Beacon Economics

BEACONOMICS

AN ECONOMIC FORECAST FOR THE U.S. AND CALIFORNIA

BEACONOMICS

Beaconomics is produced quarterly by Beacon Economics LLC, one of California's leading economic research and consulting firms specializing in economic and revenue forecasting; sustainable growth and development; housing, land use, and real estate markers; economic fiscal, and social impact analysis; public policy analysis; regional economics; and EB-5 Visa analysis.

Volume 14 | Number 3 | Summer 2020

This publication was prepared by:

CHRISTOPHER THORNBERG
Founding Partner
5777 Century Boulevard, Suite 895
Los Angeles, California 90045
(424) 646-4651
Chris@beaconecon.com

TANER OSMAN
Research Manager
5777 Century Boulevard, Suite 895
Los Angeles, California 90045
(424) 666-2166
Taner@beaconecon.com

For further information about this publication, or about Beacon Economics, please contact:

VICTORIA PIKE BOND
Director of Communications
(415) 477-6030
Victoria@beaconecon.com

RICK SMITH
Director of Business Development
(858) 997-1834
Rick@beaconecon.com

Or visit our website at www.BeaconEcon.com

UNITED STATES OUTLOOK

By Christopher Thornberg, PhD

HOW STRONG A BOUNCE?

The Covid-19 pandemic, and the public health mandates implemented to control its spread, have created a record decline in U.S. economic activity. Retail sales dropped by a full 25% in the two-month period from February to April as unemployment soared from 3.5% to 14.7%, driven by the 21 million-plus jobs that have been furloughed due to stay-at-home orders across the nation. The scale of these numbers dwarfs anything that has occurred in the United States in the post war period and may be the most dramatic change ever in such a short time. With most of April's data in, the Federal Reserve Bank of Atlanta's GDPNow forecast for second quarter growth currently sits at a startling -51% annualized pace – five times worse than the worst quarter for growth ever recorded in the United States.[1] The Congressional Budget Office (CBO) released a recent forecast that predicted U.S. economic output at the end of 2022 will be 5% smaller than if there had been no pandemic, and a full recovery could take a decade – very similar to what transpired after the Great Recession.[2]

The good news is that the second quarter, as bad as it's expected to be, will still be significantly better than this early GDPNow prediction as that is not a true forecast, but a 'current cast' that uses available data to predict the current trajectory. In other words, the -51% growth will only occur if May and June look like April. The pieces of data that have been coming in for May, however, all suggest that the nation is already past the trough of economic activity and things are rebounding. Moreover, evidence continues to build that the third quarter will be even better. Despite continued dismal outlooks from a broad group of pundits, economists, and government officials, the "V" shaped recovery is already underway.

The argument for a "V" recovery starts with the very good news that the number of new COVID-19 cases continues to fall in the United States from a high of over 90 cases per million people to just slightly over 60 cases per million, per day. This is true globally as well. While there are a number of new hot spots emerging, most nations that saw a significant spike in cases in March and April (Spain, the UK, and Italy for example) are now all experiencing a decline in the number of new cases. The tide seems to have turned, at least for the moment.[3]

As new COVID-19 cases fall, governments have started to ease health mandates, albeit at a fairly inconsistent pace from location to location. The debate is over whether the economy will rebound rapidly as restrictions go away. Those predicting the "U" or "Nike-swoosh" type recovery are suggesting a weak bounce in activity after the health mandates are lifted. Indeed, some of the grimmer outlooks suggest that the economy will continue to shrink through the third quarter even if the mandates are fully rescinded.

Beacon Economics' last national economic outlook dove into this debate and is worth repeating. These grim outlooks stem from a basic historic fact of business cycles—once unemployment goes up, it falls back down slowly. Hence, with unemployment already at record high levels, it only makes sense that the recovery will be slow. The problem with this logic is that the current situation is nothing like past business cycles. In the past, the loss of jobs was driven by some large negative shock to the economy—such as a collapsing sub-prime lending bubble—and were mostly permanent. This time around, the shock is the furloughing of jobs due to health mandates, and in theory, once the mandates are lifted the jobs should return.

This should not imply that there won't be harm—clearly some businesses will not reopen or will not staff-up fully when they do. How many depends on how much damage is done during the shutdowns, and that, in turn, boils down to five simple questions:

1. How long will the mandates stay in place?
2. How much of the economy has been impacted?
3. How healthy was the economy before the pandemic?
4. What government interventions have been implemented?
5. Will there be a change in post-pandemic spending patterns?

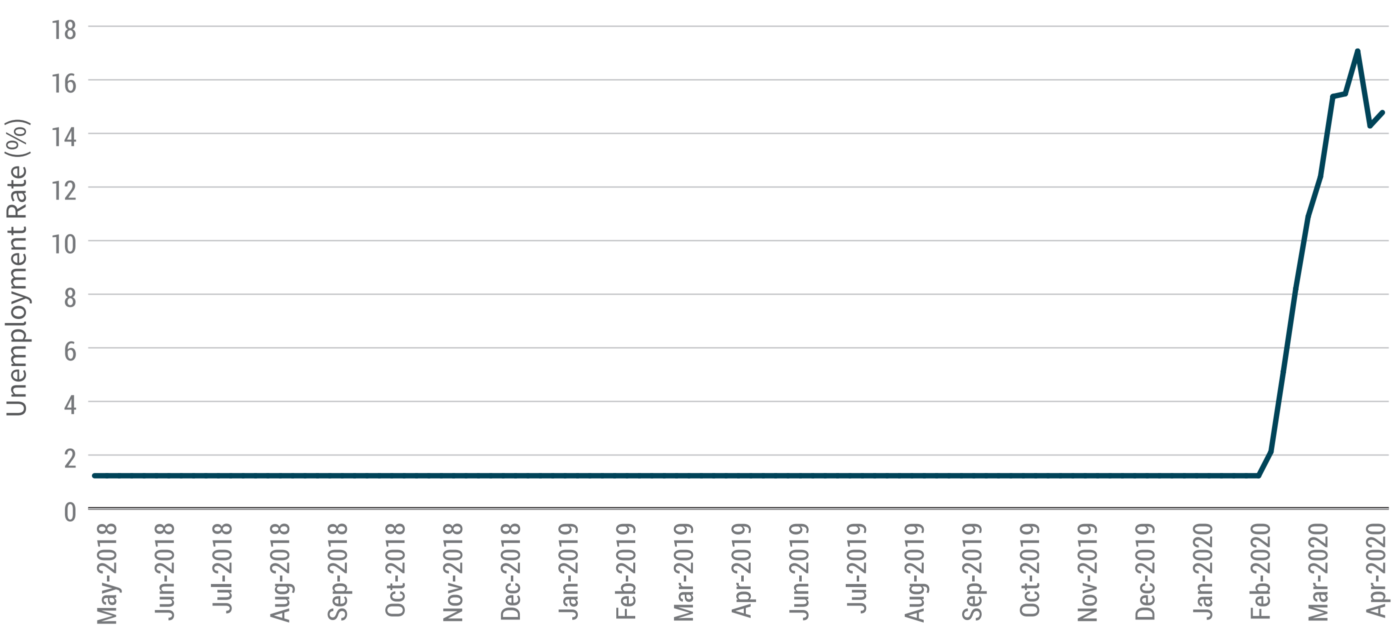
[1] https://www.frbatlanta.org/cqer/research/gdpnow
[2] https://www.cbo.gov/system/files/2020-06/56376-GDP.pdf
[3] https://www.nytimes.com/interactive/2020/us/coronavirus-us-cases.html#states

In reviewing these specific questions, it's evident that the amount of damage being done is relatively minimal—and that, in turn, means the economy should rebound rapidly after the mandates are lifted. This conclusion is already being borne out in the data. While there isn't much May data available yet, what we do have leaves little doubt that April was the bottom in terms of economic activity in the United States—and to be more specific, mid-April. Data from Opportunity Insights (an economic tracker from the Bill and Melinda Gates Foundation) suggests that consumer spending dropped over 30% from mid-March to the start of April. But it recovered by over half from mid-April to mid-May.[4] Data from other sources such as Google Mobility and Foursquare paint a similar picture. The industrial side of the economy looks better as well, with the May ISM report on Manufacturing showing better results than in April.[5]

As noted, employment is typically a lagging indicator of the business cycle—and this is true even for this sharp, but short downturn. The insured unemployment rate hit a peak of 17.1% during the week of May 9, falling to 14.8% by the end of the week of May 23. The number of hourly employees working at small businesses dropped by 60% at the start of the mandates, according to Opportunity Insights, but by mid-May that had recovered by one-third. All of these positive indicators proved correct when the May employment estimate was released by the U.S. Bureau of Labor Statistics last week. Payroll jobs increased by over 2.5 million as unemployment dropped by 1.4 percentage points. While this reflects only a small portion of the job declines over the previous two months, it is a solid starting point and one that is occurring much more rapidly than most economists had predicted.

INSURED UNEMPLOYMENT RATE

WEEKLY, 2018 TO 2020



Source: U.S. Employment and Training Administration; Analysis by Beacon Economics

[4] https://www.tracktherecovery.org/

[5] https://www.instituteforsupplymanagement.org/ISMReport/MfgROB.cfm

What is interesting about this data isn't just the speed of the bounce back, but that much of the improvement occurred before public health mandates were actually lifted in most locations. This is important because it suggests that people's choices mean as much, if not more, as the actual rules put into place by local governments. It also suggests that many people don't fear the virus intensely enough to prevent them from resuming activity. Anecdotal evidence from the recent reopening of beaches, lakes and other public spaces lends support to the view that people are ready to get back to their lives. This may or may not be a public health concern, but it goes a long way in dismissing the "new-normal" arguments that suggest consumers will be too afraid to go out and spend even after mandates are lifted. Certainly, some people will be wary, and that is entirely understandable for the relatively small group that is critically threatened by this malady. But for most people, this is unlikely to be a game changer.

The prognosticating pessimists out there will likely view all these indications of a rebound as nothing more than a "dead-cat bounce" that will quickly plateau leaving the U.S. economy far behind where it was just a few months ago – as detailed in the recent CBO forecast mentioned above. Even a casual look at that forecast strongly suggests that they are using the Great Recession as the model on which to base their current outlook. Yet there could be no worse metaphor for the current situation.

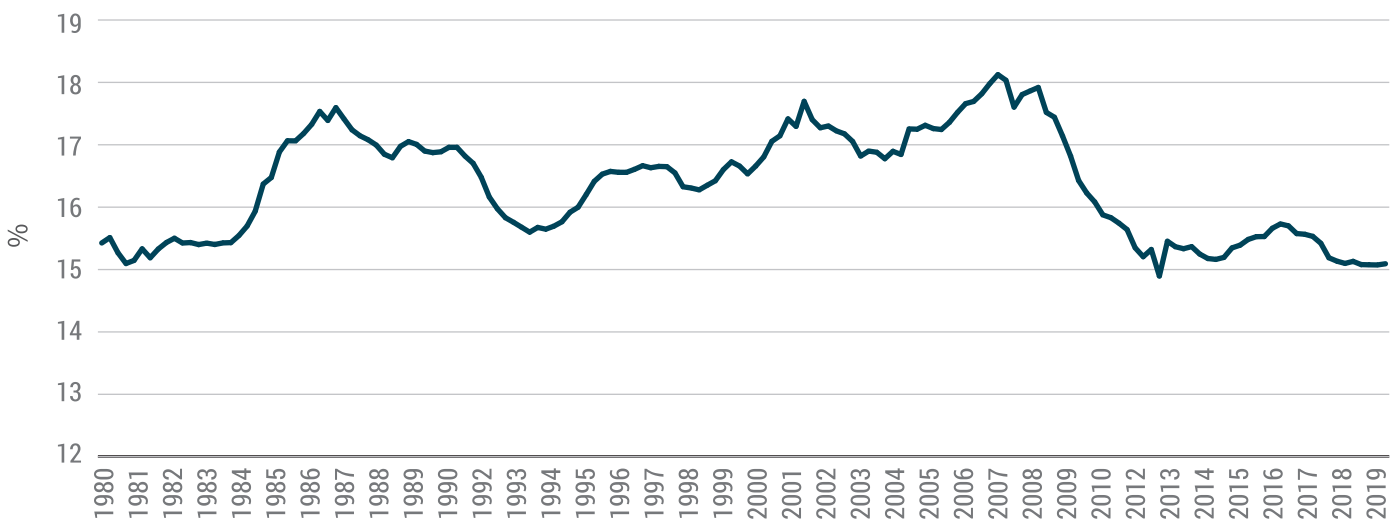
The Great Recession was driven by the collapse of a $15 trillion sub-prime bubble that had overheated the housing market and consumer spending during the preceding years. Millions of jobs in those sectors were lost permanently, and consumer spending was hampered for years as households had to rebalance their financial accounts. The pain of that cycle was predictable, as detailed by the highly-recommended book, This Time is Different: Eight Centuries of Financial Folly.[6] The authors convincingly show how collapsing financial bubbles invariably cause the worst recessions and the slowest recoveries – from the Great Depression to pre-revolutionary France.

The current business cycle has none of these characteristics. In fact, prior to the current recession, the U.S. economy was financially the healthiest it has been for decades. Prior to the Great Recession, the consumer savings rate had dropped to an all-time low of 3.5% of disposable current income, and the Financial Obligations Ratio had risen to an all-time high despite falling interest rates The stress in the debt markets was apparent long before the recession began, with delinquency rates on mortgage, credit card, and auto debt starting to rise in early 2006. Debt markets were pushed to the brink of collapse by the massive amount of bad debt that had been issued during the runup.

[6] This Time Is Different: Eight Centuries of Financial Folly, Carmen M. Reinhart and Kenneth S. Rogoff 2010

HOUSEHOLD FINANCIAL OBLIGATIONS AS % OF DISPOSABLE PERSONAL INCOME

QUARTERLY, 1980 TO 2019

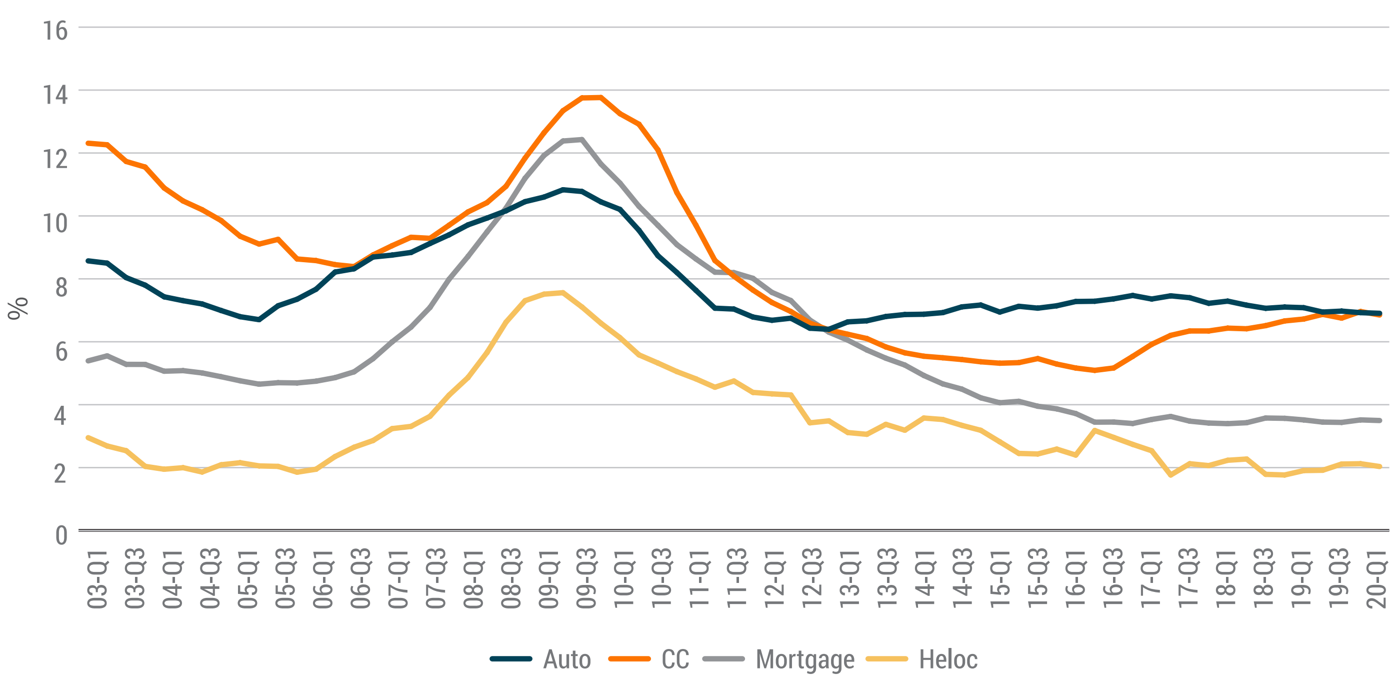


Source: Board of Governors of the Federal Reserve System; Analysis by Beacon Economics

It couldn't be more different today. Savings rates in February reached 8%, the highest consistent level since the early 1990s, and the Financial Obligations Ratio was at an all-time low level. Data from the Federal Reserve's Survey of Consumer Finances suggest that debt burdens are currently lower for households at every income level than they were in 2007 or in 1998. Prior to the pandemic there were no signs of any major issues with consumer debt. Delinquency rates for mortgages are at record low levels, and while credit card delinquencies have been on the rise, they are still lower than at any time prior to 2012. Overall, private sector debt to GDP has been on the decline for more than a decade and there is little reason to expect major problems within the debt markets.

SHARE OF DEBT

30 DAYS+ DELINQUET



Source: Federal Reserve Bank of New York; Analysis by Beacon Economics

The pessimist will say that while this is helpful, these numbers don't take into account the millions of households falling behind on their obligations while not working, something that will surely slow the recovery. But this argument fails to take into account two things. First, although some people are falling behind on income, others are falling behind on spending. The U.S. personal savings rate jumped to 13.1% in March because the aggregate decline in consumer spending was greater than the aggregate decline in income. This additional savings will help the economy rebound as consumers who have deferred spending will spend more than usual, making up for a slower rebound among those who have fallen behind. While there are clearly distributional issues here, from an aggregate perspective, this again suggests a "V" shaped recovery.

Perhaps more importantly is the question as to who is falling behind. The Federal government last month announced one of the fastest and most aggressive stimuli plans ever seen in the United States. Over $2.7 trillion was committed to supporting the economy through various mechanisms. Two of the most important include the Paycheck Protection Program, which gave forgivable loans to businesses, and expanded unemployment benefits, which increased the number of workers who could receive benefits as well as providing an additional $600 per week in payments. The data for May suggest that 22 million Americans are receiving unemployment benefits—functionally speaking, that is everyone who is unemployed. And with the supplemental payment, anyone who was earning less than $42,000 per year is actually making more money being unemployed.

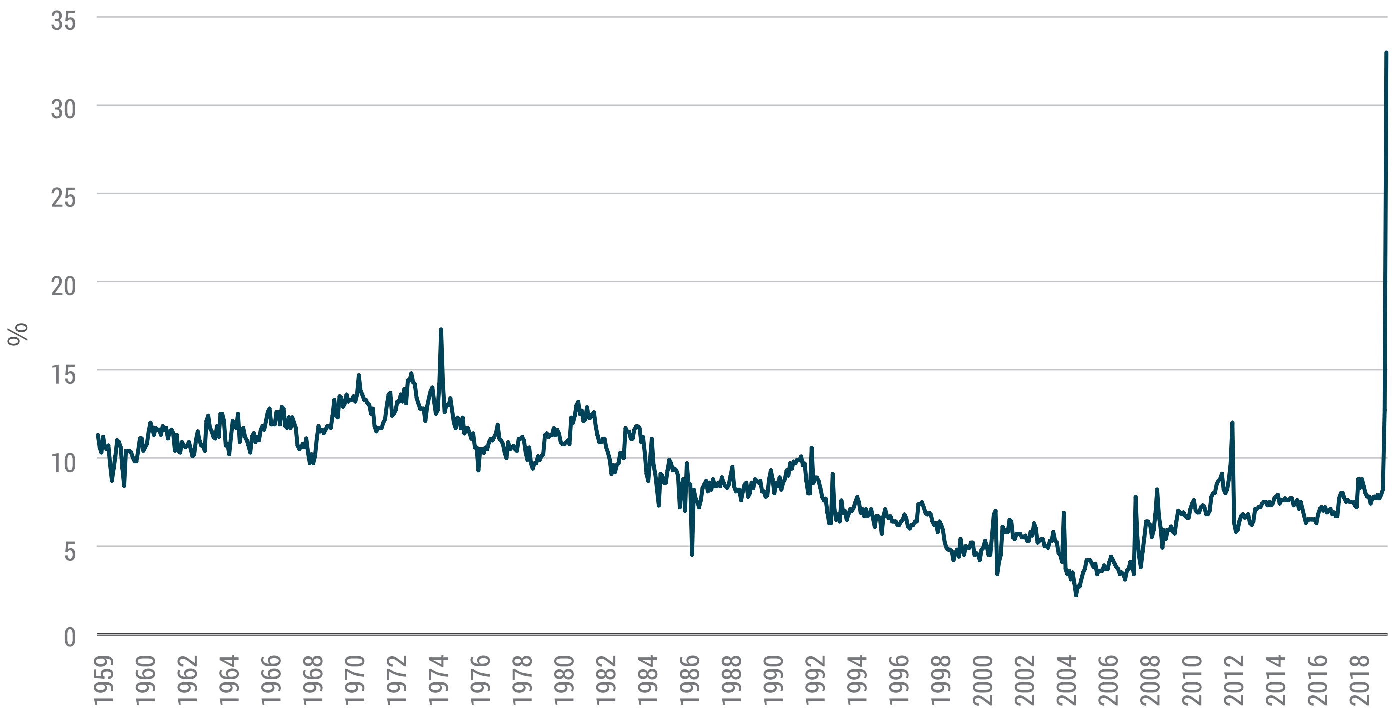
When April's personal income numbers were released, they were, like many other statistics throughout this unusual business cycle, eye-popping. From February to April, worker incomes fell almost 11%, while proprietors' incomes fell by 19.5%, a loss of $1.6 trillion at an annualized pace. Personal outlays (spending) fell by $3 trillion. This is a situation where savings were going to increase sharply given the $1.4 trillion gap between lost income and reduced spending. On net, without any government intervention, the economy had plenty of dry powder to help the recovery. But with the massive government stimulus, an annualized equivalent of $3 trillion has been injected into the economy on top of the $1.4 trillion in pent up demand. This has caused the U.S. savings rate to explode to 33%.

PERSONAL INCOME AND ITS DISPOSITION

	April 2020	Percent Change Feb-April	Absolute Change Feb-Apr
Personal income	20675	8.1%	1552
Compensation of employees	10478	-10.7%	-1253
Proprietors' income	1425	-19.5%	-346
Rental income	801	0.4%	3
Government social benefits	6291	95.3%	3069
Less: Personal current taxes	2014	-10.1%	-227
DPI	18660	10.5%	1779
Less: Personal outlays	12511	-19.2%	-2979
Equals: Personal saving	6149	342.1%	4758
Total, billions (2012) dollars	16967	11.3%	1725

Source: U.S. Bureau of Economic Analysis; Analysis by Beacon Economics

PERSONAL SAVINGS RATE



Source: U.S. Bureau of Economic Analysis; Analysis by Beacon Economics

This all points not to the slower "U" rebound, but rather to a rapid economic recovery now that the health mandates are being lifted. There are definitely wildcards in the mix – including a reemergence of a new strain of the virus. But short of this, Beacon Economics continues to forecast a strong, rapid economic recovery. We expect the economy to reach close to pre-virus levels of production by the end of the year and unemployment to decline to the 5% range. The 2020 coronavirus recession will be one of the sharpest and shortest on record.

As data on both the economy and the virus continues to come in, we will have a better sense as to exactly where we're heading and the appropriateness of our current policy choices. Although the jury is still out, we may find that the massive closure of the economy was an overreaction. This isn't to say that public health officials should have done nothing to stem to spread of the virus, but data tracking the number of COVID-19 cases in countries and states with less stringent rules (Sweden and Georgia for example) suggest that the health value of full closures, in terms of the number of new cases, may be marginal, or far less than what would justify the economic chaos generated by the halt in activity.

Equivalently, the Federal stimulus package from the U.S. Congress seems enormous relative to the true pain being experienced in the economy. And that is anything but a costless exercise. By the end of 2020 the U.S. government will be borrowing \$3 to \$4 trillion. This will distort credit markets, accelerate our speed towards the fiscal crisis that is already underway due to unsustainable entitlement programs and unwise tax cuts handed out over the last two decades, and leave our children with a massive debt to repay in the future. Future economic historians will have every right not to be kind to us.

CALIFORNIA OUTLOOK

By Taner Osman, PhD

THE STATE OF THE CORONAVIRUS IN CALIFORNIA

While California has the third highest number of Covid-19 cases among all states in the country, on a relative basis (cases per million residents) it ranks 31st in the nation. As of June 8, there have been just over 3,000 cases of the Novel coronavirus per million residents in California, compared to a national average of 6,000 cases per million people. In relative terms, California falls far behind some of the worst hit states, such as New York, where there have been a little over 20,000 cases per million residents, New Jersey (nearly 19,000 cases per million), and Massachusetts (15,000 cases per million).

In California, private industry and many localities, followed by the state government, acted to implement stringent stay-at-home orders before most other parts of the country. When a statewide stay-at-home order was issued on March 19, there had been only 1,000 cases reported in California. These efforts help to explain why the state has fared so well compared to other parts of the nation, although it should be noted that over 100,000 cases were added in the state in the face of stay-at-home orders. On a more somber note, California has reported close to 5,000 coronavirus-related fatalities, and this number is set to rise in the coming weeks, While this may be a small number for a state with close to 40 million residents, it is of no comfort to the families grieving for their loved ones.

Stay-at-home orders in California are now being lifted, just as the number of reported cases in the state have reached their peak to this point. On June 5, the state recorded its highest number of cases in a single day (3,593), and in the most recent week recorded the highest number of new cases over a 7-day period. Of course, testing has increased, and the detection of cases has increased with it, but it's important to note that in some states, such as New York, New Jersey, Illinois, and Massachusetts, the number of new cases has gone down in the face of increased testing.

The important question concerns how governments and the public will react if the number of new cases in California continues to rise. Given how politicized stay-at-home orders have become, and the desire of leaders to reignite economies, it's hard to imagine that we will see the type of stay-at-home orders that were implemented in March. How the public reacts to an increased number of cases remains to be seen, and their reaction will be critical to understanding how quickly the economy returns to trend, since there is evidence that the economy started to contract before stay-at-home orders were put in place. How quickly the economy returns to full speed, will rest largely on the willingness of the public to return to their regular routines.

IT WAS THE BEST OF TIMES, IT WAS THE WORST OF TIMES

At 3.7%, December 2019 marked the best unemployment rate in California history. Four months later, at 15.5%, April 2020 marked the state's worst unemployment rate in more than 80 years. Today, now that stay-at-home health mandates have eased, California's employment picture is certainly brighter than it was in April. The release of national data on Friday June 5, revealed that the national economy added jobs in May, returning a relatively small, but not insignificant, number of employees to work. The expectation is that these national gains will filter through to California, and that employment growth returned to the state in May.

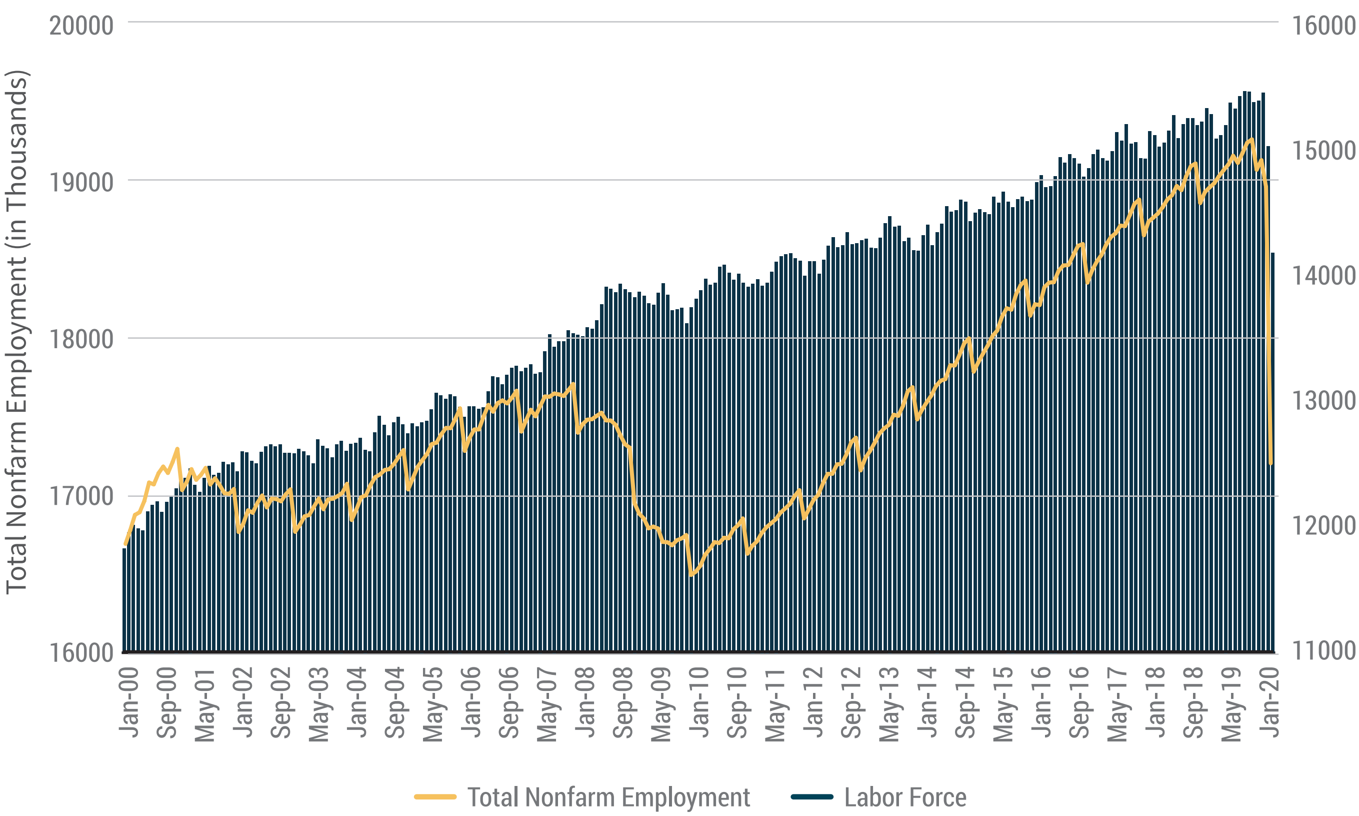
Most of the time, official employment releases do a pretty good job of tracking trends in the economy, but these are not normal times. Employment gains and losses in the state are swinging by hundreds of thousands of workers from week to week. This means that April's figures are now sorely out of date, although they do provide lessons about how the labor market in the state will recover.

APRIL AVALANCHE

In April 2020, total nonfarm employment in California fell by 2.3 million positions compared to the month earlier. This represents a 13.5% drop in the number of nonfarm jobs in the state over the course of just one month. The number of jobs in California has not been this low since March 2013. Seven years of job gains lost in the blink of an eye.

From March to April, 1.8 million workers were added to the state's unemployment ranks. The number of unemployed workers, at just shy of 3 million, is now the highest on record. Just as alarming is the drop in labor force participation – which is effectively the number of people actively engaged in the labor market. From February to April 2020, the civilian labor force shrank by 1 million workers in California, as many became discouraged and stopped their search for employment. August 2012 was the last time the state's labor force was this low.

TOTAL NONFARM EMPLOYMENT AND LABOR FORCE IN CALIFORNIA



Source: California Employment Development Department; Analysis by Beacon Economics

On the brighter side, we can take comfort in the fact that 75% of the state's unemployed workers report their layoffs as being temporary, and that employment growth returned to the national economy in May.

LEISURE AND HOSPITALITY WOES

California's Leisure and Hospitality sector led job declines in April, shedding 866,200 positions. This translates into an extraordinary 44% drop in one month for the sector. The Accommodation and Food Services subsector was responsible for the majority of this decline, with 732,800 positions lost. As the economy opens up, food services jobs should rebound more quickly than accommodation jobs, as we expect restaurants, in some capacity, to fill up quicker than hotels. In fact, the national jobs release on June 5 revealed that around two-thirds of the regained jobs nationally were in the Food Services sector. While air travel has picked up since the lows of April and May, it's still around 80% lower than pre-crisis levels. American Airlines will be operating up to 55% of its domestic schedule through July, while United Airlines will be operating up to 25% of its schedule through July. Given constrained inter-regional and international travel, the pain in the accommodation industry will be felt for a longer period.

Other sectors posting sizeable declines in April were Retail Trade (-275,200 or -17%) and Health Care (-246,500 or -10%). We expect employment in Health Care to bounce back quickly since, in anticipation of capacity constraints due to a potential virus outbreak, hospitals cancelled many elective procedures over the past two months, which led to job losses. Many of these cancelled procedures, however, will take place in the coming quarter, meaning a significant rebound in employment for the sector. A full return of retail employment is less certain since it will depend on consumer sentiment and their willingness to mingle in large crowds in major shopping malls. While we have seen a considerable boost in e-commerce, overall consumption has dropped by historic proportions over the past two months.

The state's highest paying sectors have not been immune to lay-offs, although the declines in these industries have been less pronounced. In the Professional and Business Services sector, 242,800 (-9%) jobs were shed during the month. This included nearly 80,000 (-6%) positions in Professional, Scientific and Technical Services. In the Information sector, the number of jobs fell by 40,500 (-7%) during the month. While the job losses in these industries are fewer in number, they are concerning because these sectors typically pay higher wages, meaning they generate higher multiplier effects as these wages are spent in other sectors of the economy. These job losses are also concerning because they should have been relatively shielded from stay-at-home orders, since many of the jobs can be performed in remote locations (at home on computers).

EMPLOYMENT CHANGE BY MAJOR SECTOR IN CALIFORNIA, MARCH-APRIL 2020

Industry	Job Losses March to April 2020
Total Nonfarm	-2,286,600
Goods Producing	-233,000
Mining, Logging and Construction	-114,000
Manufacturing	-119,000
Service Providing	-2,053,600
Trade, Transportation & Utilities	-386,700
Information	-37,500
Financial Activities	-32,400
Professional & Business Services	-238,600
Educational & Health Services	-280,800
Leisure & Hospitality	-841,600
Other Services	-139,300
Government	-96,700

Source: California Employment Development Department; Analysis by Beacon Economics

TOWARDS RECOVERY

Recent data releases suggest that the labor market reached its lowest point in April and in the coming months we expect to see extraordinary and unprecedented employment growth in the state. As stay-at-home orders are eased, people will return to work. The big question is: when will employment levels in the state reach their pre-crisis levels?

Borrowing from stock market lore, they say stocks go down a lot quicker than they go up. The stock market can lose 20% of its value in a matter of days or weeks, while it takes months for that value to be regained. This will be the case for California's labor market as well. The state will not regain the jobs it has lost in a month or two, and there are a number of reasons for this:

1. We know that many segments of the state's economy will not be operating at full capacity until at least the end of the year.

- Many universities in the state have moved to online instruction until the end of the calendar year. This means that the economies that surround universities will continue to struggle.

- Government restraints on international travel, coupled with sheepish travelers, will mean the peak travel season will come and go before jobs in tourist-related sectors can be fully regained. Relatedly, executives of the major airlines have said to expect significant layoffs once restrictions tied to Federal bailouts are lifted.

- When and to the extent that sports leagues – major and collegiate – return, activity will occur at reduced capacity. Major League Baseball has proposed cutting its season in half. And in Europe, sports leagues are returning to empty stadiums. We expect to see a similar return to action in California.

- Most major music concerts and festivals in the state have been postponed until 2021.

- Theme parks around the world are re-opening at reduced capacity. Southern California's major theme parks have yet to announce a reopening date.

- To be clear, most of the activity outlined above is found in the Accommodation and Food Services and the Arts, Entertainment and Recreation sectors of the economy, which account for around 13% of the state's workforce. But the bleeding will not be restricted to these sectors. The plunge in air travel, for example, has meant that companies like Boeing and Airbus have seen the demand for planes crater, and have laid off thousands of workers.

2. As with any recession, some employers will find productivity improvements and learn they can produce more, or maintain the same level of output, with fewer workers. Such productivity gains benefit the economy in the medium- and long-term but cause short-term labor market dislocation.

3. Some consumers will be reticent to return fully to normal activity, even after stay-at-home orders are lifted. If only 10% to 15% of the state's residents are cautious about returning to normal life, this means that fewer employees will be needed to meet the associated reduced demand.

4. Strains on public budgets will inevitably lead to job losses in the public sector.

5. Finally, the effect of the Federal policies, which have kept the economy on life support, will fade over time. At present, a race is on. At the end of July, the additional $600 per week in unemployment benefits that workers have been receiving from the Federal government will expire. The Payroll Protection Program (PPP), which helped employers keep employees on their books, will expire on June 30. As time goes on, money from PPP loans will be depleted, meaning this source of funding for payrolls will vanish. Congress could act to extend either of these programs, but at present, the economy is set to lose a major source of stimulus in the next eight weeks. In both cases, if the economy has not returned to pre-recession levels before the programs expire, their expiration will have a significant, negative effect on economic performance.

This all means that California's employment highs and lows have likely been posted for the year. We will not see unemployment rates hover in the mid-teens, but we also will not see sub 4% unemployment. There are still many unknowns with respect to the trajectory of the virus in the state, and the public's reaction. However, given that stay-at-home orders are lifting, we expect the unemployment rate to be closer to pre-recession lows rather than the recession's depths by the end of the year.

BUDGET OUTLOOK

The pandemic's economic disruption will impact California's budget and local budgets across the state. Roughly two-thirds of the state budget comes from income taxes, meaning that the loss of jobs equates to a direct loss of revenue for California. Furthermore, job losses will lead to increased expenditures on health and human services programs and unemployment insurance benefits. The net result of these changes has led Governor Gavin Newsom to propose $14 billion in cuts to state spending for fiscal year 2020-2021.

While it's clear California faces a significant budget deficit this year, at present, the state's revenue outlook seems overly pessimistic. The Department of Finance's (DOF) fiscal revision of May 7, 2020, forecasts a budget deficit of $54 billion this year as a result of the responses to COVID-19. This, more than likely, overstates the extent of the state's fiscal woes since the DOF assumes U.S. real GDP will not grow in the third quarter this year. Most economists predict that the economy will experience a sharp bounce back in the third quarter. Furthermore, the DOF forecast assumes an unemployment rate of 18% for the year. Again, while the unemployment rate will not reach 2019 levels this year, 18% seems considerably off the mark. Nationally, the Congressional Budget Office forecasts an unemployment rate of 11.7% in the fourth quarter of 2020, which Beacon Economics believes to be overly pessimistic. Finally, most of the job losses in the state have occurred in lower-paying sectors of the economy, which have a disproportionately low impact on California's income revenue streams. California will have to make significant cuts this year, but they won't be as extreme as currently projected. Of course, this is of little comfort to the millions who will be directly affected by budget cuts.

While the outlook for the state budget isn't bright, the outlook for many local governments is quite bleak. As mentioned above, the annual peak travel season will pass by at greatly reduced capacity. This means hotel vacancy rates will be considerably higher than usual, and communities that rely heavily on the transient occupancy tax as a source of income (TOT) will face significant financial stress. The TOT is a tax levied on hotel stays. The table below illustrates the importance of TOT as a source of revenue for select cities in the state. For example, the transient occupancy tax accounts for 46% of general revenue in the City of Avalon, 44% in Anaheim, 30% in Palm Springs, and 28% in Monterey. National retail data also show that consumer sales have been hard hit by the government response to the pandemic, meaning that sales tax revenue, one of the primary revenue sources for cities, will be negatively affected. Taken together, absent a Federal bailout, we will see large spending cuts by local governments in the coming fiscal year.

TRANSIENT OCCUPANCY TAX SHARE OF GENERAL REVENUE

City	Share of General Fund Revenue from Transient Occupancy Tax
Anaheim	44%
Avalon	46%
Carmel	28%
Monterey	28%
Napa	22%
Palm Springs	30%
Pismo Beach	46%
Santa Barbara	17%
Sonoma	19%
South Lake Tahoe	22%

Source: Individual City Websites; Analysis by Beacon Economics

The sense of optimism surrounding the economy today is grounded in the hope that re-opening will not be derailed by the continued spread of the virus. Government and public responses to the coronavirus remain the biggest cloud hanging over the economy. From an economic perspective, all indications are that California's labor market bottomed out sometime in late April or early May. Significant damage was done to the labor market in a very short period of time and, unfortunately, those jobs will not return to the state's economy as quickly as they were lost. At the same time, from these lows, we expect to see unprecedented employment and output growth in the state for the remainder of the year.

BEACONOMICS

Beaconomics delivers a current analysis of where the U.S. and California economies are headed directly from the renowned forecasters at Beacon Economics. Published quarterly, the outlook includes the latest on unemployment, home prices, personal income, taxable sales, GDP growth, and other major indicators of the economy. BeaconEcon.com

Beacon Economics
5777 West Century Blvd. Suite 895
310-571-3399 |Los Angeles, CA 90045 | www.BeaconEcon.com