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Economics Group

Special Commentary

California Had Solid Momentum Prior to COVID-19

The Latest Payroll Numbers Can Only Make Us Long For What Was

The California economy was on fairly solid footing heading into the COVID-19 pandemic. After adding 29,100 jobs in January, employers added 29,000 more in February. What’s more, hiring was running at a 1.7% year-over-year rate, on par with the nation. The unemployment rate was unchanged at a record low of 3.9%. February predates the COVID-19 crisis and does not capture the coming tsunami of job losses since mid-March. In order to suppress the spread of COVID-19, nonessential businesses have been forced to shut down and residents have been ordered to shelter-in-place, which together have caused economic activity to ground to a halt in many industries.

A clearer indication of what is likely to unfold is provided by the most recent initial unemployment insurance claims, which are released every week. Nationally, jobless claims surged to a record 3.3 million for the week ending March 21, which is 12 times higher than the level registered just one week earlier. Claims in California more than tripled from about 57,600 to 186,800. Even with this record increase, these numbers are likely understated as many states had difficulty processing the extraordinary flood of new applications. More recent reports put the number of claims filed in California over the past two weeks at over one million. Unfortunately, this represents just the tip of the iceberg. Large parts of the California economy remain closed for business. Tourism, travel and entertainment spending is down 80% or more across the state, resulting in massive layoffs in the state’s large hospitality sector. Retailers have also largely shut down, necessitating massive job cuts. Manufacturing and construction are faring somewhat better but will struggle the longer virus-related shutdowns hold down overall economic activity.

The sheer size of the California (if it were a separate country, it would have the fifth largest economy in the world) makes the state particularly vulnerable to the adverse effects of the spread of COVID-19. The outbreak began relatively early in the state but has not been nearly as bad as in New York. The shutdowns have been fairly extensive, however. And with immigration tightening, the state’s large agriculture sector may have even greater difficulty finding workers.

Figure 1

California Nonfarm Employment Year-over-Year Percent Change

Figure 2

California vs. U.S. Unemployment Rate Seasonally Adjusted

Reports put the number of claims filed in California over the past two weeks at over one million.

Source: U.S. Department of Labor and Wells Fargo Securities

This report is available on wells Fargo.com/economics and on Bloomberg WFRE.
California’s leisure & hospitality industry is likely to be most directly impacted by COVID-19. As residents either “stay at home” or “shelter in place,” many restaurants, hotels and bars have begun to lay off or furlough workers. In addition to domestic travel grinding to a standstill, all nonessential international travel has essentially been banned. Hotels have been particularly hard hit and occupancy rates in Los Angeles and San Francisco have collapsed. For the week ending March 21, occupancy rates averaged just 29% in Los Angeles and 16.6% in San Francisco. This time last year, occupancy rates were above 80% in both markets.

International trade is also likely to take a hit. Container traffic through the Port of Los Angeles and Port of Long Beach fell sharply in February, although those declines were tied to the timing of the Chinese Lunar New Year. Activity will also likely be off sharply on a year-over-year basis in March, reflecting dislocations tied to the COVID-19 outbreak in China, and remain soft through the first half of this year, reflecting sluggish demand in the United States and slower growth overseas. We currently expect global GDP to decline 2% this year and look for U.S. GDP to decline 2.4% on an annual basis, although we forecast output will fall at a 14.7% annual rate in the second quarter and a 6.3% pace in the third quarter. The slowdown in global trade will fall heaviest on Southern California’s transportation and logistics sector, much of which is located in the Inland Empire.

California’s tech sector should hold up reasonably well, although we would expect to see hiring slow at healthier firms and look for layoffs at some of the more thinly capitalized firms. The unusual nature of this recession, which has resulted in large portions of the workforce working remotely, has increased the demand for technology services. Social media and digital streaming have also seen a surge in demand. Advertising revenues for social media and search engines will likely take a hit, however, which may lead to some belt tightening. Capital may also become harder to lock down for some businesses.

We expect California’s economy to largely track the nation. The business cycle likely peaked in February, as the economy turned down sharply during the second half of March, likely producing a net drop in output for that month as a whole. We expect the recession to be unusually sharp but fairly short. Overall job losses will likely be worse than during the Great Recession but the composition will be different. Housing, which was at the center of the last recession, should be less impacted during the current downturn and will play a critical role in the recovery. Housing is severely underbuilt throughout California today, and home construction has been deemed an essential industry. Moreover, a great deal of construction work can be done while adhering to the CDC guidelines on social distancing. To be certain, home sales will weaken this spring and home construction has been deemed an essential industry. Moreover, a great deal of construction work can be done while adhering to the CDC guidelines on social distancing. To be certain, home sales will weaken this spring and home construction will probably fall by more than 20% per year.

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**Figure 3**

California Transportation & Warehouse Employment Year-over-Year Percent Change

**Figure 4**

California Employment Growth By Industry Year-over-Year Percent Change of 3-MMA

![Graphs showing California Transportation & Warehouse Employment and California Employment Growth By Industry](source: U.S. Department of Labor and Wells Fargo Securities)