CALIFORNIA BUDGET PROJECT

policy points

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THE HOUSING SLOWDOWN HAS WIDESPREAD IMPLICATIONS FOR THE CALIFORNIA ECONOMY

California's housing-related industries accounted for nearly two-thirds of the state's job growth in the early 2000s. However, the recent slowdown in the housing market has begun to take its toll on the economy. California's nonfarm job growth declined in 2006, due in large part to diminished job gains in housing-related industries. Sluggish growth in the housing sector also has translated into slower growth in personal income and consumer spending, which could lead to weaker growth in other sectors of the economy. This *Policy Points* examines the recent housing market slowdown and its effect on California workers and the economy.

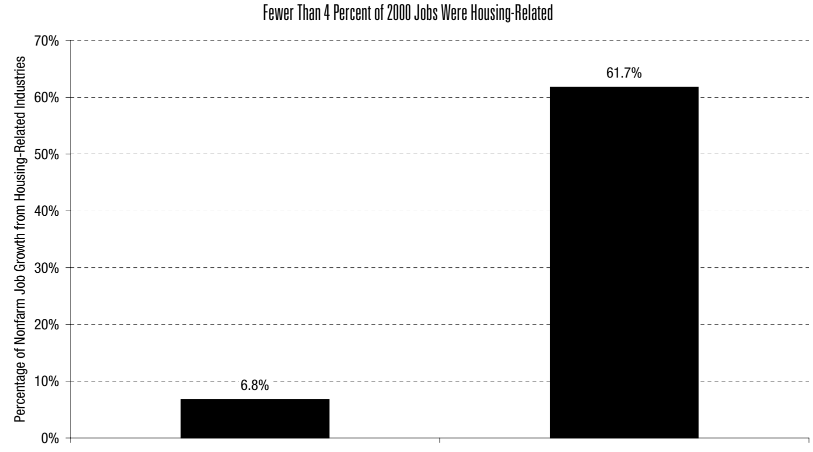
KEY FACTS

- **Housing-related industries supplied nearly two-thirds of the state's job gains in the early 2000s.**

A full 61.7 percent of nonfarm job growth occurred in three key housing-related industries – residential construction, residential specialty trade contracting, and real estate – between 2000 and 2005, even though only 3.7 percent of the state's jobs were in these industries in 2000.[1] In contrast, just 6.8 percent of the job growth between 1995 and 2000 was driven by these industries. The surge in housing-related jobs in the early 2000s helped to offset relatively weak job growth in other sectors during this period.

Housing-Related Industries Drove Job Growth Between 2000 and 2005

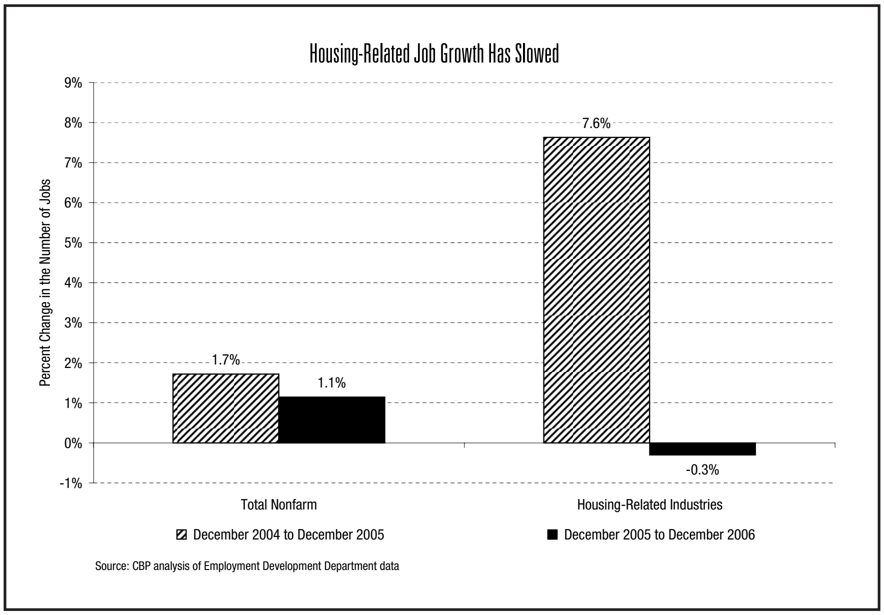
Fewer Than 4 Percent of 2000 Jobs Were Housing-Related



Note: Housing-related industries include residential construction, residential specialty trade contracting, and real estate.
Source: CBP analysis of Employment Development Department data

- **Job growth slowed in 2006, reflecting a slowdown in the housing market.**

The number of California jobs increased by 1.1 percent between December 2005 and 2006, down from a 1.7 percent increase between December 2004 and 2005. Increasingly sluggish job growth largely reflects a sharp slowdown in the housing market. Between December 2005 and 2006, the number of housing-related jobs declined by 2,228 (0.3 percent), marking a sharp reversal from the previous year when the number of housing-related jobs increased by 52,779 (7.6 percent).



- **Housing-related construction industries lost jobs in 2006, as demand for housing waned.**

The number of residential building construction jobs – which represents nearly one in five housing-related jobs (19.9 percent) – declined by 4,200 (2.8 percent) between December 2005 and 2006, after increasing by a substantial 13,300 jobs (9.8 percent) between December 2004 and 2005. The Legislative Analyst's Office (LAO) projects that residential construction will decline by another 13 percent in 2007.[2] Job growth in residential specialty trade contracting – which represents slightly more than half (51.8 percent) of housing-related jobs – also came to an end in 2006. The state lost 2,328 residential specialty trade jobs (-0.6 percent) between December 2005 and 2006, after adding 31,379 jobs (8.9 percent) between December 2004 and 2005.

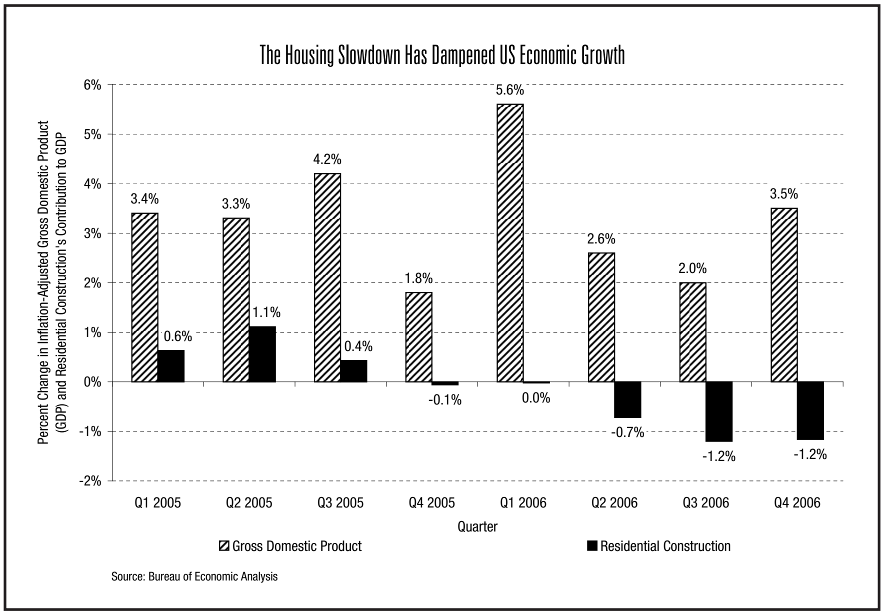
- **The housing market slowdown could have a significant impact on California's workers.**

Workers in a number of industries have begun to feel the impact of the housing slowdown. According to the LAO, the real estate slump "is having a major adverse impact on the incomes of realtors, developers, contractors, and real estate lenders."[3] Many workers in the construction sector also are directly affected by waning demand for housing.[4] Contraction of the construction sector can be expected to have a disproportionate effect on young Latino males with relatively low levels of educational attainment – workers who make up just 8.5 percent of the state's workforce, but account for more than one-quarter (28.4 percent) of construction workers.[5]

- **The housing slowdown has dampened national economic growth.**

In the last three quarters of 2006, the housing slowdown dampened growth in the national gross domestic product (GDP) – the value of all goods and services produced in the US. For example, inflation-adjusted GDP increased at an annual rate of 2.0 percent in the third quarter of 2006. However, the contraction in residential construction pulled GDP growth down by 1.2 percentage points. Although economic growth picked up in the fourth quarter of 2006, continued declines in residential construction dragged down the overall growth rate.

The housing market's drag on economic growth for much of 2006 contrasts sharply with trends in the first three quarters of 2005, when residential construction significantly boosted GDP. For example, in the second quarter of 2005, residential construction contributed to one-third of the annual increase in inflation-adjusted GDP, even though it represented only one-sixteenth (6.2 percent) of the economy.



- **Slower growth in housing-related industries has reduced consumer spending and could weaken growth in sectors of the economy that are not directly related to housing.**

In recent years, homeowners have used the equity from rapidly appreciating home values to bolster consumer spending. However, as home values stabilized and, in some cases, declined, many homeowners lost this ability to supplement their incomes. As a result, growth in personal income and household spending has slowed.[6] In addition, since a large share of recent homebuyers financed the purchase of their homes with non-traditional mortgages – such as adjustable rate mortgages – many homeowners will have fewer resources to spend in coming years as promotional interest rates expire and their rates rise.[7] A further drop in consumer spending could lead to weak growth in sectors of the economy that are not directly related to housing.

- **The housing slowdown presents a risk to the budget.**

The slowdown in the housing market could also have a significant impact on the state's budget. To the extent fewer homes are built or bought and sold, consumer spending on building materials, appliances, and other furnishings will be reduced. In addition, due to rising mortgage payments, some homeowners are spending more of their incomes on shelter and have less money to spend on taxable goods. Perhaps more significantly, sluggishness in the housing market translates into weaker growth in local property tax revenues. This, in turn, could increase the state's obligation under Proposition 98's school spending guarantee which, in most years, is based on the amount schools receive from both local and state sources. Thus, if local property tax revenue growth slows, the state must increase its share of funding for schools and community colleges.

Alissa Anderson Garcia prepared this Policy Points with the assistance of Jean Ross. The California Budget Project (CBP) was founded in 1994 to provide Californians with a source of timely, objective, and accessible expertise on state fiscal and economic policy issues. The CBP engages in independent fiscal and policy analysis and public education with the goal of improving public policies affecting the economic and social well-being of low- and middle-income Californians. General operating support for the CBP is provided by foundation grants, individual donations, and subscriptions. Please visit the CBP's website at www.cbp.org.

ENDNOTES

1 Specialty trade contracting includes specific activities related to construction, such as pouring concrete, plumbing, painting, and electrical work.

2 Legislative Analyst's Office, *California's Fiscal Outlook* (November 2006), p. 9.

3 Legislative Analyst's Office, *California's Fiscal Outlook* (November 2006), p. 11.

4 Approximately 16.1 percent of California construction jobs were in residential building construction and 42.1 percent were in residential specialty trade contracting in 2006.

5 CBP analysis of Current Population Survey data. Includes Latino workers ages 25 to 39 with a high school degree or less in 2006.

6 The LAO calls the recent real estate slump "the single largest factor behind the slowdown in personal income growth during the second half of 2006." Legislative Analyst's Office, *California's Fiscal Outlook* (November 2006), p. 11.

7 Some estimates suggest that more than 60 percent of homes purchased in California in 2005 were financed with non-traditional loans. Legislative Analyst's Office, *California's Fiscal Outlook* (November 2006), p. 11.