Economic Outlook
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Economic Outlook

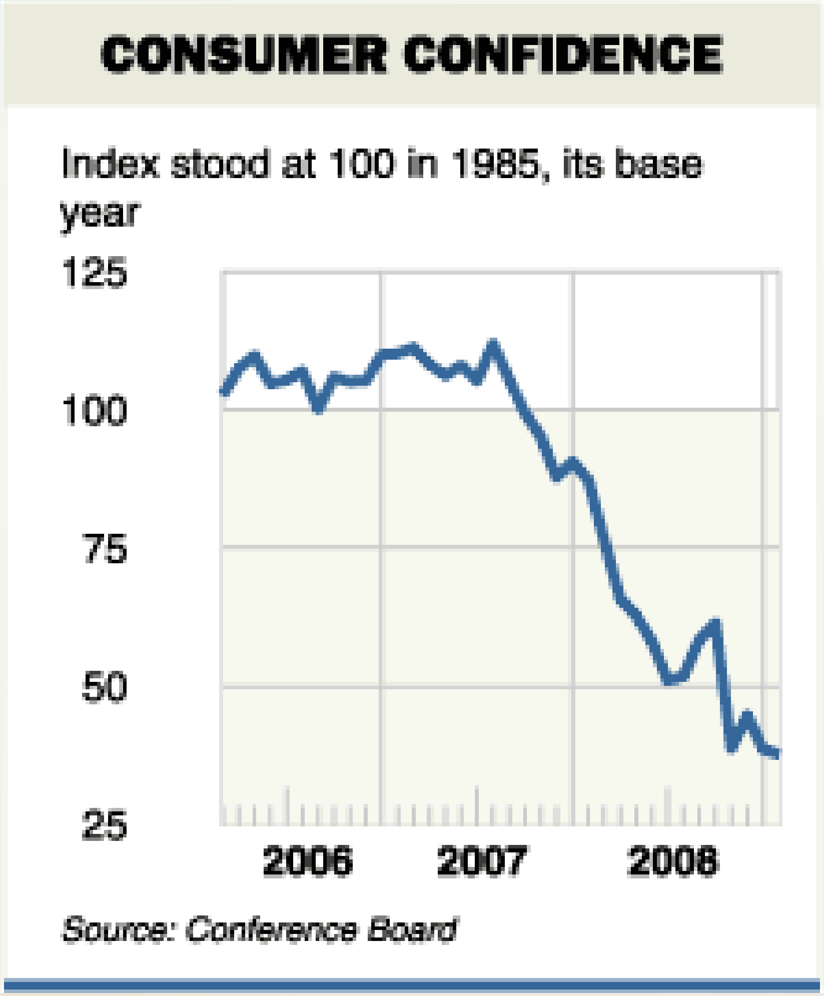
- Situation and outlook for the national economy
- Situation and outlook for the Nashville area

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.

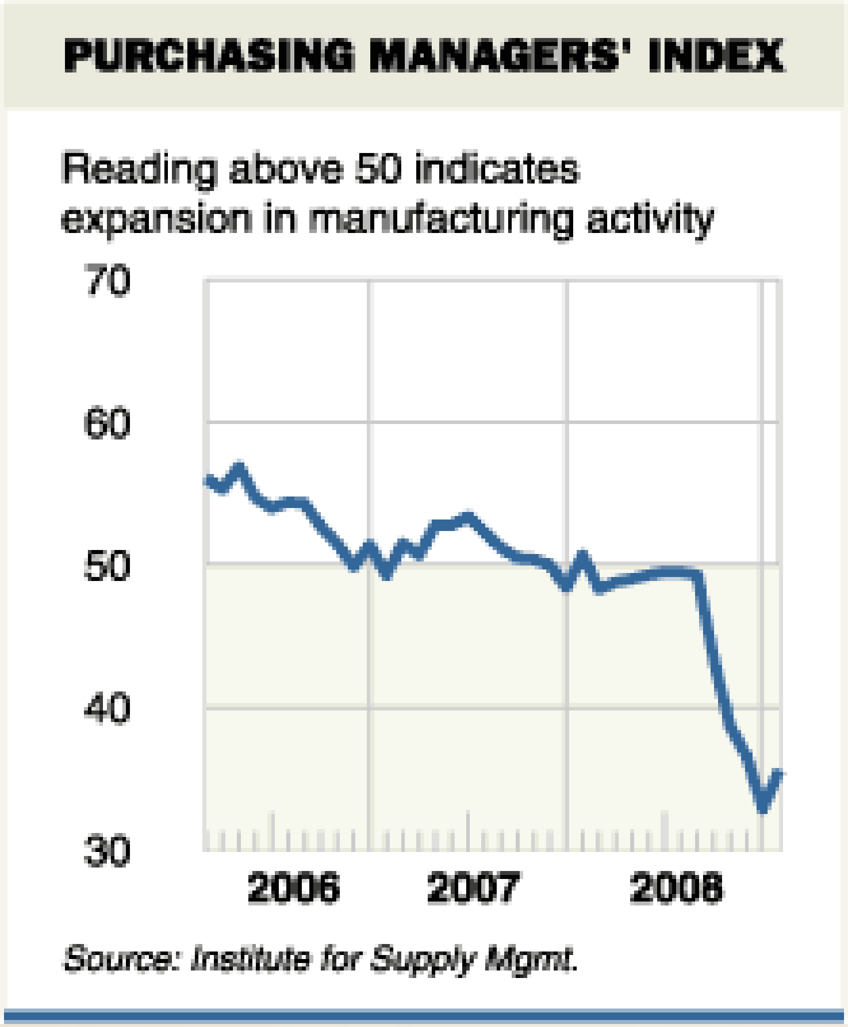
Consumer confidence

- 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).



Manufacturer confidence

- Reading below 50 indicates contraction.
- January 2009 improved from December.
- Manufacturing continues to contract, but not as fast.



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?

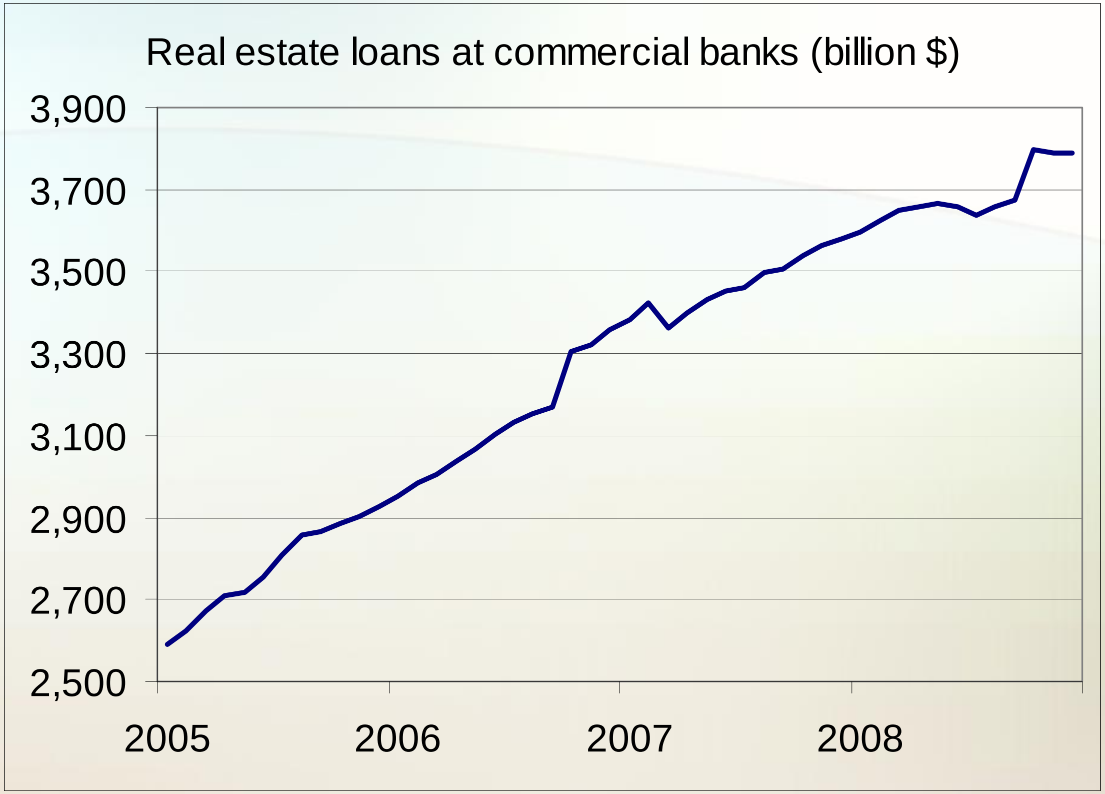
- Cause of our problem:
  - Too many risky loans.
  - Too much credit .
- Consequences today:
  - Lenders spooked, flight to safety.
  - Too little credit.

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.

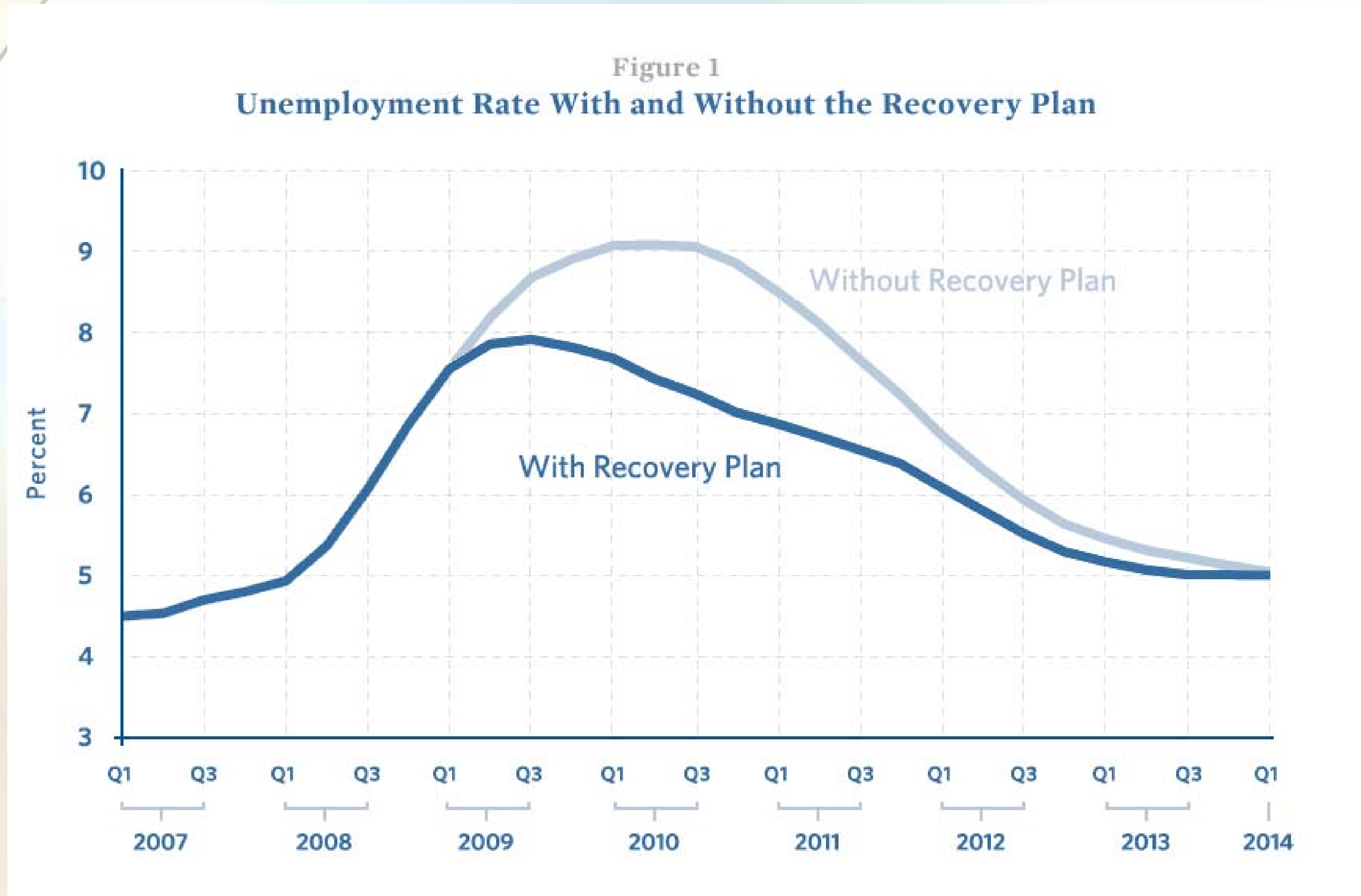
Monetary Policy (Federal Reserve)

- 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



Source: Romer and Bernstein, *The Job Impact of the American Recovery and Reinvestment Plan*.

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

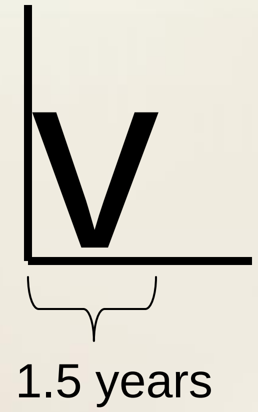
- The economy <u>**will**</u> recover. But when?
- And what does *recovery* mean?
  - Regaining the previous peak?
  - Better than last year?
  - Better than last quarter?
  - Gradual improvement?
- Which sectors will improve first?

Vision for the Future

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

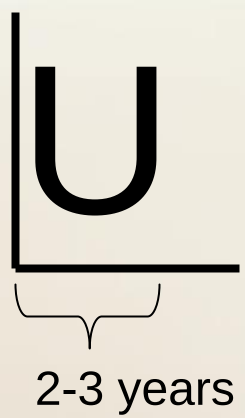
V-Shaped Recovery

- 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.



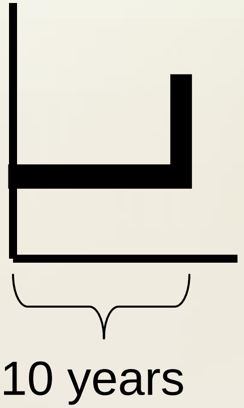
U-Shaped Recovery

- 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.



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.



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

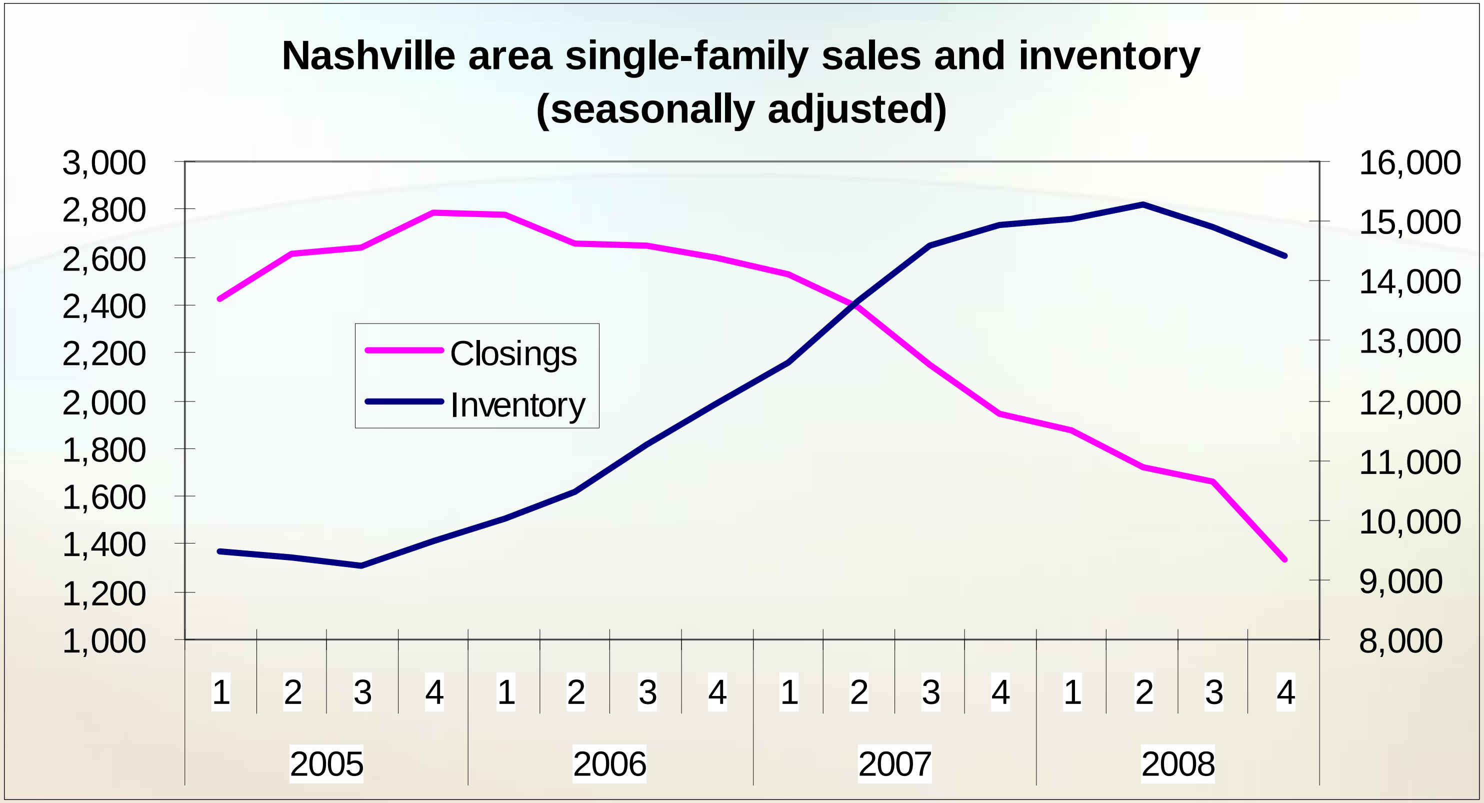
- Bad news:
  - Negative trends accelerating.
  - No bottom yet in sight.

- 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



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.