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# COLUMN - After the gold rush, California finds thrift: James Saft

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-- James Saft is a Reuters columnist. The opinions expressed are his own --

By James Saft

LONDON (Reuters) - As it did when the housing bubble began to burst, California is leading the way in the next leg: a consumer bust.

Squeezed by rising unemployment, inflation in food and energy costs and plunging house prices, Californians are cutting back on spending. Besides causing woes for state and local government, this is giving California's economy another knock and makes further job losses, home repossessions and banking problems more likely.

The figures are pretty bad. The median home price has fallen by 29 percent in the year to March, according to the California Association of Realtors, and repossessions are surging. Unemployment has risen by 24 percent, to 6.2 percent, in the same period.

But most importantly, in the 10 months to the end of April sales tax receipts in California are actually down in absolute terms. Gasoline tax receipts are essentially flat. When you factor in that there would have been considerable inflation during the period, and that some essentials like gasoline will have risen sharply in cost, the picture is clear: Californians are tightening their belts.

And California matters. It accounts for 13 percent of U.S. GDP. It was also where more than a third of the non-mainstream home loans such as subprime and Alt-A were made in 2006 and 2007, making it very important to the health of the banking system.

"California is big enough that it is going to drag a lot of the nation down with it," said Christopher Thornberg of Beacon Economics consultancy in Los Angeles.

"You can't have collapsing consumer demand in California and not expect it to have an influence."

Thornberg sees the recession in California being closer to the difficult one of the early 1990s in severity rather than the briefer version after the internet boom ended. But while California is not suffering from an industrial bust, as it did when aerospace was hit after the Berlin Wall came down, its consumers are coming into this with very little left in the tank.

"People have racked up a phenomenal amount of debt, savings rates have been at zero and the piper has to be paid," Thornberg said.

Vallejo, in northern California, last week said it would file for bankruptcy, prompted by rising costs and falling tax receipts due to the housing slump.

And Governor Arnold Schwarzenegger is expected to unveil plans for $15 billion in bonds backed by lottery revenues to help plug a budget hole.

A lottery jackpot is just about what the state needs right now, though the odds seem commensurately remote.

POOR SALES FROM JACK IN THE BOX TO NORDSTROMS

The downturn is clear too from a host of company results.

Higher end department store chain Nordstrom Inc. last week reported that same-store sales fell 6.5 percent in the first quarter, dragged down in part by poor traffic in California, which accounts for about a third of its turnover.

Starbucks too blamed some of its recent disappointing performance on a new unwillingness among subprime-hit coffee drinkers in California and south Florida to pay top dollar for stimulants.

At the lower end of the scale, fast food chain Jack in the Box said on Wednesday that it had seen softer sales at restaurants in California.

One particular area of concern is the way in which California's faltering economy and rising unemployment interact with falling housing prices to prompt greater rates of mortgage defaults. This could hit banks with exposure to California in their mortgage loan portfolios, not to mention Fannie Mae and Freddie Mac.

"There is a very strong relationship between delinquencies and the coupling of job losses with falling home prices," Ajay Rajadhyaksha and Derek Chen of Barclays Capital in New York wrote in a note to clients.

For example in the areas of Modesto, Stockton and Merced the unemployment rates are above 10 percent while more than 60 percent of loans are close to being underwater, or larger than the value of the underlying house. Serious delinquencies in those areas are above 18 percent, while the national average is 3.6 percent, according to Barclays.

But beyond the implications for banks, California can really be seen as the testing ground for what the U.S. consumer looks like in coming years, and how he or she manages. If, somehow, the move from spending to savings can be done gradually, the downturn in the United States may be gentle.

If, on the other hand, it happens quickly, watch out. "Savings rates should probably have to rise to five to six percent in the next year or two to get us back to a stable position," said Thornberg at Beacon Economics.

"If you have a five or six percent rise in the savings rates, it's functionally a five or six percent decrease in consumer spending.

"We've never seen that kind of drop in consumer spending in the U.S. economy."

-- At the time of publication James Saft did not own any direct investments in securities mentioned in this article. He may be an owner indirectly as an investor in a fund --