The Logistics Sector Continues to Fuel the Inland Empire Economy But with Much Lower Octane Levels than Before

by

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At our State of the Region conference in March, we forecasted a national recession to begin most likely during the second half of this year or first part of 2024. We were not alone in this prediction since a large number of Wall Street forecasters painted a similar scenario. We also mentioned that the Inland Empire would show the first signs of a national downturn, because a significant number of its workers are commuters who live in the region but work in coastal Southern California. These workers hold positions that tend to see layoffs at early stages of an economic downturn. Unemployment is measured by residency, and hence, if you have an Inland Empire resident, who works in LA County but resides in the Inland Empire, and he is laid off, the unemployment rate in LA County is unaffected, but that of the Inland Empire increases.

What do the latest employment numbers for the Inland Empire tell us? Our region was one of the first to recover from the Coronavirus downturn of March 2020 to April 2020. It took 20 months or almost two years (so much for the V-shaped recession) and until December of 2021 for San Bernardino County and Riverside County to regain all lost employment. By December 2022, the area had surpassed pre-pandemic employment by 48,000. We were the envy of the other regions in California. Since then, we have lost 61,000 jobs, putting us back to November 2021 levels of employment: 21 months of success washed down the drain. Our (seasonally unadjusted) unemployment rate stands at 4.9% as of July 2023, 1.5 percentage points higher than in May 2022. That is significant.

Here is the mistake we made: we interpreted the weakening of the Inland Empire labor market as a first sign of an economic downturn in Southern California and perhaps even the nation. What we did not realize was how much of this was driven by the Cinderella sector of the recovery, the Logistics sector (Transportation, Warehousing, Wholesale trade), adjusting first to pandemic-driven changes in consumer spending, and, more recently, reverting to pre-pandemic spending patterns. The bottom line is, the Logistics industry is hurting while adjusting. 20,000 trucking firms, e.g. Yellow (one of the biggest ones) have shut down after declaring bankruptcy or ceased activity, the industry has seen three quarters of revenue declines, investments have been scaled back (warehouse construction is 40% lower compared to a year ago), Amazon has changed expansion plans for over 110 properties, etc. The list goes on and on.

The underlying cause is that the pandemic forced many spending habits of households to change dramatically. Prior to the pandemic expenditures on goods accounted for 36 percent of total spending, but that rose significantly during the pandemic, as consumers were unable to dine out, go for work outs, take trips, visit tattoo parlors, get hair cuts, and consume many other services.

As the danger of the pandemic abated and the economy re-opened, spending shifted again with households tempering their purchases of goods and resuming their purchases of services. These changes in consumption patterns directly affected the Inland Empire Logistics sector and overall employment in the region. Uncertainty about the San Pedro ports, environmental concerns regarding the expansion of transportation and warehousing, and automation also contributed but to a lesser degree. Bottom line: the problems of the Logistics industry indicate that its fortunes have gone from boom to bust, without deeper implications for the U.S. economy.

Compared to the last month of the previous economic expansion (February 2020), the Logistics sector added 62,500 jobs in the Inland Empire by December 2022. At its peak employment level in December 2022, there were 284,000 workers employed in the sector, making it the second largest employer in our region. What has happened since then? As of last month, the Logics sector is back to just below 265,000 employees, which represents a loss of almost 20,000 positions. Freight volumes tell a similar story. Ontario International Airport data show a year-to-year decline in cargo shipments of 17%. Container imports at the ports are also down by 2%..

Even if some of these losses can be explained by seasonal factors, year-to-year changes do not suffer from seasonal distortions. Furthermore the fact is that the showcase sector for our local economy has certainly not continued to expand at rates seen earlier in the recovery. However, and this is the crux of our story, the decline in the rapid growth rates following the last recession has little to do with cyclical factors and therefore does not underline a prediction of an oncoming recession. Instead it is structural: the decline in employment growth is driven by changes in spending habits of households rather than an across the board cutback in spending.

Have we rescinded our March forecast of an upcoming recession? No - not yet. While some of the "sensors" of an upcoming downturn do not sound as loud an alarm as they did in the spring (the consumer sentiment index has recovered from historical low levels, housing starts have bounced back from their low and are close to the historical average, national unemployment rates remain unchanged), there are others that have not moved out of the "alarm bell" status: the spread between short-term and long-term interest rates, and average hours worked in manufacturing are stuck at a fairly low level. But we can definitely say that the signals we are getting out of the Inland Empire are not as bad as we thought they were when looking at the local labor market in March. They say more about the local economy than the national economy. Stay tuned.

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