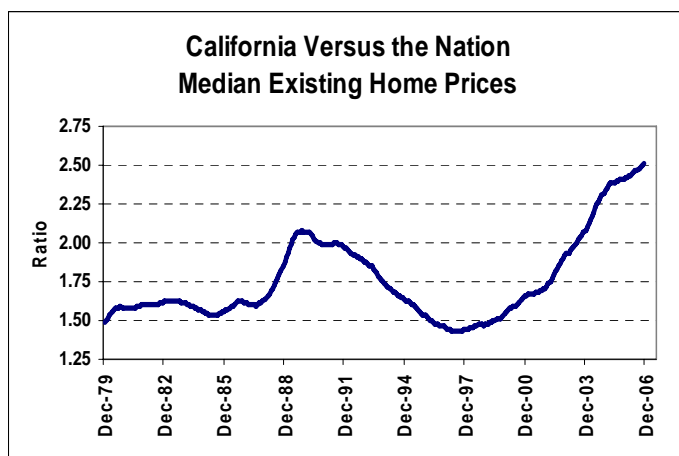


## Changing Population Dynamics

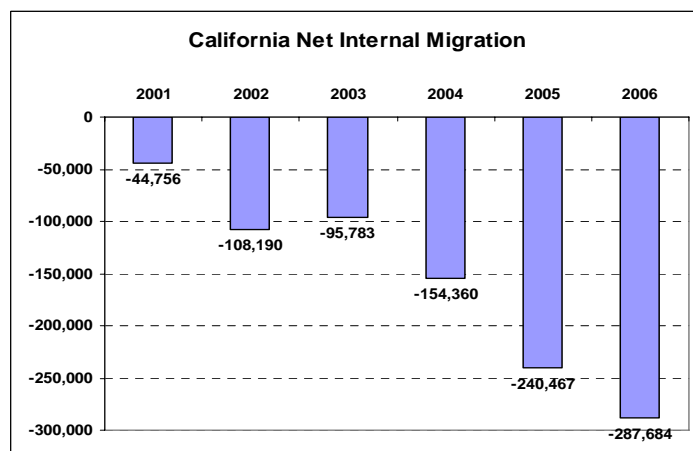
California has a huge, vibrant economy. It continues to have a leading position in many of the knowledge sectors critical to the nation's economic future. Historically, its climate, natural beauty, world-class universities, and economic opportunity have been a magnet for people both inside and outside the United States. The resulting influx of talented and ambitious people is the primary reason that the state economy usually has outperformed the nation.

Another byproduct of these population trends have been soaring house prices. Strong demand along with an increasing scarcity of land suitable for residential development has pushed house prices in California far above those in most other parts of the United States. As the chart below indicates, the median price of an existing home for sale in California is now 150 percent higher than the national median. Seven years ago, the California median was just 50 percent above the national median.



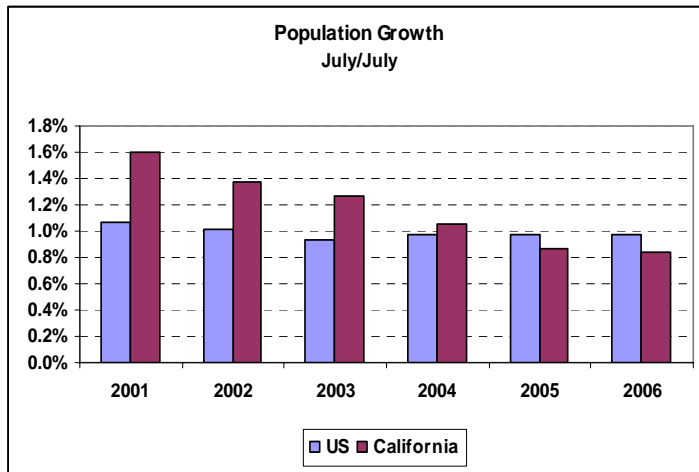
This dramatic decline in the relative affordability of housing is contributing to an important change in the population growth dynamics of California.

As the chart below shows, the net migration of California to other states has accelerated quite dramatically over the past several years. In 2006, California led the nation in the net number of people who moved to other states. Relative to population, only six states had a faster rate of net outward migration.



California still leads the nation in net migration from other countries according to the US Bureau of the Census. They estimate that the net international migration to California was 266,000 in 2006. That is down about 14 percent since 2001 but still is the highest rate of international immigration among the states.

With the outflow of California residents to other states now somewhat more than offsetting the inflow of people from other countries, California's population growth rate has fallen by half over the past six years. As the chart on the next page shows, instead of growing 0.6 percentage point faster than the US, the state is now growing 0.2 percentage point slower than the nation.



The key take away is that sky-high housing costs are constraining growth in the state. Local businesses that compete nationally or globally have to keep the wages and salaries that they pay in line with their competitors. With housing costs outstripping income gains, an increasing number of California residents are voting with their feet, relocating to other parts of the country where they can afford a higher standard of living. In the process, the California economy is growing a bit less rapidly, reflecting the slower growth of its labor force.

The latest labor market data reflect these broader trends. In the 12 months to December, nonfarm payrolls increased 1.1 percent in California, while nationally job growth was 1.4 percent. In California, the job growth was sufficient to push down the average unemployment rate in 2006 to 4.8 percent, down 0.5 percentage point from 2005. Nationally, the unemployment averaged 4.6 percent in 2006, a drop of 0.4 percentage point. As these data make clear, the job market remains tight in California just as it is nationally. The slightly slower pace of job growth in California over the past year primarily reflects the reduced growth of the local labor force and by no means reflects any worrisome degree of slack.

Likewise, the state housing market so far has adjusted in a relatively orderly fashion to slower population growth. Existing home sales in

California dropped by about 1/3 percent between mid 2005 and mid 2006, but have been relatively stable since then. Existing home prices are about level with where they were a year ago, a performance that roughly parallels the national experience.

To be sure, California house prices still are high relative to national prices, and the inventory of unsold houses remains elevated. The potential for sizable house price declines is an obvious risk factor for the local economy in 2007. But the state, like the national economy, has already weathered a big drop in residential home building. My expectation is that growth in California will reaccelerate along with the national economy over the course of 2007. Real GDP in California should advance about 2 ½ percent in the coming year, slightly lagging national growth of around 2 ¾ percent.

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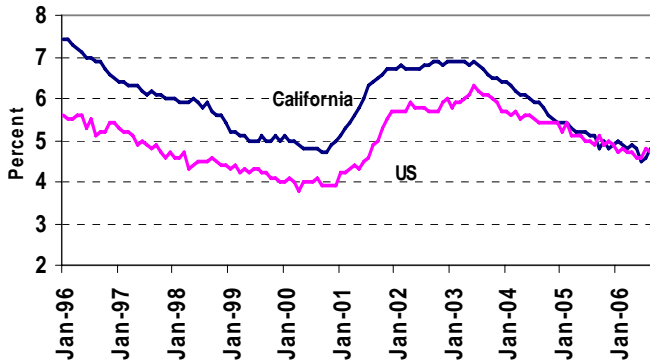
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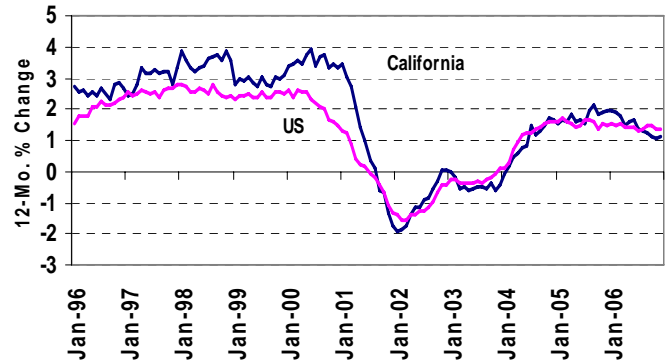
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# California Brief

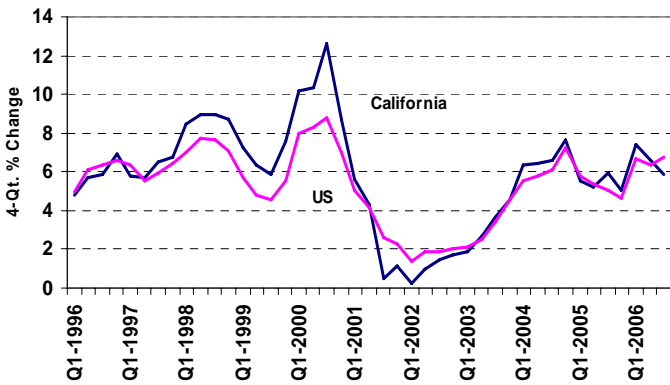
### Unemployment Rate



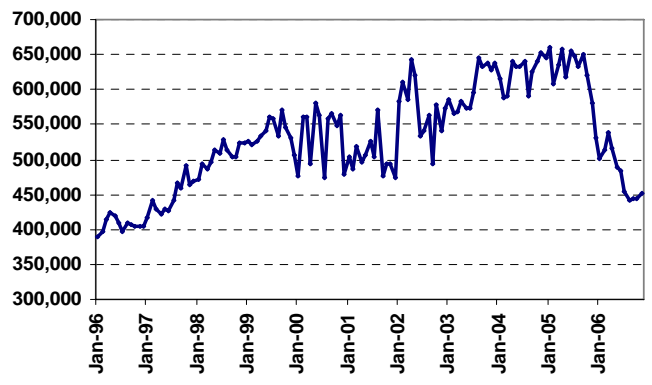
### Nonfarm Payroll Employment



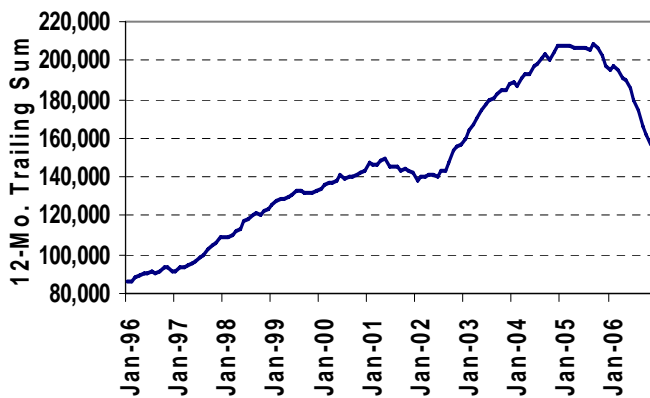
### Personal Income



### Existing Home Sales



### Residential Building Permits



### Real Gross State Product

