Midsummer Night's Economic Dream, Act 1:
The National Picture

by

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Having reached the halfway mark of 2025 and enjoying the summer weather so far, it is time to look forward and evaluate various plausible economic outcomes for the second half of the year. Alternatively, we could just sit back and enjoy the scene. It certainly gives us a more pleasurable view than being in a room without air conditioning during the heatwave in Europe facing a recession. Worse, you could be in the humidity during monsoon season in Seoul, Tokyo, or Shanghai facing higher tariffs imposed by the Trump administration, with deadlines, once again, moved from July 9 to August 1. In this piece, we will focus on aspects from the national picture, which affect the state and our regional economy. A follow up piece will look more on impulses generated within California and the Riverside County and San Bernardino Bounty (Inland Empire).

At first glance, the national employment report published on July 3 by the Bureau of Labor Statistics-Department of Labor seemed to contain encouraging news: the unemployment rate, which had been at historical lows of around 4.2 percent for a year now, actually dropped by 0.1 percentage points while adding almost 150,000 new positions last month. This is certainly welcome news compared to analysis, which forecasted an imminent recession given the decline in real GDP during the first quarter, and fears about government layoffs and uncertainty resulting from the imposition of tariffs. Perhaps the absence of a deadline until August 1 may be used by the doom and gloom forecasters to explain the continuously booming labor market at the national level (only three foreign trade deals have been signed so far).

On the downside, it also means that the Federal Reserve is unlikely to reduce interest rates during their July meeting, especially when coupled with the fact that core inflation, as measured by the personal consumption expenditure price index (excluding food and energy) actually went up slightly last month. The combination of a labor market at full employment coinciding with inflation above the Federal Reserve's target range (2 percent) makes it unlikely that the U.S. central bank will lower the Federal Funds Rate by more than 50 basis points by the end of the year, if at all. This is the sort of number that would be required to stimulate housing starts and construction and would have more of an immediate impact compared to Governor Newsom suspending the California Environmental Quality Act (CEQA), a policy decision many

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economists, including us, had called for previously. In the words of our governor, it “is a game changer, which will be felt for generations to come”. While this will benefit housing starts in the medium term, it takes some time for builders to act on.

There are a few dark clouds on the horizon of the national forecast. First, the decrease in the unemployment rate, according to the household survey (Current Population Survey) shows that the unemployment rate fell because the labor force shrank, coinciding with an increase in employment. The change in the unemployment rate is approximately equal to the difference between the growth rate of the labor force and employment growth; hence both factors contributed to it. In general, a shrinking labor force is not a healthy signal since it means that some people may have given up looking for jobs or, worse, immigrants withdrawing from the labor force. Second, the vast majority of the jobs created since May 2025 have come from just two sectors: Health, and Public Education (Local Government). The two sectors contributed 132,000 new positions, or over 91 percent of the increase in employment. This is not healthy for the long run development of an economy, especially if these two sectors are going to be negatively affected by national fiscal policy decisions and demographics. Third, if we focus on the private sector, then employment increased by less than 75,000, of which 68,000 came from Health sector hirings. Watch out, the rest of the private sector created only 8,000 new positions, with many sectors, including manufacturing, contracting.

Another concern comes from looking in more detail at companies that are affected by the expansion of Artificial Intelligence (AI). Tech companies like Microsoft, Amazon, Intel, Meta, and Google have been implementing workforce reductions this year and restructuring as they prioritize AI investments. Software development jobs are in steady decline, together with scientific and technical consulting, professional business services, advanced manufacturing, and TV, film, sound recording and video streaming. Regarding the latter, AI is displacing 3-D modelers, sound editors, re-recording mixers and broadcast, audio and video technicians, sound designers and engineers, script writers, artists, animators and graphic designers. More than 50,000 jobs have been downsized in this sector since the Spring of 2023. If you are watching Wimbledon or the U.S. Open Tennis tournament, you will notice that AI has displaced all line judges.

Surveys have shown that AI has already displaced many workers in the information, entertainment, and gaming industries, but at the same time, job formation in the form of developing, maintaining, and overseeing AI systems is expected. Moreover, while new opportunities have and will continue to emerge in AI, the layoffs appear to have far offset the jobs created to date. In addition, due to the tariff uncertainty that still haunts businesses this year, new hiring to supplement AI systems is likely to remain restrained.

Despite the reminder that economics is a dismal science, talk about an imminent national recession does not sound realistic and reminds us of the situation in 2022 and 2023, when many forecasters predicted a downturn within a year, only to move back the starting date repeatedly before realizing that it would not happen. This became known as the “Godot Recession” - referring to Becket’s play “Waiting for Godot” where a boy messenger repeatedly announces to the two main characters that Mr. Godot, who they have been waiting for, will not appear today but for sure tomorrow - in the end, he never comes. We continue to forecast positive economic growth for the rest of the year, including the current quarter (we will not get the data for 2023 Q2 until later this month). We expect the number to show growth in real GDP of about 2 percent, with lower, but positive, values to follow for the rest of the year.