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Charting the Path Forward

2025

The Nation,
Southern California
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ECONOMIC FORECAST

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THE "VIBES ECONOMY"
OUTLOOK FOR GROWTH AND INFLATION AMIDST ELECTION UNCERTAINTY

The Nation, Southern California and Orange County

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THE "VIBES" ECONOMY

"I'm gonna hang by the bar…put out the vibe!"
– Lloyd Christmas, *Dumb and Dumber*

Overview

"I'm talkin' about a place where beer flows like wine, where beautiful women instinctively flock like the salmon of Capistrano. I'm talkin' about Aspen!"
– Lloyd Christmas, *Dumb and Dumber*

The wisdom of fools can be more profound — and endlessly more entertaining — than one cares to admit, seems to be the message of *Dumb and Dumber*, the spark-driven, inspired, irreverent, crass, off-kilter, slapstick comedy about a pair of two affable dimwitted friends on a quest to reunite a pretty woman they barely know with her mysterious suitcase. The film burst onto American screens (and ultimately hearts) exactly 30 years ago, around the time when this forecast made its first debut. But unlike this forecast, its reception was mixed: Critics welcomed it with a crinkled brow while the moviegoing public loved it. Time has been decidedly kinder proving that it is indeed hard not to love a silly movie which, though faithfully a low-brow comedy, is brilliantly intelligent in its core. Brimming with Kerouacian beat and Odyssean escapades, the film is the ultimate road trip buddy comedy (in an '84 Sheepdog) chockful of misadventures from strayed paths (I expected the Rocky Mountains to be rockier than this), awkward hot tub confessions (I got a John Deere letter), thwarting seasoned assassins (these guys must be pros), surviving getting shot by hardened kidnappers (what if he shot you in the face), and rubbing elbows with high society (this party really died). Despite all this, there is no romanticizing of our heroes: No one gets the girl or is showered with financial success. In the end, we are left with two friends, walking down a highway, with no van or moped, no money, and no prospects, playing tag and making up rules along the way (you can't triple stamp a double stamp). They don't have much, but they have each other and that's just enough. They'll be fine. It is the happy ending to end all happy endings.

The U.S. economy has been busy writing its own happy ending, at least for this hiking cycle. Much like our two lovable misfits, it has deftly (and almost effortlessly) thwarted untold dangers ever since the Fed embarked on its rate hiking cycle two and a half years ago. A four-decade high inflation, the most aggressive rate hike in a generation, a banking panic, two hot wars, rising geopolitical risks, and a massive shake-up of the presidential race with one major political candidate dropping out and another surviving two assassination attempts. The script was so dark, few expected the U.S. economy to remain unscathed. But it did, not only barely, but spectacularly.

The U.S. economy has been busy writing its own happy ending, at least for this hiking cycle. It has deftly (and almost effortlessly) thwarted untold dangers ever since the Fed embarked on its rate hiking cycle two and a half years ago.

Take growth first. U.S. real GDP has grown by an average pace of 2.8% over the past two years and a heftier 3.2% over the past year — both far above the economy's potential of around 1.7%. Momentum ebbed a bit in the first quarter of this year when growth came at 1.4%, but the quick rebound in the second quarter — a robust 3% — more than made up for the early hiccup (Figure 1). At 3.1%, the current quarter is shaping up to be another blockbuster figure, according to the Atlanta Fed which tracks a "nowcasting" model updated in real time with high frequency data. Economic activity appears to have picked up from a summer lull: A weekly tracker produced by the Dallas Fed, has strengthened to 2.7% as of the end of September (the time of this writing), up from 1.5% in mid-July. Not surprisingly, growth expectations for this year have been consistently ratcheted up. Last June, the Federal Reserve (Fed) expected it to come in at a paltry 1.1%. Those figures have nearly doubled, to 2.1%, after the September meeting. The IMF is even sunnier, having revised up its projections from 1.5% last October to a current 2.6%.

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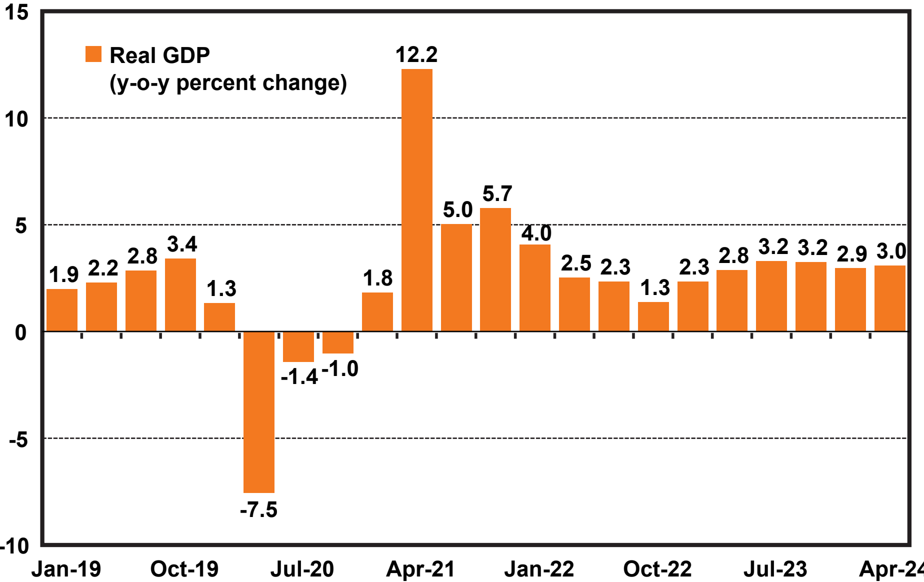
FIGURE 1
What Recession? Growth Has Remained Robust
(Real GDP growth, y-o-y percent change)

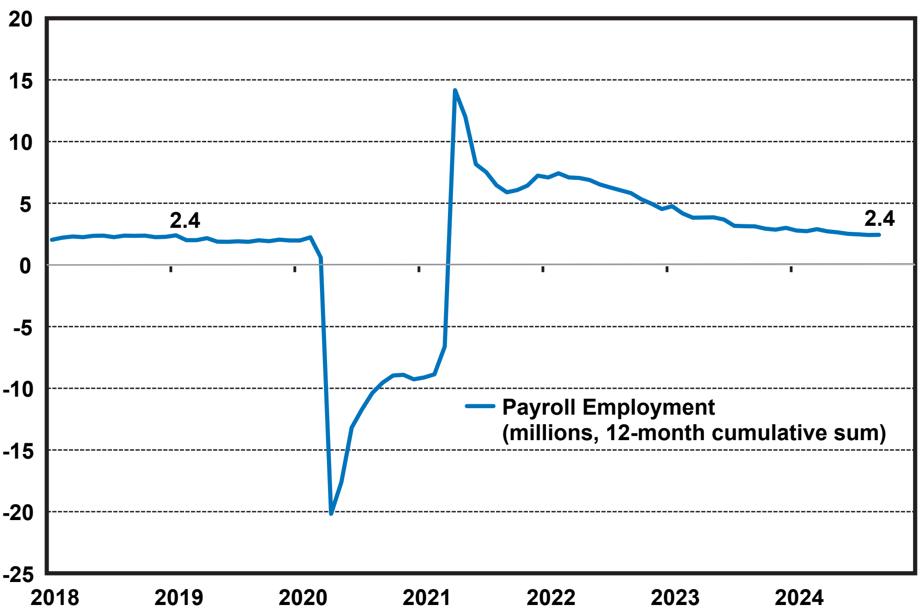


Other metrics look equally heartening. The labor market has performed admirably, even as it cools. Employment rolls have swelled by a total of 7.4 million jobs since March 2022, when the Fed started raising rates, of which 3 million were added just last year. The pace of job formation has slowed lately, but it is still sturdy: 1.4 million during the first eight months of the year — similar to the pre-pandemic rate (Figure 2). Consumer spending is robust, rising at an average pace of 2.2% in the first half of the year. Recent trends are even more upbeat: Real spending grew by 2.8% in July (latest available data) on a year-over-year basis, but by a staggering 4.7% (annualized) on a three-month-basis, suggesting that the pace of consumption has edged up. Business investments grew by 5.6%

Employment rolls have swelled by a total of 7.4 million jobs since March 2022, when the Fed started raising rates, of which 3 million were added just last year. The pace of job formation has slowed lately, but it's still sturdy: 1.4 million during the first eight months of the year — similar to the pre-pandemic rate.

in the second quarter, the highest pace since the start of the hiking cycle. Though rate hikes have made for a tough environment, mining and manufacturing activity bounced back in August after hurricane-related disruption stymied output in July. Productivity growth has rebounded over the past four quarters and is currently running at 2.7%, roughly double the rate posted after the financial crisis. Corporate earnings have also improved dramatically, posting a fifth consecutive positive quarter after wobbling late in 2022 and early in 2023.

FIGURE 2
Still Healthy Labor Market
(nonfarm payroll employment, millions, 12-month cumulative sum)



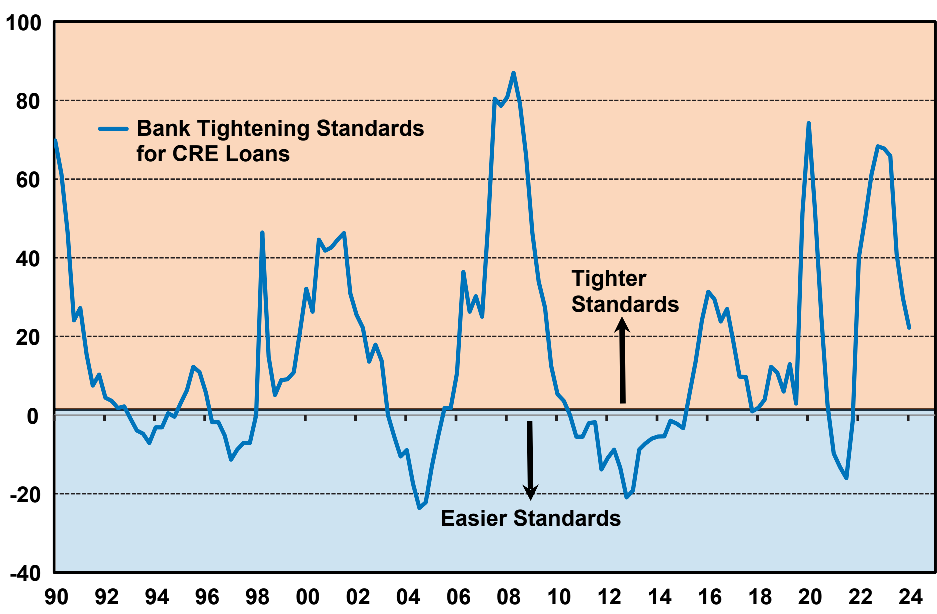
Regional banks appear to have shored up their balance sheets by setting aside chunks of funds for loan provisions in the beleaguered commercial real estate (CRE) sector.

Even corners of the market that were flashing red not too long ago seemed to have turned around. Regional banks appear to have shored up their balance sheets by setting aside chunks of funds for loan provisions in the beleaguered commercial real estate (CRE) sector. Some are gradually reducing their exposure to CRE by tilting their portfolios towards industrial loans, which have performed much better. Others sold bond holdings at a loss and used the cash proceeds to buy new bonds which will likely perform quite well now that rates are coming down. Most importantly, earnings reports seem to indicate that lenders are not aggressively selling down their CRE loans, opting instead to allow them to run off their balance sheet naturally. In the brilliant words of Lloyd Christmas (*Dumb and Dumber*) after he mistakenly drives one-sixth of the way in the wrong direction: “We're in a hole. We're just going to have to dig ourselves out.” Regional banks appear to be heeding the message, attempting to dig themselves out of troubles brewed by a toxic combination of high interest rates and souring CRE loans.

Encouragingly, banks’ lending standards for CRE loans have eased dramatically from recession-high levels recorded a year ago, and though they remain a bit tighter than in normal times, the turnaround is unmistakable.

Troubles in the CRE market are by no means over, but as we have consistently argued in these pages, they will likely simmer for a while rather than boil over and trip the expansion. Indeed, the S&P 500 regional banking sector index is up a jaw-dropping 61% since May of last year. Though this is still around 25% below March 2023 — prior to the collapse of the SVB — it is, nonetheless, a remarkable improvement. Encouragingly, banks’ lending standards for CRE loans have eased dramatically from recession-high levels recorded a year ago, and though they remain a bit tighter than in normal times, the turnaround is unmistakable (Figure 3).

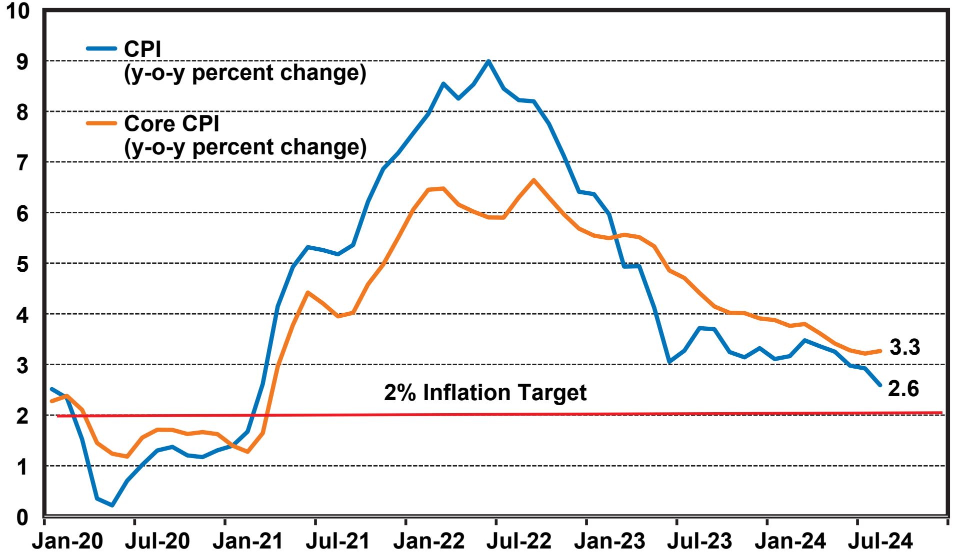
FIGURE 3
Bank Lending Standards for CRE Loans are No Longer Very Tight
(percent of banks tightening standards)



On a three-month annualized basis, core CPI is currently growing at 2% — right around the Fed's target — while core PCE at an even cooler 1.8%.

Most importantly, the miraculous outperformance of the U.S. economy is occurring against a backdrop of falling inflation. Wherever you look, inflation metrics have a consistent story to tell: Inflation appears to be well on its way to the Fed's 2% target. Consumer price index (CPI) inflation currently stands at 2.6%, the lowest since March 2021, when inflation began its ascent (Figure 4). The price index for personal consumption expenditures (PCE), a broader measure of consumer basket, has oscillated between 2.2% and 2.7% for the entire year so far after reaching a high of 7.1% in the summer of 2022. Even notoriously sticker measures of inflation, such as core CPI and core PCE which exclude volatile energy and food prices, have stepped down meaningfully: Core CPI has fallen from a high of 6.7% to a current 3.3%. Core PCE — the Fed's preferred inflation measure — has fallen by more than half, from 5.6% to 2.7%. Recent trends are even more reassuring. On a three-month annualized basis, core CPI is currently growing at 2% — right around the Fed's target — while core PCE at an even cooler 1.8%.

FIGURE 4
Lots of Progress on Inflation... But Still Above the 2% Target
(CPI and Core CPI, y-o-y percent change)



All this means that the U.S. economy has performed a rare feat: chugging along even as inflation cools. No one is more surprised than the Fed. "No way! We landed on the moon!" Lloyd exclaims after spotting a framed newspaper clipping of Apollo's moon landing, some quarter of a century ago in one of the more comical scenes of *Dumb and Dumber*. The Fed would be forgiven if it had a similar reaction of astonishment because not too long ago, it did not think it would be possible to whip inflation without causing a recession. Just look at its own dot plot in June of last year.

It's not just the Fed that the U.S. economy has taken by surprise. As it plows ahead, this expansion seems to play by its own rules, obliterating old ones along the way. Tried-and-true recession indicators have consistently sent spectacularly wrong recessionary-signals for an alarmingly long time. The yield curve has remained inverted for over two years; the Leading Economic Indicator (LEI) has languished in negative territory for a jaw-dropping 26 months (Figure 5); the ISM manufacturing index has been in recession territory since December 2022; and the number of banks tightening lending standards has never been this high outside of a recession. The alarm bells from these indicators have been nothing short than "the most annoying sound in the world" …. a Lloyd Christmas irritating "EEEEEEH" which will remain embedded in minds of economists (and *Dumb and Dumber* fans) for a very long time. Of course, over time, most analysts have learned to tune out these noises: In the latest Wall Street Journal survey, only 28% expect a recession over the next 12 months, down from 63% in October 2022. So strong was the U.S. economy that the first rate cut — slated for March — was delivered in September, a full half a year later. Optimism about the U.S. economy fueled market exuberance: From the start of the year until mid-July the S&P 500 rose by an eye-popping nearly 19%, posting positive returns in 28 out of the previous 37 weeks, its best streak in over three decades.

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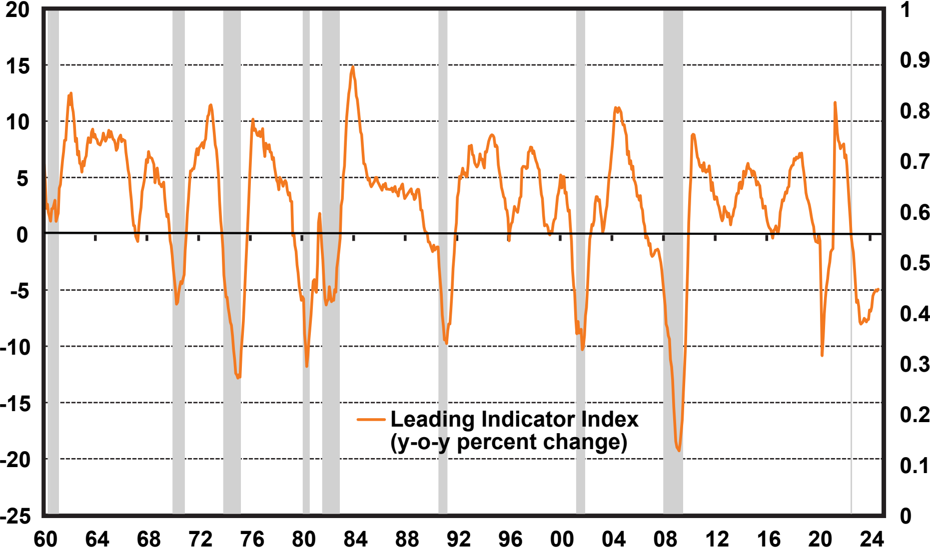
So strong was the U.S. economy that the first rate cut — slated for March — was delivered in September, a full half a year later.

FIGURE 5
A Negative Leading Indicator Has Preceded All Recessions…But Not this Time (Leading Indicator Index, y-o-y percent change, recession bars)



But the mood turned darker in early August. The S&P 500 shed nearly 6% in a span of three days. America's tech-heavy NASDAQ fared much worse, dropping by nearly 10%. Japan's benchmark TOPIX index suffered a gut-churning plunge, collapsing by 12% in a single day, marking its worst performance since 1987. For a moment in the sweltering summer heat, it appeared as if, collectively, the financial world had decided to channel its inner Lloyd Christmas complete with over-the-top-dramatic flair and despair: "We've got no food, we've got no jobs…our pets heads are falling off!"

Four main catalysts were at the heart of the doom-mongering. First, lackluster earnings from tech companies brought forth a dawning realization that perhaps the AI revolution may be imbued with wildly unrealistic expectations. Even companies that beat earnings expectations (Alphabet, Microsoft) were punished as the AI-fueled euphoria began to ebb. The second event, an unexpected interest rate hike by the Bank of Japan unraveled yen-based carry-trades — a successful strategy of borrowing at low rates in Japan to fund purchases of higher-yielding assets elsewhere— forcing many investors to liquidate positions in a hurry and reinforcing a vicious cycle in the process. Then, a weak reading from ISM manufacturing further added to jitters that perhaps the U.S. economy is slowing down more rapidly than previously thought.

But the mightiest punch was delivered by the labor market report released on Aug. 2. It landed with a thud, showing that the pace of job formation had slowed to a crawl with the economy adding a measly 114,000 jobs, far below the 175,000 expected by the consensus (these figures were subsequently revised higher, which underscores the importance of not placing too much stake on a single report). The unemployment rate rose to 4.3%, near one percentage point higher than in January 2023. Worse, the higher unemployment rate triggered the infamous Sahm Rule (developed by Claudia Sahm, an economist), which finds that since 1960, a recession has always followed when the three-month average of the unemployment rate has moved by at least half a percentage point above its 12-month low (Figure 6).

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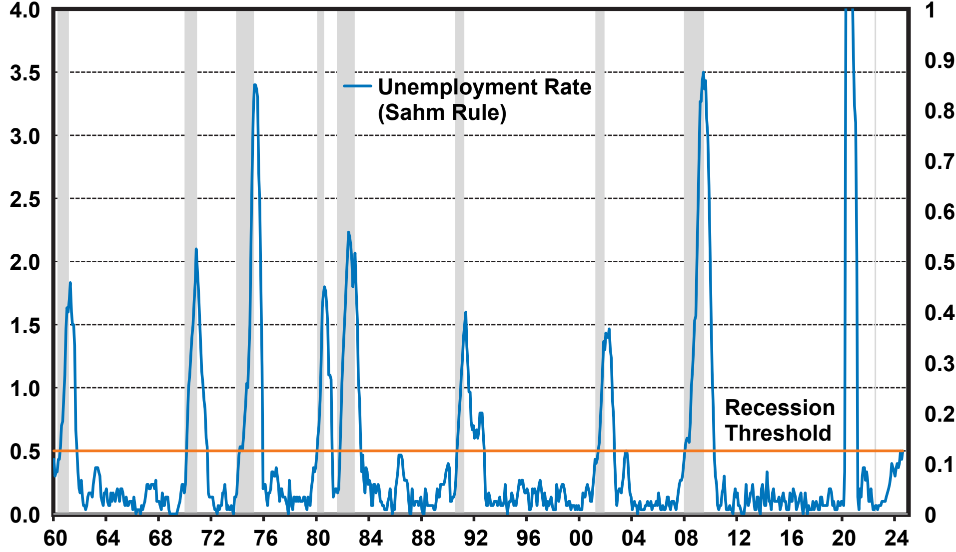
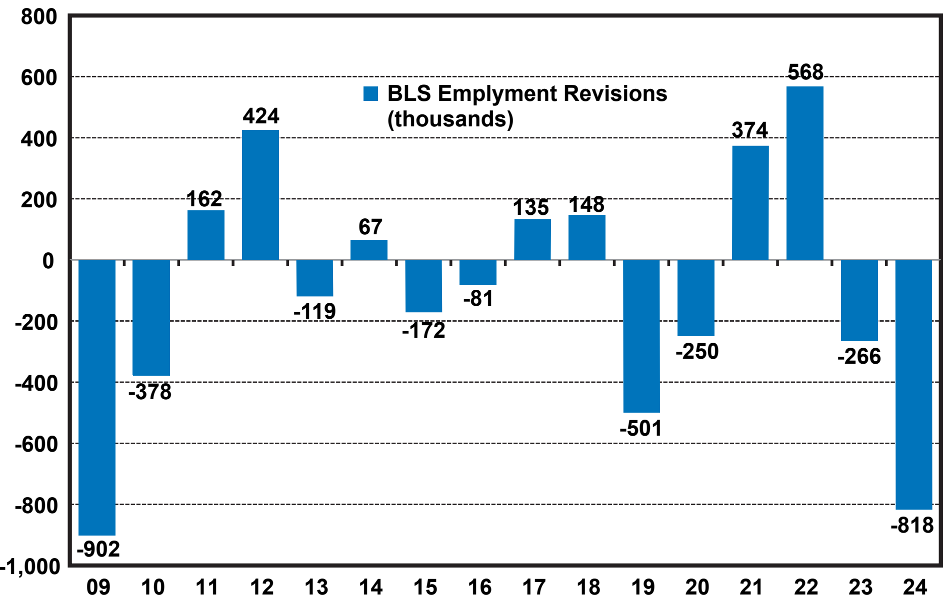
FIGURE 6
Sahm Rule Was Breached Indicating Recession Risks (unemployment rate, percent, recession bars)



Other labor market rules received immediate scrutiny: An indicator that combines the unemployment rate with the yield curve (developed by Thomas Philips, an economist) showed that a recession started in July. An expanded version of the Sahm Rule which combines the unemployment rate with job vacancies delivered an even more ominous prediction, indicating that the U.S. economy has been in recession as far back as March. Labor market doldrums intensified further when, in mid-August, the Bureau of Labor Statistics (BLS) revealed in its preliminary annual benchmark revision of data that the labor market may have not been as strong as previously reported. From March 2023 to March 2024, employment rolls were revised down by jaw-dropping 818,000 jobs, the largest revision since 2009 (Figure 7). It was enough to give investors another attack of the vapors: Panicked calls that the Fed was hopelessly and irrevocably behind the curve filled the airwaves.

FIGURE 7
Labor Market May Not Be as Strong as Initially Reported
(BLS benchmark employment revisions, thousands)



Which brings us to the Fed. In its boldest (and riskiest) move since at least the financial crisis, it lowered interest rates for the first time in four and a half years (a widely anticipated move), by a jumbo-sized 50 basis points (a somewhat disputed move). It is the closest the Fed has ever gotten to taking a victory lap on its flight to quash inflation, though Mr. Powell, the Fed Chairman, went to great pains to assure the market that "we're not declaring mission accomplished." But the message was muddled because Mr. Powell also insisted that the "economy is in a good place and our decision today is designed to keep it there," which belies the logic of an aggressive rate cut. By this reasoning, a 75 basis points cut would have signaled an outright booming economy.

In its boldest (and riskiest) move since at least the financial crisis, it lowered interest rates for the first time in four and a half years (a widely anticipated move), by a jumbo-sized 50 basis points (a somewhat disputed move).

But no matter. The market, though confused at first from mixed messaging, shook off its qualms and staged a spectacular rally the following day. "Just when I thought you couldn't get any dumber, you go and do something like this... and totally redeem yourself!" exclaims Harry Dunne, when Lloyd trades their '84 "Sheepdog" van for a small bike "straight up." In the eyes of investors, it seems the Fed has finally fully redeemed itself from letting inflation get out of hand in the first place.

We are not convinced, at least not yet. In fact, we are somewhat bewildered both by the wild swings in sentiment and the Fed's aggressive move. An economy that is growing at a 3.1% rate cannot also simultaneously be on the brink of a recession and in desperate need of an oversized rate cut. A proper recession is, in the words of Justice Porter, like obscenity: you know it when you see it. Job losses abound, growth takes a nosedive, defaults spike, businesses close. None of this has happened and there are few signs that a marked deterioration of this magnitude is in the offing. Sure, a swirl of contradictory economic news — as we have witnessed recently — usually characterizes turning points, but the U.S. economy seems poised for a gradual downshift rather than a crash landing. And even the softening is likely a few months away, at least not until early 2025.

We are somewhat bewildered both by the wild swings in sentiment and the Fed's aggressive move. An economy that is growing at a 3.1% rate cannot also simultaneously be on the brink of a recession and in desperate need of an oversized rate cut.

Thus, our outlook is a tale of two halves: continued decent (but not spectacular) growth for the remainder of the year, followed by an easing into lower gear. This seemingly benign outlook is of a soft-landing variety, with two important differences. A proper soft landing implies both no recession

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and on-target inflation of around 2%, all while interest rates fall. While we agree with the first premise — that the economy will avoid a recession over the forecast horizon — our view about rates and inflation is decidedly less sanguine than the consensus, as we expect both to remain elevated over the forecast horizon with inflation firmly stuck on a 2.5%-3% range and rates above neutral territory.

At first brush, slower growth and sticky inflation appear to go against the teachings of the most basic of economic principles: Unless strong adverse supply shocks are buffeting the economy (as was the case of oil shocks in the 1970s), shifting to a lower gear should imply softer inflation. But there is another scenario that would deliver such a seemingly contradictory outcome: a bifurcated economy. Since the commencement of the Fed hiking cycle, the U.S. economy has run on two speeds. Vulnerable sectors (low-income households and highly levered firms and banks) have struggled. In contrast, consumers and businesses with strong balance sheets have thrived. In a sense, the soft-landing aeronautical metaphor was always somewhat misguided: rather than a single plane gearing up for a downshift, the U.S. economy is fragmented in two celestial bodies traversing two completely different astral planes.

A more apt analogy would be that of a massive ship: The vessel chugs along with the upper decks comfortably sailing ahead even as the lower decks are rocked by turbulent undercurrents. The reason why the U.S. economy has managed to escape a recession thus far and will likely continue to do so (at least) in the immediate future, is because the at-risk segments account for a significantly smaller share of spending than the upper decks: Nearly two third of consumption comes from the top 40% of income earners. As long as the fortunes of this group hold up — and they should, given sizable gains in home and equity prices, rock-bottom mortgage rates locked in during the pandemic, and still strong labor markets — growth will continue and inflation will persist. This may stay the hand of the Fed, stemming the zest and the speed of future rate cuts, which in turn will inflict further pain for households in the bottom of the income distribution. The end result is slower growth and somewhat elevated inflation, even as the economy continues to evade a headlong plunge into a recession.

The case for continued growth is relatively straightforward. Recession fears were stoked primarily by midsummer blues about a significant (and unexpected) deterioration in the labor market. But that was just one report. We have cautioned extensively in these pages against overreliance in a single data point as it tends to obscure real underlying trends. “She’s a full-on Monet. It's like a painting, see. From far away it's okay, but up close it's a big ol' mess,” is a timeless line from *Clueless*, another contemporary film of the *Dumb and Dumb* era and just as unforgettable. Interpreting the data is similar to viewing an impressionist painting. Each report is a dot in the overall tableau and can be quite messy when seen in isolation. Indeed, it is now painfully obvious that the July report was an outlier. Labor market figures from the following two months were in the blockbuster range: The economy added 159,000 jobs in August and a spectacular 254,000 in September. The unemployment rate has actually edged down: from 4.3% in mid-summer to a current 4.1%. And much of the rise in unemployment figures that triggered a hair-raising panic in the summer came from temporary layoffs which tend to be volatile; they fell in the more recent reports.

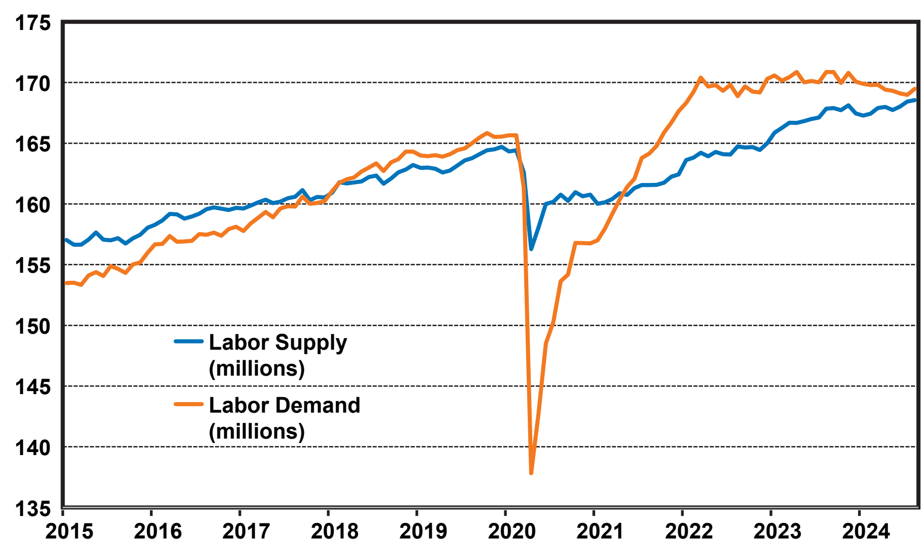
Even the triggering of the Sahm Rule has a more benign explanation: the unemployment rate did not rise because firms are laying off workers en masse, nor because of weak labor demand. Layoffs continue to remain at cycle lows and labor demand (the sum of employed workers and job openings) is finally almost in line with labor supply (as captured by the labor force). Labor demand currently exceeds supply by a mere 500,000 jobs after outstripping it by as much as 6.1 million in mid-2022 (Figure 8). Instead, the jump in unemployment rate is due to a propitious development: A rise in labor supply as a surge in immigration over the past few years and — to a significantly lesser extent — an increase in reentrants to the labor force, has swelled workforce participation rates.

While we agree with the first premise — that the economy will avoid a recession over the forecast horizon — our view about rates and inflation is decidedly less sanguine than the consensus, as we expect both to remain elevated over the forecast horizon.

Since the commencement of the Fed hiking cycle, the U.S. economy has run on two speeds. Vulnerable sectors (low-income households and highly levered firms and banks) have struggled. In contrast, consumers and businesses with strong balance sheets have thrived.

A more apt analogy would be that of a massive ship: The vessel chugs along with the upper decks comfortably sailing ahead even as the lower decks are rocked by turbulent undercurrents. The reason why the U.S. economy has managed to escape a recession thus far and will likely continue to do so (at least) in the immediate future, is because the at-risk segments account for a significantly smaller share of spending than the upper decks.

FIGURE 8
The Labor Market is Finally Normalizing
(millions of workers)



The jump in unemployment rate is due to a propitious development: A rise in labor supply as a surge in immigration over the past few years and — to a significantly lesser extent — an increase in reentrants to the labor force, has swelled workforce participation rates.

Indeed, since April 2020 when the pandemic labor market carnage ended, until August of this year (latest available data), the labor force for immigrant population has risen by a mind-boggling nearly 26%, while native-born figures show a much more modest 4% growth (Figure 9). Foreign-born workers have also been the beneficiaries of much of the recent job growth: Employment rolls for native workers rose by 625,000 in 2023, less than half the 1.3 million recorded for immigrant labor. The trend is even more pronounced this year, with native born population gaining only 265,000 jobs and the immigrant population gaining 1.3 million (Figure 10).

FIGURE 9
An Unprecedented Increase in Immigrant Labor Force Since COVID
(labor force, percent change since April 2020)

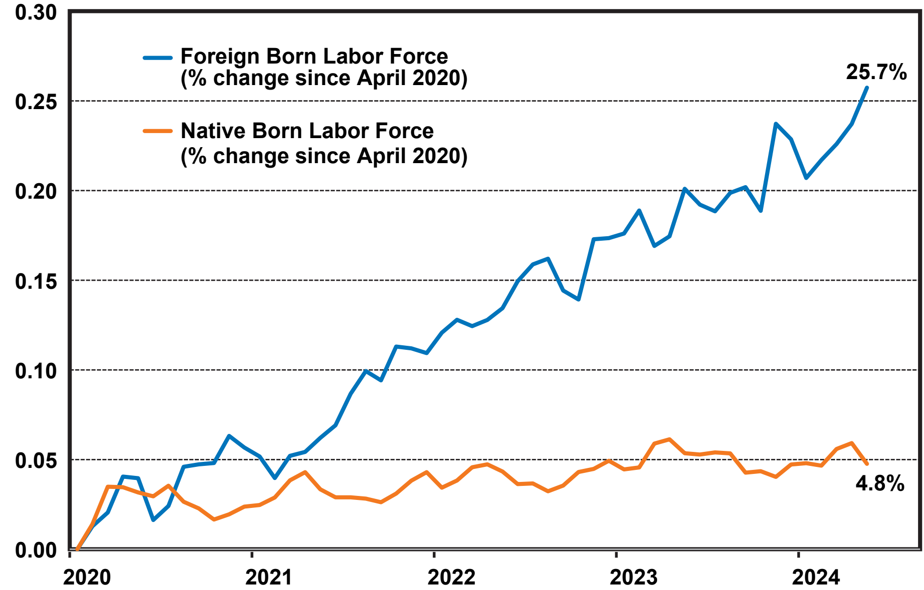
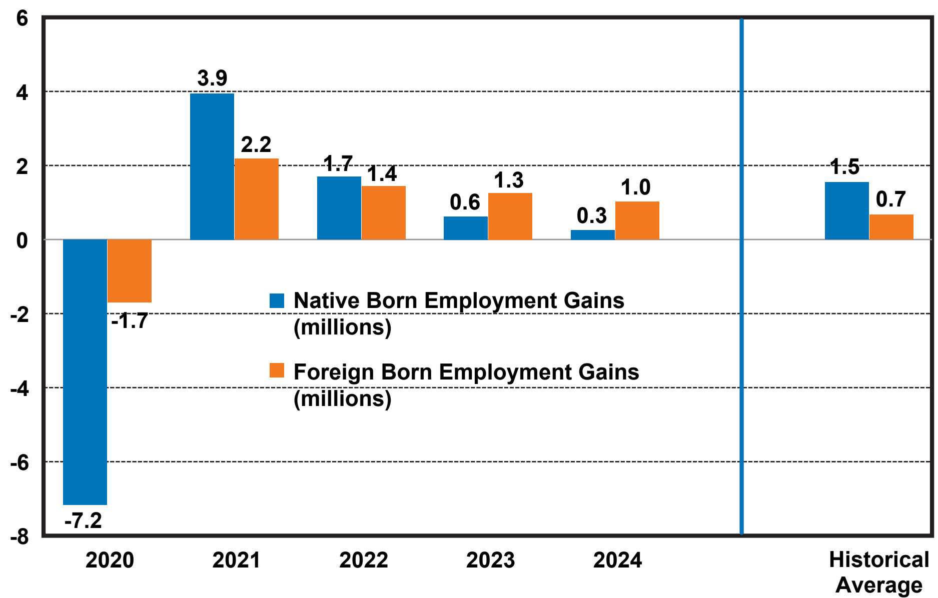
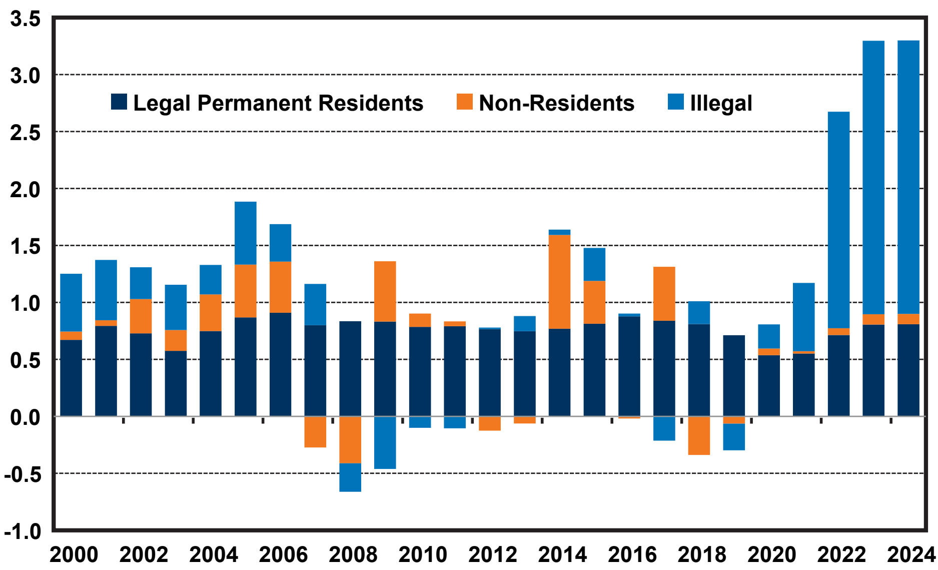


FIGURE 10
Employment for Immigrants at Historical Highs
(millions, jobs per year)



Some of these trends reflect aging demographics as over 4 million baby boomers are expected to retire each year between now and 2027. This has undoubtedly contributed to the slow pace of labor growth for the native-born population. At the same time, historically large levels of immigration have fueled the ranks of the foreign-born labor force. Immigration (legal and illegal) has shot up to 3 million per year over the past three years, more than double the 1.4 million rate that prevailed in the past two decades (Figure 11). Because recently arrived migrants are more likely to be jobless initially, a swelling of the labor force due to immigration accounts for nearly half of the rise in unemployment rate.

FIGURE 11
Immigration Has More than Doubled from Historical Levels in the Last Three Years
(millions)



Of course, the labor market has downshifted and will soften further. But this is a feature, not a bug, and is done by design. The Fed does not need to cause a slump to squash alarmingly high inflation. It merely needs a normalization in the labor market, which seems to finally be well on its way. Besides, most factors that helped America dodge a recession this past two years are still at play. Fiscal largesse will continue to prop up growth as the funding from three bills — the bipartisan infrastructure bill ($1 trillion), the Inflation Reduction Act ($1.2 trillion) and the CHIPS Act ($280 billion) — continues to make its way through the economy. Out of $220 billion of announced projects under the CHIPS Act, around $85 billion have been delayed or paused, which means that additional money is in the pipeline. Fiscal policy has been as profligate as the Fed has been tightfisted: The budget deficit for this year is expected to account for a jaw dropping 7% of GDP, a rather bizarre figure when unemployment is this low. More spending appears to be in the pipeline as both presidential candidates have promised hefty handouts to various constituencies. Some of this may not come to pass because, thankfully, the composition of Congress also matters, but legislative infeasibility should not be an excuse for outlandish campaign promises.

The Fed does not need to cause a slump to squash alarmingly high inflation. It merely needs a normalization in the labor market, which seems to finally be well on its way.

Businesses are also feeling more confident. Global CEOs are not giddy, but sentiment has improved this year. A mini-recession in earnings which lasted until mid-2023 is over and earnings have been positive for four straight quarters (Figure 12). Ten out of 11 major sectors are expected to post positive earnings this year, a complete turnaround from last year when only four sectors did. The outlook also appears heartening: Earnings expectations for the S&P 500 companies are for a blockbuster 15% growth in the fourth quarter and an additional double-digit figure in 2025.

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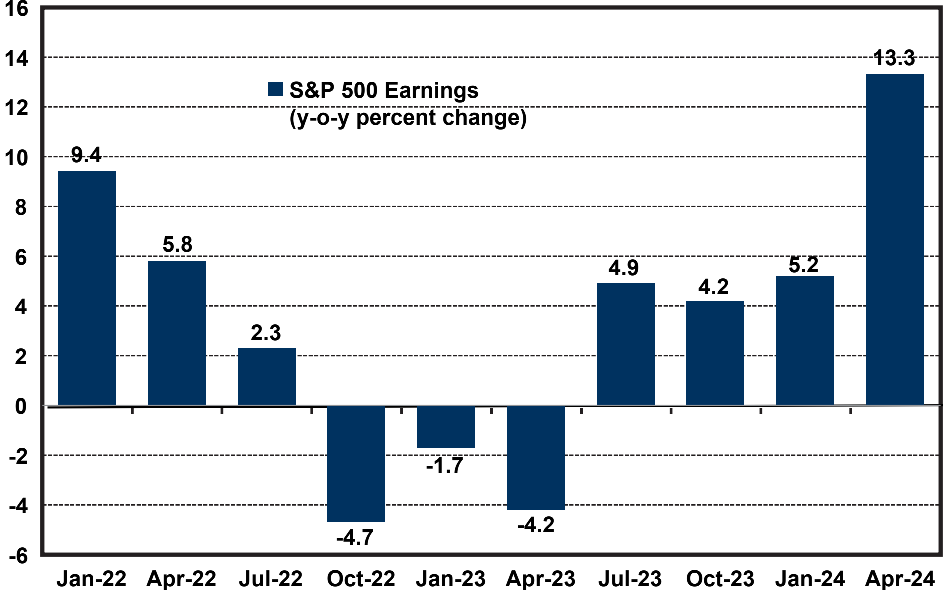
FIGURE 12
Corporate Earnings Have Rebounded...After a Mini-Recession
(earnings, y-o-y percent change)



Financial conditions have eased considerably not just recently as the Fed began to cut rates, but as far back as December when the Fed first signaled its intent to begin a rate-cutting cycle. As we cautioned in our last report, still elevated inflation and strong growth meant that rate cuts would not materialize until later in the year (as they did, in September), but the Fed pivot in December was a clear signal that the message was no longer "higher for longer." This unleashed a flurry of activity: M&A activity came to life, posting the best two quarters after being frozen for nearly sixteen months. Demand for corporate debt jumped, with investment grade, high yield, and leverage loan issuance capping the best start of the year in over two years. Corporate bond spreads have narrowed significantly as has the spread between high-yield (below-investment-grade) corporate bonds and 10-year Treasuries (Figure 13). Though interest rates are still elevated at the 4.75%-5% range, financial conditions — as measured by the Chicago Fed index — are easier than in March 2022, when the Fed began its rate hiking cycle.

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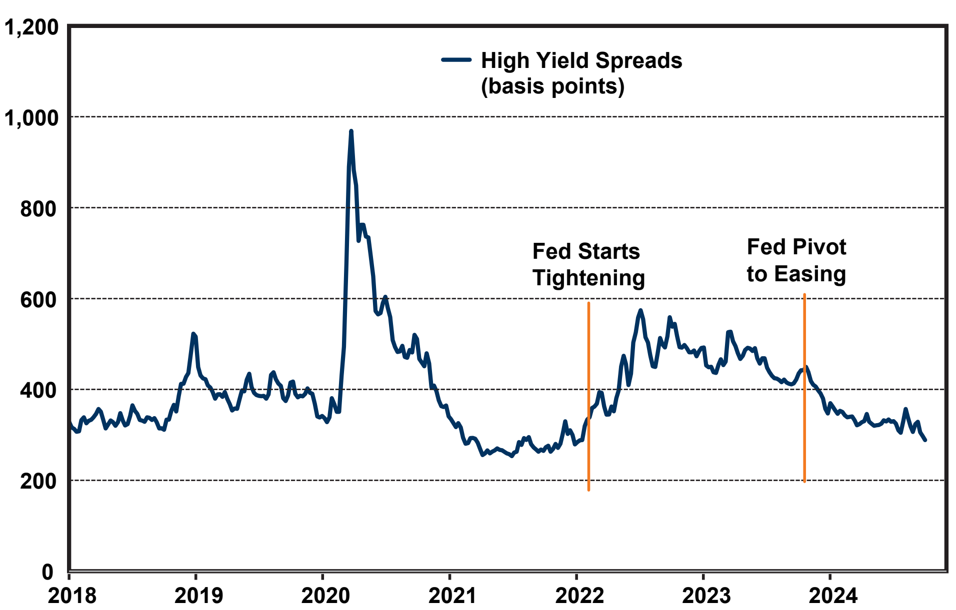
FIGURE 13
Financial Conditions Are Not Tight and Have Eased Further Since the Fed Pivot (high yield spreads, basis points)



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But perhaps the best case for a less gloomy outlook in the short term is the U.S. consumer, or more specifically, the strength of the top cohort of income earners. This slice of consumers has had a banner couple of years, continuing to spend lavishly even as interest rates rose. Their mortgage liabilities are pegged at rock-bottom pandemic rates (95% of mortgages have an effective rate of 3.9%), while their assets have benefited from an effervescent stock market and a sharp rise in home prices. And because the upper cohort owns most of financial wealth — the top 10% of household own a staggering 93% of U.S. equities — aggregate balance sheets have never looked so rosy: Financial wealth has risen by an astounding $27 trillion compared to pre-pandemic levels while homeowner equity by an additional $16 trillion, combining for an astounding $43 trillion increase in four short years (Figure 14).

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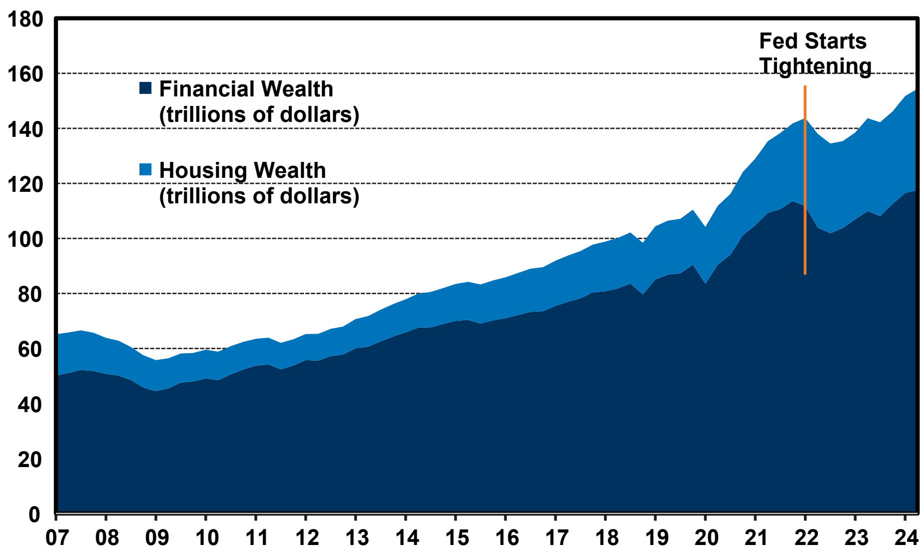
FIGURE 14
Household Wealth Has Never Grown so Fast
(financial and housing wealth, trillions of dollars)



It is no wonder that consumption has held up and even accelerated in the latest data, especially spending on services. Real spending on services rose by an average annualized rate of 2.3% in 2023, but it has stepped up to an average pace of 2.8% in the current year. The upper cohort continues to splurge on everything from themed cruises, transatlantic flights, and niche vacations. Foot traffic at airports continues to remain strong according to TSA data, OpenTable reservations are higher than last year, and Redbook retail sales — an index of sales growth from a large sample of merchandise retailers — has improved materially from a lull last summer. One of the authors of this piece experienced firsthand the heft of Taylor Swift fans — a full 150,000 of them, many of whom had flown thousands of miles— when her three concerts in Vienna were cancelled this summer due to a terrorist threat. The concerts did not go on, but Swifties made the most of it: For days, Corneliusgasse, a street in Vienna that shares the name with Swift's song "Cornelia Street," echoed the voices of thousands who gathered to sing-along, cope with the disappointment, exchange friendship bracelets and generally "shake it off."

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All this means that the outlook for inflation is more cautious than what the consensus and the Fed expect. A still strong (top cohort) consumer and additional impending rate cuts may slow the current disinflationary trend to a crawl, much as the Fed pivot last December did. CPI inflation touched 3.1% in June of 2023, remained range-bound for a while, and picked up speed in the first quarter of this year. It has declined to a current 2.6% — a mere 0.5 percentage points over a period of 14 months — largely because of a drop in energy prices. Should oil prices pick up again if the Middle East conflict broadens, expect CPI numbers to reverse trend again. Agonizingly slow disinflation can also be seen in other inflation metrics: Service inflation has only dropped from an annualized pace of 5% at the start of the year to a current 4.8%; core services — a measure of service inflation that excludes volatile food and energy prices — has inched down from 5.2% to 4.9% (Figure 15). "According to the map, we've only gone four inches," says Harry Dunne in one of the more memorable (and comical) moments of Dumb and Dumber. The same can be said about progress on inflation over the current year: It can be measured in inches. The worry is that rate cuts may slow the process even further.

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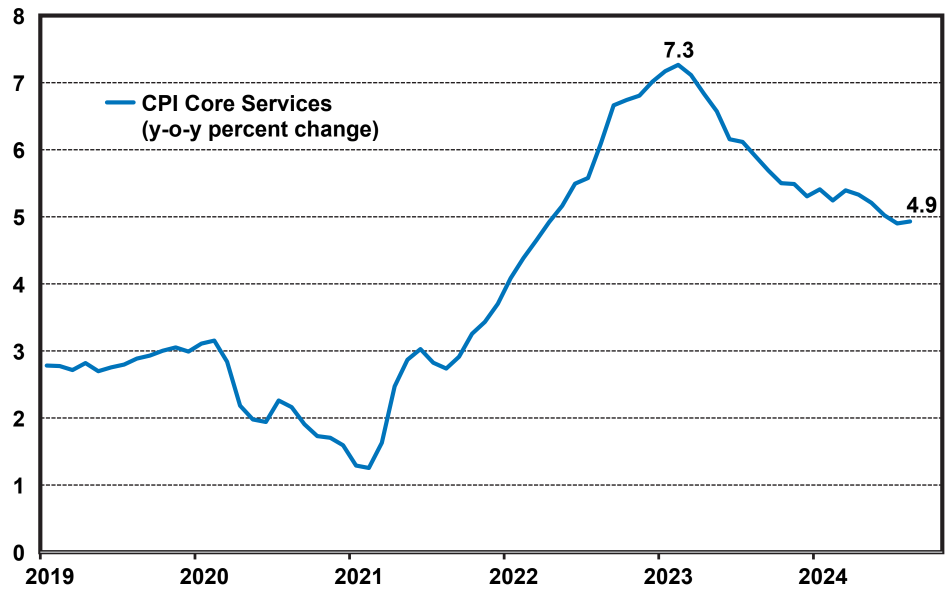
FIGURE 15
The Fight Against Inflation is Not Over: Core Service Inflation is Quite Sticky (y-o-y percent change)



The tale of two Americas brings about a second concern: slower growth beyond the immediate setting. While we don't expect the U.S. economy to plunge the depths of a recession, our view is that it is poised for a downshift, dragged primarily by the woes of lower-income households. For these consumers winter has already come. Their excess savings have been depleted: in real terms, households in the lowest quintile of the income distribution had more savings before the pandemic then they do today. They are relying significantly more on credit card debt (now upwards $1 trillion) even as interest rates on revolving debt remain at historical high levels (a staggering 21.9%) (Figure 16).

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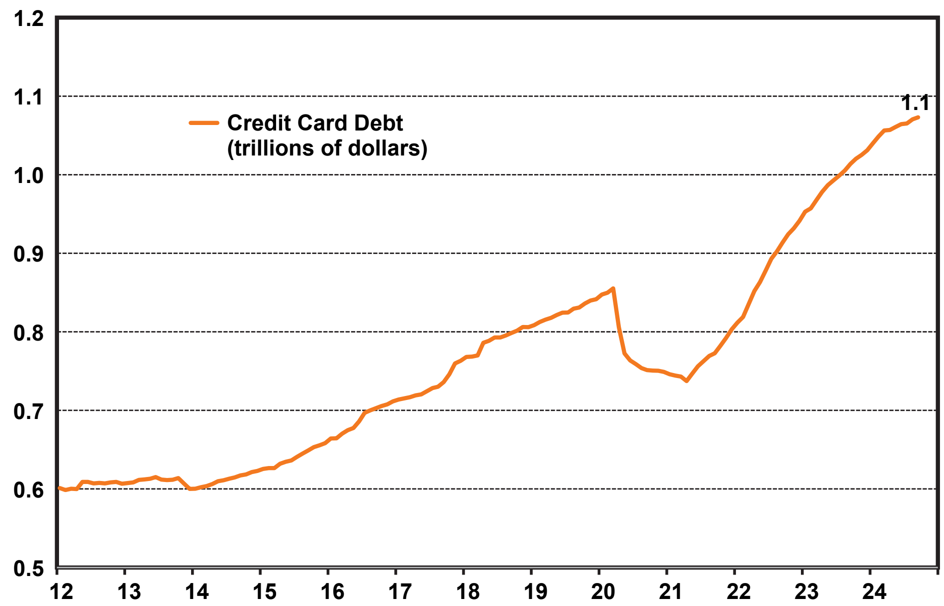
FIGURE 16
Household Stress: Credit Card Debt Over $1 Trillion (credit card balances, trillions of dollars)



Borrowers with low credit scores also account for a larger share of consumer loans than mortgage loans: As of the first quarter (latest available data) only 7% of mortgage originations went to borrowers with a credit score below 660. By contrast, 25% of auto loan originations, 34% of credit card originations, and a full 51% of personal loans were for borrowers with sub-660 credit score. It is not surprising that, while mortgage defaults have remained low, default rates for these other debt products have spiked to levels last seen at the height of the Great Recession (Figure 17). Rate cuts will bring some relief to low-income households, but the pace and magnitude of such cuts may be slower and stingier than what the consensus currently expects given still stubbornly sticky inflation.

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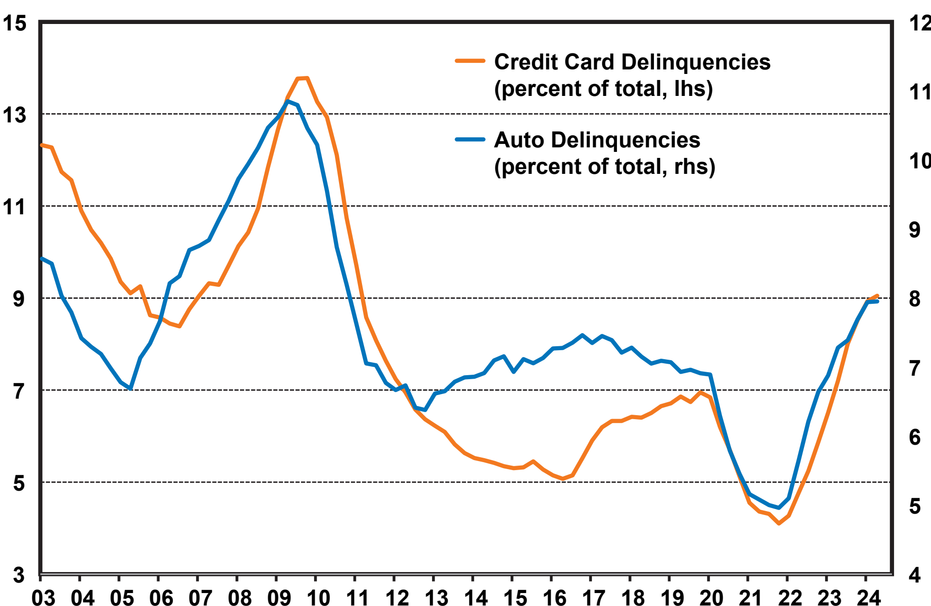
FIGURE 17
Auto and Credit Card Delinquencies Have Edged Up (transition to 30+ days delinquent, percent of total)



The labor market has softened appreciably from the red-hot pace of the past two years, a trend that will continue as elevated interest rates weigh on economic activity even as the rate cutting cycle gets on its way. The unemployment rate has edged up by nearly one percentage point from its cycle low last March. Job openings and quits have normalized, with quits running slightly below the pre-pandemic trend. The pace of job formation has downshifted to 200,000 this year, from 250,000 in 2023 and nearly 390,000 in 2022. Consumers' views of the labor market have also soured: The latest Conference Board Survey registered the lowest job market differential — the difference between the proportion of consumers who say jobs are plentiful and those who say jobs are hard to get — since March 2021.

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Could these developments eventually spell doom for the U.S. economy? Our baseline scenario eschews such an ending and forecasts that the U.S. economy will cool rather than crack over the next six quarters. But our relatively happier base case rests uncomfortably on the continued strength of a sliver of the U.S. economy: consumers, businesses and banks with strong balance sheets. This means that the outlook is uncommonly fragile, and any shock can knock it off course. Stock market valuations have gone from pricey to alarming and investors are in a mercurial mood. It won't take much for any shock — an escalation of geopolitical conflicts, election risks, a souring of sentiment — to send them into a tailspin. Should this occur, the top cohort will also retrench, dragging the entire economy into a recession. While this is not our baseline scenario, we are the first to admit that odds of a downturn are more elevated than in normal times: We put them at one in three.

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In his heart wrenching plea to his friend to take a cross-country trip in search of the girl with the briefcase, Lloyd paints a sublimely mythical place for their final destination, Aspen, a place where "beer flows like wine, where beautiful women instinctively flock like the salmon of Capistrano." Misquoting aside — he probably means where wine flows like water and where swallows (not salmon) flock in San Juan Capistrano (for some reason, he thinks Aspen is in California) — Aspen is an earthly manifestation of heaven itself: A slice of paradise with worldly delights and mystical promises where happy endings are possible even for a couple of misfits. It's the much-sought-after soft-landing-destination the Fed has been trying to reach for over two years. May it be successful. May we get to Aspen…even if it is in an '84 Sheepdog.

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A One in a Million Chance: A Soft Landing with an Asterisk

Lloyd Christmas: "What are the chances of a guy like you and a girl like me…ending up together?"
Mary Swanson: "Not good"
Lloyd Christmas: "Not good like one out of one hundred?"
Mary Swanson: "I'd say more like one in one million"
Lloyd Christmas: "So you're telling me there's a chance"
– *Dumb and Dumber*

Soft landings are the holy grail of monetary policy. They are hard to pull off — there has been only one proper soft landing in the entire post-war era, and none in the wake of a blistering bout of inflation. They require both skill (appropriate calibration of interest rates to quash inflation without chocking growth) and luck (the absence of adverse supply shocks). The consensus at the current moment seems to be that the Fed has been blessed on both fronts as the economy continues to hum along at an above-trend pace of 3% while inflation has plunged from a four-decade high of 9.1% to a current 2.4%. The Fed, it appears, is either about to or has already pulled off "a-one-in-a-million" miracle: an immaculate soft-landing.

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Perhaps. A proper soft-landing has two components: bringing down inflation to the 2% target and avoiding a recession. It happened in the 1994 tightening cycle, around the time when *Dumb and Dumber* was entertaining America with its antics. Back then, the Fed hiking cycle began in February 1994 and ended one year later, with a cumulative increase in the fed funds rate of 300 basis points. A few months later, in July 1995, the Fed pivoted and began cutting rates reducing them by a total of 75 basis points. Real GDP growth moderated to 2.2% by the end of 1995, but aside from this hiccup, it never fell below 4% for the rest of the decade. Inflation remained relatively quiescent, averaging a 2.7% annualized pace from 1994-1997, followed by a decline to 1.6% in 1998. Unemployment fell steadily, from 6.6% at the start of 1994, to a cycle-low of 3.9% in December 2000.

Could this miraculous performance be repeated? Since the 1980s, there have been three other hiking cycles (barring the 2016-2019 cycle which was followed by the pandemic) that ended in a recession. In those three instances, the average number of months from the last rate hike until a recession hit was 15 months (Figure 18). We are currently on the 14th month since the Fed last raised rates. Is a recession lurking around the corner?

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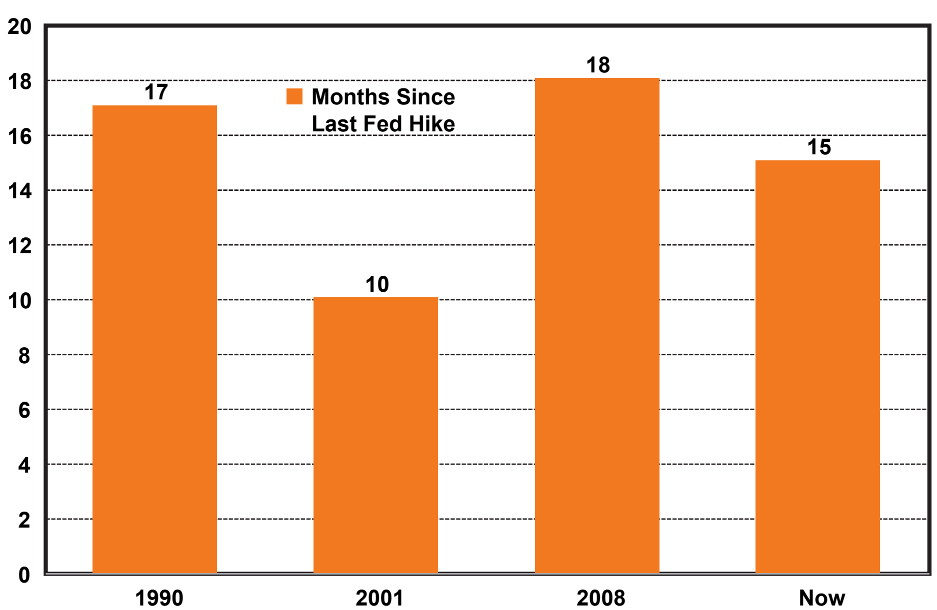
FIGURE 18
At a Crucial Juncture: Recession Has Followed 15 Months After Last Hike (months until recession after last Fed hike)



Our view is that this time the Fed will likely pull off half of the soft-landing prophecy: avoiding a recession. The other half — on-target inflation — will be a bit more elusive and harder to deliver. The outlook for economic growth is also more complex and less aligned with a textbook soft-landing scenario: we expect growth to remain robust in the short term (in contrast to soft-landing predictions), with a downshift occurring in the medium to long run. Interest rates will also remain more elevated than the consensus expects. Call this a landing on the soft-ish side, or a soft-landing with an asterisk.

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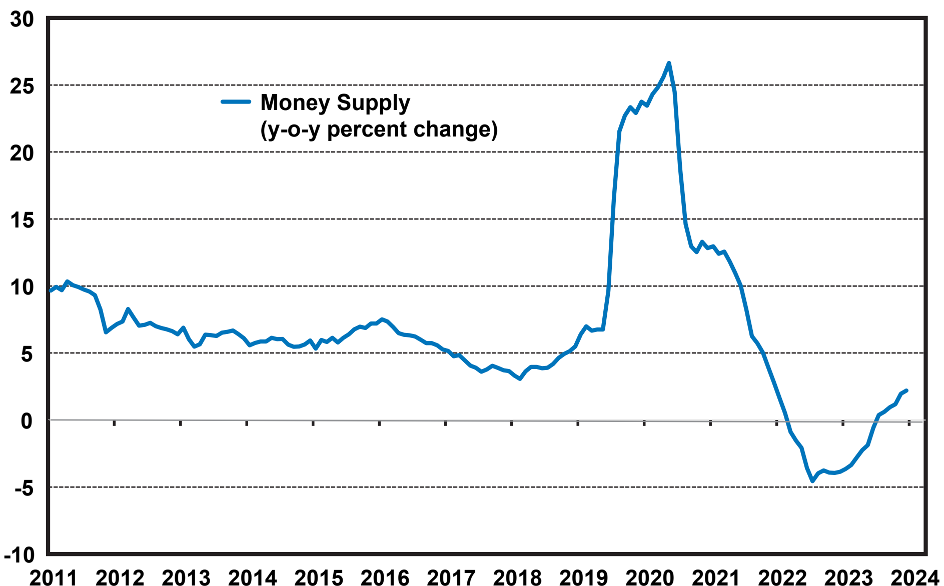
Take inflation first. The Fed's bet at the moment seems to be that inflation is sufficiently whipped so it can ease aggressively to prevent a downturn that has not yet happened. But, as argued above, financial conditions are not as tight as the Fed believes them to be. Besides, prior to the rate cuts the Fed had substantially dialed back quantitative tightening — the amount of Treasuries that are allowed to roll off Fed's balance sheet — from $60 billion to $25 billion. After shrinking for nearly one year and a half, money supply has begun to grow again (Figure 19). In its dot-plot, the Fed is projecting two more quarter-points cuts this year, and an additional four cuts in 2025, bringing its key benchmark interest rate to 3.25-3.5 percent by the end of next year. The market is even more optimistic, placing the fed funds rate by end-2025 at the 2.75-3% range.

Call this a landing on the soft-ish side, or a soft-landing with an asterisk.

FIGURE 19
Money Supply is Growing Again
(M2, y-o-y percent change)



None of this is disinflationary. In fact, a strong case can be made that such easing, coupled with a still strong economy, may slow and even reverse somewhat the hard-fought progress on inflation. That's because moderating inflation is not the same as vanquishing inflation and the battle against inflationary pressures, while no longer a full-out war, may still need a few more skirmishes before victory is declared.

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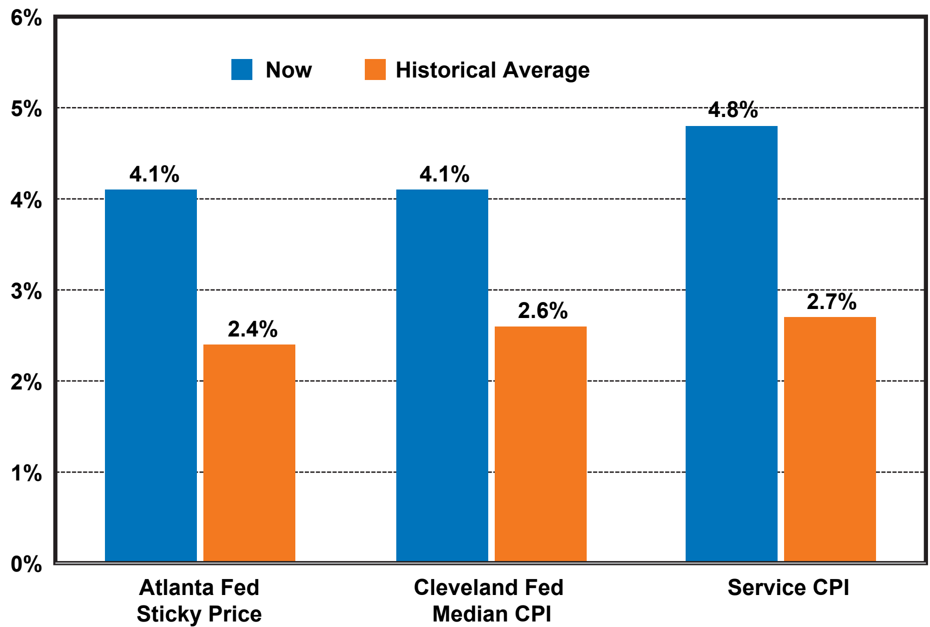
Indeed, unlike in 1994 when the Fed raised rates to preemptively stop inflationary pressures from building (inflation was 2.5% at the start of the hiking cycle), the task was monumentally more difficult this time around when inflation was already out of hand, reaching a peak of 9.1%. And on that front, much progress has been made, with the headline number dropping to a current 2.4%. However, peer underneath the hood and inflationary measures, especially those that strip away volatile prices, do not seem quite as tame. The Atlanta sticky price index, which is based on a basket of goods and services that tend to change prices less often than other items, is running at 4.1%— a full 1.6 percentage points above its historical average. The Cleveland Fed median CPI — a measure designed to capture underlying inflation by eliminating extreme price changes — is also at 4.1%. Before the pandemic it averaged an annual pace of 2.6% (Figure 20). For what it's worth, consumers also see a higher rate of inflation ahead: 12-month inflation expectations rose to 5.2% in September, according to the Conference Board's consumer confidence survey.

FIGURE 20
Inflation is Still Above Historical Trends
(annualized, percent change)



The headline figures have benefited greatly from a drop in energy prices (down 4% year-over-year and 16% from peak in June 2022) and a decline in goods inflation (down 4.2% year-over-year and 6.5% from peak in August 2022). But some emerging signs indicate that further progress may stall, at least in the short-term. Commodity prices have inched up — the Bloomberg Commodity Price index is up 7% from early September — as easier financial conditions and constrained supply chains put pressure on prices. Poor weather has sent the price of coffee beans soaring this year, resulting in "fear and panic" among Italians, according to the Italian Espresso Institute. The Drewery World Container Index (WCI), which measures the price of a forty-foot container has moderated from a high of $5,900 in July to a current $3,700, but this is still nearly double the rate of a year ago. This reflects heightened geopolitical tensions: Red Sea attacks continue to divert cargo ships away from the Suez Canal towards the Cape of Good Hope, adding an additional week to shipments from China to Europe. The ISM index of prices paid — a gauge of goods inflation six months down the road — is running 11% hotter than last year. And though oil prices have remained contained in the mid-$70 to mid-$80 range over the past four months, scenarios where they can be inflamed back up are not too outlandish. A broadening of the Middle East conflict is one of them. A growth revival in China — which has just unveiled a blitz of monetary measures from rate cuts to outright credit ($100 billion worth) to support sagging stock prices — is another factor that may juice up oil prices.

Though oil prices have remained contained in the mid-$70 to mid-$80 range over the past four months, scenarios where they can be inflamed back up are not too outlandish.

The biggest concern continues to be service inflation. This has fallen from a cycle high of 7.6% to a current 4.8%, but it's still running more than two percentage points higher than its historical average. In part, this is due to housing costs: shelter inflation — which captures both rents and owner's equivalent rent (OER) (how much owners would pay for rent if they leased their own homes) — has slowly moderated, but still continues to remain nearly two percentage points above its historical average. The slow pace of moderation is expected: As we have argued in these pages in the past due to quirks related to data computation, rent growth appears with a 12-month lag in inflation statistics. Thus, recent moderation in rents (the Zillow national average index has been growing at a historical pace of 3.5% for the past fourteen months) should continue to filter through to inflation statistics.

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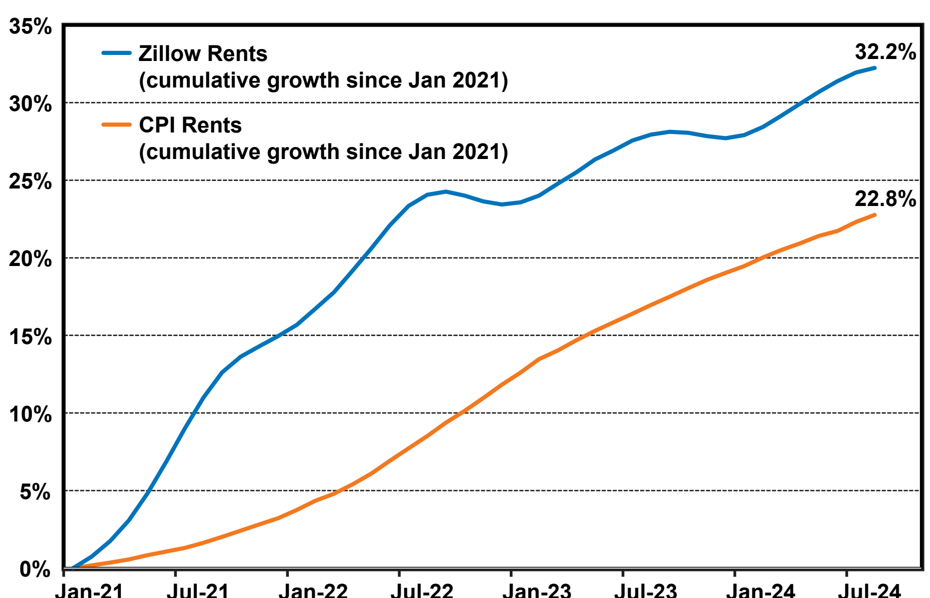
However, there is reason to believe that the filtering may be even more snail-paced than in the past. The Zillow rent index has risen by a jaw-dropping 32% since January 2021, whereas the CPI shelter has only risen by 22% over this period (Figure 21). This means that the CPI rent measure understated rent growth in 2021-2022 and therefore has a bit more to catch up. This will slow the pace of rent moderation. It also explains why shelter inflation ticked up in the latest data (August). The issue is one of timing, not of fundamentals, but speed bumps in the transmission process means that core CPI will take a while longer to return to target. Rate cuts will also juice up the long-dormant housing sector, placing additional strains on home prices, and by extension, inflation.

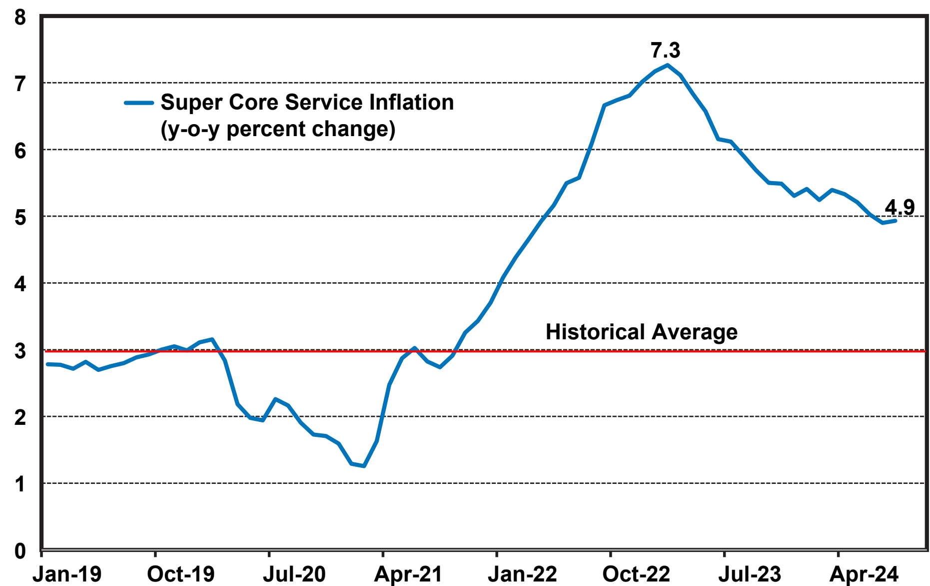
FIGURE 21
Rent Increases Have Yet to be Fully Reflected in CPI
(rents, CPI rents, percent change from January 2021)



Even if we dismiss troubles with shelter inflation as purely a "timing" issue, the picture does not improve materially. Super-core service inflation, a measure that excludes housing inflation, is currently running at 4.3% rate — a full 2.3 percentage points above its historical average.

Even if we dismiss troubles with shelter inflation as purely a "timing" issue, the picture does not improve materially. Super-core service inflation, a measure that excludes housing inflation, is currently running at 4.3% rate — a full 2.3 percentage points above its historical average (Figure 22). Part of this is due to a dramatic price increase in things like car insurance (up 16% year-over-year and nearly 50% since January 2020) and vehicle repairs (up 4% year over year and 36% since January 2020). Though the labor market has softened significantly, wage growth is also pushing up core service inflation: The Atlanta Fed Wage Tracker Index has moderated

FIGURE 22
Service Inflation is High Even After Stripping Housing Costs
(core service inflation less housing, y-o-y percent change)



to 4.6% in the most recent data from a high of 6.6% recorded last year, but it is still above its pre-pandemic average of 3.2%. The BLS Employment Cost index is running at a 4% annualized pace, down from a high of 5.1% recorded in 2022. It would have to decrease to about 3% to be consistent with the Fed's 2% inflation target.

All this means that inflation, though headed in the right direction, will likely continue to remain sticky in the short run. But a strong case can also be made that secular forces will also keep it elevated in the long run. By some estimates, the green-energy transition — converting the entire U.S. grid to run on fully renewable energy — will cost around $4.5 trillion over the next decade. This will put pressure on prices, at least while the transition is ongoing. A fragmentation of global trade where supply chains are redesigned with an eye towards resiliency rather than efficiency, will also weigh on inflation. Tariffs are here to stay no matter who wins the presidential election in November and will likely escalate further if Mr. Trump is elected. Though the impact of tariffs on inflation is much more muted than what is touted in the media (after all, they account for a small slice of imported goods and an even smaller sliver of CPI), they are inflationary on the margin. Geopolitical conflicts have necessitated more defense spending: Global spending on defense rose to an-all-time high of $2.4 trillion in 2023. More is in the pipeline, which will put further upward pressure on inflation. Government spending will also keep inflation elevated: The Congressional Budget Office (CBO) projects that the U.S. budget deficit will remain above 5.5% of GDP over the next three years, even though it forecasts no recession for those years.

All this means that inflation, though headed in the right direction, will likely continue to remain sticky in the short run. But a strong case can also be made that long-term secular forces will also keep it elevated in the long run.

With these dynamics, it is no wonder that long term rates edged up even as the Fed cut rates by an outsized 50 basis points in September. This means that the neutral rate of interest (r-star) — the rate at which monetary policy is neither restrictive nor accommodative — is likely higher than in the past and almost surely higher than what the Fed thinks. It does not help that the neutral rate of interest is remarkably elusive because it does not really exist in observable reality. "Like faith, it is seen by its work," wrote John Henry Williams, an economist, back in 1931. Nonetheless it is hailed as the guidepost for central banks: Without it, it is hard to determine whether the stance of monetary policy is too tight or too loose which makes it difficult to set a target for where the fed funds rate ought to land.

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The Fed's latest "dot plot" projections currently put the neutral rate at 3%, but there is remarkable uncertainty about it. Based on 11 "dot plot" forecasters, it could be as low as 2.375% or as high as 3.75%. Three models maintained by the Atlanta Fed, put it at a much higher rate, ranging from 3.5% to 4.8%. Our own view hews more closely to the latter estimates, with the neutral rate likely in the range of 3.5% to 4%. The same factors keeping inflation elevated in the long term — decarbonization, deglobalization, vast public debts, and increased military spending — have also pushed the neutral rate higher and are likely to keep it there for the foreseeable future. Should significant productivity gains from artificial intelligence also materialize, this could juice up potential growth, and as a result, the r-star. The risk is that the Fed, thinking that r-star is much lower, may cut rates too aggressively inviting resurgent inflation.

Thus, half of the story of a soft landing — 2% on-target inflation— may be harder to achieve this time around. However, we believe the Fed will be more successful on the second front — avoiding a full-scale recession. Our outlook is for continued, relatively solid growth in the short-term, followed by a downshift likely two to four quarters down the line.

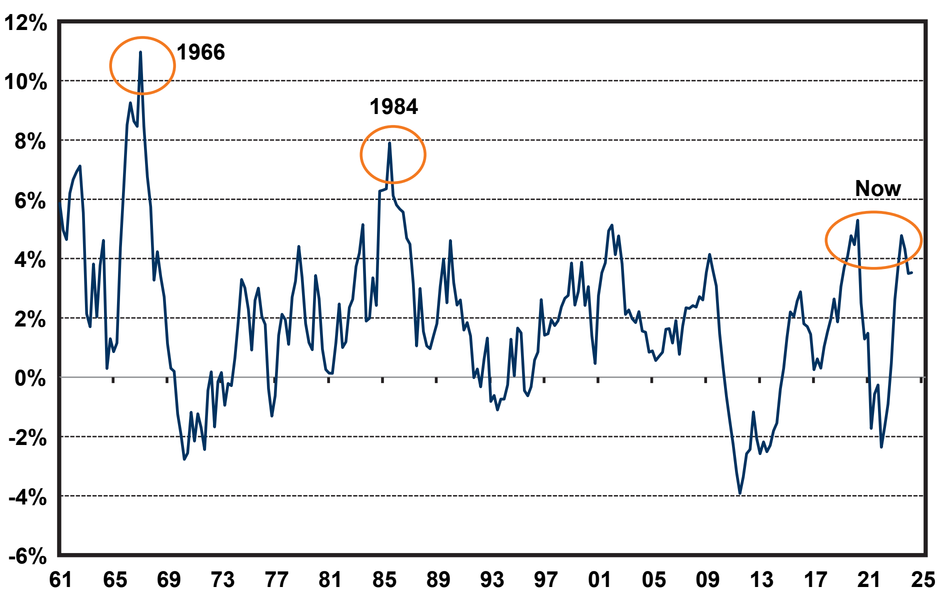
Thus, half of the story of a soft landing — 2% on-target inflation— may be harder to achieve this time around. However, we believe the Fed will be more successful on the second front — avoiding a full-scale recession.

A few factors shape our outlook. First, the commencement of the recent rate-cutting cycle should extend the life of this recovery. In fact, much like Benjamin Button in *The Curious Case of Benjamin Button* — a man who ages in reverse, transforming over time from an old man to a young child — the U.S. economy is on the cusp of a rejuvenation brought on by rate cuts. The usual pattern of the business cycle — early, mid, late and recession — has been arrested and reversed, with the economy transitioning from late-stage expansion (with high inflation, tight labor market and restrictive monetary policy), to a mid-stage cycle where corporate earnings pick up, credit expands, and monetary policy is generally neutral.

In fact, much like Benjamin Button in *The Curious Case of Benjamin Button* — a man who ages in reverse, transforming over time from an old man to a young child — the U.S. economy is on the cusp of a rejuvenation brought on by rate cuts.

In many ways this recovery has more in common with the quasi-soft-landings of 1966 and 1984, than the one in 1994. We call them "quasi landings" because neither fits the proper definition of a soft-landing. In 1996, the Fed raised rates by 175 basis points, only to immediately lower them and the tightening and subsequent easing of 1984 was mostly a policy recalibration after the inflation battle of the early 1980s. In both scenarios, a recession was avoided, in large part because of outsized government spending. Between 1965-1968, government spending as share of GDP rose by 3.5 percentage points due to the escalation of Vietnam war and an expansion of social benefits. Likewise, the economy received a boost from government spending in the mid-1980s (Figure 23). A similar story has unfolded over the past couple of years with lavish fiscal support cushioning the blows of tight monetary policy. More is to come: The CBO projects the deficit to remain above 800 billion over the next two years.

FIGURE 23
Soft Landings Aided by Government Support
(real government spending, y-o-y percent change)



Our growth outlook — stronger in the near term but slower longer term — is driven primarily by the bifurcated economy, the two Americas that are pulling growth (and inflation) in opposite directions. Wherever you look, it's impossible to miss the two-track expansion. A full 58% of U.S. households own stock, but the top 10% owns 93% of equities; the top 1% owns 38%. Households in the bottomer 10% of the income distribution devote 75% of income towards necessities (food, housing, transportation), compared to 55% for the top 10%. The bottom cohort also relies more on credit cards for spending: Households in the lowest decile of the income distribution have credit card debt equal to 85% of monthly income. By contrast, debt accounts for only 10% of income for households in the top decile.

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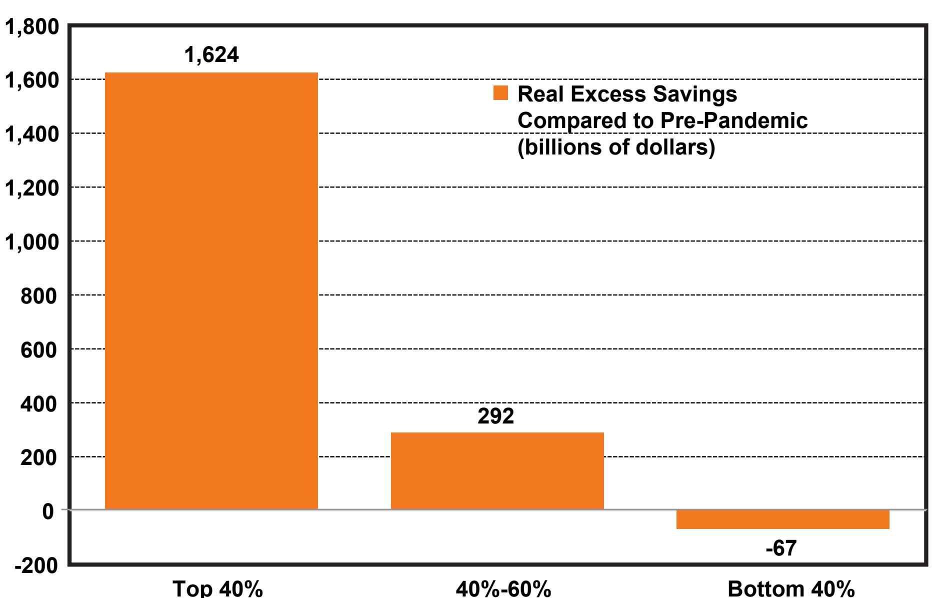
Of course, America has always had a two-track economy, but the bifurcation has become significantly more pronounced in the wake of higher rates. As rates rose, credit card and auto loan delinquencies spiked for young households, which tend to be less wealthy, and more credit constrained. Instead, the top cohorts benefited from higher rates since their liabilities (mortgages) were pegged at low pre-pandemic rates, while their assets earned higher interest. Indeed, the top 40% of income earners are still swimming in cash: For this cohort, excess savings adjusted for inflation is a staggering $1.6 trillion higher than before the pandemic (Figure 24). In contrast, for the bottom 40% of households real excess savings are now running $67 billion below pre-pandemic levels. It is no surprise then that the top 20% of income earners accounted for 45% of spending over the past year, up from a historical average of 37%.

America has always had a two-track economy, but the bifurcation has become significantly more pronounced in the wake of higher rates.

FIGURE 24
A Tale of Two Americas: The Top Cohort Doing Well..the Bottom, Not so Much (real excess savings compared to Q4 2019, billions of dollars)



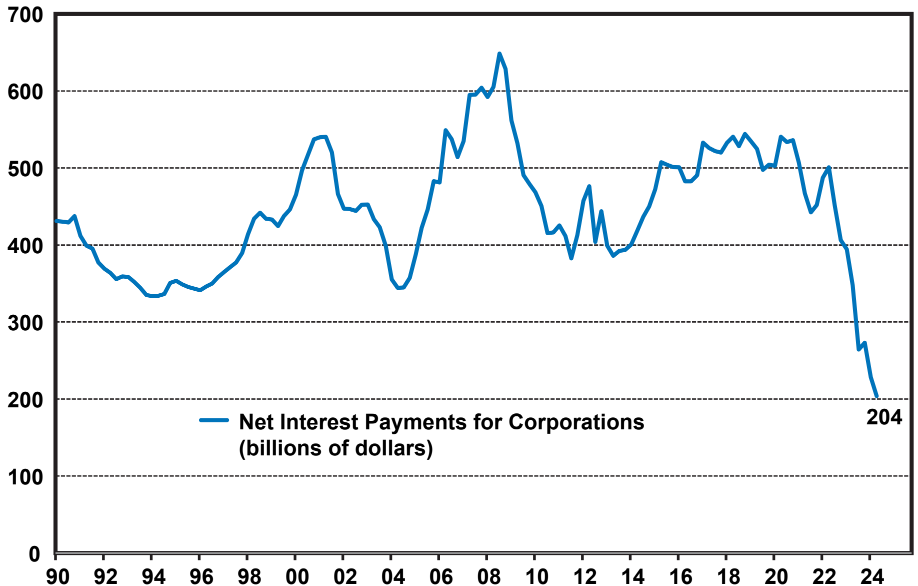
The two-tiered economy extends beyond consumers. There has never been a more lopsided market rally than the present one. Barring the past few weeks when gains appeared to have broadened out, tech stock — or more specifically, the Magnificent 7 (or Mag 3…or Mag 2) — accounted for as much as 75% overall S&P 500 gains.

The two-tiered economy extends beyond consumers. There has never been a more lopsided market rally than the present one. Barring the past few weeks when gains appeared to have broadened out, tech stock — or more specifically, the Magnificent 7 (or Mag 3…or Mag 2) — accounted for as much as 75% overall S&P 500 gains. Forty two percent of firms in the Russell 2000 (which includes primarily small firms) have negative earnings. That figure is much smaller (only 14%) for the Russell mid-cap and almost imperceptible (only 6%) for firms in the S&P 500 index.

Firms with strong balance sheets have performed particularly well during the past two years, even benefitting from high interest rates.

Firms with strong balance sheets have performed particularly well during the past two years, even benefitting from high interest rates. They entered this rate hiking cycle unusually cash-rich: Corporate cash rose from an average of $1.1 trillion in 2019 to an astounding $2.7 trillion in 2021. Their debt was locked in at low interest rates during the pandemic while their cash buffers turned in a hefty interest as rates marched upwards. This explains why net interest fell by 35% instead of rising during the past two years (Figure 25). In contrast, highly leveraged firms have suffered: Default rates have risen both for high yield bonds and leveraged loans.

FIGURE 25
Corporate Net Interest Payments Have Dropped Even Though Rates Have Risen (billions of dollars)

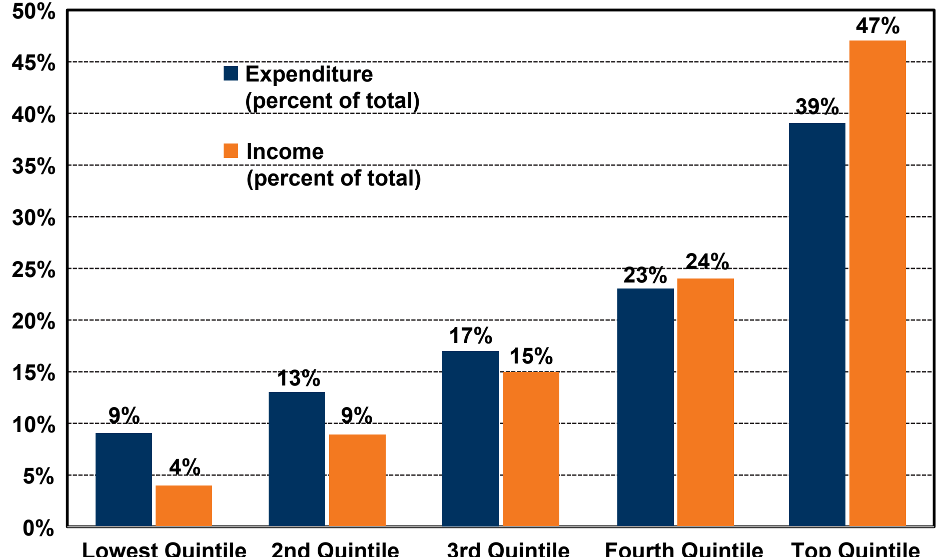


It is precisely this dramatic bifurcation that lies at the heart of the "vibes" economy, the notion that hard data and sentiment have not only been diverging over the past two years, but outright contradicting each other.

The story is the same in the banking sector. Higher rates have brought on a windfall of $1 trillion for large banks as they received higher rates on their reserves with the Fed but kept rates much lower on their deposits. In contrast, small regional banks which are more exposed to commercial real estate (CRE) have suffered both from potential portfolio losses tied to higher rates and CRE defaults. Nearly 300 (out of 4,000) small regional banks are at risk, having dipped below their minimum capital requirements.

It is precisely this dramatic bifurcation that lies at the heart of the "vibes" economy, the notion that hard data and sentiment have not only been diverging over the past two years, but outright contradicting each other. Headline numbers — real GDP, aggerate income, aggregate wealth — have never seem so strong, yet consumer confidence has never been so glum. That's because topline (aggregate) numbers are driven primarily by top cohorts of the income distribution: The top 40% of U.S. households account for 71% of total income and 63% of consumption (Figure 26). These households are doing fine. But for most consumers — the bottom 60% — fortunes have diverged, and sentiment has soured: a full 66% of consumers expect the US economy to fall into a recession over the next 12 months.

FIGURE 26
The Top Cohorts Account for Most of the Expenditures in the Economy (percent of total)



Our baseline outlook of no recession reflects almost entirely the fortunes of the top cohorts. They still have heft and buffers to continue to spend: Their excess savings remain high, housing wealth and financial net worth has hit record levels, and income growth continues to remain strong. The same is true on the corporate side: Distressed segments of the market — leveraged loans and high yield bonds — combine for a small portion of the market, a total of $2.7 trillion, far lower than investment grade credit which is a jaw-dropping $9 trillion. And even distressed firms have fared better during this cycle: instead of liquidating, which invariably leads to mass layoffs, companies are restructuring/reorganizing at the highest rates in record. They have been able to do so thanks to equitization — exchanging debt for equity — supported by plenty of dry powder: $1 trillion in private equity and $400 billion in private credit. Now that interest rates are falling, default rates should also decline: Default rates for leveraged loans were 1.55% in September, a sharp drop from a peak of 2% recorded as recently as February.

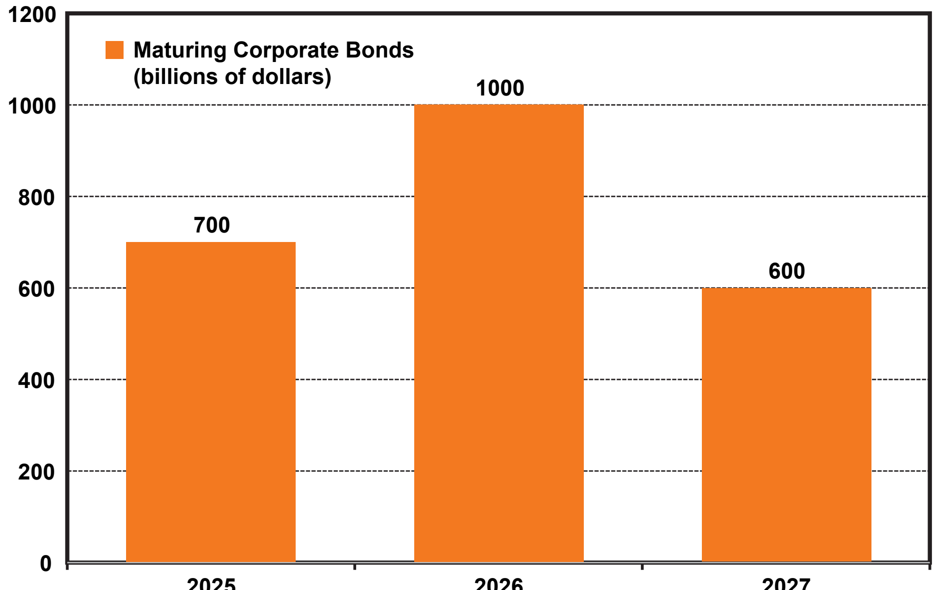
Our baseline outlook of no recession reflects almost entirely the fortunes of the top cohorts. They still have heft and buffers to continue to spend: Their excess savings remain high, housing wealth and financial net worth has hit record levels and income growth continues to remain strong.

Having said that, we expect the economy to slow beyond the current setting. Consumption spending is already showing strains from stressed households: Spending growth for the bottom 40% of the income distribution has slowed from above 8% in 2021 and 2022, to 3% in 2023. When data are compiled for the current year, we expect further retrenchment. Anecdotal evidence seems to indicate that while consumers are not panicky, they have become more picky. While Taylor Swift concerts are packed, Burning Man (an annual week-long festival in the Nevada desert) and Coachella (America's biggest music festival), failed to sell out for the first time since 2010, at the depth of the Great Recession. McDonalds and Starbucks signaled weaker sales in recent months, as low-income consumers have pared back dining out. Consumers are prioritizing needs over wants: Discretionary spending (outlays on things like recreation, restaurants, furnishing) is growing slower than non-discretionary spending (outlays on housing, health care, insurance, etc.). This has historically been a reliable indicator that the business cycle is at a turning point when growth slows and economic activity downshifts.

Anecdotal evidence seems to indicate that while consumers are not panicky, they have become more picky.

Paradoxically, as rates fall, interest expenses for businesses will likely rise. That's because, unlike mortgages, business fixed-rate loans typically last 3 to 5 years. A full $2.5 trillion of corporate loans are due to be refinanced between now and 2027: $700 billion in 2025 and $1 trillion in 2026. As interest rates are unlikely to hit the zero-lower-bound as they did during the pandemic, these loans will be refinanced at higher rates. Ditto for corporate bonds. Bonds of BBB-rated firms due to expire in 2025 have a current average rate of 3.8%. They will probably attract a rate close to 5%-plus when reissued next year and beyond.

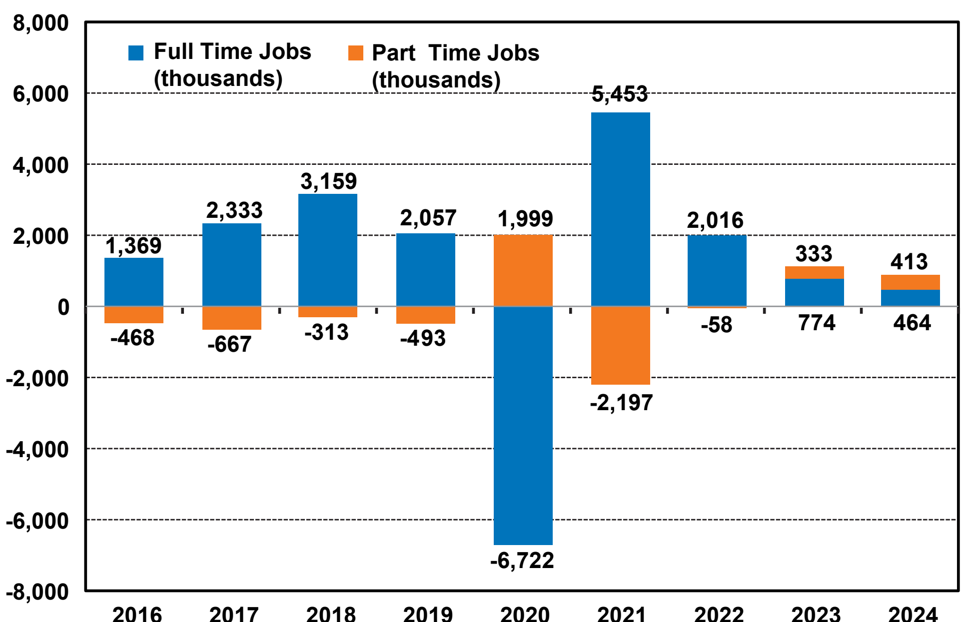
FIGURE 27
$2.5 Trillion Corporate Debt Will Be Refinanced at Higher Rates (billions of dollars)



The biggest concern is the outlook for the labor market. Though initial claims remain low as layoffs are still rare, it has become painfully obvious that the current labor market is no longer the miraculous engine it was over the past two years. Temporary help jobs — usually a leading indicator of labor market health— have collapsed to levels consistent with an impending recession. Though the drop likely reflects a normalization after a sharp post-pandemic increase rather than an imminent recession, it undoubtedly points towards a softening of the labor market. Job composition is also worrisome: The economy has added 464,000 full-time jobs this year — a sizable downshift from 770,000 posted last year and more than 2 million in 2022. In contrast, part-time employment has risen by 413,000 so far this year, larger than the 330,000 recorded for the entirety of 2023 (Figure 28). The breadth of job formation has also narrowed: Over the past three months a jaw-dropping 66% of jobs were in government and health care, a dramatic increase from a historical average of around 28%. This is concerning because uncommonly large job gains in these two sectors tend to reflect secular trends rather than underlying labor market strength. Historically, the job market tends to narrow before it shifts to lower gear.

The biggest concern is the outlook for the labor market. Though initial claims remain low as layoffs are still rare, it has become painfully obvious that the current labor market is no longer the miraculous engine it was over the past two years.

FIGURE 28
Labor Market Has Added Too Few Full-Time and Too Many Part-Time Jobs (thousands of workers)



Faced with a possibility of inflation at 3% and a sagging labor market, the Fed will prioritize the labor market and continue with rate cuts. This is probably the more prudent course, but the Fed should be more upfront in acknowledging its newfound tolerance for an inflation rate more in the "two point something" to 3-point range, rather than its 2% target. Of course, the hope is that rate cuts will extend the life of this expansion. "I get 70 miles to the gallon on this hog," exclaims an ecstatic Lloyd about the tiniest minibike for which he traded his "Sheepdog" van. Here is to hoping that this expansion gets a lot of mileage from these cuts.

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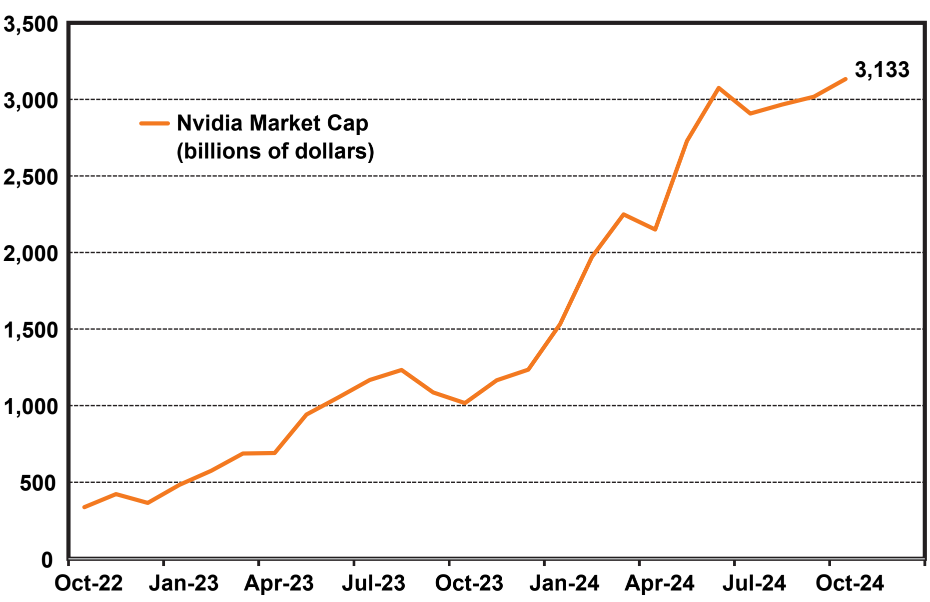
The Revolution Won't be Televised: The AI Revolution and the Economy

Lloyd Christmas: "My friend Harry and I are saving up money for a pet store"
Mary Swanson: "That's nice"
Lloyd Christmas: "I got worms!"
Mary Swanson: "I beg your pardon?"
Lloyd Christmas: "That's what we're gonna call it. I got worms! We're gonna specialize in selling worm farms. You know, like ant farms"
– Dumb and Dumber

The promise of generative AI — as a tool to transform companies, industries and societies — has taken the world by the storm. Unlike the idea of a worm farm (enthusiastically named "I got worms!") which sounded brilliant only to our two hapless Dumb and Dumber friends, generative AI is being embraced wholeheartedly and universally. No other company embodies the AI-frenzy more completely than Nvidia, whose meteoric rise in market value is unparalleled in history. Its market capitalization rose from $350 billion in early 2023 to $1 trillion (in May 2023), to $2 trillion (in February 2024), and then, to $3 trillion (this summer), briefly becoming the world's most valuable company (Figure 29). It has since been dethroned from that spot (by Apple and Microsoft, who regained dominance), but at a $2.9 trillion valuation (as of this writing) it is still in the enviable spot of being the third most valuable company in the world.

FIGURE 29
The AI Revolution: Nvidia Valuation Has Taken Off
(billions of dollars)



For all its hype, the AI wave has little to show so far, or so the thinking goes. It is essentially a vibe-driven revolution, at least for now.

For all its hype, the AI wave has little to show so far, or so the thinking goes. It is essentially a vibe-driven revolution, at least for now. Firms that have invested heavily, like Microsoft, will only make around $10 billion from generative AI sales this year, and even this figure is likely on the optimistic side. AI has yet to show up in productivity statistics. Its adoption has also not been as widespread

as initially hoped partially because, while its disruptive potential is clear, no one knows for sure what the "killer app" for AI would be. Though surveys by McKinsey and LinkedIn show that "knowledge workers" use some form of AI at a rate of 67%-75%, most of it is in the form of searches that are a bit more sophisticated than simple Google searches. But the incorporation of AI into business and technological processes remains sparse. The Census Bureau, which poses AI-related questions to a broader set of firms and wider range of industries, found that only 9% of businesses in the U.S. use AI. And its capacities are still rudimentary: McDonalds recently scrapped a trial AI customer order when it erroneously added $222 worth of chicken nuggets to a customer's bill. Even to chicken nuggets enthusiasts like us, this seems quite over the top.

The Census Bureau, which poses AI-related questions to a broader set of firms and wider range of industries, found that only 9% of businesses in the U.S. use AI.

Other challenges abound. Perhaps the most acute in the immediate term are supply constraints — shortages of key inputs such as chips and power. Shortages in High-Bandwidth Memory technology and Chip-on-Wafer-on-Substrate packaging — two critical AI chip components— will likely constrain AI growth in the short run as demand for these components vastly outstrips supply. Power demand is another hurdle: A chat GPT query can cost seven times more than a Google search and AI servers in general require up to 10 times more power than conventional servers. If AI tools are used as much as Google search engine today, the growth in power demand will rise to 7% per year between now and 2030, a dramatic increase compared to the 0.2% rate over the 2010-2022 period. Some studies estimate the need for additional power capacity at around 100 gigawatts (GW), placing a significant burden on a system with a peak capacity of only 800 GW. It is hard to build so much capacity quickly. Some companies are filling the gap by using off-grid power (nuclear, fuel-cell). But that's not nearly enough for what is needed to power the AI revolution. Indeed, the amount of time to build up the infrastructure around AI is likely measured in years, not months.

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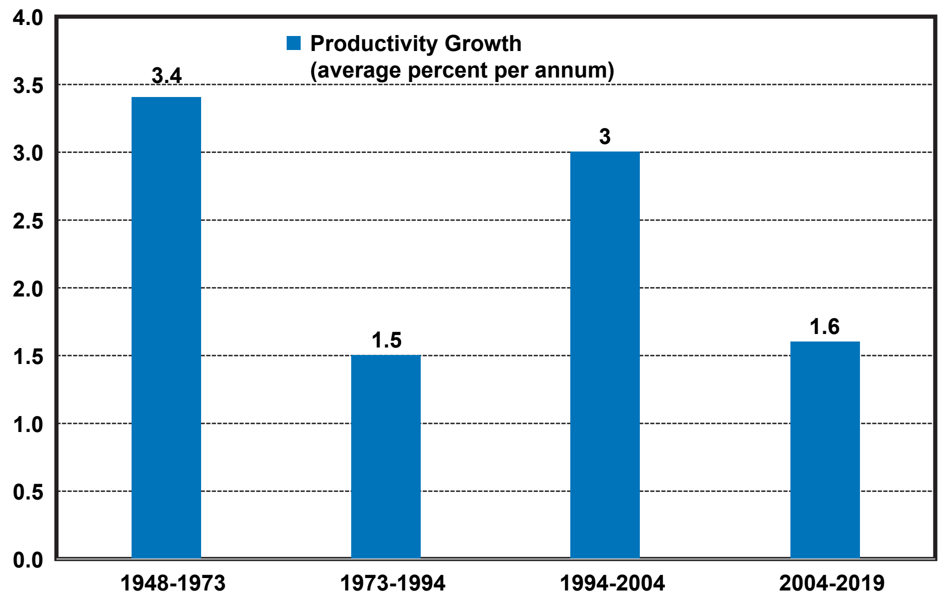
Not surprisingly given these challenges, the long-run benefits of AI run the gamut from unduly pessimistic to overly pessimistic. Some are skeptical that AI costs will decline enough to make large-scale automation affordable given the upfront high fixed costs of building critical infrastructure. Replacing low-cost labor with tremendously pricey technology runs counter to any prior tech disruption. As such, the thinking goes, long term benefits will be rather disappointing: A study from MIT reckons that only a quarter of AI-exposed tasks will be cost-effective to automate within 10 years, increasing productivity by a measly 0.5% and real GDP by a cumulative 0.9% over the next decade. Others are more hopeful, arguing that while AI may not be cost effective today, its potential for massive, large-scale cost savings in the long run will make task automation possible as it is often the case with new technologies. This camp estimates that AI will replace 25% of all tasks over the next decade, boost productivity by 9%, and increase GDP growth by a cumulative 6.4%.

Some are skeptical that AI costs will decline enough to make large-scale automation affordable given the upfront high fixed costs of building critical infrastructure.

Others are more hopeful, arguing that while AI may not be cost effective today, its potential for massive, large-scale cost savings in the long run will make task automation possible as it is often the case with new technologies.

Of course, productivity gains from new technologies can be elusive at first. "You can see the computer age everywhere but in the productivity statistics," Robert Solow, a Nobel prize winning economist, once famously quipped. That 1987 quote laments the slowdown in U.S. productivity growth in the 1970s and 1980s despite massive investments in computers and information technology. It turns out, Mr. Solow spoke a few years too soon: Productivity soared to 3% in the mid-1990s from the 1.5% rate recorded over the period 1973 to 1995 (Figure 30). This mattered greatly: The Fed was able to engineer a perfect soft-landing in mid-1990s precisely because a supply-side boost to productivity fueled growth while simultaneously lowering inflation.

FIGURE 30
Key to the Soft Landing in the 1990s: Productivity Growth (productivity growth, average percent per annum)



Our view is that significant productivity gains from AI technology will not materialize immediately given large start-up fixed costs. But what is missed by this singular obsession about productivity, are potential gains for growth in the short term.

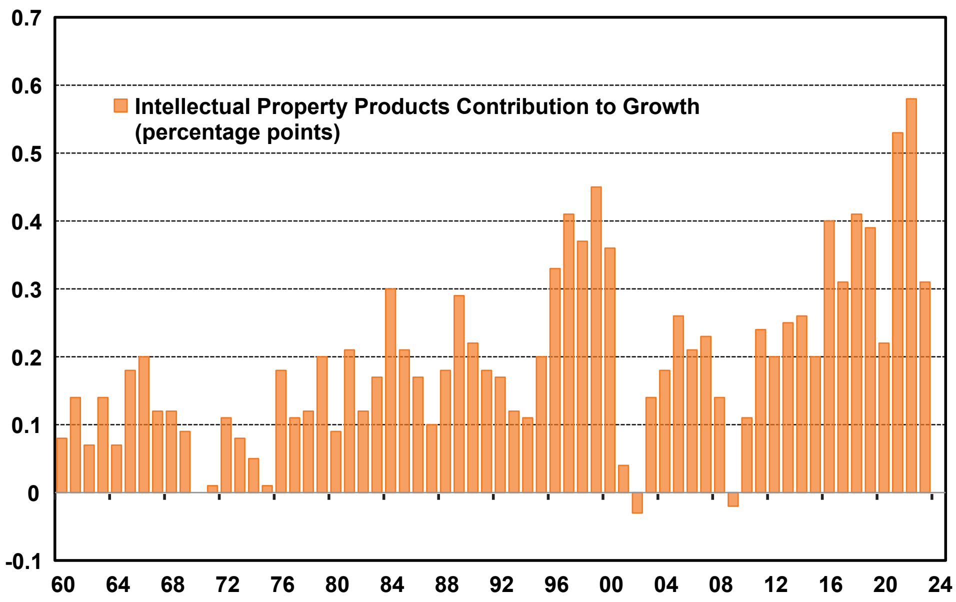
A productivity shock then is crucial for the ability to deliver both sides of the soft-landing promise: continued growth and tamed inflation. Our view is that significant productivity gains from AI technology will not materialize immediately given large start-up fixed costs. But what is missed by this singular obsession with productivity, are potential gains for growth in the short term. Wherever you look, business investments have not only skyrocketed but have quietly undergone a profound revolution. Gone are the days when "CapEx" conjured images of heavy machinery and equipment: They are being replaced with generative AI and software. Since the fourth quarter of 2019, real business investments in structures have fallen by 0.1%; investments in equipment have only grown by 5%, while investments in intellectual property products (which includes spending on software and research and development) have jumped by an eye-watering 32%.

The numbers are dizzying: The five big tech firms — Alphabet, Amazon, Apple, Meta and Microsoft — have budgeted an estimated $400 billion for capital expenditures this year, mostly for AI-related hardware and R&D. Data centers and other spending from smaller firms have also ramped up their capital outlays. By some estimates, overall spending in AI will reach $1.4 trillion between 2024 and 2027.

Spending on intellectual property has added a hefty 0.5 to 0.6 percentage points to real GDP over the past few years — the highest in history — outpacing even the robust pace of the mid-1990s.

This has immense implications for growth and is one of the reasons why we believe the Fed will deliver on half of the soft-landing promise: avoiding a recession. Spending on intellectual property has added a hefty 0.5 to 0.6 percentage points to real GDP over the past few years — the highest in history — outpacing even the robust pace of the mid-1990s (Figure 31). Add to that the investment frenzy on manufacturing plants spurred by the infrastructure and CHIPS act, and the outlook for growth seems relatively solid. Of course, this massive spending also tends to be inflationary, which is why we don't think the second mandate of a classical soft-landing scenario will fully materialize this time around.

FIGURE 31
Investments in AI Have Boosted Real GDP Growth for the Last Two Years (contributions to growth, percentage points)



As for the impact of AI in the long term, it is perhaps best to be humble. There is much we don't know, but we are optimistic that given time, the world will address thornier issues and AI challenges related to both supply constraints and potential demand limitations (a killer app or apps will ultimately appear). This will have crucial implications for productivity. In the words of American futurist Roy Amara: "We tend to overestimate the effect of technology in the short run and underestimate the effect in the long run." Most aptly put.

The TikTok Election: The U.S. Goes to the Polls

Herry: "Hi Lloyd"
Lloyd: "Hi Harry"
Harry: "How was your day?"
Lloyd: "Not bad. Fell off the jetway again."
– Dumb and Dumber

You must forgive the U.S. electorate for feeling as if it "fell off the jetway again." It's election season in America, replete with campaign rhetoric, over-the-top promises, exhaustive apocalyptic predictions (should the other side win), served with a side of hope-y-change-y optimism (should your side win). Pollsters would have an easier time predicting American sentiment rather the outcome of the election, as the sentiment would be unanimously one of anxiety and stress. A recent Pew Research Center survey found that 65% of Americans are exhausted when thinking about politics; 55% are angry. Nearly three quarters of the electorate is stressed about the race, according to a 2024 poll by the American Psychiatric Association. The only good news — if there is such a thing — is that this is not unique to this cycle: Consumer confidence drops precipitously 3 to 6 months before presidential elections, but then picks up robustly once the election is over. There is hope after all, which is all that really matters.

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The presidential race has shaped up to be one between two quasi-incumbents: a current vice president and a former president. As of this writing, the race is so tight one would have no choice but feel empathy for political pundits who may be brave enough to venture a prediction on the outcome. Currently, Ms. Harris has a small lead of 2% in the national polls over Mr. Trump. On the battleground states, Mr. Trump has a razor-thin, barely perceptible lead of 0.1%, based on the average of polls. Polymarket, the world's largest betting site which trades on everything from political, crypto and sporting events, has the odds at exactly 50/50. There is even talk about the titillating (highly improbable but not impossible) scenario of an electoral tie, though this outcome ought to be viewed as an interesting academic exercise rather than a serious potential result. Like everything else, the election is turning out to be the ultimate "vibes" election: Ms. Harris has even wholeheartedly embraced the "politics of joy," a catch-all phrase meant to convey some sort of optimism about the future.

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Control of Congress also appears to be a toss-up. History favors Republicans in the House: Control of the House has not switched parties in a presidential election year since 1952. Nonetheless, the Democratic party holds a small edge in the Real Clear Politics generic polling average (of 1.8%) and the margins of Republican control are so razor-thin (219 to 213 with three vacant seats) that a switch is quite possible. Polymarket gives it a 65% probability. On the other hand, the Senate map is more favorable for Republicans: Democrats need to defend a full 23 seats (when counting three independents that caucus with them), while Republicans must defend only 11. Some are in states that Mr. Trump won in 2020 and where he is currently leading by large margins: West Virginia, Montana, and Ohio. Others are in swing states, which means tight races: Wisconsin, Arizona, Nevada, Michigan and Pennsylvania. Polling shows Republicans with a commanding lead over Democrats in West Virginia and Montana. Polymarket predicts a 98% chance of Republicans winning both seats, which should be enough to switch control of the Senate. Democrats best chance to flip Senate seats are in Florida and Texas. Though long shots, recent polls show a tightening of races in both states.

As things stand, a Democratic sweep seems unlikely. In fact, Polymarkets gives it only a 20% chance. This is not negligible, but it's small nonetheless in an election this tight. This leaves the other two possibilities: either a divided government or a Republican sweep. The probability of a Republican sweep in Polymarkets is 32%; that of a divided government is 48% (the probability of a Democrat White House, Democrat House and a Republican Senate is 26%, according to Polymarkets).

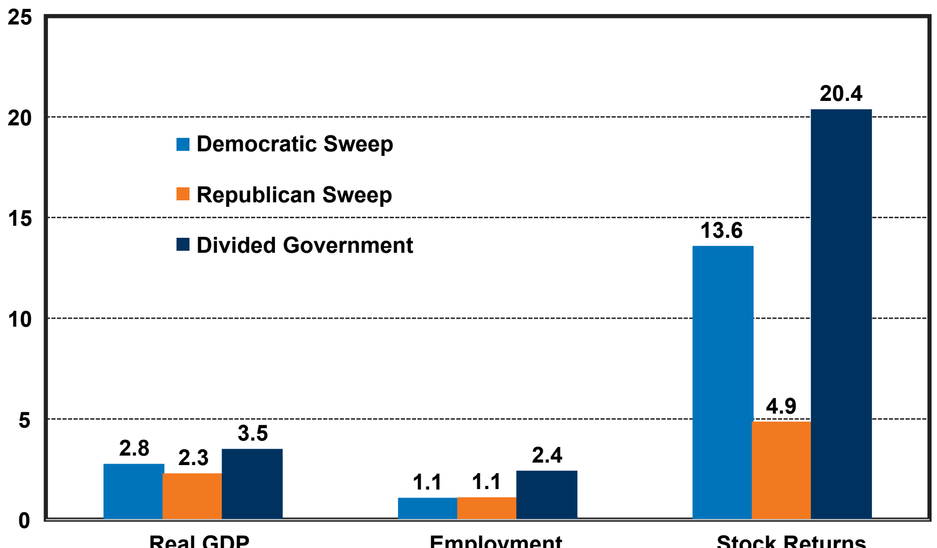
This may be for the best. A divided government this time around may be more welcome than in the past: Instead of fiscal cliffs and government shutdowns, it may bring a much-needed restraint on profligate spending while simultaneously weeding out extreme policies. Hoping for some form of gridlock may seem a bit unusual, but it is perhaps the prudent course given that the current campaign season is shaping up to be chockful of outlandish proposals and lavish giveaways. Generous promises are nothing new in campaigns, but the current cycle has vastly surpassed even the most fanciful pledges of previous elections.

A divided government this time around may be more welcome than in the past: Instead of fiscal cliffs and government shutdowns, it may bring a much-needed restraint on profligate spending while simultaneously weeding out extreme policies.

Indeed, history has some useful lessons for us. Since the 1960s, there have been five instances of a Democratic sweep (1960, 1964, 1992, 1996 and 2008), three instances of a Republican sweep (2000, 2004 and 2016), and seven instances of a divided government (we exclude the 2020 election given the very unusual nature of the pandemic). Digging at the data, it appears that the economy has had its best performance in the year following a presidential election under a divided government. In those cases, real GDP growth averaged 3.6%, employment grew by an average of 2.4%, while the average return on stocks was 20%. All this was accomplished while federal spending fell by an average of -0.4% (Figure 32).

It appears that the economy has had its best performance in the year following a presidential election under a divided government.

FIGURE 32
The Economy Does Better Under Divided Government
(average annual growth, year after the election)



In contrast, the performance of the economy has been more lackluster when there were sweeps, either Democrat or Republican, with the results being almost the same regardless as to who won. Under a Democratic sweep, real GDP grew by an average of 2.7% and employment by 1.1% in the year following an election. The figures for a Republican sweep are almost identical: 2.3% for real GDP and 1.1% for job growth. The only difference is the performance of S&P500, which averaged a much higher 13.5% under Democratic sweeps relative to a more subdued 4.9% under Republican sweeps. Federal spending rose under both scenarios by an identical amount: 2.1%.

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Looking a bit closer at the divided government cases, the economy performs best when there is a unified Congress (both houses under one party), with the White House controlled by the opposition party. Real GDP growth and employment growth were 4.5% and 2.6%, respectively, in the year following the 1996 election, the only time with a presiding Democratic president and a unified Republican Congress. Likewise, economic performance is quite robust under a Republican president and a unified Democratic Congress (1968, 1972 and 1988) with growth averaging 4.1% and employment rising by 3.5%.

Splitting the data according to whether an incumbent or non-incumbent president wins, results are surprisingly clear-cut. The economy performs much better the year following a presidential election under an incumbent than non-incumbent: Real GDP growth is nearly twice as high — 4.3% versus 2%. This holds for every metric you care to look at: Employment grows by 2.8% the next year if an incumbent wins, compared to a 0.9% rate under a non-incumbent; business investments rise by 7.1% under incumbents versus 2.1% under non-incumbents; stock returns average nearly 19% the year after an incumbent win versus 6.5% when a non-incumbent wins (Figure 33). This analysis is likely less insightful in the current cycle given that the race is between two semi-incumbents rather than between a proper incumbent and non-incumbent.

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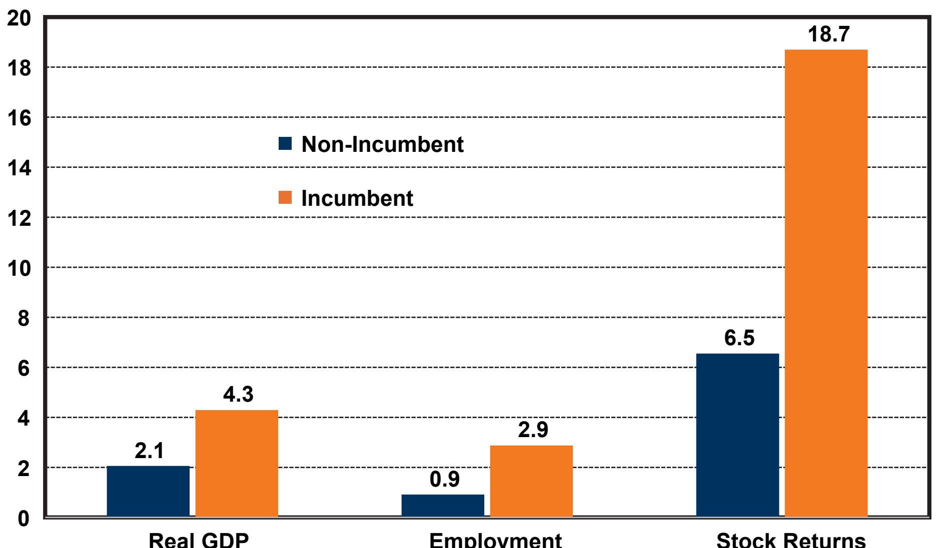
FIGURE 33
Economy Performs Better When the Incumbent President Wins
(average annual growth, year after the election)



Uncharacteristically, though we are late in the election cycle, we know less about Ms. Harris' and Mr. Trump's plans about the economy than what we would traditionally know in a run-of-the-mill election round. Ms. Harris is purposefully vague, though lately she has unveiled a few more specific proposals for what she calls an "opportunity economy" and "a new way forward." Mr. Trump's plans have come primarily from off-the-cuff campaign pitches and social media posts. Ms. Harris labels herself a "pragmatic capitalist," a departure from her previous run in 2019 when she championed a single-payer healthcare system and outlawing of fracking. Mr. Trump has shattered what once were the tenants of Reaganomics: free trade, concerns about debt, and skepticism about tax credits and entitlement programs. In a Trump universe — should he win — taxes remain low (and corporate taxes are reduced even further), tariffs are higher, and energy production ramps up. In a Harris world, families, homebuyers and small businesses receive lavish handouts, taxes for corporations and higher-income individuals rise, and price controls (mostly for groceries) via a price-gouging ban make a comeback.

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One can only hope that some of these proposals are merely campaign pitches that will never see the light of day once the dust settles, as they belong in a basket of supremely bad ideas. It is understandable why Ms. Harris would like to address voters' top concern — the cost-of-living issue — but a federal ban on price gouging on food and groceries is not only unworkable but will do little to fix the problem given that the current bout of inflation is not related to price gouging and grocery store margins are already thin. Not to be outdone, Mr. Trump recently proposed a temporary cap on credit-card interest rates at 10%, a sort of price control on credit. Ironically, his idea goes beyond what two leading Social Democrats — Ms. Ocasio-Cortez and Mr. Sanders, two politicians with which Mr. Trump vehemently disagrees — proposed back in 2019, only in their case the cap would be set at 15%. In their campaign travels to Las Vegas in swing state Nevada, both Ms. Harris and Mr. Trump have embraced a "no tax on tips" agenda, in an effort to woo workers in the leisure and hospitality sector. Pretty soon just about everyone, from your electrician to your plumber, lawyer and tax accountant, would insist on getting paid in tips. This time, let's hope what happens in Vegas, truly stays in Vegas.

One can only hope that some of these proposals are merely campaign pitches that will never see the light of day once the dust settles, as they belong in a basket of supremely bad ideas.

Perhaps their biggest divide comes on taxes. Many of the provisions of the Tax Cuts and Jobs Act (TCJA) enacted in 2017 under President Trump will expire by the end of 2025. Mr. Trump wants to not only extend all tax provisions (which will cost $4.8 trillion on a 10-year horizon) but go even further. He has proposed lowering the corporate tax rate from 21% first to 20% (he prefers round numbers) and more recently to 15%, though the lower figure seems to be aimed at companies that produce domestically. If implemented across the board, this provision will cost $460 billion (on a dynamic basis). If only applied to domestic producers, it will likely cost $200 billion on a 10-year horizon. Mr. Trump has also proposed a slew of other tax cuts: no taxes on overtime pay (which will amount to a loss in revenue between $250 billion to $1.4 trillion, depending on its structure); no taxes on tips (costing between $150 billion to $250 billion); no taxes on Social Security benefits (costing around $1.7 trillion). In a campaign rally in New York, he recently proposed removing the SALT cap deduction — the $10,000 cap on state and local tax deduction taxpayers are able to deduct when filing federal taxes. This will likely cost another $1.2 trillion in lost revenues over a 10-year horizon.

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Mr. Trump is more vague on how he will pay for all this, though he is not entirely out of options. One tranche of revenue could come from tariffs: He has campaigned on a universal 10% tariff (more recently that figure seems to have gone up to 20%), and a 60% rate on goods imported from China. It is hard to judge the amount of revenues this will raise — the volume of trade would fall, and other countries may retaliate — but if no other changes occur, tariffs could bring in $2.8 trillion over the next decade. Mr. Trump has vowed to reverse some provisions from the Inflation Reduction Act — Mr. Biden's climate-subsidy package — which could tally as high as $1 trillion. Mr. Trump has also suggested unwinding Mr. Biden's student debt cancellation, which is on track to cost around $1 trillion.

Ms. Harris' agenda offers a mix of tax hikes and generous handouts.

Ms. Harris' agenda offers a mix of tax hikes and generous handouts. She has proposed a plan to lift the corprate tax rate from 21% to 28%, which should increase revenues on a 10-year horizon by around $800 billion, but also lower growth by almost the same amount ($700 billion) when scored dynamically. She would let the marginal tax rate for high earners (those making above $400,000 per year) revert to the 39.6% rate that prevailed prior to the TCJA. Her plan would raise the tax rate on long-term capital gains to 33% (from 20%) for those earning more than $1 million per year; would quadruple the stock buy-back tax to 4% from 1%; and would introduce a new tax on unrealized capital gains on people with net worth of $100 million and above, the so-called "billionaire's tax." All in all, these proposals will increase revenues by around $1.2 trillion over the next decade.

Ms. Harris would also extend the tax cuts of TCJA for those making less than $400,000 per year, which could cost up to $2.8 trillion over the next decade.

Harris' plan also has a bevy of tax credits. She has proposed raising the earned income tax credit (EITC) for workers without children to $1,500. The child tax credit (CTC) would go from $2,000 per child to $6,000 for newborns, $3,600 for children under age six, and $3,000 for those ages six to 17. Homebuyers will receive a $25,000 down payment assistance, while the small business tax credit will expand from $5,000 to $50,000 to help startups cover the average cost of $40,000 to launch a new business. The cost of these programs would be around $1.7 trillion and could go up to $2 trillion if housing subsidies are made permanent. Ms. Harris would also extend the tax cuts of TCJA for those making less than $400,000 per year, which could cost up to $2.8 trillion over the next decade. Her "America Forward" plan also includes $100 billion tax credits in domestic manufacturing in fields such as green energy, biotech, data centers, semiconductors and aerospace.

Some of these proposals dwell on the realm of fancifulness. The "billionaire tax" makes for enthusiastic campaign fodder, but it is unworkable not in the very least because it would send markets in a tailspin. Billionaires own $5 trillion in publicly traded stocks, and financial wealth accounts for nearly two thirds of their net worth. They would need to sell billions of dollars of stocks to fund the wealth tax payments.

Some of these proposals dwell on the realm of fancifulness. The "billionaire tax" makes for enthusiastic campaign fodder, but it is unworkable not in the very least because it would send markets in a tailspin.

In addition, high net worth individuals with assets of more than $100 million hold approximately $4 trillion in unrealized capital gains in private (not publicly traded companies). These are even harder to trade to cover the wealth tax. Promising $25,000 tax credit for first time homebuyers is worthy, but unless the supply of housing increases dramatically — a tall order — subsidies of this type will likely send home prices into overdrive.

Mr. Trump's greatest weakness is tariffs. Under his proposals, the U.S. tariff rate would increase from the current 2.6% to over 8%, surpassing China's rate and nearly doubling that of the EU. Mr. Trump's second round of tariffs would go far beyond what he did in his first term, radically overhauling U.S. policy that has prevailed for nearly a century. He aims to repeat the success of his first term's tariffs on washing machines when prices went up, but only temporarily. Most importantly, two foreign companies — LG and Samsung — built manufacturing appliances factories in the U.S, creating upwards of 2,000 new jobs. Mr. Trump's first rounds of tariffs on China, covering around half of U.S. imports from the country (nearly $300 billion), did not turn out to be as inflationary as many expected. A study from UCLA estimated that higher import taxes costed the economy around $51 billion initially. But with a broader model that accounted for the economy's response, that estimate fell by 85%.

The problem with this line of thinking is that targeted tariffs are far different from broad, indiscriminate ones, like the ones Mr. Trump is proposing this time around. Should his entire agenda be implemented — a broad 20% tariff on all imports and a 60% tariff on Chinese imports — it is very likely that the economy will experience a mild stagflationary shock. The severity depends on whether there is retaliation from other countries. Assuming tarrifs take immediate effect (in February 2025) and no retaliation, we estimate that growth slows to 0.4% in 2025, but rebounds quickly in the longer term, coming at near baseline case by 2029 (Figure 34). Inflation, on the other hand, will end the decade two percentage points higher than the base case. If other countries retaliate, growth drops by -0.4% in 2025 and ends up being 1.7 percentage points lower than the base case in the long run.

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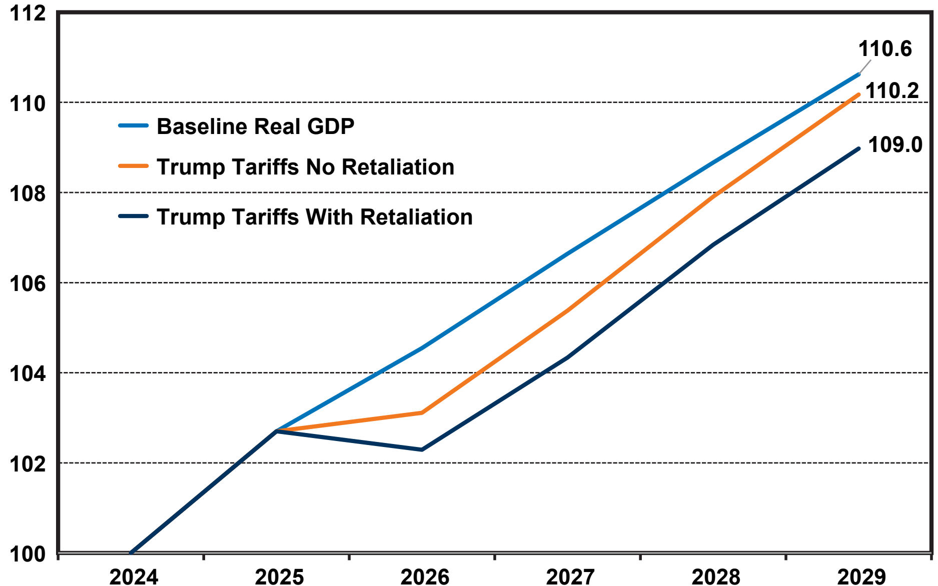
FIGURE 34
Impact of Trump's Proposed Tariffs on U.S. Real GDP Growth (index, 2024=100)



It is safe to say that neither Kamala Harris nor Donald Trump are champions of fiscal prudence. Neither will win the presidency in November by promising fiscal restraint. Deficits are set to explode under both, but more so under Mr. Trump than Ms. Harris. Scoring both conservatively, we find that the deficit will rise by $6.45 trillion over the next decade under a Trump presidency, and by $3.2 trillion should Harris win (Figure 35).

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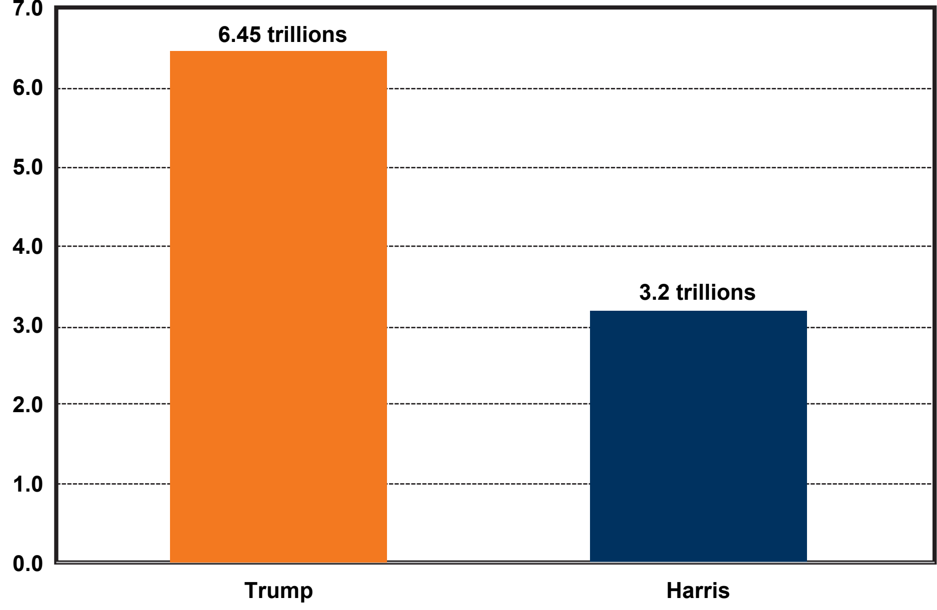
Towards the end of Dumb and Dumber, the kidnappers find out that all the ransom money was spent by our two friends, only to be replaced by worthless pieces of paper serving as IOUs. “That's as good as money, sir. Those are I.O.U.'s. Go ahead and add it up, every cent's accounted for. Look, see this? That's a car. 275 thou. Might wanna hang onto that one,” says Lloyd with the most earnest look in his face. Would that our government’s IOUs be more worthy than those of Lloyd and Harry’s. What a heartwarming thought!

FIGURE 35
Up and Away: Budget Busting Plans from Both Candidates
(increase in budget deficit over 10 years, trillions of dollars)



ORANGE COUNTY, SOUTHERN CALIFORNIA AND CALIFORNIA

In our previous economic forecast, we noted: “The Federal Reserve’s monetary policy has reached a critical juncture, aiming to achieve a neutral stance to stabilize the economy without inducing a hard landing. Strong consumer spending and robust hiring by businesses supported the economic outlook in 2023, though emerging signs of weakness are evident.” The recent federal funds rate cut in September does precisely that: A transition to an easing cycle with the hopes of avoiding a recession. The pace of future rate reductions depends primarily on evolving labor market dynamics, though inflationary pressures —should they persist, or worse, pick up—may also become again an important determinant for monetary policy. As discussed above, our outlook for the nation is for a continued expansion in the short run and a downshift longer-term with a persistent, gradual weakening in labor market conditions that will unfold over time. But unlike the nation—where the downshift has yet to emerge, Southern California has exhibited clear indications of a regional economic slowdown since mid-2023. Nonetheless, as is the case for the national economy, our outlook for the region does not foresee an imminent recession in the coming year.

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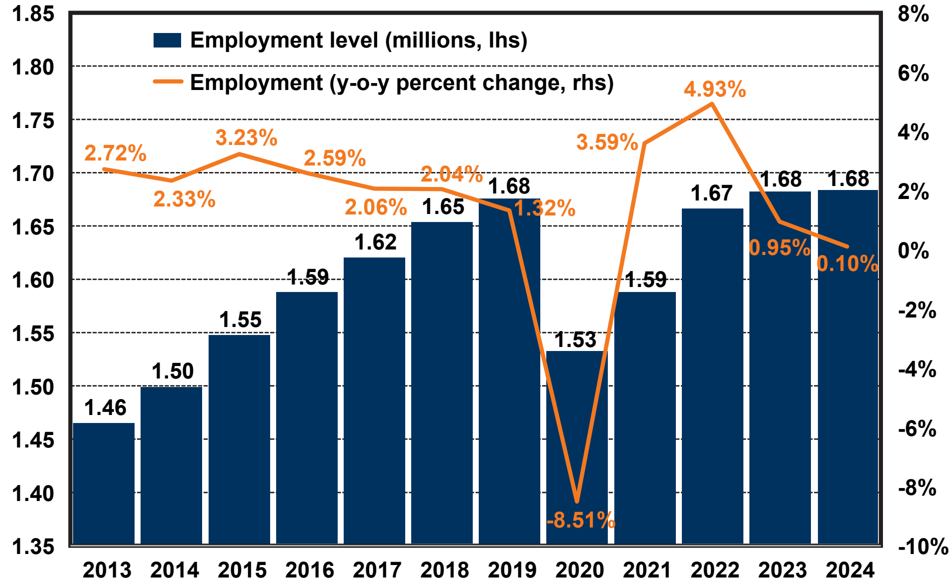
Employment and Demographics

The post-pandemic economic landscape is gradually normalizing, particularly in the labor market. In Orange County, following extraordinary gains in payroll employment during 2021 and 2022—55,500 jobs (3.6%) in 2021 and 78,000 jobs (4.9%) in 2022—growth decelerated significantly to 15,800 jobs (0.9%) in 2023 and 14,400 jobs (0.9%) on an annualized basis as of August 2024 (latest available data) (Figure 36). These figures align closely with the county’s 20-year average growth rate of 0.85%.

FIGURE 36
The Labor Market Has Softened in Orange County (employment, level and annualized percent change)



Similarly, for Los Angeles County, the pace of job formation has also downshifted to historical norms: After adding 13,700 jobs (3.3% growth) in 2021 and 228,000 jobs (5.3%) in 2022, employment growth slowed to 10,500 jobs (0.2%) in 2023. This deceleration extended into 2024, with the county adding 21,100 jobs (0.5%) through August. Thus, in both Orange County and Los Angeles County, employment growth is reverting to long-term growth rates, signaling that the post-pandemic labor market normalization is nearly complete. A similar trend can also be seen for the state of California, where job growth is currently running slightly below historical values: 0.9% in 2023 and 0.8% so far in 2024, against a backdrop of a 1% average annual rate for the past 20 years.

In both Orange County and Los Angeles County, employment growth is reverting to long-term growth rates, signaling that the post-pandemic labor market normalization is nearly complete.

In contrast, the Inland Empire job market has slowed beyond its historical average pace of 2.2%. The county added only 20,000 jobs in 2023 (1.2% growth), with the pace downshifting further to 14,900 jobs (0.9%) through August of this year. This is far below the 79,300 (5.3%) gained in 2021 and 85,600 (5.4%) in 2022. In large part, the downshift has to do with weaknesses in the main two sectors: Transportation and Professional and Business Services, which have shed jobs these past two years. Specifically, the largest sector (accounting for 27% of all jobs in the county) — Trade, Transportation and Utilities— lost 8,400 jobs (-1.8%) in 2023, and an additional 6,000 (-1.3%) so far this year. More concerning is the fact that in current year, even the Leisure and Hospitality sector — another major sector for the Inland Empire economy — has also softened. Overall employment has increased in large part because job losses in these sectors have been more than offset by gains in employment in the Government and Health Care sectors.

The deceleration in Orange County's employment can be partially attributed to its largest sector, Professional and Business Services, which makes up almost one fifth (19%) of its employment base.

The deceleration in Orange County's employment can be partially attributed to its largest sector, Professional and Business Services, which makes up almost one fifth (19%) of its employment base. Within this sector, Administrative and Support Services was the main sub-sector with the largest job losses in 2023 (-9,000 or -6.1%) and in 2024 (- 2,500 or -1.8%). In contrast, other sectors have performed well: Health and Educational Services, the second largest category for the county, gained 15,000 jobs in 2023 (for a 6% growth) and another 11,700 (4.4%) through August 2024. The Leisure and Hospitality sector, which has added jobs consistently since the end of the pandemic, continues its expansion, albeit at a slower pace, gaining 11,600 jobs in 2023 (5.3% growth) and 4,200 so far in 2024 (1.8%).

The household survey paints a starker picture of a softening labor market with unemployment rates rising across the board.

In Los Angeles County, while its largest sector— Health Care — added 43,500 (5%) jobs in 2023 and 36,900 (3.8%) in 2024, the next two biggest sectors— Trade, Transportation and Utilities and Professional and Business Services — shed employment over the last two years. The next two large sectors, Government and Leisure and Hospitality, experienced small gains.

A different measure of the health of the labor market comes from the household survey and provides both labor force statistics and unemployment rates. The household survey paints a starker picture of a softening labor market with unemployment rates rising across the board. The unemployment rate for the state currently stands at 5.9%, up from 5.3% recorded a year earlier (in August 2023) and more than two percentage points above the 3.7% rate in May 2022, the lowest of this cycle. For Orange County, the unemployment rate stands at 4%, up from 3.3% in August 2023 and from 2.7% in May 2022, when the unemployment rate hit a cycle low (Figure 37). The unemployment rate for Los Angeles County has jumped even higher to 6.7%, from 5.6% from a year ago and from 4.8% in August 2022 which marked the lowest rate in this cycle. The unemployment rate for the Inland Empire stood at 6% in August 2024, higher than the 5.3% rate recorded in 2023 and the cycle-low of 4.4% in September 2022. It is evident that the health of the labor market, as reflected by the unemployment rate, has deteriorated significantly in Southern California since the Fed began its rate-hiking cycle.

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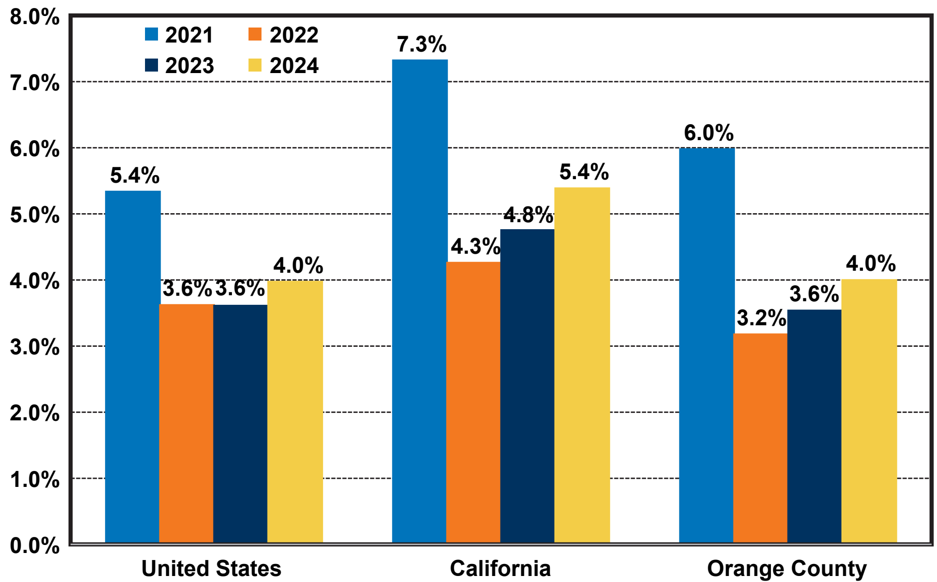
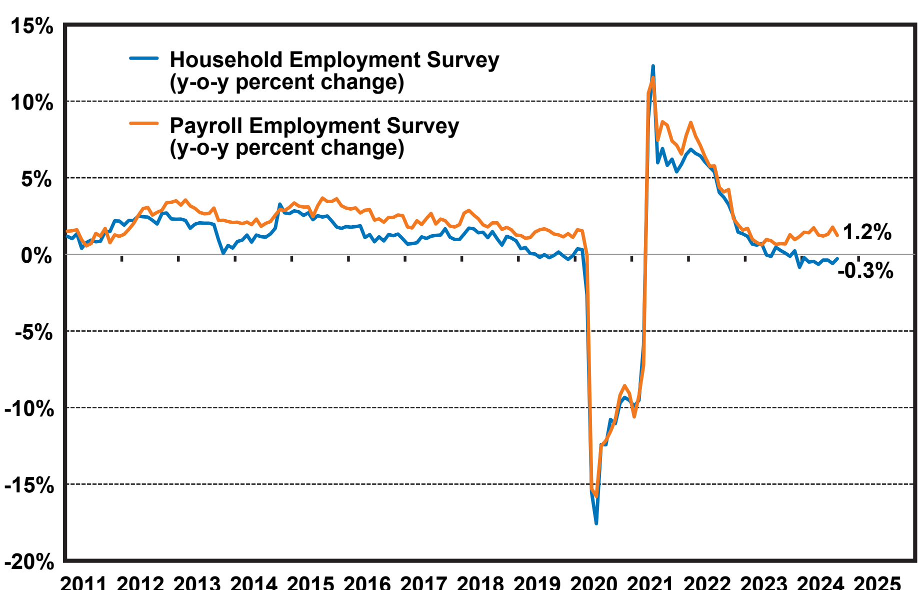
FIGURE 37
Unemployment Rates Have Risen Across the Board
(unemployment rate, average annual rate)



The labor force continues to languish reflecting both aging demographics and adverse migration patterns. Orange County's labor force is currently 1.6% below its 2019 figure (on an annualized basis). In fact, there was little growth over the 2023-2024 period. In addition, the employment picture is also much less rosy when based on the household survey: Household employment for the county is currently 44,000 jobs below its pre-pandemic level. In contrast, the payroll survey shows growth of 21,000 positions. While household employment have been lower than the payroll figures for most years during the past 20 years, the current gap between the two surveys is unusually large (Figure 38).

Household employment for the county is currently 44,000 jobs below its pre-pandemic level. In contrast, the payroll survey shows growth of 21,000 positions.

FIGURE 38
The Gap Between Payroll and Household Surveys Has Never Been This Large
(y-o-y percent change)



The labor force for Los Angeles County has fared even worse, with a shortfall of 2.2% compared to 2019 and a household employment gap of 165,500 (payroll data shows a gain of 2,000 compared to pre-pandemic). In contrast, the labor force in the Inland Empire grew by 4.9% over the same period with household employment level higher by approximately 7,000 jobs (payroll data show a gain of 142,000 jobs compared to 2019).

The labor force, which is the sum of people working and those looking for work, is affected by a multitude of factors. There is normal turnover because of retirements, deaths and new entrants in the market as the young start to work. This process was severely disrupted by the extraordinary changes unleashed by the pandemic, but the trend has begun to normalize. The effects of a significant jump in normal-age retirements and early retirements during the pandemic as well as fiscal support have mostly been exhausted, but in our view, those who chose to retire early are unlikely to return to work in droves. Most importantly, aging demographics and adverse migration trends are likely the main factors weighing on labor force growth for both the SoCal region and the state over the longer-term horizon.

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Population Trends

Of course, the labor force is affected by changes in population which derives from different sources of growth, such as natural births, deaths and migration patterns both internal and international. Population has been on a downtrend over the past few years in California as well as in Orange and Los Angeles counties, spurred primarily by domestic net migration. In fact, had it not been for foreign immigration and a healthy rate of natural increase, the drop in population would have been even more dramatic.

Population has been on a downtrend over the past few years in California as well as in Orange and Los Angeles counties, spurred primarily by domestic net migration.

Specifically, California's population shrunk by 0.1% from July 2022-July 2023 (latest available data) for a loss of 37,000 persons (Table 1). This follows on the heels of a decline of 295,000 (-0.75%) in 2022. Between July 2022-July 2023, overall population also dropped in Orange County (by nearly 12,000) in Los Angeles County (by 15,000) and in the Inland Empire (by almost 10,000). The declines were blunted by gains in foreign immigration: After two years of slow growth immediately following the pandemic, foreign immigration in the state and regional economies is on the rise again. California gained 110,900 immigrants in 2023 after an increase of 90,300 in 2022. Orange County gained 8,031 in 2022 and 12,069 immigrants in 2023; Los Angeles County gained 31,000 in 2023 and the Inland Empire gained 9,084 immigrants in 2023 compared to 7,880 in 2022.

TABLE 1
Outmigration is Weighing on Demographic Trends in CA and SoCal

	TOTAL POPULATION		CHANGE 2022-2023				
	REVISED JULY 1, 2022	PRELIMINARY JULY 1, 2023	NUMBER CHANGE	PERCENT CHANGE	NATURAL INCREASE	NET IMMIGRATION	NET DOMESTIC MIGRATION
Los Angeles County	9,840,925	9,825,708	-15,217	-0.15%	21,070	31,393	-67,680
Orange County	3,154,042	3,142,277	-11,765	-0.37%	7,241	12,069	-31,075
Riverside County	2,432,203	2,431,254	-949	-0.04%	6,813	4,747	-12,509
San Bernardino County	2,179,263	2,170,593	-8,670	-0.4%	9,196	4,337	-22,203
California	39,146,273	39,109,070	-37,203	-0.1%	107,269	115,936	-260,408

While foreign immigration has nearly returned to pre-pandemic levels, the biggest reason for adverse population trends is net domestic migration. The state simply continues to lose residents to other domestic regions. It lost 260,408 persons to other states in 2023 and 295,578 in 2022. Similar adverse trends are seen in Orange County (where net domestic migration was -31,000 in 2023), in Los Angeles County (-67,680) and the Inland Empire (-24,700).

But while net out-migration will likely continue to remain an issue, the latest figures released by the California Department of Finance in April 2024, appear to bear some good news. Initial estimates (as of Jan. 1, 2024) for the full year show that the population of California actually grew in 2023, driven by decreases in the mortality rate and a strong rebound in legal foreign immigration. In all, California added a total of 67,000 people in 2023 (an annual rate of 0.17%) with the population reaching 39,128,162. The department projects that the overall population growth is likely to return to its slow but steady pace over the long run.

Initial estimates (as of Jan. 1, 2024) for the full year show that the population of California actually grew in 2023, driven by decreases in the mortality rate and a strong rebound in legal foreign immigration.

Technological Advances and Labor Market Dynamics

Employment growth is also affected by other factors, among them changes in technology. Over time, new technologies change the nature of work as well as growth rates of output and employment. Unquestionably the most disruptive force on this front is artificial intelligence, which will likely transform not only companies, industries and production processes, but has the potential to ultimately transform societies. Though in early stages, the release of ChatGPT has already brought a dramatic improvement in search engines. When, and not if, the expected growth of artificial general intelligence (AGI) materializes, it will create an inorganic life form that, unlike AI which is trained to mimic human behavior, can think and act without human intervention.

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As with any innovations of this importance, concerns abound. Yuval Harari (author of *The Nexus: A Brief History of Information Networks from Stone Age to AI*) and others have sounded the alarm about the unguarded growth of AGI. The concern is that AGI is more than a set of tools as it has the potential to learn and behave independently. If we are going to colonize space, it may not be done by humans. It could be the inorganic AI entities that will make it possible.

Most developers of AI agree that we must devise controls for them. But if we don't understand how AI algorithms make decisions, accountability becomes difficult. With these concerns in mind, California legislators passed SB 1047 – Safe and Secure Innovation for the Frontier Artificial Intelligence Systems this year, though the bill was ultimately vetoed by the governor. It would have required developers building large models to assess whether these algorithms are "reasonably capable of causing or materially enabling a critical harm," ranging from malicious use or theft to the creation of a biological weapon. Companies would then be expected to take reasonable safeguards against these identified risks. Under the bill, developers would have to build a "kill switch" into any new models over a certain size in case they are misused or go rogue. They would have been required to "report each artificial intelligence safety incidence" to the state's attorney general and undertake a third-party audit to ensure compliance every year. The bill introduced civil penalties of up to 10% of the cost of training a model on companies whose models cause death, theft or harm to property. Failure to devise controls could result in fines up to $10 million. The bill would have applied to all companies doing business in California, regardless of where they are based, which would in effect have covered every company currently capable of developing top models.

If we are going to colonize space, it may not be done by humans. It could be the inorganic AI entities that will make it possible.

The bill was directed at models that cost more than $100 million to train, which is the ballpark amount used currently to develop and train today's most sophisticated models. But this is a fast-moving target: Anthropic, an AI startup, has predicted that the next generation of cutting-edge models will cost $1 billion to train and $10 billion by 2026.

Supporters of the bill included Anthropic, Elon Musk as well as SAG-AFTRA, the actors' union. In September, 100 employees of OpenAI, xAI, Google Deep Mind and other top companies penned an open letter calling on Governor Newsom to sign the bill. Nonetheless, as expected, there was plenty of resistance. Opponents argued that the bill would hinder innovation and encourage California engineers and enterprises to leave the state. They also argued that the purview of this large-scale regulation rests with the federal government rather than the states. And even though the California bill failed to become law, the issue is of utmost importance and future legislative actions are almost surely going to come. We will have to wait and see if the next congress is up to the task. In the meantime, the clock is ticking.

Finance is the ideal playground for AI because it is a world of pure information and mathematics. AI algorithms will certainly have the capability to create financial products that no human can understand.

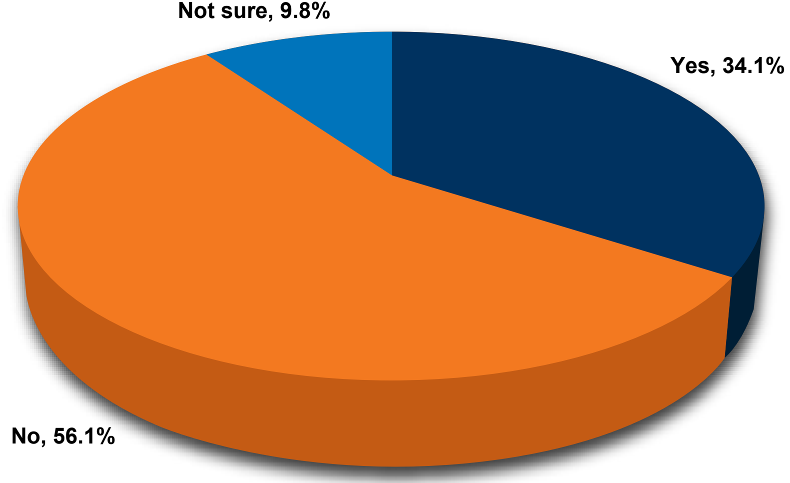
No one wants to be left behind in the AI race. So, the race is running unchecked. Salesforce is introducing Agentforce, an autonomous agent, which will supersede copilot models being touted by the likes of Microsoft. Agentforce features sales agents that go beyond chatbots and can resolve customer inquiries. These are being used by Saks and the reservation platform OpenTable. Agentforce is being released widely in October to Salesforce customers. The company insists that it is building AI with good intentions but acknowledges that development is moving faster than regulatory agencies.

We found that, despite the hype about AI and automation and their growing adoption by large firms, small businesses are not in the game yet.

Finance is the ideal playground for AI because it is a world of pure information and mathematics. AI algorithms will certainly have the capability to create financial products that no human can understand. The progress of AI is accelerating. The current AI-powered chatbots are akin to amoebas of the AI evolutionary process. It took organic evolution 4 billion years to evolve from tiny microorganisms to homo sapiens. But the rate of growth of AI is much faster. AI does not need to rest or sleep, it works continuously, nonstop. And it is not billions of years into the future. It may be more like 20 to 30 years, if unchecked. In the words of Harari, "what would AI T-Rex look like"?

While these issues may appear to be esoteric, they are likely to be front and center in a not-too-distant future. With the importance of AI in mind, we took a closer look at our local businesses, asking Orange County business leaders in our recent quarterly survey if they had used technology for automation in their line of work. We found that, despite the hype about AI and automation and their growing adoption by large firms, small businesses are not in the game yet. A majority of Orange County business respondents, 56.1%, said that they had not deployed automation or other similar technologies in the last six months or were planning to do so any time soon. Just over a third, 34.1%, had deployed such technologies, while 9.8% were not sure (Figure 39).

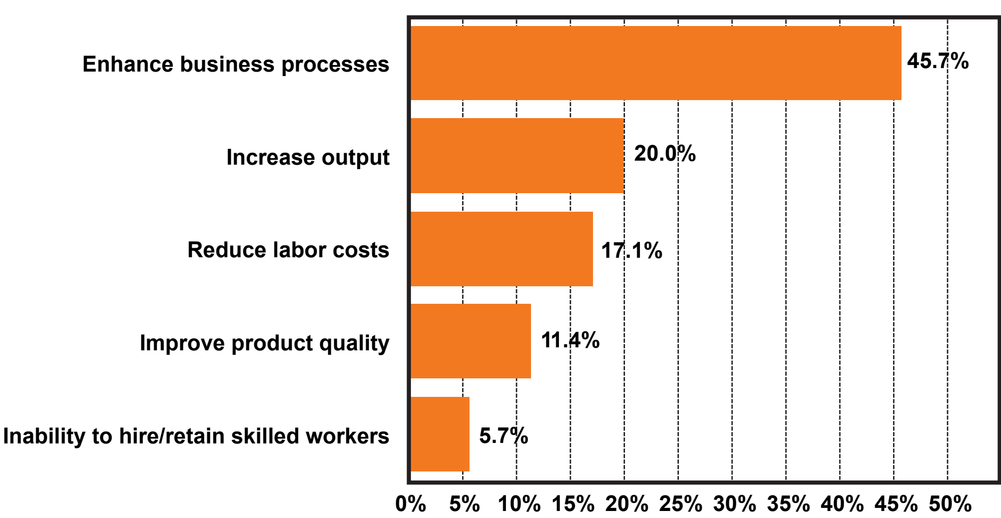
FIGURE 39
Have You Implemented Software or Automation Technology? (percent of respondents, OCBX Survey, Q4 2024)



We will not be surprised if this is representative of small businesses nationwide. In fact, as mentioned in our previous section, the Census Bureau survey of a wider section of firms and industries finds that few businesses (around 9%) have already incorporated AI into their business operations. Nonetheless, the speed with which AI tools are developing will force most businesses to pay attention to the upcoming changes.

When we asked the survey respondents to list the reasons, they might deploy automation technologies including AI, the most important factor was to enhance business processes (45.7%), followed by increase in output (20%), and to reduce labor costs (17.1%). Improving product quality and inability to hire qualified workers were also mentioned as reasons for possible adoption of such technologies (Figure 40).

FIGURE 40
Reason for Using AI
(percent of respondents, OCBX Survey, Q4 2024)



To be sure, technologies often spread task by task, slowly, rather than role by role. Before machines replace individuals, they change the nature of work they do. It matters whether new technologies are introduced in collaboration with employees or imposed from above and how they affect employee morale.

Housing Market Trends

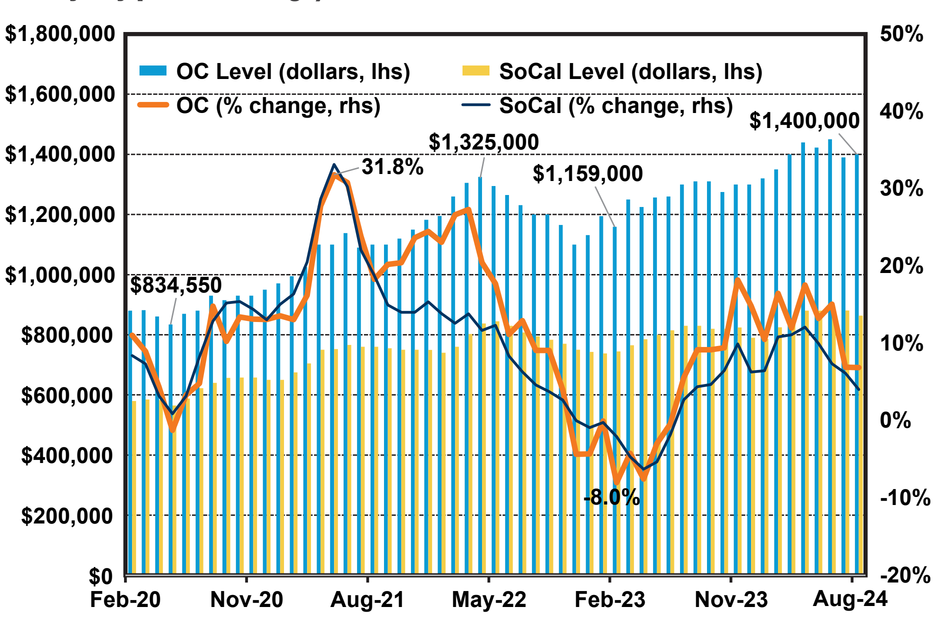
The Southern California housing market continues to be constrained by limited supply, persistently high mortgage rates, and declining affordability. Since the pandemic, home prices have continued to rise, though the pace has fluctuated. For example, median home prices in many parts of Southern California jumped by double-digit rates in early 2024 after having slowed in 2023. Over the past 12 months (through August of this year), median home prices were up by an average of 12.4% in Orange County, 7.4% in Los Angeles County, 4.2% in Riverside County, 6.4% in San Bernardino County, and 6.6% in California overall (Table 2 and Figure 41). The stellar performance over the past 12 months is a reversal of the previous 12 months when home prices fell across the board as the Fed raised interest rates. From August 2022 to August 2023, home prices fell by -0.5% in Orange County, by -2% in Los Angeles County, by -0.8% in Riverside County, by -0.1% in San Bernardino County, and by -2.7% in California. As of August 2024, median prices stand at $1,400,000 for Orange County, $919,900 for Los Angeles County, $630,000 for Riverside County, $515,000 for San Bernardino County and $888,700 for California.

The Southern California housing market continues to be constrained by limited supply, persistently high mortgage rates, and declining affordability.

TABLE 2
Through the Roof: Home Prices Keep Rising Throughout the Region

AUGUST-TO-AUGUST MEDIAN SINGLE-FAMILY ANNUALIZED PRICE CHANGES					
	CALIFORNIA	LOS ANGELES COUNTY	ORANGE COUNTY	RIVERSIDE COUNTY	SAN BERNARDINO COUNTY
2021	23.20%	18.50%	18.80%	20.50%	22.80%
2022	8.90%	12.20%	19.50%	15.70%	16.50%
2023	-2.70%	-2.00%	-0.50%	-0.80%	0.00%
2024	6.60%	7.40%	12.40%	4.20%	6.40%

FIGURE 41
Home Prices Continue to March Upward
(level and y-o-y percent change)



Redfin recently reported that just 2.5% of homes changed hands nationally in the first eight months of this year, the lowest turnover rate in at least 30 years.

Redfin recently reported that just 2.5% of homes changed hands nationally in the first eight months of this year, the lowest turnover rate in at least 30 years. This means that only 25 of every 1,000 homes were sold through August: The normal pace is 35 to 40. This small volume is even lower than last year's — by 37% — and 32% lower than in 2019, prior to the pandemic. The housing market is thus truly frozen, much as it has been since 2023.

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Seven of the 10 metro areas with the lowest turnover were in California. The Los Angeles metro area had the ignoble distinction of earning the top spot as the area with the lowest turnover among all metros analyzed by Redfin, with just over 15 of every 1,000 homes changing hands, a drop of 32% from the same period in 2019. One reason, among many others such as high mortgage rates and low inventory, is the slowdown in hiring in the entertainment industry. The lagging effects of last year's writers' and actors' strikes and disruptions of the business by streaming services is weighting mightily on the industry.

According to the California Association of Realtors, affordability index stands at just 11% for Orange County, meaning only 11% of households can afford the median-priced home.

Affordability, which was already a challenge in the region, has reached its worst levels in over 20 years. According to the California Association of Realtors, affordability index stands at just 11% for Orange County, meaning only 11% of households can afford the median-priced home while it is 14% for California and 33% for the U.S. (Table 3). The minimum qualifying income for a median-priced home in Orange County has escalated to over $375,000 annually, with monthly payments of around $9,400.

TABLE 3
Worst Home Affordability in Two Decades

	Q2:2024 AFFORDABILITY INDEX, %	MINIMUM QUALIFYING INCOME	MEDIAN HOME PRICE	MONTHLY PAYMENT INCLUDING TAXES AND INSURANCE
Los Angeles County	13	$223,200	$854,760	$5,580
Orange County	11	$375,200	$1,437,500	$9,380
Riverside County	18	$169,600	$650,000	$4,240
San Bernardino County	25	$133,200	$510,000	$3,330
California	14	$236,600	$906,600	$5,920
U.S.	33	$110,000	$422,100	$2,750

As we have noted previously, pent-up demand for housing following the pandemic is only partly responsible for the hot housing market. The other part, perhaps the most important one, has to do with the supply-side: Housing market in the region is, even more so than the nation, severely constrained. Existing homeowners, with low mortgage rates, are hesitant to let go of their advantage and would rather stay put. The Fed's inflation battle hinges partly on the cooling of the housing market since housing costs account for 41% of the personal consumption expenditure (PCE) basket. Shelter costs, rents in particular, rose dramatically up until mid-2023, and even though they have finally normalized, their effects have been slow to materialize.

Mortgage rates have fallen over the past several months, reflecting the easing stance of the Fed: The current Freddie Mac 30-year fixed rate of 6.1% is 1.4% below that of a year ago and 70 basis points below its 52-week average. This may encourage refinancing, bringing some life to the frozen housing market, but low-inventory and a potential downshift in economic activity will likely keep the housing market on ice for a while longer. We expect median home prices in Southern California to rise by approximately 5% this year and next.

Homelessness and Housing Initiatives

The rising cost of housing and escalating rents, combined with issues of mental illness and substance abuse, continue to exacerbate homelessness in California. The state has spent billions of dollars and passed several bills in an effort to remedy this issue, to little effect. In addition to investing over $40 billion to boost affordable housing and more than $27 billion to address homelessness, California has also tried to elevate the urgency of solving the housing and homelessness crisis. In August 2024, the governor issued an executive order which, among other things, urges local governments to use state funding to address unsanitary and dangerous encampments within their communities and provide people experiencing homelessness with care and support services.

In addition to investing over $40 billion to boost affordable housing and more than $27 billion to address homelessness, California has also tried to elevate the urgency of solving the housing and homelessness crisis.

Proposition 1 passed by a razor-thin majority of voters in March 2024, with the purpose of raising $6.38 billion to fund housing for veterans and homeless individuals. Its focus is on people with the most serious illnesses, substance abuse disorders, and housing needs. It will also move around $140 million of tax revenues from counties to the state with the express purpose of addressing mental health care and addiction issues. The governor also announced the release of new program guidance for Prop 1, allocating up to $2.2 billion to build permanent supportive housing for veterans and other individuals with mental health and/or substance use disorders who are at risk for or are currently experiencing homelessness. The program, known as Homekey+, is the centerpiece of this effort: It will expand the acquisition and rehabilitation of existing buildings or other projects that can be quickly converted or constructed into permanent affordable housing.

California is also trying to transform its entire mental health and substance abuse system under Proposition 1. Up to $3.3 billion in grant funds from Proposition 1 are available now to help build treatment sites. Following applications in March, the bond money was awarded to cities, counties, tribal entities and other organizations for treatment sites and supportive housing. By the summer of 2026, all counties are expected to implement new three-year comprehensive behavioral health services plans.

Despite these investments, progress remains elusive and uneven. Local governments face mounting pressure to meet their housing development obligations, particularly in high-cost areas. The state of California has begun to flex its muscle to press cities and counties to meet these obligations, especially for the homeless. The Housing Accountability Unit (HAU) created in 2021 to implement the state's housing priorities, was given additional powers this year to enforce the state's mandates for housing development on cities and counties.

Despite these investments, progress remains elusive and uneven. Local governments face mounting pressure to meet their housing development obligations, particularly in high -cost areas.

Legal battles, such as the one with the city of Norwalk over its moratorium on building homeless shelters, reflect the complex political landscape surrounding housing developments. Previously, the HAU forced a few cities — Huntington Beach, Coronado, Malibu, San Bernardino and Fullerton — to modify their housing plans to conform to the state's requirements for housing expansion. More subtly, it has intervened in several NIMBY (Not in My Backyard) cases where the cities try to block certain developments. The HAU claims to have supported so far, the development of over 7,500 homes including over 2,700 for the homeless.

Orange County's 2024 survey of homelessness conducted in January 2024 produced mixed results. The number of the homeless increased to 7,322 from 5,718 in the 2022 survey, for a 28% increase. But the increase was smaller, 6.7%, when compared to the 2019 survey which showed a total of 6,860 homeless people in the county. The homeless population in California grew from 151,278 in 2019, to 171,521 in 2022 and 181,399 in 2024. This account for a total increase of 20% from 2019 to 2024, and a smaller rise of 4.8% from 2022 to 2024. The much larger increase in recent years for Orange County (compared to the state) could be due to the fact that the county used a new state-of-the-art much improved methodology in compiling its most recent survey.

Orange County's 2024 survey of homelessness conducted in January 2024 produced mixed results. The number of the homeless increased to 7,322 from 5,718 in the 2022 survey, for a 28% increase.

The new methodology provided a wealth of information and a more detailed approach regarding identifying the homeless population by age, type of homelessness, etc. Tables 4 and 5 below offer a detailed breakdown about selected characteristics of the homeless population.

TABLE 4
Characteristics of the Homeless Population

ORANGE COUNTY HOMELESS SURVEY, 2024		
	SHELTERED	UNSHELTERED
Veterans	80	248
Transitional Age Youth	146	162
Senior 62+	456	413
Other	2,467	3,350
Total	**3,149**	**4,173**

TABLE 5
Characteristics of the Homeless Population

ORANGE COUNTY HOMELESS SURVEY, 2024		
Disability Conditions*	SHELTERED	UNSHELTERED
Adults	**4,074**	**2,557**
Chronic Homelessness	38.40%	34.30%
Substance Abuse Disorder	49.90%	23.50%
Physical Disability	31.40%	29.90%
Serious Mental Disorder	30.70%	35.30%
Developmental Disability	17.40%	0.20%
Domestic Violence	10.00%	10.40%
HIV / AIDS	2.30%	6.90%

*An adult could have multiple disabilities

Orange County Business Sentiment

The quarterly Orange County Business Executives Survey conducted by the Woods Center for Economic Analysis and Forecasting has consistently provided useful information on the local business conditions and is a tried-and-true barometer for the outlook. It has proven to be a rich source of information regarding business leaders' expectations on their own plans as well as their outlook for the local economy over the upcoming quarter, thus supplementing our own models and data. Based on survey responses, we construct an overall index, OCBX, with values ranging from 0 to 100. A value of over 50 indicates optimism for growth over the upcoming quarter. The index has had a good track record in predicting changes in quarterly employment and is a useful tool for pinpointing turning points in the business cycle (Figure 42).

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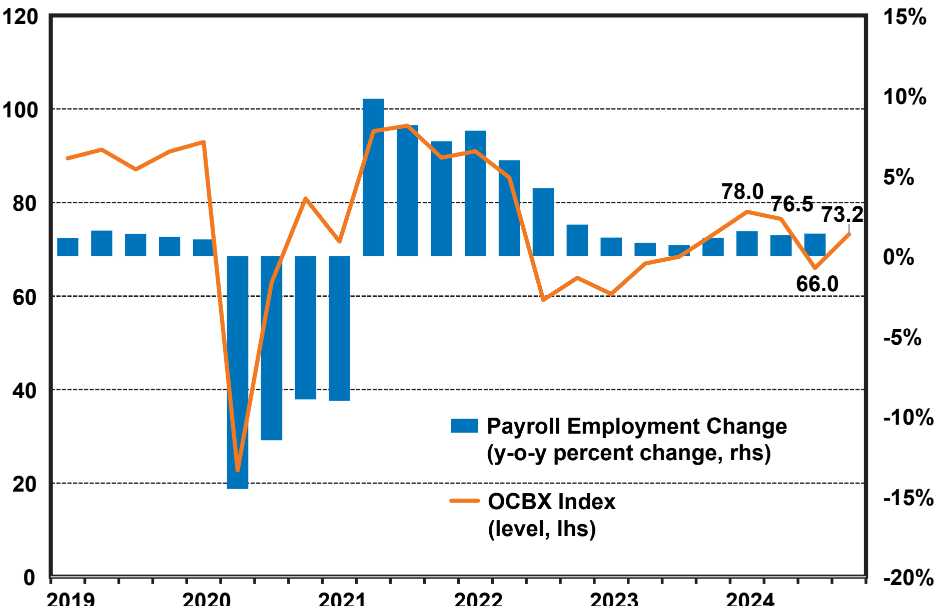
FIGURE 42
Sentiment Has Improved for Orange County Businesses But Still Below Historical Levels (OCBX Sentiment Index and OC employment, levels and y-o-y percent change)



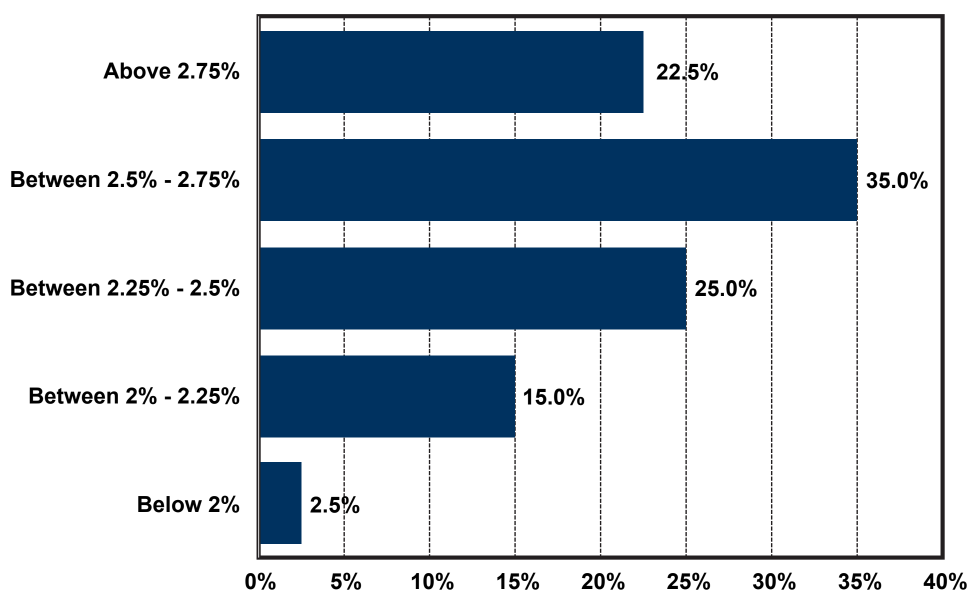
Our latest survey was conducted at the end of September 2024 for the fourth quarter of 2024. The index rose to 73.4 from 66 in the previous quarter, reflecting a more positive outlook. It should be noted that, despite this improvement, the index is still below its long-term average, indicating that Orange County business executives remain cautious about the economic environment.

A recurring question for the survey asks business leaders to list their top concerns. For several quarters before the latest survey, interest rates were listed as the most important concern. But the latest survey conducted after the first rate cut in September brought back inflation worries as the most important concern. Indeed, nearly one in four (24.4%) Orange County business respondents rated inflation as their most important concern. Government deficits were listed as the second most important concern (19.5%) with interest rates dropping to the third place (14.6%). Geopolitical risks took the fourth place at 12.2%. Labor shortages, which had dominated businesses' concerns in the post-pandemic scramble, have by and large faded as a major issue. Other concerns mentioned were insurance costs, labor costs/availability and election risks.

For several quarters before the latest survey, interest rates were listed as the most important concern. But the latest survey conducted after the first rate cut in September brought back inflation worries as the most important concern.

We asked respondents to share their forecasts for inflation for December 2024. Inflation expectations have come down considerably compared to the last quarter. Over 42% of respondents (compared to 26.4% last quarter) expect the rate to fall to 2.5% or below by the end of the year (Figure 43). A sizeable number, 35%, expect it to be between 2.5% and 2.75%, and 22.5% expect it to stay above 2.75% (compared to over 45% last quarter).

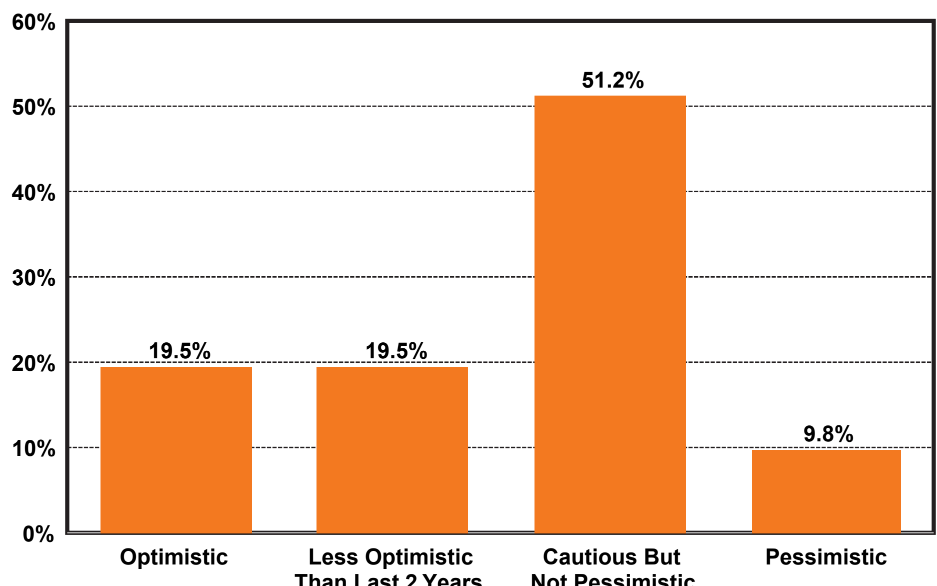
FIGURE 43
Expectations for Inflation Have Improved, But Still Above 2%
(percent of respondents, OCBX Survey, Q4 2024)



When asked how many more federal funds rates cuts of 25 basis points they expect to see for the rest of this year, 22% expect no additional cuts in 2024 (compared to 38.6% last quarter), 43.9% expected one rate cut (53% last quarter) and 34.1% expected two cuts (compared to 9.4% before).

Given the continuing uncertainty about the U.S. economy, we asked business executives for their expectations regarding the general outlook of the economy over the next 12 months. 19.5% said they were optimistic (23% last quarter) while 9.8% (11.5% last quarter) said they were pessimistic about the near-term outlook (Figure 44). The vast majority, a full 51.2% (last quarter 44.2%) were cautious about the next 12 months. Nearly one fifth said they were less optimistic than in the previous two years. Generally speaking, more people have moderated their outlook for the economy. In response to another question, 60% of the businesses expect to hold on to their hiring plans and are neither planning to expand nor cut their workforce.

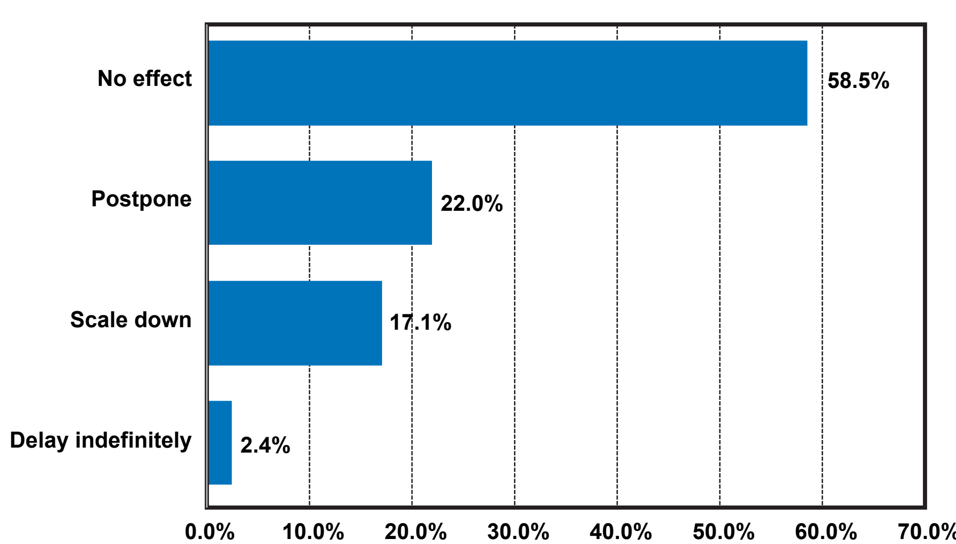
FIGURE 44
Outlook for Growth: Cautious But Not Pessimistic
(percent of respondents, OCBX Survey, Q4 2024)



The significance of elections for the economy is an open question; however, the uncertainty surrounding a tight election, where the two sides propose quite different policies, could influence business decisions leading up to the election (Figure 45). With that in mind, we asked business executives if the upcoming election had affected their business plans. A majority, 58.5%, indicated that that their business had not been affected by the uncertainty surrounding the November election. But 22% had postponed some plans and 17.1% indicated that they had scaled back on their expansions. A small number, 2.4%, have delayed their plans indefinitely.

We asked business executives if the upcoming elections had affected their business plans. A majority, 58.5%, indicated that that their business had not been affected by the uncertainty surrounding the November election.

FIGURE 45
Election Impact on Business Decisions
(percent of respondents, OCBX Survey, Q4 2024)



Forecasts

There is no question that the past two years have been particularly volatile for the economy. Fighting higher inflation while unwinding the post-pandemic stimulus could have resulted in a much slower economy, as most analysts predicted last year. But the strength of the U.S. consumer and the normalization of supply chains have so far kept GDP and employment growth in better shape than expected. Yet, as we get closer to the end of the year, there are unmistakable signs of a slowing labor market. Southern California's economies are experiencing that slowdown more severely than the national economy, as we discussed above.

While we expect the downshift to continue, barring a black swan event, a recession is not in our baseline scenario over the next six quarters, for the national or local economies. We do expect the current slowing to persist well into next year. For example, we expect the average annual rate of unemployment in Orange County to rise to 4.3% in 2025 following a rate of 4.1% in 2024 and 3.6% in 2023. Other regions in Southern California are expected to experience similar deceleration in employment: Los Angeles County's unemployment rate is expected to be 5.6% in 2024 and 5.9% in 2025, and for the Inland Empire, 5.3% in 2024 and 5.6% in 2025. Our longer terms outlook remains optimistic however, as we expect unemployment rates to decline and job growth to pick up beyond 2025.

Payroll employment growth is expected to follow a similar trend: Orange County is expected to grow by 1.3% in 2024 and 1.1% in 2025, Los Angeles County's expected growth will be 1% in 2024 and .8% in 2025, and Inland Empire is expected to grow at rates of 1.8% in 2024 and 1.6% in 2025. (Figure 46). Details are provided in the accompanying tables.

While we expect the downshift to continue, barring a black swan event, a recession is not in our baseline scenario over the next six quarters, for the national or local economies.

We expect the average annual rate of unemployment in Orange County to rise to 4.3% in 2025 following a rate of 4.1% in 2024 and 3.6% in 2023.

FIGURE 46
No Recession But Subdued Employment Growth
(employment growth, annualized percent change)

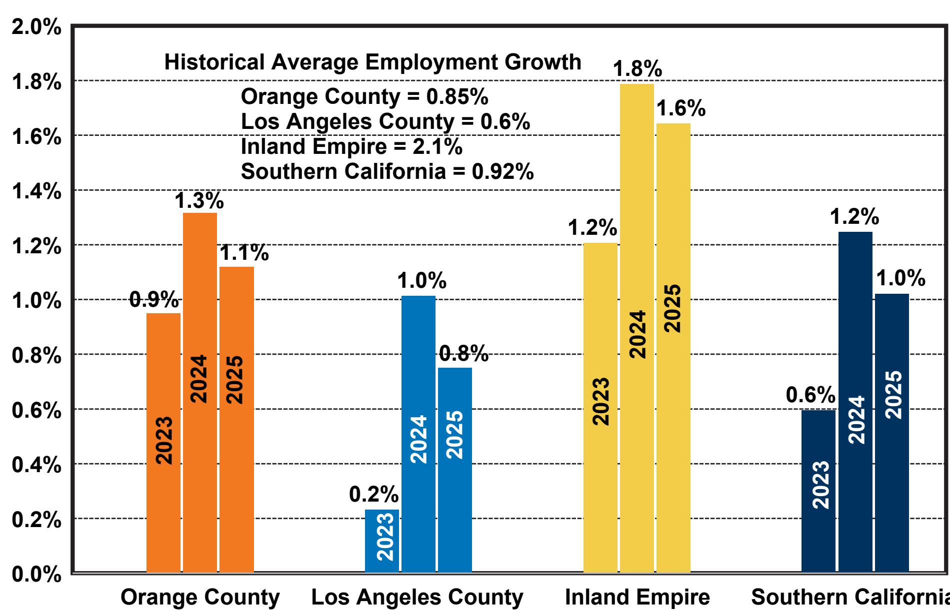


TABLE 1 - NATIONAL

	2018	2019	2020	2021	2022	2023	2024f	2025f	3-Year Average 2023-2025
GDP									
Real GDP (Bil. $)	20,194	20,716	20,268	21,495	22,035	22,671	23,306	23,749	23,242
% change RGDP	3.0	2.6	-2.2	6.1	2.5	2.9	2.8	1.9	2.5
Nominal GDP (Bil. $)	20,657	21,540	21,354	23,681	26,007	27,721	29,218	30,532	29,157
% change Nominal GDP	5.3	4.3	-0.9	10.9	9.8	6.6	5.4	4.5	5.5
RGDP Components									
Personal Consumption (% change)	2.7	2.1	-2.5	8.8	3.0	2.5	2.5	2.0	2.3
Business Fixed Investments (% change)	5.1	2.7	-1.9	7.3	2.7	2.4	4.3	3.9	3.5
Residential Investments (% change)	-0.7	-0.9	7.7	10.9	-8.6	-8.3	4.2	2.5	-0.5
Exports (% change)	2.9	0.5	-13.1	6.5	7.5	2.8	2.6	3.8	3.1
Imports (% change)	4.0	1.2	-9.0	14.7	8.6	-1.2	6.5	4.8	3.4
Net Exports (Bil. $)	-594	-616	-663	-937	-1042	-933	-1092	-1170	-1,065
Federal Deficit (Bil. $)	-779	-984	-3,132	-2,775	-1,300	-1,695	-1,850	-1,900	-1,815
Labor Sector									
Unemployment Rate (%)	3.9	3.7	8.1	5.4	3.6	3.6	4.1	4.4	4.0
Payroll Employment (% change)	1.6	1.3	-5.8	2.9	4.3	2.3	1.7	1.2	1.7
Average Weekly Hours (saar)	34.5	34.4	34.6	34.8	34.6	34.4	34.3	34.5	34.4
Labor Productivity (%, saar)	1.5	2.1	5.2	1.7	-1.9	1.5	2.8	2.3	2.2
Prices and Wages									
CPI (% change)	2.4	1.8	1.2	4.7	8.0	4.1	2.9	2.6	3.2
Core CPI (% change)	2.1	2.2	1.7	3.6	6.2	4.8	3.5	2.8	3.7
PCE Deflator (% change)	2.0	1.4	1.1	4.1	6.6	3.8	2.5	2.2	2.8
Core PCE Deflator (% change)	1.9	1.6	1.3	3.6	5.4	4.1	2.7	2.3	3.0
Employment Cost Index (% change)	3.0	3.0	2.9	4.0	5.3	4.6	4.1	3.8	4.2
Income/Profits									
Personal Income (% change)	5.2	4.8	6.8	9.2	3.1	5.9	5.8	4.6	5.4
Real Disposable Income (% change)	3.6	3.1	6.3	3.5	-5.6	5.1	3.2	2.3	3.5
Savings Rate (% of disp. income)	6.4	7.3	15.1	10.9	3.0	4.7	5.1	4.6	4.8
After-Tax Profits (% change)	1.1	2.9	6.4	30.6	2.2	4.0	6.2	3.5	4.6
Financial Markets (year-end)									
Federal Funds Rate (Upper range) (%)	2.50	1.75	0.25	0.25	4.50	5.50	4.50	3.50	4.50
3-Month T-bill rate (%)	2.40	1.52	0.09	0.06	4.30	5.20	4.35	3.27	4.27
10-Year Treasury Note (%)	2.69	1.92	0.93	1.52	3.88	3.88	3.05	3.78	3.57
30-Year Fixed Mortgage Rate (%)	4.55	3.74	2.67	3.11	6.42	6.61	6.23	5.74	6.19
Exchange Rate, Major Trading Partners (% change)	5.0	-0.8	-2.9	3.6	5.3	-2.2	2.8	1.2	0.60
Other Key Measures									
Crude Oil - Brent ($ per Barrel)	71.3	64.3	42.0	70.9	100.9	82.5	79.3	77.6	79.8
Industrial Production (% change)	3.2	-0.7	-7.1	4.4	3.4	0.2	-0.2	1.4	0.5
Housing Starts (Mill. Units, saar)	1.25	1.29	1.39	1.60	1.55	1.42	1.37	1.44	1.4
Light Vehicle Sales (Mill. Units, saar)	17.2	17.0	14.5	14.9	13.8	15.5	15.6	16.4	15.8

TABLE 2 - ORANGE COUNTY

	2021	2022	2023	2024f	2025f	3-Year Average 2023-2025
Levels in Thousands						
Household Employment						
Labor Force	1557.3	1,579.3	1,588.9	1,593.6	1,609.6	1,597.4
Total Employment	1464.1	1,528.5	1,532.4	1,528.3	1,540.4	1,533.7
Total Unemployment	93.2	50.7	56.5	65.3	69.2	63.7
Unemployment Rate	6.0%	3.2%	3.6%	4.1%	4.3%	4.0%
Wage and Salary Employment						
Total Nonfarm	1,587.8	1,666.1	1,681.9	1,704.0	1,723.1	1,703.0
Goods Producing	252.3	261.1	261.4	262.1	267.3	263.6
Mining and Logging	0.4	0.3	0.3	0.3	0.3	0.3
Construction	102.2	105.3	104.6	107.3	112.3	108.1
Manufacturing	149.8	155.4	156.5	154.5	154.7	155.2
Durable Goods	111.4	116.1	117.5	116.2	117.0	116.9
Nondurable Goods	38.3	39.4	39.0	38.3	37.7	38.3
Service Providing	1,335.5	1,405.0	1,420.4	1,441.9	1,455.8	1,439.4
Trade, Transportation and Utilities	252.0	258.3	262.1	263.7	267.4	264.4
Wholesale Trade	77.5	79.0	80.8	81.5	84.2	82.2
Retail Trade	143.4	145.5	146.1	147.3	148.7	147.3
Transportation, Warehousing and Utilities	31.1	33.8	35.2	34.9	34.5	34.9
Information	24.0	24.3	22.6	21.7	21.8	22.0
Financial Activities	117.1	112.3	104.1	103.1	101.9	103.0
Professional and Business Services	321.7	331.5	321.4	321.5	322.8	321.9
Educational and Health Services	237.3	249.3	264.3	275.8	281.6	273.9
Leisure and Hospitality	180.4	217.9	229.6	236.3	238.0	234.6
Other Services	47.5	53.1	55.3	57.0	58.0	56.7
Government	155.7	158.2	161.2	162.8	164.3	162.8
Percentage change						
Total Nonfarm	3.6%	4.9%	0.9%	1.3%	1.1%	1.1%
Goods Producing	0.2%	3.5%	0.1%	0.2%	2.0%	0.8%
Mining and Logging	7.0%	-15.2%	-7.7%	1.1%	4.8%	-0.6%
Construction	0.8%	3.1%	-0.6%	2.5%	4.7%	2.2%
Manufacturing	-0.2%	3.8%	0.7%	-1.3%	0.1%	-0.2%
Durable Goods	-0.8%	4.1%	1.3%	-1.1%	0.7%	0.3%
Nondurable Goods	1.6%	2.7%	-1.0%	-1.7%	-1.7%	-1.5%
Service Providing	4.3%	5.2%	1.1%	1.5%	1.0%	1.2%
Trade, Transportation and Utilities	3.2%	2.5%	1.5%	0.6%	1.4%	1.2%
Wholesale Trade	0.9%	1.9%	2.3%	0.9%	3.3%	2.2%
Retail Trade	4.2%	1.5%	0.4%	0.8%	1.0%	0.7%
Transportation, Warehousing and Utilities	4.9%	8.9%	4.2%	-1.1%	-1.2%	0.7%
Information	-0.3%	1.0%	-7.1%	-3.8%	0.5%	-3.5%
Financial Activities	1.0%	-4.0%	-7.3%	-0.9%	-1.2%	-3.2%
Professional and Business Services	4.0%	3.1%	-3.1%	0.0%	0.4%	-0.9%
Educational and Health Services	5.1%	5.0%	6.0%	4.4%	2.1%	4.2%
Leisure and Hospitality	11.5%	20.8%	5.3%	3.0%	0.7%	3.0%
Other Services	7.5%	12.0%	4.0%	3.0%	1.8%	3.0%
Government	-0.3%	1.6%	1.9%	1.0%	0.9%	1.3%

TABLE 3 - SOUTHERN CALIFORNIA

	2021	2022	2023	2024f	2025f	3-Year Average 2023-2025
Levels in Thousands						
Household Employment						
Labor Force	9,152.4	9,189.0	9,269.7	9,362.4	9,456.1	9362.7
Total Employment	8,747.2	8,760.1	8,783.6	8,868.2	8,963.8	8871.9
Total Unemployment	405.2	428.9	486.1	514.7	492.3	497.7
Unemployment Rate	4.4%	4.7%	5.2%	5.5%	5.2%	5.3%
Wage and Salary Employment						
Total Nonfarm	8,170.4	8,219.1	8,294.9	8,363.4	8,485.2	8,381.2
Goods Producing	998.1	995.2	993.3	997.1	1,013.3	1,001.2
Mining and Logging	4.5	4.5	4.6	4.6	4.8	4.7
Construction	389.2	389.4	395.2	401.7	423.5	406.8
Manufacturing	604.4	601.3	593.5	590.8	585.0	589.8
Durable Goods	385.8	388.0	383.9	383.4	383.6	383.6
Nondurable Goods	218.6	213.4	209.6	207.4	201.3	206.1
Service Providing	7,172.4	7,223.9	7,301.6	7,366.3	7,471.9	7,379.9
Trade, Transportation and Utilities	1,615.0	1,601.6	1,601.6	1,614.7	1,648.1	1,621.4
Wholesale Trade	365.4	361.7	360.6	362.5	369.3	364.1
Retail Trade	769.5	772.4	774.2	778.8	789.9	781.0
Transportation, Warehousing and Utilities	480.1	467.5	466.8	473.4	488.9	476.3
Information	276.1	232.6	228.6	232.5	247.3	236.1
Financial Activities	390.1	375.3	373.7	373.3	371.4	372.8
Professional and Business Services	1,216.5	1,182.2	1,173.5	1,169.3	1,167.2	1,170.0
Educational and Health Services	1,439.1	1,520.2	1,578.5	1,615.7	1,683.2	1,625.8
Leisure and Hospitality	948.4	988.4	999.7	1,006.4	989.5	998.5
Other Services	262.9	272.0	275.5	277.7	279.6	277.6
Government	1,024.3	1,051.5	1,070.4	1,076.8	1,085.7	1,077.6
Percentage change						
Total Nonfarm	5.2%	0.6%	0.9%	0.8%	1.5%	1.1%
Goods Producing	3.1%	-0.3%	-0.2%	0.4%	1.6%	0.6%
Mining and Logging	4.8%	-1.3%	2.2%	0.9%	4.0%	2.4%
Construction	2.8%	0.1%	1.5%	1.6%	5.4%	2.9%
Manufacturing	3.2%	-0.5%	-1.3%	-0.5%	-1.0%	-0.9%
Durable Goods	2.7%	0.6%	-1.0%	-0.1%	0.1%	-0.4%
Nondurable Goods	4.2%	-2.4%	-1.7%	-1.1%	-2.9%	-1.9%
Service Providing	5.5%	0.7%	1.1%	0.9%	1.4%	1.1%
Trade, Transportation and Utilities	3.2%	-0.8%	0.0%	0.8%	2.1%	1.0%
Wholesale Trade	1.5%	-1.0%	-0.3%	0.5%	1.9%	0.7%
Retail Trade	2.2%	0.4%	0.2%	0.6%	1.4%	0.8%
Transportation, Warehousing and Utilities	6.2%	-2.6%	-0.2%	1.4%	3.3%	1.5%
Information	10.8%	-15.8%	-1.7%	1.7%	6.3%	2.1%
Financial Activities	-0.4%	-3.8%	-0.4%	-0.1%	-0.5%	-0.3%
Professional and Business Services	4.6%	-2.8%	-0.7%	-0.4%	-0.2%	-0.4%
Educational and Health Services	3.9%	5.6%	3.8%	2.4%	4.2%	3.5%
Leisure and Hospitality	17.4%	4.2%	1.1%	0.7%	-1.7%	0.0%
Other Services	11.6%	3.5%	1.3%	0.8%	0.7%	0.9%
Government	2.2%	2.7%	1.8%	0.6%	0.8%	1.1%

TABLE 4 - LOS ANGELES COUNTY

	2021	2022	2023	2024f	2025f	3-Year Average 2023-2025
Levels in Thousands						
Household Employment						
Labor Force	5007.6	5,013.4	5,015.6	5,065.8	5,116.4	5,066.0
Total Employment	4558.9	4,764.5	4,763.6	4,782.1	4,829.9	4,791.9
Total Unemployment	448.7	248.8	252.0	283.7	301.9	279.2
Unemployment Rate	9.0%	5.0%	5.0%	5.6%	5.9%	5.5%
Wage and Salary Employment						
Total Nonfarm	4,305.1	4,533.0	4,543.5	4,589.5	4,624.0	4,585.7
Goods Producing	463.8	474.7	471.9	466.5	464.8	467.7
Mining and Logging	1.6	1.7	1.7	1.7	1.8	1.7
Construction	149.0	151.3	151.0	151.8	154.4	152.4
Manufacturing	313.1	321.7	319.2	313.0	308.6	313.6
Durable Goods	186.0	189.5	191.0	188.3	187.3	188.9
Nondurable Goods	127.1	132.2	128.2	124.7	121.3	124.7
Service Providing	3,841.3	4,058.3	4,071.6	4,123.1	4,159.2	4,117.9
Trade, Transportation and Utilities	814.0	834.5	826.4	827.5	833.0	829.0
Wholesale Trade	202.6	204.4	200.4	199.3	200.0	199.9
Retail Trade	396.1	406.5	407.2	408.7	410.1	408.7
Transportation, Warehousing and Utilities	215.2	223.6	218.8	219.5	222.9	220.4
Information	208.8	234.9	193.0	188.5	204.7	195.4
Financial Activities	213.2	215.7	211.0	210.5	212.7	211.4
Professional and Business Services	630.8	666.9	652.5	638.1	631.8	640.8
Educational and Health Services	844.4	871.1	914.5	960.4	984.1	953.0
Leisure and Hospitality	434.2	512.4	534.1	543.9	537.9	538.6
Other Services	135.7	153.0	157.8	161.4	160.8	160.0
Government	560.2	570.0	582.3	592.7	594.2	589.7
Percentage change						
Total Nonfarm	3.3%	5.3%	0.2%	1.0%	0.8%	0.7%
Goods Producing	0.0%	2.4%	-0.6%	-1.2%	-0.4%	-0.7%
Mining and Logging	-6.7%	3.6%	-1.5%	1.4%	8.0%	2.7%
Construction	1.7%	1.6%	-0.2%	0.5%	1.7%	0.7%
Manufacturing	-0.7%	2.7%	-0.8%	-1.9%	-1.4%	-1.4%
Durable Goods	-2.2%	1.9%	0.8%	-1.4%	-0.5%	-0.4%
Nondurable Goods	1.6%	4.0%	-3.0%	-2.8%	-2.8%	-2.8%
Service Providing	3.7%	5.6%	0.3%	1.3%	0.9%	0.8%
Trade, Transportation and Utilities	3.7%	2.5%	-1.0%	0.1%	0.7%	-0.1%
Wholesale Trade	0.8%	0.9%	-2.0%	-0.6%	0.3%	-0.7%
Retail Trade	5.4%	2.6%	0.2%	0.4%	0.3%	0.3%
Transportation, Warehousing and Utilities	3.5%	3.9%	-2.1%	0.3%	1.6%	-0.1%
Information	9.3%	12.5%	-17.8%	-2.3%	8.6%	-3.8%
Financial Activities	0.0%	1.2%	-2.2%	-0.2%	1.0%	-0.5%
Professional and Business Services	5.0%	5.7%	-2.2%	-2.2%	-1.0%	-1.8%
Educational and Health Services	2.8%	3.2%	5.0%	5.0%	2.5%	4.2%
Leisure and Hospitality	10.3%	18.0%	4.2%	1.8%	-1.1%	1.7%
Other Services	5.4%	12.7%	3.1%	2.3%	-0.4%	1.7%
Government	-1.8%	1.7%	2.2%	1.8%	0.3%	1.4%

TABLE 5 - INLAND EMPIRE

	2021	2022	2023	2024f	2025f	3-Year Average 2023-2025
Levels in Thousands						
Household Employment						
Labor Force	2120.6	2,148.6	2,171.5	2,193.3	2,215.2	2,193.3
Total Employment	1964.3	2,058.4	2,068.8	2,077.0	2,097.8	2,081.2
Total Unemployment	156.3	90.2	102.7	116.2	117.4	112.1
Unemployment Rate	7.4%	4.2%	4.7%	5.3%	5.6%	5.2%
Wage and Salary Employment						
Total Nonfarm	1,575.1	1,659.8	1,679.8	1,709.8	1,737.9	1,709.1
Goods Producing	207.7	216.3	216.1	217.2	220.9	218.0
Mining and Logging	1.4	1.5	1.5	1.6	1.5	1.5
Construction	110.1	114.7	115.7	119.3	121.6	118.9
Manufacturing	96.1	100.0	98.9	96.3	97.7	97.6
Durable Goods	60.0	61.3	60.4	58.9	60.0	59.8
Nondurable Goods	36.2	38.7	38.5	37.4	37.8	37.9
Service Providing	1,367.4	1,443.5	1,463.7	1,492.6	1,517.0	1,491.1
Trade, Transportation and Utilities	443.2	464.9	456.5	454.4	464.2	458.4
Wholesale Trade	67.4	69.5	68.7	67.9	69.0	68.5
Retail Trade	177.0	181.0	182.7	182.3	184.4	183.2
Transportation, Warehousing and Utilities	198.8	214.4	205.1	204.2	210.8	206.7
Information	12.5	13.0	13.3	12.9	12.9	13.1
Financial Activities	45.2	46.0	44.9	44.5	44.7	44.7
Professional and Business Services	166.6	173.9	164.8	164.5	165.9	165.1
Educational and Health Services	254.3	267.5	287.5	308.4	317.0	304.3
Leisure and Hospitality	160.2	180.9	186.5	186.1	188.7	187.1
Other Services	43.6	47.4	49.3	49.2	49.6	49.4
Government	242.0	250.0	260.9	272.6	273.9	269.1
Percentage change						
Total Nonfarm	5.3%	5.4%	1.2%	1.8%	1.6%	1.5%
Goods Producing	2.7%	4.1%	-0.1%	0.5%	1.7%	0.7%
Mining and Logging	10.4%	8.8%	-2.2%	5.6%	-3.1%	0.1%
Construction	5.0%	4.2%	0.9%	3.1%	1.9%	2.0%
Manufacturing	0.2%	4.0%	-1.2%	-2.6%	1.5%	-0.8%
Durable Goods	-2.1%	2.3%	-1.5%	-2.4%	1.8%	-0.7%
Nondurable Goods	4.1%	7.0%	-0.6%	-2.8%	1.0%	-0.8%
Service Providing	5.7%	5.6%	1.4%	2.0%	1.6%	1.7%
Trade, Transportation and Utilities	8.9%	4.9%	-1.8%	-0.4%	2.2%	0.0%
Wholesale Trade	2.8%	3.1%	-1.2%	-1.1%	1.6%	-0.3%
Retail Trade	4.9%	2.2%	1.0%	-0.2%	1.2%	0.6%
Transportation, Warehousing and Utilities	15.2%	7.9%	-4.3%	-0.4%	3.2%	-0.5%
Information	1.1%	3.9%	2.7%	-3.0%	-0.1%	-0.2%
Financial Activities	2.5%	1.8%	-2.3%	-0.9%	0.5%	-0.9%
Professional and Business Services	9.5%	4.4%	-5.2%	-0.2%	0.9%	-1.5%
Educational and Health Services	2.2%	5.2%	7.5%	7.3%	2.8%	5.8%
Leisure and Hospitality	13.3%	12.9%	3.1%	-0.2%	1.4%	1.4%
Other Services	8.4%	8.9%	3.9%	-0.2%	0.8%	1.5%
Government	-2.4%	3.3%	4.4%	4.5%	0.5%	3.1%

TABLE 6 - VENTURA COUNTY

	2021	2022	2023	2024f	2025f	3-Year Average 2023-2025
Levels in Thousands						
Household Employment						
Labor Force	406.6	411.1	412.9	417.1	421.2	421.2
Total Employment	381.4	395.8	395.3	396.2	400.2	400.3
Total Unemployment	25.2	15.4	17.6	20.9	21.1	20.9
Unemployment Rate	6.2%	3.7%	4.3%	5.0%	5.3%	5.1%
Wage and Salary Employment						
Total Nonfarm	299.6	311.6	314.0	318.3	321.6	321.1
Goods Producing	44.5	46.0	45.8	45.8	46.7	47.3
Mining and Logging	0.9	1.0	1.0	1.0	1.0	1.0
Construction	17.1	17.8	18.0	18.2	18.8	19.3
Manufacturing	26.5	27.3	26.8	26.6	26.9	26.9
Durable Goods	18.3	18.9	19.1	19.0	19.0	18.9
Nondurable Goods	8.2	8.3	7.7	7.7	7.9	8.0
Service Providing	255.1	265.6	268.2	272.5	274.9	273.8
Trade, Transportation and Utilities	55.7	57.3	56.6	56.7	57.9	58.3
Wholesale Trade	12.3	12.5	11.8	11.5	11.4	11.3
Retail Trade	36.4	36.5	36.4	36.9	38.3	38.9
Transportation, Warehousing and Utilities	7.0	8.3	8.4	8.3	8.2	8.1
Information	3.9	4.0	3.7	3.5	3.3	3.3
Financial Activities	16.1	16.1	15.3	15.1	14.5	14.2
Professional and Business Services	43.6	44.3	43.6	44.1	44.0	44.0
Educational and Health Services	49.6	51.2	53.9	56.5	58.1	58.4
Leisure and Hospitality	32.8	37.2	38.3	39.1	39.8	38.5
Other Services	8.9	9.4	9.7	9.8	9.8	9.8
Government	44.5	46.1	47.1	47.7	47.4	47.4
Percentage change						
Total Nonfarm	3.2%	4.0%	0.8%	1.4%	1.1%	1.0%
Goods Producing	2.3%	3.4%	-0.4%	0.0%	2.1%	2.5%
Mining and Logging	-3.6%	9.3%	2.6%	0.4%	2.7%	2.8%
Construction	2.3%	3.6%	1.5%	0.8%	3.4%	5.4%
Manufacturing	2.6%	3.0%	-1.8%	-0.5%	1.1%	0.5%
Durable Goods	-0.7%	3.2%	0.9%	-0.6%	0.3%	-0.6%
Nondurable Goods	10.8%	2.4%	-7.8%	-0.4%	3.0%	3.2%
Service Providing	3.3%	4.1%	1.0%	1.6%	0.9%	0.7%
Trade, Transportation and Utilities	5.0%	2.9%	-1.3%	0.3%	2.1%	2.3%
Wholesale Trade	2.6%	1.1%	-5.1%	-2.4%	-1.3%	-2.5%
Retail Trade	4.3%	0.5%	-0.4%	1.4%	3.9%	4.6%
Transportation, Warehousing and Utilities	14.0%	19.0%	0.5%	-0.9%	-1.4%	-1.8%
Information	-1.5%	2.3%	-6.7%	-7.6%	-3.7%	-6.5%
Financial Activities	2.5%	-0.3%	-4.6%	-1.6%	-3.6%	-5.5%
Professional and Business Services	2.4%	1.4%	-1.6%	1.4%	-0.2%	0.1%
Educational and Health Services	2.6%	3.3%	5.3%	4.8%	2.8%	3.9%
Leisure and Hospitality	8.6%	13.4%	2.8%	2.1%	1.9%	-1.2%
Other Services	7.2%	5.8%	3.4%	0.9%	0.0%	0.0%
Government	-0.6%	3.7%	2.1%	1.4%	-0.7%	-0.1%

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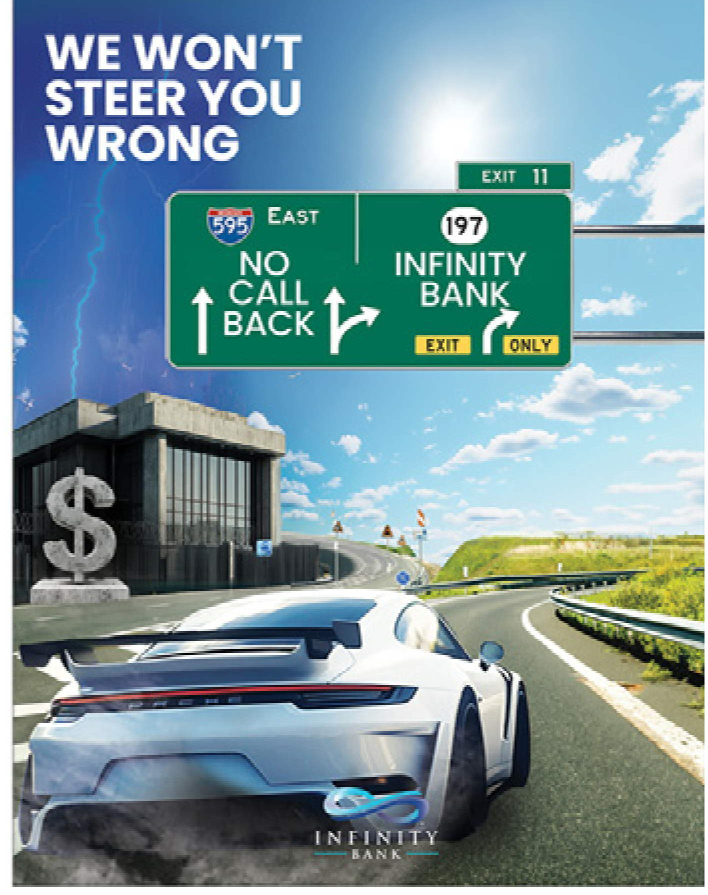

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