

Big picture economics and local real estate

**Real estate investors group, Nashville
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Short-term Outlook

Upside

- The national economy is no longer in freefall.
- Population growth continues in Middle Tennessee. Murfreesboro experienced the 12th highest rate of population growth in the nation for 2007-08.
- Housing construction and home sales are on the rise buoyed by lower prices, low mortgage rates, \$8,000 tax credit for first-time buyers, and mending consumer confidence. Home construction and sales bottomed out in January.
- Increasing housing activity will generate much needed state and local government revenue.
- Inflation is not a problem and probably won't be an issue for some time.
- Consumers can be brought back to spending when the right deal comes along. The cash-for-clunkers program has been hugely successful, and demonstrates that consumers will bite if the deal is attractive.

Downside

- Double-digit declines in manufacturing employment have hit Tennessee hard. Tennessee is more reliant on manufacturing compared with the average state.
- Manufacturing decline particularly gruesome in the rural counties, causing large increases in the unemployment rate. In June, 21 counties experienced unemployment rates of 15% or higher.
- Unemployment rate still on the rise; 11.1% for Tennessee, 10.0% in metro areas, 13.8% in rural areas (June 2009).
- Unemployment is not expected to peak until next year. Higher unemployment generates a large drag on consumer spending.


What does 'recovery' mean?

- If recovery means a return to the status quo before the downturn, then we have a very long way to go. Research Insight estimates that Tennessee's economy will not experience a full recovery until 2014.
- We should consider a more modest definition of recovery: a sustained improvement from last month or last quarter. By this definition, the local economy has begun the process to recovery, but some sectors (housing) will improve even though other indicators (unemployment) are still negative.

Going forward

- Second quarter 2009 marked the fourth consecutive quarter of falling GDP; first time since the late 1940s. GDP data for this quarter (third quarter) will probably show an increase.
- Don't make year-to-year comparisons (it is too depressing).
- Make comparisons with the previous month or previous quarter.
- Forget about 'recovery'; settle for sustained improvement.
- The unemployment rate will be the last indicator to improve; don't look to this indicator to assess the strength of the economy.
- Job growth will not occur until employers have confidence that sales will continue to rise.
- Jobless recovery is likely; growth of GDP of at least 2.5 percent is needed to bring down the unemployment rate.

What will be the shape of recovery?

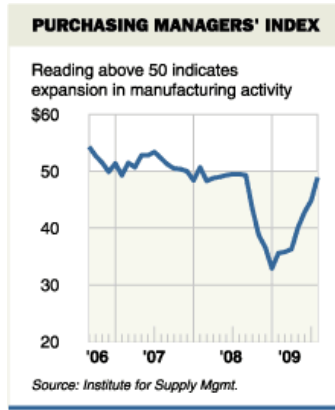
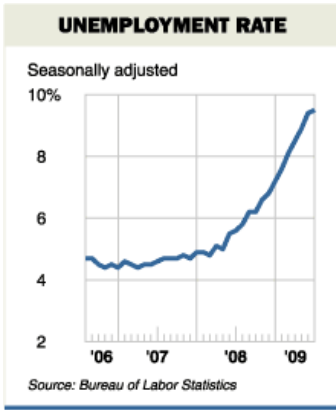
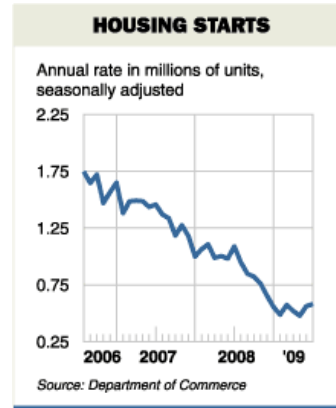
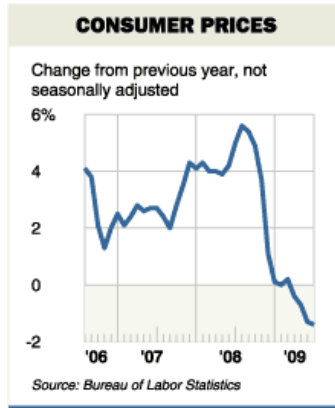
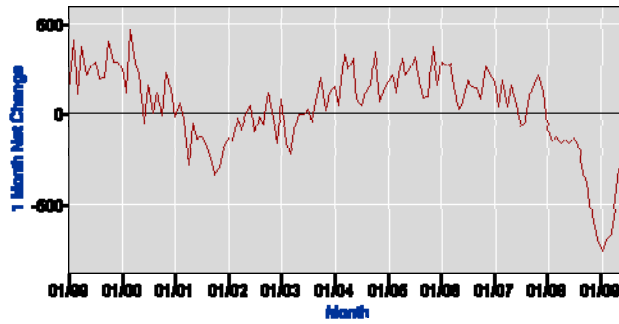
- **V** – sharp downturn followed by sharp recovery (1983)
- **U** – typical downturn followed by recovery (1991, 2001)
- **W** – short, severe recession followed by weak recovery, leading to another recession (1980, 1982)
- **Sideways L** – long downturn followed by recovery (Japan)
- **Checkmark**  - sharp downturn followed by gradual recovery

Today's subjective odds:

V	20%
W	10%
L	20%
Checkmark	50%

Important National Indicators

Monthly change in payroll employment



Long-run considerations

- Demand for housing and residential real estate depends on growing the *number of households*.
- Household growth depends on *population growth* and *household size*.
- Population growth depends on *net natural population increase* (births minus deaths) and *in-migration* (from other counties, states, or countries).
 - Population growth 2000-2008 for the Nashville MSA:
 - Total growth: 238,944 (18.2% increase)
 - Net natural increase: 80,195
 - Net in-migration: 138,753
 - Domestic: 112,353
 - Foreign: 26,400
- In-migration has been a very important for the Nashville area, accounting for 58% of total population growth.
- Population growth trends are slow to change. In-migration to the Nashville area continues, despite the large rise in unemployment rates.
- Household size has been drifting lower since 2000, now at 2.374 persons per unit (2008). The recession has probably caused household size to increase somewhat since 2008.
- Housing stock increased by 2.3% annually 2000-2008, compared with 2.1% population growth.

Short-run considerations

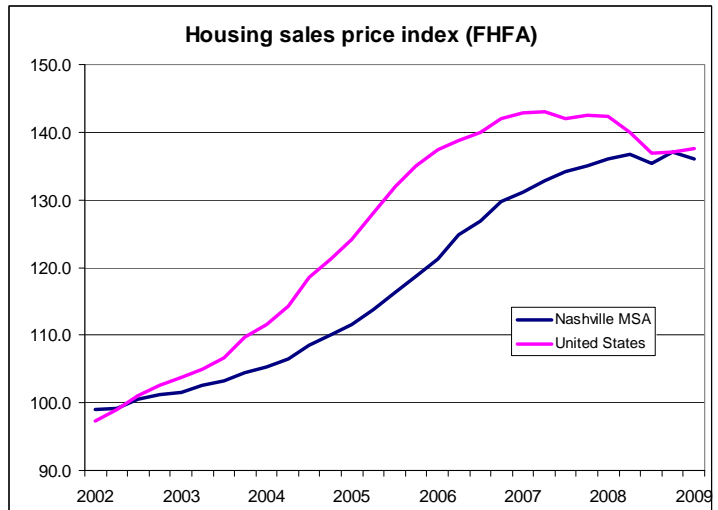
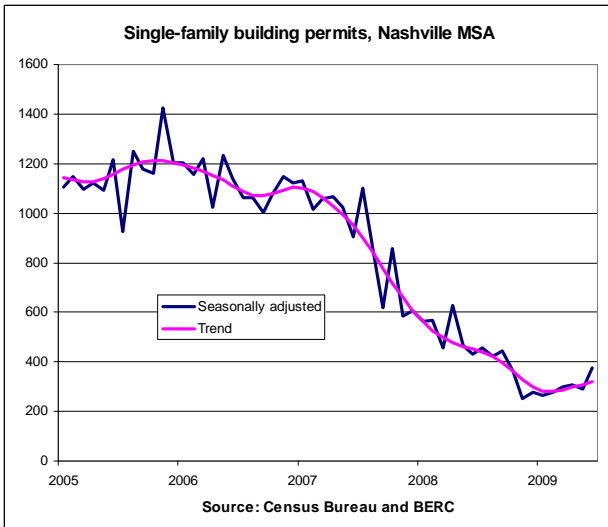
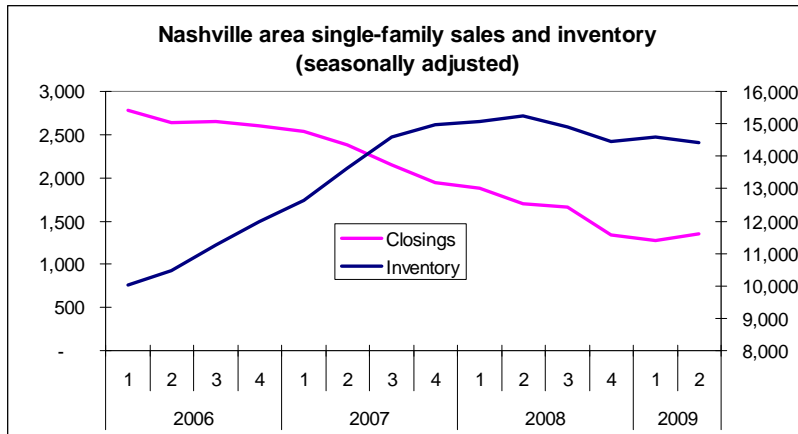
- Demand for housing (new or existing) depends on employment and income growth, interest rates, the price of housing, rental rates, and the availability of long-term credit.
- Sustained increases in the inflation rate can create investor demand for housing, as real estate values typically grow faster than the inflation rate when inflation is rising. We see little indication that inflation will be an issue in the near future.
- Supply of housing (new construction) depends on cost of labor and materials, price of land, local regulatory environment, and the availability and cost of credit.

Equilibrium (balancing supply and demand)

- Short-term booms (2003-2005) can cause the housing market to grow faster than the long-term trend (this is the bubble). Economists contend that the market will eventually return to the long-term trend; this is called the error-correction model.
- Short-term busts (like now) are characterized by growth rates lower than the long-term trend. If population growth continues, the market will eventually move up towards the trend as inventory becomes depleted.
- The housing market tends to return to trend growth, but almost always overshoots. In other words, housing growth is usually either above trend or below trend, rarely equal to trend.

Nashville Area

- Payroll employment continues to plummet, with manufacturing and construction producing double-digit percent losses.
- The unemployment rate continues to rise; will likely rise through the remainder of the year.
- Housing market is showing signs of life; sales are up and single-family construction appears to be on the mend.
- Sustained growth will depend on increasing consumer confidence, income and job growth.



Important macro indicators

- Change in nonfarm employment (BLS)
- Household confidence (Conference Board, Univ. of Michigan)
- Business confidence (PMI index)
- The price level and the rate of inflation (BLS)
- Interest rates (mortgage rate, 10 yr Treasury)
- The unemployment rate (BLS)
- GDP (Bureau of Economic Analysis, www.bea.gov)

Important sources of information

Primary data

- Bureau of Labor Statistics (www.bls.gov)
 - Unemployment rate
 - Change in nonfarm employment
 - Consumer price index
- Census Bureau (www.census.gov)
 - Housing starts and permit-authorized housing
- Energy Information Administration
 - Prices and stocks for oil and gasoline (www.eia.doe.gov/)
 - Short-term forecasts

Secondary data

- Federal Reserve Bank of St. Louis (<http://research.stlouisfed.org/fred2/>)
 - Very wide variety of data from a variety of sources; up to date
- Wall Street Journal online (www.wsj.com)
 - Economic indicators
 - Economic chartbook
 - Forecasting survey
- Business and Economic Research Center (www.mtsu.edu/~berc)
 - Permit-authorized housing construction
 - Economic updates

Value added data

- RGE Monitor (www.rgemonitor.com/)
- Moody's economy.com (www.economy.com)

Unemployment rates (not seasonally adjusted, June 2009)

U.S.	9.7
Tennessee	11.1
Metro areas	10.0
Rural areas	13.8
Nashville MSA	10.0