The Desert Sun Coachella Valley Index of Leading Indicators and The Chapman University Economic Forecast for the U.S. and the Inland Empire

Rancho Mirage, CA — The A. Gary Anderson Center for Economic Research at Chapman University released today the results of its second annual economic forecast for the U.S., Inland Empire and Coachella Valley Employment Outlook. Following are forecast highlights.

2006 U.S. Forecast:

- Much has been made about the Federal Reserve Board’s seemingly aggressive action since mid-2004 in ratcheting up the fed funds rate. Our model for the U.S. economy suggests that it’s not the nominal fed funds rate but rather the real (inflation-adjusted) fed funds rate that’s important. And the real fed funds rate is still well within a range where it is acting to stimulate economic growth.

- We expect the Fed to continue increasing the fed funds rate from 4.25 percent currently to 4.75 percent by mid-2006. Given our forecast that price pressure will ease, the real federal funds rate is projected to increase through year-end 2006 and move into a restrictive range that will tend to dampen economic growth. It will mark the first time since the 2001 recession that the real fed funds rate will no longer be stimulative.
Residential construction has been an important engine of economic growth since the end of the 2001 recession. But increasing mortgage rates, coupled with diminished expectations regarding future housing prices, suggest that housing construction will slow. Our forecast calls for the average annual rate of housing starts to decline from more than 2.0 million to 1.8 million units – a drop of about 12 percent.

Our forecast for 2006 calls for continuing positive real GDP growth of 2.8 percent. This would mark, however, a second year where the average annual rate of real GDP growth has slowed since the peak year during the current expansion of 4.2 percent registered in 2004.

2006 Inland Empire Forecast:
- Payroll employment, as reported by the Employment Development Department (EDD), showed an annual average growth rate of 2.1 percent in 2005. This compares to a growth rate of 4.6 percent in 2004. The reported slowdown in the Inland Empire's job growth contrasts significantly with U.S. and California trends that show a pickup in growth in 2005 when compared to 2004.
- We believe that the EDD's current reported job figures, which are based on the payroll survey, are undercounting actual payroll jobs. This year, rather than using the current EDD statistics, we are adjusting payroll job numbers to conform to our projections.
- With steady real export growth, a moderate decline in real GDP growth and a sharp decline in the rate of growth of local construction spending, the Chapman Employment Indicator Series points to slower job growth in 2006 compared to 2005. On a quarterly basis, the Chapman forecast points to job growth dropping back steadily from an estimated 2.6 percent...
at year-end 2005 to 1.6 percent by year-end 2006. On average, our forecast calls for the creation of 25,000 additional payroll jobs — an increase of 2.1 percent.

- Trade, transportation & utilities, along with the services sectors will be the fastest growing sectors of the economy in 2006. Employment in the construction sector is forecasted to increase by 1.9 percent compared to an estimated growth rate of 7.7 percent in 2005.

- After three years of robust growth, total building permit valuation, both residential and nonresidential, is forecasted to hit $12.4 billion — slightly lower than the estimated level of $12.8 billion in 2005. This will be caused mainly by a forecasted decline in the number of residential permits from an estimated level of 53,800 units in 2005 to about 50,000 units in 2006.

- With moderate income growth, higher interest rates and a slowdown in home price appreciation, consumers will gradually cut back their spending throughout 2006. Our forecast calls for growth of 5.7 percent in total taxable sales, sharply lower than the estimated growth rate of 8.3 percent in 2005.

- Our projection of higher interest rates coupled with a moderate income growth calls for a softening in demand for housing. As a result, we are forecasting that median detached single family resale home prices will appreciate by only 1.0 percent in 2006.
Desert Sun Coachella Valley Index of Leading Indicators:

- In the summer of 2004, the A. Gary Anderson Center for Economic research, in cooperation with The Desert Sun, developed an Index of Leading Indicators for the Coachella Valley. The Index was published in the first issue of The Desert Sun Business Review in November of 2004.

- The Index of Leading Indicators is strongly correlated to Coachella Valley payroll employment growth. Based on the historical relationship between the indicator series and employment growth, an index value over 100 generally points to positive payroll job growth.

- The indicator series is comprised of variables found to have a significant influence on Coachella Valley payroll employment growth. These variables include movements in total airline passengers, median home prices, total hotel occupancy and Coachella Valley construction spending. A weighted average of changes in these variables, based on their relative importance in explaining local employment, is then used in constructing the indicator series.

- Three components of the Index are positive, but are increasing at a slower rate than the previous quarter. Year-over-year percentage change in median home price has increased by 20.4 percent in the fourth quarter of 2005 compared to a growth rate of 21.4 percent in the third quarter of 2005. Coachella Valley construction spending, which is derived from six-quarter lagged real values of total building permit valuation, is increasing at 1.9 percent compared to a growth rate of 9.4 percent in the previous quarter. Similarly, total airline passenger growth shows a year-over-year increase of only 1.8 percent compared to the growth rate of 4.5 percent in the previous quarter. Year-over-year percentage change in hotel occupancy, the only component of the Index with negative growth, decreased by 1.4 percent compared to the -2.8 percent growth rate in the third quarter of 2005.

- The Indicator Index has been steadily decreasing since its peak at 144.3 in the fourth quarter of 2004. The continuous fall in the Index indicates that the pace of job creation has slowed in 2005. And, the current value of 119.1 suggests positive job growth in the first quarter of 2006, but slightly lower than last year’s fourth quarter growth rate.