California Executive Summary

2018 Q2

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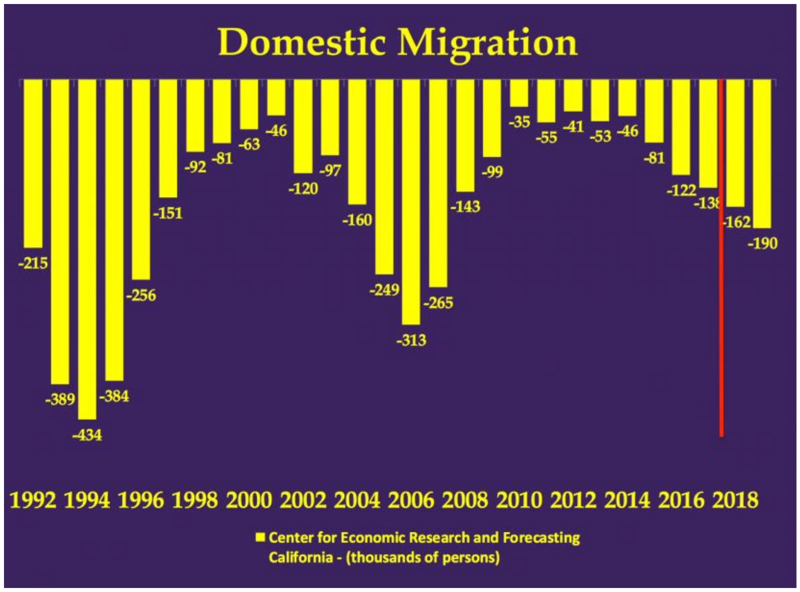
The March 2018 forecast marked what appeared to be a turning point in the economic outlook for California. In March, we wrote:

> "We are currently forecasting a convergence in the economic fortunes of California and the nation. While California has historically grown at a rate that is significantly higher than the nation's, 2017 may have marked a turning point…While growth was accelerating around the country, it appeared to slow down in California. We are forecasting that this dynamic continues in the years ahead. It is even possible that the growth premium maintained by California may vanish altogether."

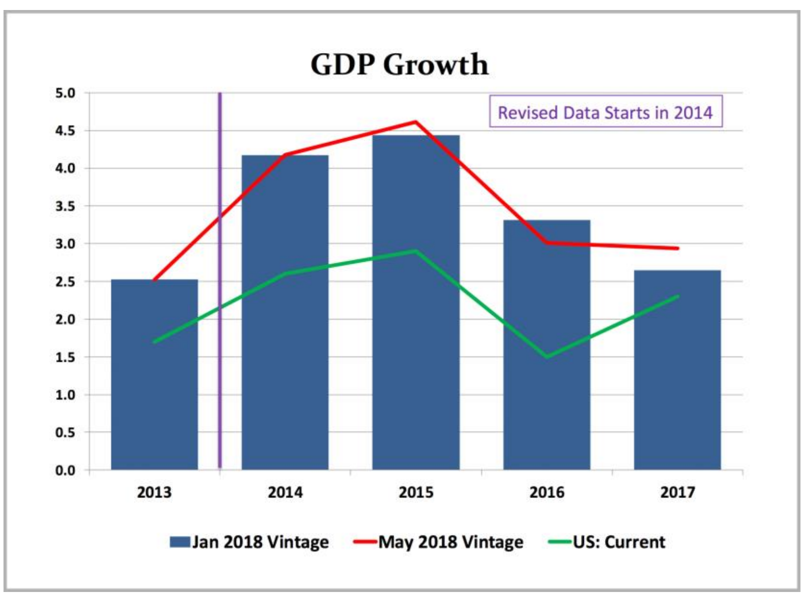
The story of a vanishing growth premium in California is not new to the CERF team. Guided by a healthy dose of both economic theory and common-sense, the CERF team has argued for many years that California can not possibly continue down a road of crushing, anti-business policy making and still maintain its growth advantage over the rest of the country. Because California competes with other regions for the opportunity to host high value-added business activity, other regions can develop a competitive advantage by cultivating pro-business policies. Eventually, businesses of many different kinds will begin migrating to these favorable environments.

Early evidence of this dynamic was provided by California's world-renowned movie industry—or should we say, *Georgia's* world-renowned movie industry. So much production in the movie business has already fled California in search of lower-cost regions that California now ranks behind the UK, Canada, and current industry leader Georgia. The exodus of jobs and output in this iconic California industry is actually part of an economy-wide exodus that has accelerated in recent years.

The apparent slow-down of California's economy noted in the March publication coincides with a significant increase in net domestic out-migration. Households and individuals, dominated by younger, working-age adults, are fleeing California in increasing numbers. In March, the coincidence of these two patterns led us to wonder if the convergence that we have been anticipating between California's economy and the Nation's might finally be imminent.



With the advent of this forecast publication, the situation seems a little different than what we observed last quarter, although the fundamental story is unchanged. Most notably, there has been a significant upward revision to California's growth number for 2017. The initial estimate of 2.7 percent growth in real GDP has been revised upward to nearly 3.0 percent. That is to say, economic growth was flat between 2016 and 2017, rather than decreasing as we previously thought.



At the same time, 2016's growth number was revised downward from 3.3 to 3.0. While growth may have been flat between 2016 and 2017, it now appears to have slowed even more than previously thought between 2015 and 2016.

Even with the revisions, it is evident to the CERF team that the slowdown of California's economy relative to the nation's is real. Whether the slowdown happened almost exclusively in 2016 or happened over two consecutive years is less important that the reality of the slowdown itself. Perhaps more importantly, the California economy appears to be sidelined while the broader U.S. economy is accelerating. At the current rate of convergence, it is still perfectly plausible that the California growth premium could vanish within the forecast horizon.

California

Gross Domestic Product (Real SAAR Growth)

Quarter	CA GDP	US GDP	Premium
2017 Q1	-0.3	1.2	-1.5
2017 Q2	7.4	3.1	4.3
2017 Q3	2.0	3.2	-1.2
2017 Q4	3.4	2.9	0.5
2018 Q1	2.9 †	2.2	0.7
2018 Q2	3.2	3.0	0.2
2018 Q3	2.9	2.8	0.1
2018 Q4	2.7	2.6	0.1
2019 Q1	2.7	2.6	0.1
2019 Q2	2.6	2.5	0.1
2019 Q3	2.5	2.5	0.0
2019 Q4	2.4	2.4	0.0
2020 Q1	2.4	2.4	0.0
Average	2.7	2.6	0.1

Sources: U.S. BEA, CERF *† CERF Preliminary estimate*

The current forecast anticipates annual growth in California's real GDP of 3.2 percent in 2018 and 2.7 percent in 2019. This compares to forecasted annual growth of 2.7 percent in both 2018 and 2019 for the nation. It appears almost certain that California will still enjoy a growth premium this year. We await economic developments next year to learn if economic theory and common sense finally bear out.

Forecast Charts