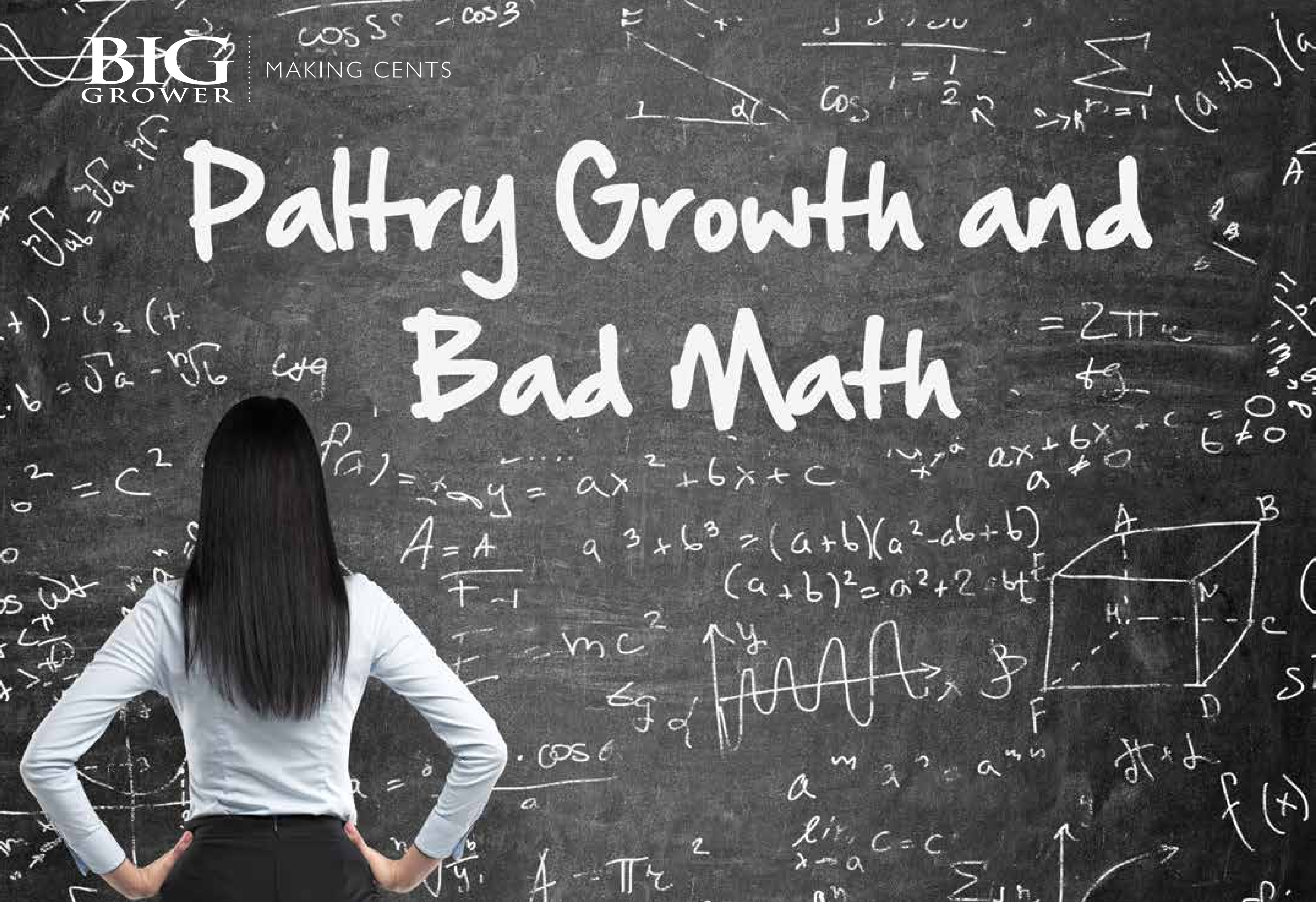

# Paltry Growth and Bad Math

**Consumer spending, housing sales, proposed hikes in the minimum wage and the upcoming presidential election are putting different kinds of pressure on the economy.**

**BY CHARLIE HALL**

Real gross domestic product (GDP) growth rose a paltry 0.5 percent in the first quarter, almost a full percentage point below the tepid pace of the fourth quarter and worse than many expected.

Sharp losses were reported in business investment, trade and inventories. The losses from those three sectors shaved more than 1.4 percent from overall growth in the first quarter. Consumer spending continued to expand slightly, but at a more moderate pace.

The weakness in business investment and trade underscores the close links between our economic performance and global growth. Exports and profits are tied to the performance of the global economy, so weakness there spills over into weakness here, most notably in investment. That undermines current and potential growth. It also suggests that the weakness we have seen in investment over the last year was farther reaching than the bust in the oil sector alone. Presidential candidates' talk of closing our borders will only exacerbate our losses in trade and investment.

Housing starts are nibbling at the 1.2 million-unit rate back, which marks a nice snap back from the first quarter, but is still below year-ago levels. The single-family market has been slow to recover, and starts are currently running well below demand.

Many municipalities increased the fees for everything from roads to utilities and schools in response to a short fall in real estate revenues after the housing market bust. This, coupled with an increase in "not in my back yard" laws, has pushed up the threshold at which builders can clear a profit and kept builders developing fewer high-end homes instead of more entry-level properties. The result is exacerbating the shortfall in supply of entry-level properties, and fueled bidding wars on move-in-ready entry level properties.

## BREAKING THE CYCLE

How do we get out of this vicious cycle? A start would be a shift in the fee structure at the local level. It is not clear that would alleviate all of the obstacles that builders are facing; they have also lost the ranks of less expensive immigrant labor that they once relied on to build less expensive homes, while materials costs have risen substantially in recent years. Housing got us into this mess, and is still limiting our ability to expand at more rapid pace. The fundamentals have improved, but the residual effects of the crisis persist. This is nothing to say of mortgage credit, which is now much tighter than it was before the bubble in housing.

It is important to keep in mind, however, that two years ago, there were numerous "doom and gloom" stories about housing. What has happened since? Housing starts are up 13 percent from March 2014 to March 2016. New home sales are up 25 percent over the two years. Existing home sales also are up 13 percent. House prices are up 9.7

percent (Case-Shiller National Index February 2014 to February 2016). Someday I'll be bearish again on housing — but certainly not now.

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## CONSUMER SPENDING AND WAGES

Another highlight is that consumers are up and still running. The rebound in growth in consumer spending the second quarter looks solid. The shift in spending from bricks to clicks, or online, continued as online sales accelerated. We also saw niche retailers do well. This, coupled with a warming trend in inflation, will allow Fed officials to feel more comfortable with another rate hike. Since the Fed did not make any changes in interest rates at its meeting in June, there was no real impact on the market. What and when the Fed will make any changes interest rates remains to be seen.

Lastly, here's a quick and dirty analysis of the proposed rate hikes in minimum wages in California, which should serve as a wake-up call to the rest of the country. A 50 percent increase in the state minimum wage from \$10 to \$15 over the next six years will be the equivalent of a \$10,000 annual tax on businesses for every full-time minimum wage worker they employ, and will raise the annual cost of employing a minimum wage worker from \$20,000 to \$30,000. That means for every 10 full-time minimum wage workers employed by a business in California, labor costs will increase annually by more than \$100,000 (once required employer-paid payroll taxes are added).

There are probably many small companies that employ 10 full-time minimum wage workers and make far less than \$100,000 in annual profits, so the increased burden of a 50 percent increase in labor costs for some employees will likely result in business closings for firms that can't survive the impact of such a large increase in operating costs.

Most businesses operate on razor-thin profit margins, often in low single-digits (2 to 6 percent), and they just can't realistically survive a 50 percent increase in labor costs for some employees. Further, there will be many businesses that will never open in California, and many jobs that won't be created, because of the unaffordable labor costs of hiring unskilled and limited-experience workers.

It's also important to note that even California businesses that pay more than the minimum hourly wage will be affected after \$15 an hour becomes the benchmark minimum upon which all wages in the state are based. Once wages increase by \$5 an hour and by 50 percent for unskilled workers, wages for all workers will likely rise by something close to \$5 an hour, which translates to an annual wage increase (and equivalent to an annual tax on employers) of \$10,000 for millions of full-time workers in California. Companies in California, already burdened by high taxes and regulations, simply don't have a magic pile of money sitting around in a back room that would allow them to absorb a \$10,000 increase in labor costs per full-time worker. In the end, it's a matter of simple "business math" and a \$15 an hour state minimum wage is some very, very bad math for business survival and job creation in the Golden State. ■

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