income by $101 billion in 2014. This was about one-fifth of the total U.S. deduction, so the new tax break limits are expected to have outsized impact on California's economy and housing market.

Another channel through which the TCJA was expected to negatively impact the housing market is home prices. According to the National Association of Realtors, the result of limiting the mortgage interest deduction to mortgage debt of $750,000 or less and capping the SALT deduction at $10,000 would be a plunge in home values across the U.S. in excess of 10% from where they would be with the tax law changes and likely more in high cost areas such as California.

But so far the negative impacts of the tax reform on the California housing market are hard to spot. The median price of existing single-family homes increased 6.0% from a year earlier in 2018, according to the California Association of Realtors data. Moreover, home prices have continued rising in 2019, hitting a record high in April 2019.

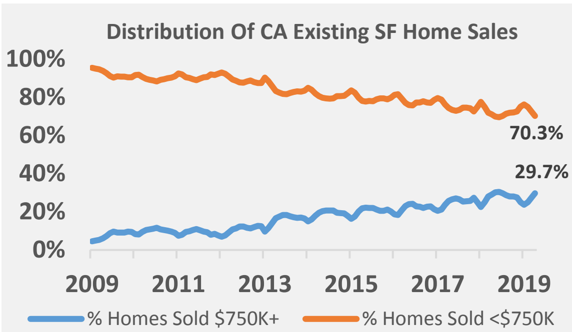
Has Demand Waned For High-Priced Homes?

Another possible effect of the limitation or elimination of itemized deductions on the California housing market – as well as other high-priced markets – is a shift away from higher-priced homes to less expensive homes because homeowners are able to fully deduct the mortgage interest and state and local taxes on the lower priced homes. This has yet to materialize in California.

The data reveals that 29.7% of existing single-family home sales in the state in April 2019 were priced above $750,000, up from 29.0% in April

2018 and 25.7% in April 2017. While some of this may be due to rising home prices, there is nothing in the home sales data yet to suggest that homebuyers are making conscious decisions to buy homes priced under $750,000 to take full advantage of available tax deductions.

Increasing High-Priced Sales in California



Source: California Association of Realtors

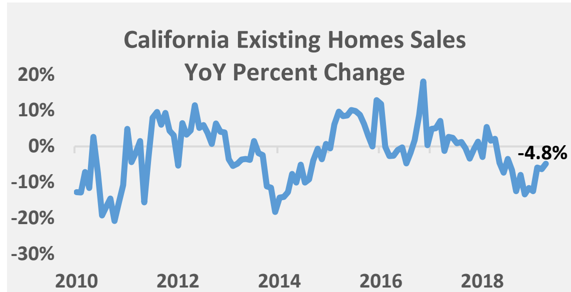
There are other forces at play that could be masking the negative impact of the reduced federal home-buying subsidies, including lower individual tax rates from the JCTA putting more money in people's pockets, continued solid job gains, and lack of supply of lower priced housing.

Moreover, it may simply be just a matter of time before homebuyers' and home builders factor tax preferences into home buying and selling decisions – essentially deciding whether to purchase and build lower priced homes below the $750,000 mortgage deduction cap.

California Housing Demand Remains Weak

California housing demand remained subdued heading into the spring home buying season with existing single-family home sales in April falling 0.1% from March and 4.8% from a year earlier. May existing home sales, released earlier this week, showed an improved 2.6% increase from April, but sales are still down 0.6% from a year ago. California existing home sales have declined from a year ago for 13 consecutive months. This is the longest stretch of year-over-year declines since home sales fell for 30 successive months from October 2005 to March 2008.

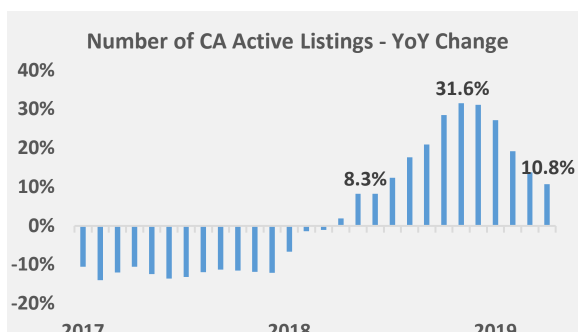
CA Home Sales Growth Negative For Last Year



Source: California Association of Realtors

Annual growth in the number of active listings of existing homes in California has been positive for the past 13 months after being negative for nearly three years. The growth rate, however, peaked at 31.6% in November 2018 and has decelerated each month since peaking. Indeed, the 10.8% growth in April is the slowest since June 2018, but is still strong enough to provide a much-needed increase in the supply of homes for sale. Furthermore, the prolonged growth in active listings should allow the market to become more balanced as supply becomes more aligned with demand.

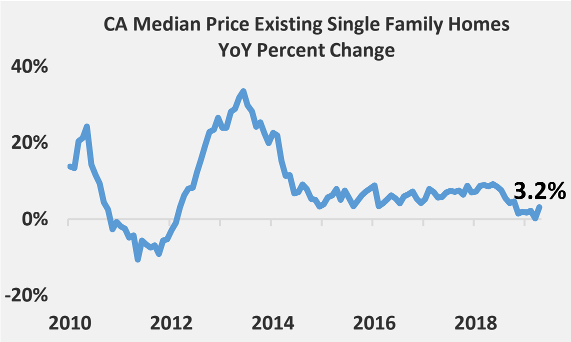
Active Listings Growth Slowed Further in April



Source: California Association of Realtors

Even though demand continued to weaken and home sales fell in April, the statewide median home price hit an all-time high of $602,920, surpassing the previous high of $602,760 set in June 2018. Prices are up 6.5% from March and 3.2% from a year earlier. The year ago price gain is the strongest since October 2018.

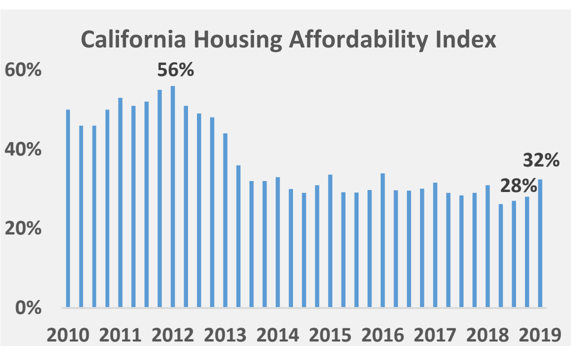
CA Home Price Growth Rebounded In April



Source: California Association of Realtors

Prior to April 2019, home price growth had been mostly moderating since mid-2018 primarily due to the surge in active listings. This, along with lower mortgage rates, is making homes in California somewhat more affordable. In the first quarter of 2019, 32% of California households could afford to buy the median-priced home. While affordability is still well below the 2012 peak of 56%, housing affordability has improved for three consecutive quarters and is at the highest level since the first quarter of 2016.

California Home Affordability Improving



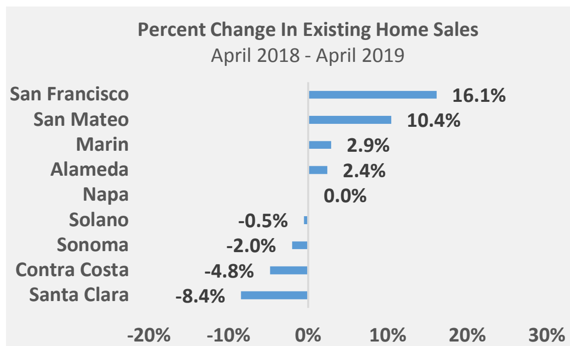
Source: California Association of Realtors

A marked deceleration in California job growth – particularly next year – slowing U.S. and global economies, continued out-migration and weak population growth will collectively weigh on the California housing market as the demand for homes continues to weaken. As a result, home price appreciation is forecast to moderate to more sustainable rates of around 2.0% over the next two years.

The **Bay Area** housing market is still weak but improving affordability is starting to lift home sales. Bay Area existing home sales increased 17.8% month-on-month in April after spiking 46.1% in March. Home sales have now risen for three consecutive months after three months of decline.

On a year earlier basis, however, home sales continue to decline but at a more subdued pace. Existing home sales dropped 1.0% in April from a year ago after declining an average of 9.5% from a year ago over the previous eight months. Sales declined in four of the nine counties of the Bay Area from a year ago in April, led by Santa Clara (-8.4%), Contra Costa (-4.8%) and Sonoma counties (-2.0%). Conversely, sales rose at the fastest pace in San Francisco (+16.1%), San Mateo (+10.4%) and Marin (+2.9%).

Bay Area Home Sales Were a Mixed Bag in April

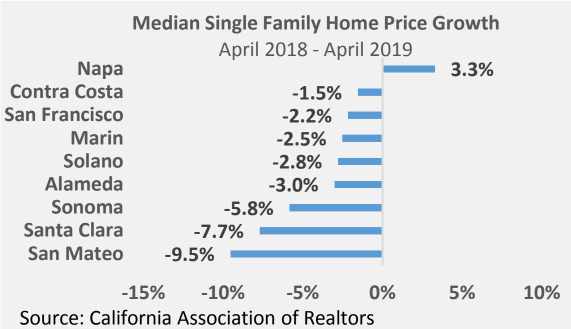


Source: California Association of Realtors

Home prices declined 2.2% from a year earlier in April in the Bay Area and have been negative for three consecutive months. The last three-month stretch of negative home price growth occurred about seven years ago. Increased supply and tepid demand continue to weigh on Bay Area home prices.

Home price declines were widespread over the last year with the biggest declines in San Mateo (-9.5%), Santa Clara (-7.7%) and Sonoma (-5.8%). The only county with an annual increase was Napa (+3.3%).

Home Prices Fell in Most Metros in April

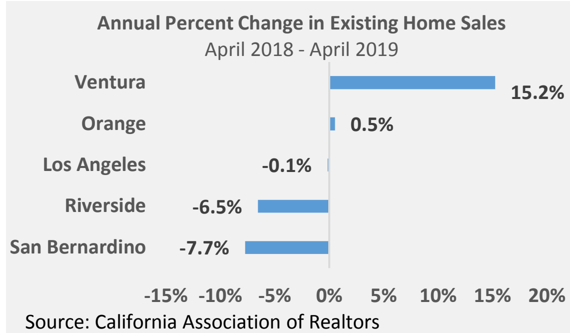


The Bay Area housing market is expected to continue moderating over the next two years due to low affordability and slowing job creation. From 2012 to 2018 average annual appreciation in the Bay Area was 12.6%, while the housing affordability index was only 28% in the Bay Area in 2019Q1 compared to 32% for the state.

Bay Area housing starts are projected to drop almost 17.0% in 2019 after rising by 11.9% last year, and then decrease 3.7% in 2020. Home prices are expected to fall 1.0% this year – the first annual decline since 2011 – and then rebound 3.8% in 2020. Average home-price growth over the last seven years has exceeded income growth by almost six percentage points, so slower or falling home prices are necessary to allow the market to become more balanced.

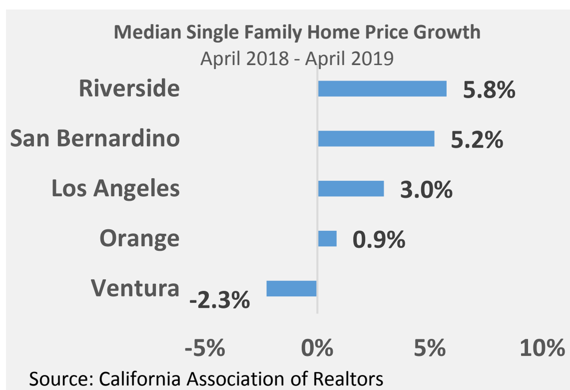
After declining by double-digit rates for five successive months starting in November 2018, existing home sales in the **Southern California** region decreased just 2.0% from a year earlier in April. Sales in most of the counties fell, led by San Bernardino (-7.7%) and Riverside (-6.5%). Home sales rose by a sizzling 15.2% in Ventura County and a more modest 0.5% in Orange County.

Home Sales Mixed in Southern California



Despite the prolonged weakness in home sales – sales have declined from a year earlier for the last twelve months – home prices in Southern California continue to advance. Home price growth from a year ago accelerated to 4.2% in April, the quickest pace since October 2018. Four of five counties experienced positive home price appreciation with Riverside (+5.8%) and San Bernardino (+5.2%) leading the way. Prices increased by more modest rates of 3.0% in Los Angeles and 0.9% in Orange County. Conversely, home prices in Ventura County declined 2.3% from a year ago.

Home Prices Advanced in Four of Five Counties

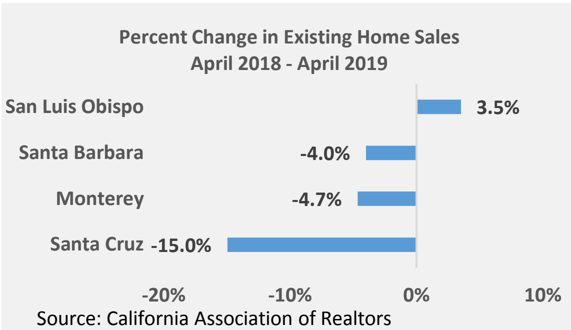


Home price growth in Southern California is forecast to weaken from 6.0% in 2018 to 2.0-2.5% in 2019 and 2020 as job growth slows significantly.

Existing home sales in the **Central Coast** region dipped 4.6% from a year earlier in April. Sales declined in three of the four metros with Santa

Cruz experiencing a particularly sharp decline of 15.0%, followed by Monterey (-4.7%) and Santa Barbara (-4.0%). San Luis Obispo was an outlier in the region with a 3.5% gain.

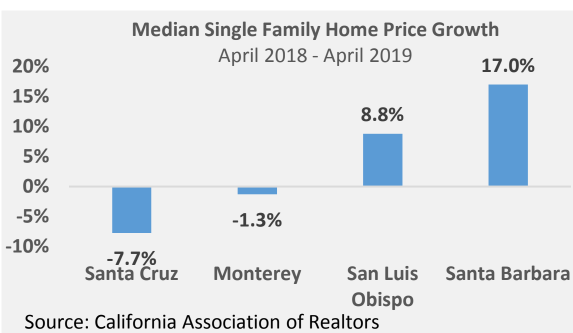
Home Sales Fell in Most Central Coast Metros



Source: California Association of Realtors

Although home sales declines were widespread in the Central Coast in April, home prices in the region increased 4.8% from a year earlier. Prices rose in Santa Barbara (+17.0%) and San Luis Obispo (+8.8%), but fell in Monterey (-1.3%) and Santa Cruz (-7.7%). Year-ago home price growth in Santa Barbara has been particularly volatile thus far in 2019, ranging from +27.9% in January to -20.5% in March. Cutting through all of the noise, average home price growth for the first four months of the year in Santa Barbara is a paltry 2.5%.

Home Prices Were Mixed in the Central Coast



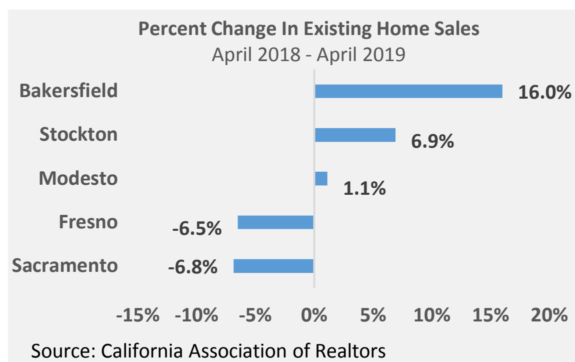
Source: California Association of Realtors

Homebuilding in the Central Coast is projected to fall almost 27.0% in 2019 after average growth of more than 30% the last two years. Growth is expected to remain slightly negative in 2020 as job and income gains slow.

Despite the pullback in homebuilding, home price growth is expected to accelerate to 4.0-4.5% over the next two years, up from 3.2% last year. Accelerating population growth and more moderate out-migration over the next two years will support modest home price appreciation.

Home sales fell a modest 0.5% from a year ago in the **Central Valley** region, the smallest decline of any of the regions. Two of the five metros in the region saw home sales decline: Sacramento (-6.8%) and Fresno (-6.5%). The best performing metro was Bakersfield with a solid gain of 16.0%, followed by Stockton (+6.9%) and Modesto (+1.1%). In Bakersfield, a lack of supply is driving up home prices. The unsold inventory index – which measures the number of months it would take to sell the supply of homes on the market at the current sales rate – was 2.8 months in April, down from 3.0 months in March and 3.5 months in April 2018.

Home Sales Rose in Three Central Valley Metros



Source: California Association of Realtors

Central Valley home prices increased 4.2% in April from a year earlier despite the slight dip in home sales during the month. Home prices rose in four of the five metros, led by Bakersfield at 6.4%, while Modesto, Sacramento, and Fresno all experienced gains of nearly 4.5%. The one outlier was Stockton where home prices were flat.

Comparatively more affordable homes – the Central Valley housing affordability index in the first quarter of 2019 was 46%, much higher than the other three regions and the state as a whole – moderate population growth and positive in-migration will prop up the Central Valley housing market in 2019 and 2020. Therefore, home prices are projected to rise around 3.0% annually over the next two years.

Economic Forecasts for California and Its Regions

CALIFORNIA	2016	2017	2018	2019f	2020f
LABOR MARKET					
Employment Growth	2.7%	2.2%	2.0%	1.2%	0.5%
Unemployment Rate	5.5%	4.8%	4.2%	4.5%	4.9%
INCOME AND SPENDING TRENDS					
Personal Income Growth	4.0%	4.6%	4.7%	4.2%	3.7%
Median Household Income ($)	67,739	71,805	75,200	78,164	81,382
Retail Sales Growth	3.6%	5.3%	5.0%	2.3%	1.5%
HOUSING MARKET					
Total Housing Starts Growth	4.4%	8.2%	8.6%	-4.7%	-4.5%
Med. Existing 1-Unit Home Price	5.0%	7.5%	7.4%	2.3%	1.5%
DEMOGRAPHICS					
Population Growth	0.7%	0.5%	0.4%	0.4%	0.4%
Net Migration (000's)	26.2	-17.9	-38.3	-32.5	-45.7

BAY AREA	2016	2017	2018	2019f	2020f
LABOR MARKET					
Employment Growth	3.4%	2.3%	2.1%	2.0%	0.6%
Unemployment Rate	4.0%	3.4%	2.8%	3.0%	3.6%
INCOME AND SPENDING TRENDS					
Personal Income Growth	6.3%	6.5%	5.5%	4.7%	4.2%
Median Household Income ($)	$88,579	$95,052	$99,620	$103,621	$108,467
Retail Sales Growth	3.7%	5.5%	5.2%	3.4%	2.8%
HOUSING MARKET					
Total Housing Starts Growth	6.7%	13.1%	11.9%	-16.8%	-3.7%
Med. Existing 1-Unit Home Price	6.6%	11.1%	9.7%	-1.0%	3.8%
DEMOGRAPHICS					
Population Growth	0.8%	0.4%	0.3%	0.4%	0.4%
Net Migration (000's)	22.1	-2.4	-7.6	-4.0	-8.0

[1]The Bay Area includes Alameda, Contra Costa, Marin, Napa, San Francisco, San Mateo, Santa Clara, Solano and Sonoma counties.

SOUTHERN CALIFORNIA	2016	2017	2018	2019f	2020f
LABOR MARKET					
Employment Growth	2.7%	1.9%	2.0%	0.9%	0.3%
Unemployment Rate	5.1%	4.5%	4.1%	4.3%	4.8%
INCOME AND SPENDING TRENDS					
Personal Income Growth	3.3%	3.7%	4.4%	3.9%	3.4%
Median Household Income ($)	71,301	74,456	77,023	79,622	82,749
Retail Sales Growth	3.4%	5.2%	4.8%	2.4%	1.9%
HOUSING MARKET					
Total Housing Starts Growth	1.4%	2.2%	3.5%	-13.0%	-4.0%
Med. Existing 1-Unit Home Price	4.6%	6.5%	6.0%	2.6%	2.0%
DEMOGRAPHICS					
Population Growth	0.5%	0.4%	0.3%	0.3%	0.3%
Net Migration (000's)	-16.6	-45.3	-53.1	-53.5	-63.2

[2]The combined Southern California region includes Los Angeles, Orange, San Bernardino, San Diego, Riverside, and Ventura counties that are home to nearly two-thirds of Californians.

CENTRAL COAST	2016	2017	2018	2019f	2020f
LABOR MARKET					
Employment Growth	1.7%	1.6%	1.5%	1.6%	0.7%
Unemployment Rate	6.1%	5.4%	4.6%	5.1%	5.7%
INCOME AND SPENDING TRENDS					
Personal Income Growth	1.8%	4.8%	4.1%	3.8%	3.5%
Median Household Income ($)	69,332	73,491	76,459	79,047	82,197
Retail Sales Growth	2.7%	3.9%	4.1%	2.3%	1.3%
HOUSING MARKET					
Total Housing Starts Growth	-1.7%	21.3%	41.7%	-26.8%	-3.5%
Med. Existing 1-Unit Home Price	3.7%	6.2%	3.2%	4.4%	4.0%
DEMOGRAPHICS					
Population Growth	0.6%	0.2%	0.1%	0.4%	0.4%
Net Migration (000's)	0.9	-3.9	-5.0	-1.7	-2.2

[3]The Central Coast region is comprised of Santa Barbara, Monterey, San Luis Obispo, and Santa Cruz counties.

CENTRAL VALLEY	2016	2017	2018e	2019f	2020f
LABOR MARKET					
Employment Growth	2.9%	2.2%	2.9%	2.1%	0.4%
Unemployment Rate	7.5%	6.6%	5.6%	6.0%	6.8%
INCOME AND SPENDING TRENDS					
Personal Income Growth	3.0%	4.3%	4.5%	3.7%	3.2%
Median Household Income ($)	55,712	58,047	59,829	61,683	63,899
Retail Sales Growth	4.2%	5.4%	5.1%	2.5%	1.4%
HOUSING MARKET					
Total Housing Starts Growth	10.9%	20.9%	2.9%	-6.3%	-5.0%
Med. Existing 1-Unit Home Price	7.9%	7.5%	6.8%	3.0%	2.7%
DEMOGRAPHICS					
Population Growth	1.1%	1.1%	1.0%	0.8%	0.6%
Net Migration (000's)	22.6	26.9	23.7	2.3	1.0

[4]The Central Valley region is comprised of San Joaquin, Fresno, Madera, Sacramento, Placer, El Dorado, Yolo, Stanislaus, and Kern counties.