California's Misery Index—Is the Recession Real or in Our Heads?

Is California in a recession? Is the economic pain felt by families real or is it "in our heads"?

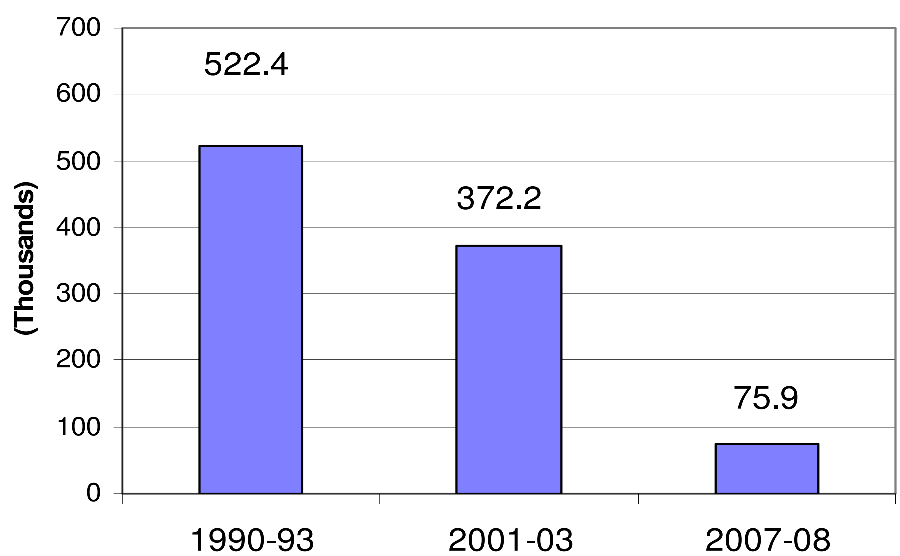
Traditional Recession Measures

There are two traditional indicators of recession—1) a decline in real GDP and 2) job loss and rising unemployment. There are no quarterly measures of state GDP and the national GDP estimates do not yet show two quarters of falling GDP, which is one indicator used to identify a recession. In fact the revised 2nd quarter GDP estimate shows a gain of 3.3%, not even close to a recession.

California lost an additional 14,900 jobs in July and state job levels are down 75,900 from the peak and at the lowest level since September 2006.

To date, though, job losses are modest compared to the recessions starting in 1991 and 2001. California lost more than 500,000 jobs from peak levels in the early 1990s aerospace/construction recession and lost nearly 375,000 jobs after the dot.com bust in late 2000.

California Job Losses in Recent Downturns



The 7.3% unemployment rate for California reported in July 2008 was the highest unemployment rate in California since July 1996. California's unemployment rate averaged between 7.3% and 9.5% for each year from 1991

through 1996. The current unemployment rate is an indicator that the labor market may be weaker than the job loss numbers show, perhaps because many previously self-employed workers have lost jobs that do not show up in the wage and salary employment data series.

So, looking at these data the answer to the “are we in a recession” question is “not yet but maybe a mild recession is coming in the next few months if job losses continue”.

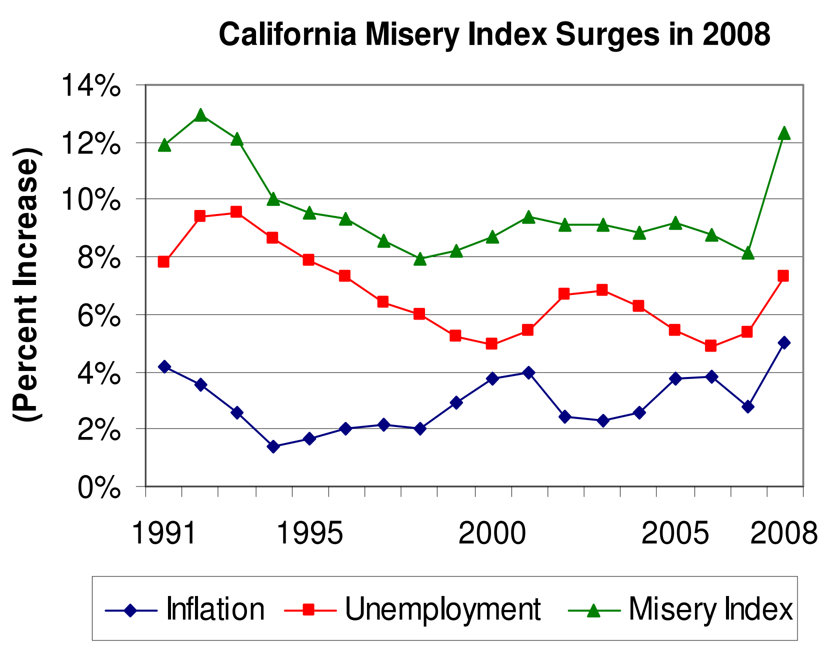
Adding Inflation and Falling Home Prices to the Recession Watch

But adding inflation and falling home prices to the job numbers paints a very different picture!!

Residents **are** feeling more pain than suggested by the unemployment numbers. The Misery Index, combining the unemployment rate with the rate of inflation, reached 12.3% in July 2008, the highest level in 16 years. California’s Misery Index was 12.9% in 1992 in the midst of that long recession and that was the only time in the past 25 years that California’s Misery Index topped July’s level.

The Misery Index has a long history at the national level and has been part of political campaigns and debate for more than 30 years. The link below provides a history of the Misery Index.

http://en.wikipedia.org/wiki/Misery_index_(economics).

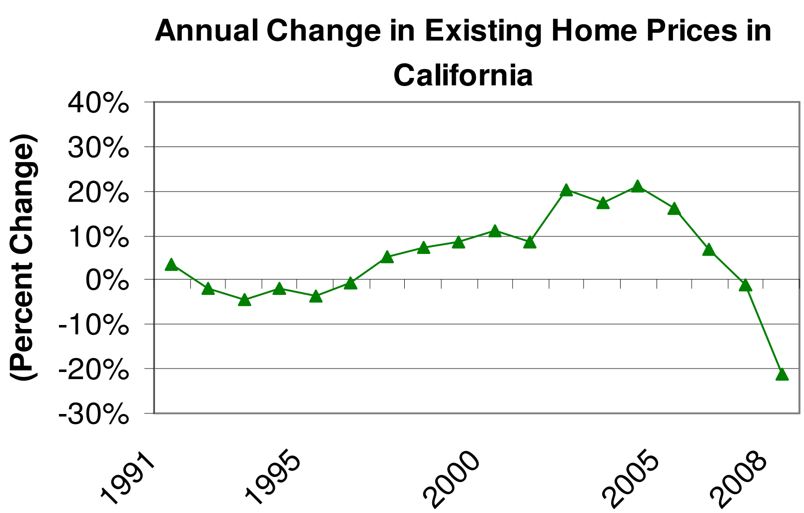


While 7.3% of California workers and their families are struggling with unemployment, all residents are facing higher energy and food prices and sharply lower home prices.

So, while the loss of 75,900 jobs is not high compared to the recessions after 1990 and 2000, the pain residents are feeling is definitely not just "in their head".

And the Misery Index would look even worse (much worse in fact) if trends in housing prices were included.

Existing home prices are down by more than 20% in 2008 in major California coastal markets (Los Angeles, Bay Area and San Diego) and down more in some inland markets more affected by the surge in foreclosures. After the early 1990s' recession, home prices dropped by 1-5% for several years but, all together, these declines are less than what current homeowners are experiencing in just 2008 alone. And more price declines are likely before California markets reach the bottom.



These price declines affect many more families than the number hurt by unemployment. And these broad home price declines can affect the pocketbook and confidence of families who have good jobs and can afford their home payments.

Adding home prices to the Misery Index shows clearly why so many families are worried about their economic situation in 2008 and shows just as clearly that their worries are **real** and not just "in their heads" as some have suggested.

The chart below combines the Misery Index from page 2 with the home price change index from page 3. Larger numbers indicate a more difficult economic environment for families.

In the early 1990s falling home prices increased the Misery Index, which was already high as a result of record unemployment rates. For the period from 1997 through 2005 rising home prices offset unemployment and inflation and the Misery Index including housing dropped to zero and below during the period when housing prices were increasing by 20% per year.

But in 2008 all of the factors—unemployment, inflation and home prices—all moved in a negative direction and the new Misery Index surged to an all-time high of 33% (7% from the unemployment rate, 5% from inflation and 21% from falling home prices).

No wonder more than 80% of residents say the economy is headed in the wrong direction. The Misery Index is likely to fall in 2009 and beyond. Inflation rates should diminish as oil prices stabilize or fall. Unemployment rates may rise for several more months but will eventually fall. And home prices will stabilize in 2009 or 2010.

Nevertheless the economic pain felt by families will recede only slowly and improvement will depend on good economic policies (including a second stimulus package) and policies that help prevent foreclosures from sending the housing market into another downward spiral.