INLAND EMPIRE BUSINESS ACTIVITY INDEX

Fall 2022

The Inland Empire Business Activity Index tracks performance of the Inland Empire regional economy on a quarterly basis and is adjusted for seasonal variations. The composite indicator is estimated using a wide range of economic data including employment, economic output, income, real estate, and other indicators at the national, state, and metropolitan level.
Business activity in the Inland Empire has continued to advance at a steady clip, despite a slowdown in domestic economic output at the national level. The Center for Economic Forecasting estimates that business activity in the region increased at a 1.6% annualized rate during the second quarter of 2022, a stark contrast to the negative print of U.S. gross domestic product (GDP), which declined by a paltry 0.6%. As the Center has noted in other reports, the first half of 2022 was not a recession as the decline in output was not created by increases in slack in the economy, but by rapidly shifting patterns of demand.

Source: UCR Center for Economic Forecasting and Development
Business Activity in the Inland Empire came in weaker than expected, due in part to a slowdown in the residential real estate market. The primary driver of the drop-off in real estate activity was (and has been) rising interest rates. Even after accounting for local inflation, the real cost of owning a home in the Inland Empire has risen 24.5% since the start of this year. Meanwhile, inflation-adjusted average hourly earnings for private-sector employees in the Inland Empire have declined 6.1%.
The impact of rising rates is readily apparent in sales activity. Home sales in the region were down significantly across major segments of the market. Sales of existing single-family homes, which comprise the lion’s share of the local market, were down 9.3% through the first half of this year, but prices increased 17.9% over the same period. Steep declines in sales also occurred in the existing-condos segment of the market, where year-to-date sales dipped 19%.

Source: Zillow, U.S. Bureau of Labor Statistics, California Department of Industrial Relations, Freddie Mac; Analysis by UCR Center for Economic Forecasting and Development
The chart above illustrates that the cost of owning a home in the Inland Empire is distinctly lower when compared to other metro areas of the state and California overall. However, home prices are partially tied to local incomes. A general rule is that home prices are not based on local household incomes, but on the incomes of people who want to live in a particular area, and there's considerable heterogeneity in terms of earnings within the state. As a simple illustration, we can get a sense of the relative cost of homeownership by scaling average hourly worker wages to the number of working hours it would take to break even with the monthly cost of ownership (since an hour in the Inland Empire is no different than an hour in San Francisco). This is done by dividing the monthly cost of owning a single-family home by the real average hourly rate for private-sector workers using local CPI.¹ What becomes clear is that, when adjusting for differences in earnings, the Inland Empire roughly matches the statewide figure. In other words, the inflation-adjusted average hourly earnings for private-sector workers in California are 33% higher compared to the Inland Empire, but the cost of owning a home in California is 35.7% higher compared to the Inland Empire.

¹This approach is a simple exercise and doesn't consider taxes, additional costs, or the possibility that a worker might work/live in one metro but earn a higher wage from another metro (e.g.: a tech worker employed by a company based in the San Francisco Bay Area who works from home in the Inland Empire).
THE OUTLOOK:

The Center for Economic Forecasting doesn’t foresee any major change in the path of the Inland Empire economy over the next 12 months and expects business activity to rise between 2% and 3%. Inflation will continue, but so will overall economic growth, albeit at a slower pace. The next downturn is unlikely to begin in the private sector where fundamentals appear strong. The problem will occur as the Federal government begins to grapple with the nation’s growing structural deficit. How long bond markets will give a blank check to the U.S. government is anyone’s guess, but at some point foreign lenders will become shy and that is when politically tough choices will need to be made. How this all shakes out remains to be seen—particularly given the strained political times we live in. There will be a reckoning, but exactly when remains unclear.