Executive Summary: United States and California | 2019 Q2

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United States

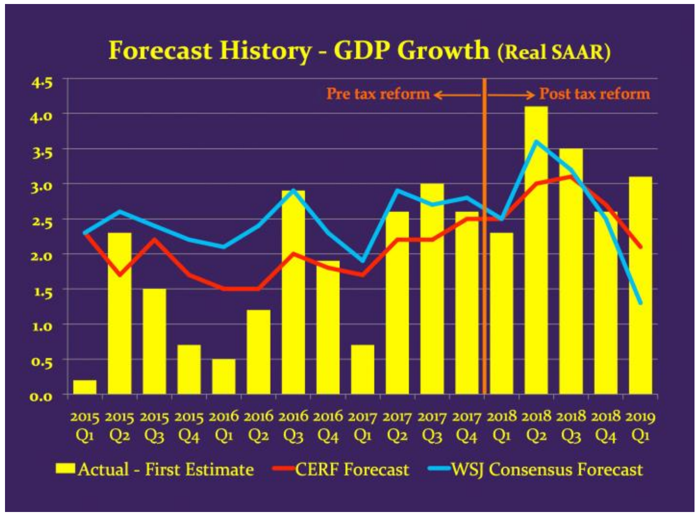
Since the economic recovery began ten years ago, there have been two distinct chapters in the evolution of the CERF forecast. In the first chapter, from the earliest days of the recovery until December 2017, the CERF forecast was systematically below consensus – often well below consensus. From 2015 Q1 through 2017 Q4, the average of our forecasted quarterly GDP growth numbers was 1.9 percent. By comparison, the average of the Wall Street Journal consensus was 2.5 percent. Unfortunately, over this period, it seems that you couldn't be pessimistic enough. The average of actual quarterly GDP growth figures was 1.7 percent. The CERF team may have been pessimistic relative to other forecasters, but reality demonstrated that were actually too sunny in our outlook.

CERF's relative pessimism was driven by a firm conviction that policy matters and that many of the extraordinary policy interventions undertaken during the financial crisis and the Great Recession condemned the nation to a future of anemic growth. We wrote in 2017, "the Country's poor economic performance over the past decade is no accident … only fundamental changes to the policies which drive poor economic activity can hope to lift the prospect of growth." At that time, we identified fundamental changes to monetary policy, corporate tax policy and regulation of the private economy as prerequisites for stronger growth.

The passage of tax reform produced an immediate upward revision to the CERF forecast. From 2018 Q1 through last quarter, the average of our quarterly growth forecasts was 2.7 percent, fully 80 basis points higher than the previous 12 quarters. During the same period, the Wall Street Journal consensus averaged 2.6 percent. This represents a dramatic change of outlooks. For the first time since the financial crisis, the CERF forecasts were optimistic relative to consensus. The reason for CERF's optimism relative to consensus is that we assign greater positive value to the impact of corporate tax reform. In addition to assigning greater impact, we also believe that the impact of tax reform is not merely transitory, not just a "sugar high" as some have called it.

Holding all else equal, the effect of corporate tax reform would be enduring. Unfortunately, all else is not equal. In recent months, the President's trade war with China has begun to overwhelm many of the economic gains from tax reform. As the effects of the trade war begin to be felt across large swaths of the U.S. economy and as uncertainly caused by trade negotiations has begun to delay business investment decisions, the CERF team has revised our forecast downward. Interestingly, as we have moved our forecasts lower over each of the past few quarters (the one-step ahead forecasts were 3.1, 2.7 and 2.1 respectively), we are chasing the consensus downhill. The Wall Street Journal consensus numbers have declined more rapidly (3.2, 2.5, and 1.3).

CERF is currently forecasting economic growth of 2.4 percent in Q2 followed by 2.3 percent in each of the remaining two quarters of 2019. This forecast is 30-40 basis points lower in each quarter than our forecast from December of last year, attributable entirely to the impacts of the trade war.



California

During the three years from 2016 to 2018, California's *population* growth has been consistently under the nation's. This is unprecedented, and noteworthy, for an expansion phase of the business cycle. The state's *economic* growth rate exceeded the national rate during the three years from 2016 through 2018. However, the state's 2018 economic growth premium narrowed considerably from 1.4 percent in 2017 to 0.6 percent in 2018.

Switching to quarterly frequency data, we see the state's economic growth in the most recent quarter available, 2018 Q4, was below that of the nation's. During the most recent six quarters, the national economy appears to be strengthening, while the state's economy appears to be weakening.

Our short-term California forecast calls for a narrow growth premium in both 2019, 2.9 percent for the state against 2.7 percent for the U.S. It calls for the premium to be zero in 2020. Our forecast presumes that the Bay Area continues in its current role as the world's technology titan, and that its growth continues. However, as we have stated in previous forecasts, Sacramento's anti-business culture and policies will ultimately bear on the economy and slow that growth.

The risks to California's forecasted growth premium over the United States in this publication might just be essentially balanced at this point. While Sacramento's economic policies are harmful, Washington DC's policies are as well. CERF has become very concerned about the economically harmful nature of national economic policies. See Matthew's piece on the CERF blog and this publication's United States *Forecast Highlights* essay for further discussions. What is hard to tell at this point is which of the two policy-making capitals is capable of greater harm.