Economic Outlook

16th Annual Economic Forum

The Factory, Franklin
February 18, 2009

David A. Penn, Director and Associate Professor
Business and Economic Research Center
Jennings A. Jones College of Business
Middle Tennessee State University
dpenn@mtsu.edu
Economic Outlook

• Situation and outlook for the national economy
• Situation and outlook for the Nashville area
National Situation

• The U.S. economy is on the ropes.
• Very serious downturn
  • Current unemployment rate 7.6% in Jan 2009.
  • Up one full point during previous three months.
  • Up two percentage points from June 2008.
• Consumer confidence at an all-time low and dropping.
• Manufacturer confidence still shows contraction, but improving.
Consumer confidence

• Important predictor of spending on big-ticket items.

• Based on monthly survey of households by the Conference Board.

• Figure of 37.7 for Jan 2009 an all-time low (since 1967).

Source: Conference Board
Manufacturer confidence

• Reading below 50 indicates contraction.

• January 2009 improved from December.

• Manufacturing continues to contract, but not as fast.

Source: Institute for Supply Mgmt.
Great Depression?

• Serious, but not the Great Depression II
  • Lowest unemployment rate 1931-1939 was 14.3% in 1937.
  • Highest unemployment rate was 24.9% in 1933.
  • Comparisons with the 1930s are mostly hyperbole.
  • Safety nets are in place that were not available for most of the 1930s.
  • Policy is extremely aggressive today, not so in the 1930s.
1982 Recession

• Current downturn is most similar to the 1982 recession.

• Unemployment rate peaked at 10.8% in 1982, following 18 months of increases.

• Needed another 18 months to drop the unemployment rate back down to 7.5%.

• Roughly a three year cycle.
Applying the 1982 Recession

• The current rise in unemployment is more steep than experienced in 1982.

• We have already experienced 13 months of increased unemployment, but large increases did not occur until October.

• Another 12-14 months of rising unemployment seems probable.
What sectors will lead?

- Keep in mind:
  - Unemployment and employment growth are lagging indicators; show where the economy has been.
  - Output will rise, even though employment growth is flat, due to productivity gains (jobless recovery).
  - Construction and real estate tend to be leading indicators.
How did this happen?

• Cause of our problem:
  • Too many risky loans.
  • Too much credit.

• Consequences today:
  • Lenders spooked, flight to safety.
  • Too little credit.
Credit Scarce

• Loan securitization boomed beginning with the 1980s.
• Home mortgages, commercial mortgages, auto loans, and student loans were brokered, packaged and resold to investors.
• This source of credit has nearly dried up.
Bank lending

- Bank loans are actually higher over the year.
- Evaporation of CMOs the real culprit.
Positives

• Very low mortgage rates
  • New wave of refinancing.
  • Credit is available to the credit-worthy.
• Lower housing prices
  • Homes are more affordable relative to income.
• Inflation has moderated
  • Gasoline prices lower.
  • Grocery prices lower.
  • Construction costs lower.
• Retail sales unexpectedly higher in January.
Positives

• Extremely aggressive policy
  • Monetary policy,
  • Fiscal policy (could do more), and
  • Structural policy.
Monetary Policy (Federal Reserve)

- Liquidity
  - Fed funds rate at 0%.

- Credit
  - Purchasing commercial paper, backing up money market funds.
  - New facility that will lend against high-quality asset back securities (auto loans, student loans, credit cards), restart consumer credit market (TALF).

- Purchase of long-term securities
  - Will purchase $100 billion GSE debt.
  - Later will purchase $500 billion agency guaranteed debt.
  - Should help hold the line on mortgage rates.
Fiscal Policy

• Stimulus will help
  • Could have helped more.
  • Much of the impact pushed into 2010.
  • Will not be large enough to stem the tide of unemployment.
  • Without stimulus, nation on track to lose 3-4 million additional jobs 2009-2011.
  • With stimulus, additional losses may be limited to 1-2 million over a shorter time period (2009-2010).
Stimulus plan and unemployment rate

Structural policy

• Treasury announced outlines of financial plan last week.

• Obama administration will announce mortgage/foreclosure plan today (Wed 2/18/09).

• Administration has announced it will do what is necessary to keep bank system running.
  • Nationalization of large banks?

• Period of financial triage is nearly upon us.
  • GM, Chrysler, tire manufacturers, auto parts manufacturers.
  • Picking winners and losers in banking.
Negatives

• Very poor household confidence
  • Confidence has fallen off the table.
  • Confidence needed to buy ‘big-ticket’ items.
  • When confidence wanes, households cut back on home purchases, autos, and appliances.

• Very poor business confidence
  • Capital expenditures plummeting.
  • Why expand plant and equipment?
  • Banks still carrying lots of bad assets.
  • Deflation may be around the corner.
On balance

- Housing prices and mortgage rates face heavy headwind.
- Household size is falling, reducing the household formation rate.
- Consumer confidence, household spending, and unemployment feed on each other.
- Households need a very large jolt in confidence to jumpstart spending.
Vision for Recovery

• The economy will recover. But when?
• And what does recovery mean?
  • Regaining the previous peak?
  • Better than last year?
  • Better than last quarter?
  • Gradual improvement?
• Which sectors will improve first?
Vision for the Future

• What will recovery look like?
  • V-shaped,
  • U-shaped, or
  • L-shaped?
V-Shaped Recovery

- Very sharp decline, followed by a very sharp recovery.
- Most recently occurred in the short 1980 recession.
- Consumer confidence falls rapidly, hits bottom, then quickly bounces up.
- Can occur if financial institutions have not suffered structural damage.
U-Shaped Recovery

- A more gradual decline, followed by a gradual increase in output.
- Most recently in the mild 2001 recession.
- Job growth is modest; can feel like a ‘jobless recovery’.
  - Unemployment rose into 2003, even though GDP began rising in 2001.
  - Productivity gains can limit the need to hire workers.

2-3 years
L-Shaped Recovery

- Actually a horizontal L.
- Long period of stagnant growth followed by a recovery.
- Recovery required a full decade in Japan.
- Zero interest rates in Japan not enough to turn the tide.
- Should be avoided at all costs.

10 years
What will be the shape of the recovery?

- What is today's probability of:
  - V-shaped recovery: 0.10
  - U-shaped recovery: 0.85
  - L-shaped recovery: 0.05
Nashville Overview

• Bad news:
  • Negative trends accelerating.
  • No bottom yet in sight.

• Good news:
  • Be happy you are not in Florida, California, Arizona, Ohio, Michigan, North Carolina, Georgia, South Carolina, or Nevada.
Nashville Overview

• Nashville indicators
  • Nonfarm employment: falling rapidly
    • Peaked in March (768,600).
    • Down 1.7% March-December.
    • Half the decline occurred in the previous three months.
  • Unemployment rate: on the rise
    • December 2008: 6.5%
    • December 2007: 4.2%
    • Up 0.5 points previous three months.
  • Housing prices probably falling, but not as much as other areas.
Single-family closings

Nashville area single-family sales and inventory (seasonally adjusted)

Source: GNAR and BERC.
Outlook

• Boosting consumer and business confidence is key.
• Housing will lead us out of the downturn, but no bottom is in sight (yet).
• Labor market will continue to weaken even as housing begins to recover.
• Forecasts of improvement in the second half are being shifted to later this year.
• Nashville likely to experience 1.9% nonfarm employment decline this year, 1% next year.
Conclusions

• The time for timid policy responses and half-measures is over (lessons from Japan).
• More fiscal stimulus possible-likely.
• More rollouts of asset purchases and major structural policies likely.
• *Whatever it takes* is the right strategy.