THERE’S STILL ROOM FOR GROWTH – BUT WHERE?

What cities will outperform at this stage in the cycle? An array of themes – ranging from industrial mix, Fed policy, to how people want to live – are unfolding to answer this question.

Matthew Mowell, Head of Americas Regional Analytics
Oxford Economics
WHAT WILL CAUSE CITIES TO OUTPERFORM...

Cities that host highly productive industries, especially with a global reach, are well-positioned.

Opportunity and lifestyle brings newcomers

(Skilled) labor force growth
AND SOME TO FALL BEHIND?

Overweight exposure to legacy mfg.

Overweight to low-productivity industry mix

Weak labor force growth...
MACRO TRENDS ARE CERTAINLY IMPORTANT (I)…

- Policy changes will add 0.7pp to ‘18 GDP (+2.9%)
- Growth will pivot to biz investment (nearly 7% in ‘18)

Stronger global & domestic growth and commodity markets are supporting biz investment. A lower USD is also helpful.
MACRO TRENDS ARE CERTAINLY IMPORTANT (II)...

LABOR MARKET OUTLOOK
- Job growth will slow (180K/month); Unemployment to 3.7%
- Wages to grow 3% y/y in ’18 (up from 2.5% in ‘17)

MONETARY AND FINANCIAL EXPECTATIONS
- New voting members of the Fed have a ‘hawkish’ bias
- We expect four rate hikes this year
- A spike in bond yields is not expected (10Y at 3.1 by YE)
- We expect core CPI to hit 2.2%; some upside risk w/wages

KEY RISKS
- Protectionist uncertainty
- Elevated equity market valuations
THERE'S A GEOGRAPHY OF BUSINESS INVESTMENT

State share of US industry growth (2018-22) – Top Performers

- CA (34%)
- NY (11%)
- WA (7%)
- TX (22%)
- CA (19%)
- IN (9%)
- NC (9%)
- CA (25%)
- OR (21%)
- TX (9%)
- MA (5%)
- NC (5%)

Expect a lot of IP activity in CA & TX but also smaller clusters in OR, NC, and MA

Source: Oxford Economics
If Apple is a guide, the repatriation of overseas profits could raise cap ex by a baseline of 2.3% this year. Specifically, this could help centers of US IP production.
THUS, LATE CYCLE PERFORMANCE WILL VARY

Industry mix and demographics are key drivers of performance
LABOR MARKETS ALSO SHOW VARYING PERFORMANCE

**Best cyclical labor markets**
Employment relative to previous peak (%)

**Struggling labor markets this cycle**
Employment relative to previous peak (%)

New industries versus legacy industries
NATIONALLY, THE LABOR MARKET IS TIGHTENING…

The labor market is showing some late-cycle signs

Employment-to-Population Ratio

25-54 year-olds (%)

Source: Oxford Economics, BLS, Federal Reserve
Patterns of structural & cyclical change are influencing labor market dynamics.
Labor market engagement is greater in places with a higher-skilled labor force.
THUS, THE PACE OF JOB GROWTH IS POISED TO SLOW

Job growth in coming years is poised to slow to below the cyclical trend.
Exceptions include: 1) Energy centers; 2) Slow-recovery cities.
OUTLOOK FOR HIRING ACROSS REGIONS

Growth is driven by TX along with CO and AZ

Cities in the Pacific NW will lead growth; Inland Empire is coming back

Homebuilding will help FL; NC and ATL will see diverse growth. ‘Old South’ will see slow growth

Growth is split between ageing industrial cities and info. economy centers

Overweight position to ‘traditional manufacturing’, weak demographics

Source: Oxford Economics
People are leaving economic successful cities in California and the Northeast
WHY ARE PEOPLE LEAVING THE GOLDEN STATE?

• 1,130 SF home selling for $1,995 / SF (roughly $2M)
• Palo Alto – close to Stanford, Google, and Facebook

• 7,000 SF home selling for $296 / SF (roughly $2M)
• Preston Hollow – prestigious neighborhood close to major employment centers in Dallas
‘GONE TO TEXAS’
WHERE ARE PEOPLE GOING TO?

Migration to Houston and Denver is cyclical (softer energy sector and declining affordability - especially in Denver)

Source: Oxford Economics, US Census
‘NIMBY’ISM IS DRIVING PEOPLE OUT

Despite upbeat economic growth, the SF Bay and Boston haven’t materially expanded their housing stock.

Source: Oxford Economics, Haver Analytics
A BIG PROBLEM - SUCCESSFUL CITIES HAVE HOUSING SHORTAGES

Onerous building regulations have weighed on affordability in CA
Labor from struggling regions can’t easily migrate to the growing West Coast economy

Source: Oxford Economics, The Wharton School, National Association of Realtors, BEA
DON’T EXPECT AN INFLUX OF WORKERS TO HIGH-COST CITIES

‘Young adults’ are going to places they can afford!
THE ‘URBAN STORY’ IS ABOUT A CERTAIN TYPE OF ‘YOUNG ADULT’...

H1-B visa restrictions could weigh on this trend
...THEY’RE LIKELY WELL PAID AND RENTING

Source: Dr. Issi Romem at Buildzoom, US Census, Oxford Economics

@ApartmentWire
#NMHCresearch
Stricter financial regulations and higher land costs have made it more difficult to build ‘starter’ homes.
TOMORROW’S SUBURBS WILL LOOK NOTHING LIKE ‘STEPFORD’

Suburbs remain relevant but they are changing
Immigration accounts for a commanding share of pop. growth in key cities
RISKS TO CONSIDER: NAFTA RENEGOTIATIONS

Small border states (VT, ND) will be impacted but so will larger manufacturing states, especially those with ties to auto production.

Source: Oxford Economics, US Census
RISKS TO CONSIDER: CHINESE TRADE CONFLICT

Exports to China / State GDP (%)

Source: Oxford Economics, US Census

Aerospace, medical devices, semiconductors, agriculture, chemicals…
RISKS TO CONSIDER: FINANCIAL MARKET STRESS

A lasting 10% stock market decline would shave 0.5pp from GDP growth
(This is different from a correction from short term peak)

Source: Oxford Economics
RISKS TO CONSIDER: UPSIDE IMPACT FROM GOVT. STIMULUS

US: Fiscal stimulus set to boost growth

Real GDP growth, %

- Underlying growth
- Impact of TCJA, 2017
- Impact of BBA, 2018

Source: Oxford Economics

BBA, 2018 = Bipartisan Budget Act of 2018
TCJA, 2017 = Tax Cuts and Jobs Act of 2017
Matthew G. Mowell

matthewmowell@oxfordeconomics.com

617.206.6116