

Economic Outlook

2009/2010

The University of Arizona's
Twenty-Eighth Annual
Forecast Luncheon

↳ Economic Outlook Luncheon 2009-10

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Dean, Professor of Economics,
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What's With Financial Markets?

- Too much financial innovation and too little regulation
 - Asset bubbles are fueled by expansion of credit
 - Subprime mortgages and securitization
 - Now credit is shrinking, banks are deleveraging
- Word of the year for 2008:
 - ***Bailout***

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Effects on the Real Economy

- Economy floats on sea of credit
 - Since September-- in a free fall
- Consumers in full retreat
 - Confidence at lowest levels since early 1980s
 - HH net worth has fallen 13%
 - Consumption dropped 3.7% 3Q, largest 28 yrs
 - Auto sales lowest since 1983
- Unemployment rate is 6.7%, 14-yr high
- Homebuilding at lowest level since 1945

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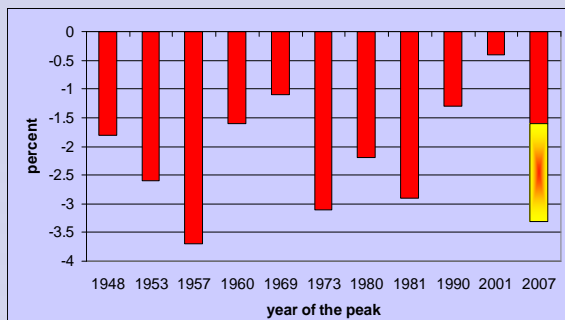
Effects on the Real Economy

- U.S. has been in recession since December 2007
 - Recession is already one year old
 - Losses were mild until August/September
- Expect a severe recession lasting at least through mid-2009
 - Similar to 1974-75 recession and early 1980s recessions

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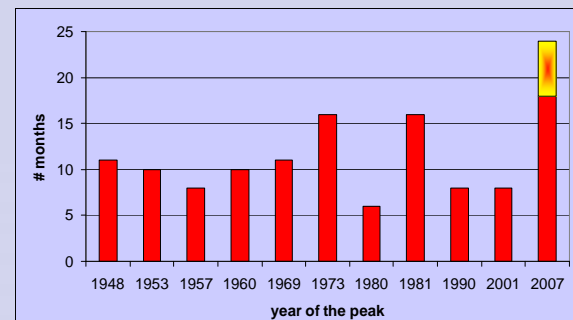
GDP Declines in Post-WW II Recessions



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Duration of Post-WW II Recessions



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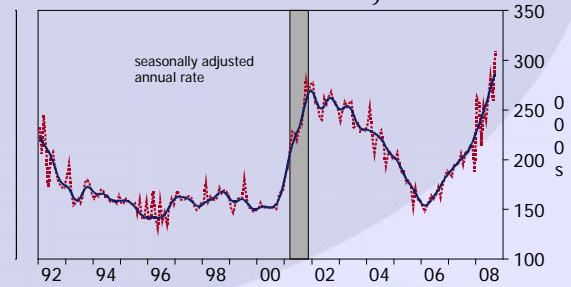
AZ Labor Markets Are Plunging

- Initial unemployment insurance claims still skyrocketing
- Unemployment rate in October
 - 6.1% in AZ and 5.8% in TUS
 - Headed above 8%
- Nonfarm job growth
 - declining at a 4% annual rate statewide
 - 2% annual rate in TUS, 5% in PHX

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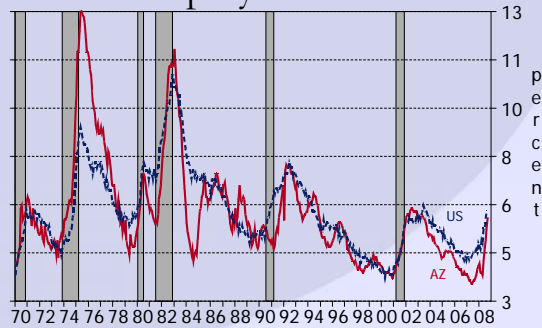
Initial Unemployment Insurance Claims, AZ



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Unemployment Rate

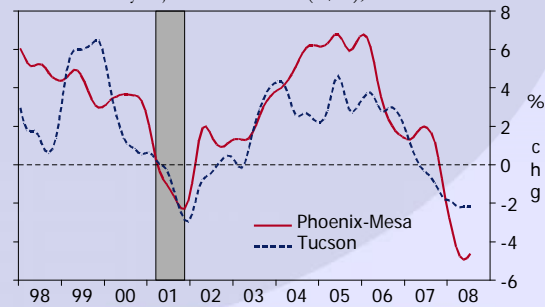


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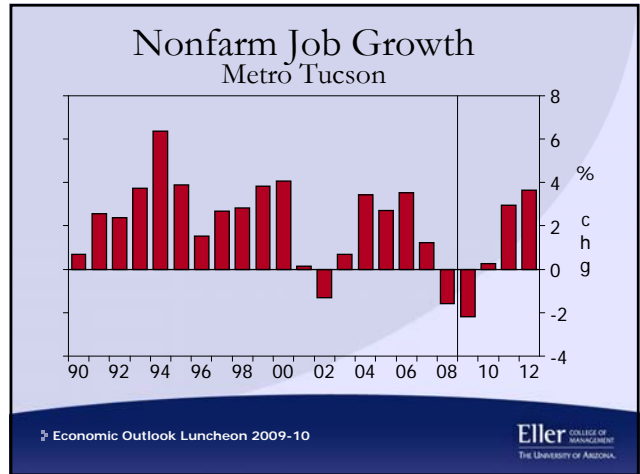
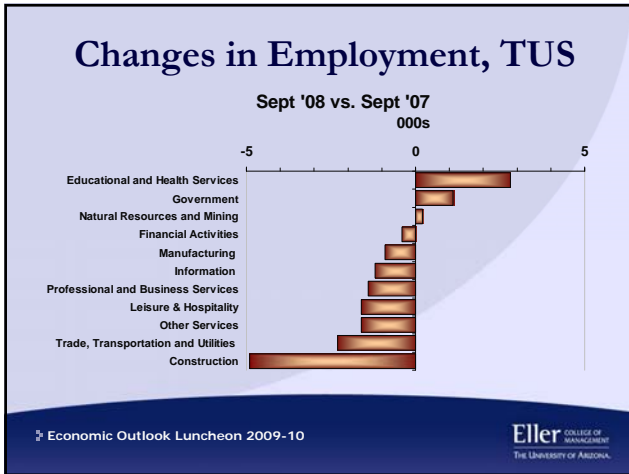
Nonfarm Job Growth

seasonally adjusted annual rate (m/m), smoothed



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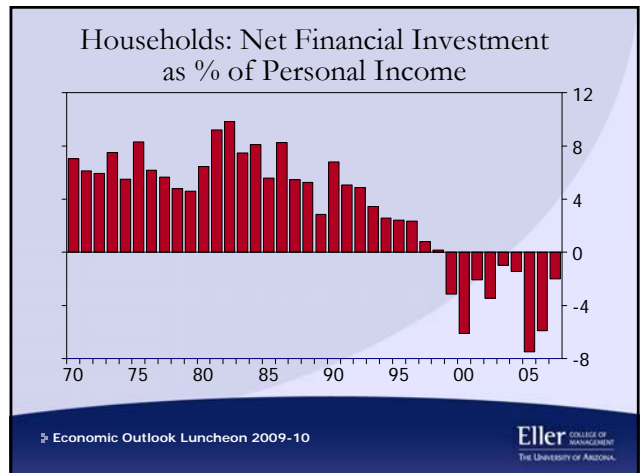
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Consumers Are In Full Retreat

- Money to support spending has disappeared
 - Tax cuts
 - Selling of huge amounts of corporate equities
 - Mortgage equity withdrawals
 - Heavy borrowing on credit cards
- Since 1999 households have been running a deficit

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Consumers Are in Full Retreat

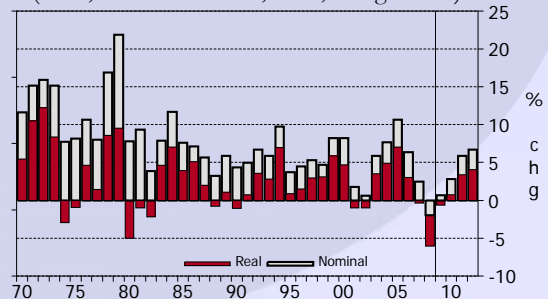
- High gasoline prices have “crowded out” other spending
- In 12 months ending August (Metro TUS)
 - Gasoline sales up 25%
 - Retail down 6.9%
 - Restaurant & bar sales down 0.6%
 - All three combined, 2.1% lower

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Retail Sales Growth, TUS

(retail, restaurant & bar, food, and gasoline)



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Housing Still in Free Fall

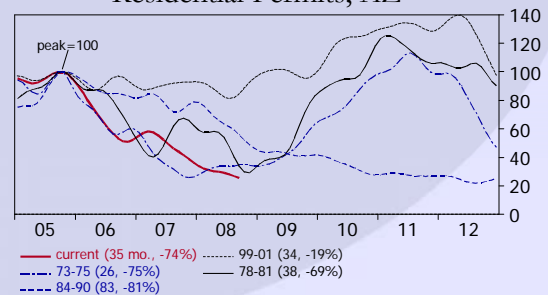
- Housing prices continue to fall (from peak)
 - NAR -9% US, -34.3% PHX, -20.5% TUS
 - FHFA/OFHEO, -4.0% US, -11.2%PHX, -5.9% TUS
 - Case-Shiller index PHX down 36.3%
- Existing home sales have bounced
 - A large portion are foreclosed properties
- Residential permits still declining
 - Down 74% from peak three years ago!
 - Bottom next year at 3,500 units

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Housing Recessions Compared

Residential Permits, AZ



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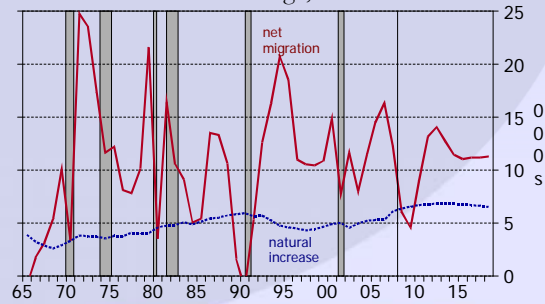
Population Growth at Decades Low

- Net migration plunged to 6,000 this year
 - 16,000 in 2006
 - 4,000 in 2009
- Natural increase continues to add 6,500 annually
- Annual growth rate drops to 1.1% next two years
 - Stays below 2.0% until 2012

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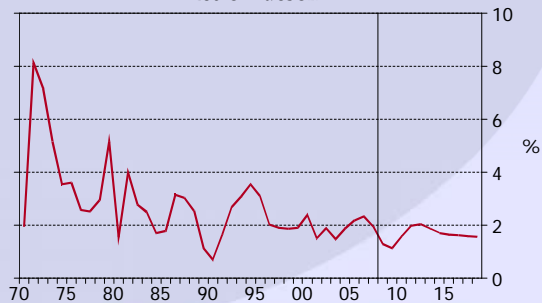
Components of Population Annual Change, TUS



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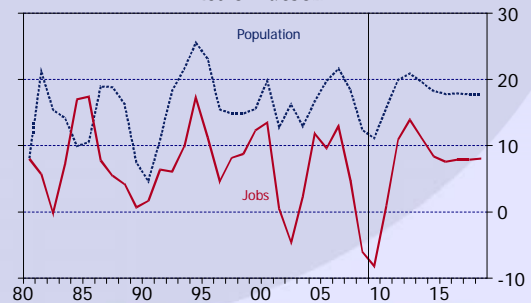
Population Growth Metro Tucson



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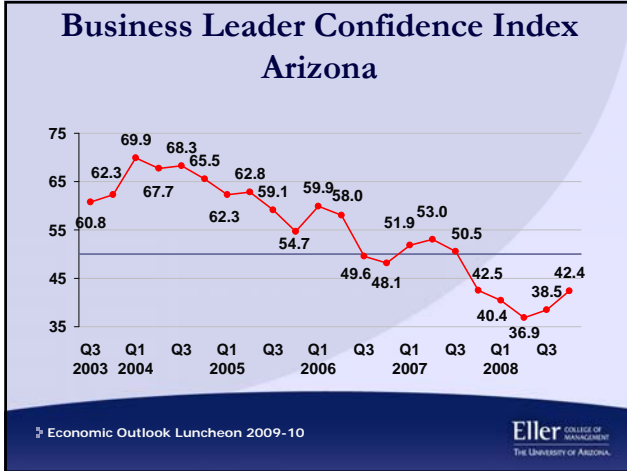
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Annual Change in Pop & Jobs Metro Tucson



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Business Confidence

- Business Leader Confidence Index for Arizona (BLCI)
 - Expectations for the 1st quarter 2009
 - Survey closes **today at 5:00 PM**
- Go to <https://www.BLCI.com> and complete our online survey

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Conclusions

- World economy is in recession that will extend well into 2009 or beyond
 - Foreclosures and bankruptcies will soar
 - Consumers spending will not lead us out of recession
 - Public sector will struggle to balance budgets
- Monetary and fiscal actions are working
- Solvency is key

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What a Difference a Year Makes!

Gerald J. Swanson, Ph.D.

Professor of Economics
Thomas R. Brown Professor
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The Core Problem

Crisis in Confidence

- Confidence in our financial institutions
- Confidence in our economy

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The Economic Backdrop

Domestic Recession
World Recession

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Unemployment

December 2007 4.7%

December 2008 6.7%

Top 8% in 2009

**We have lost two million jobs since
the beginning of the year!**

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Unemployment

State Unemployment Rates – October 2008

Michigan	9.3%
California	8.2%
Ohio	7.4%
Illinois	7.3%
Florida	7.0%
Indiana	6.4%
Arizona	6.1%
Texas	5.6%

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Inflation

Prices up 3.7%
Core inflation today 2.0%
Third Quarter CPI **-0.5%**

- **Gasoline prices down** Last year \$3.02
Today \$1.70
- **Oil prices down** Last year \$90
July peak \$147
Today \$43

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Growth

Third Quarter 2007 4.9%
Third Quarter 2008 **decrease 0.3%**

2008 officially in recession.
Deflation is on the radar.

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Balance of Payments

- Last year - Exports were the star
2007 up 13.6%
Today 2008 down \$9.9 billion in September
- Bad news - They will continue to lose their steam
- Last year - Imports were up 4.9%
Today 2008 down \$12.5 billion in September
- Bad news - Imports down because economy is down.

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Aggregate Demand

- $AD = C + I + G + X$

C = Consumption

I = Investment

G = Government Spending

X = Net Exports (exports-imports)

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Consumption Spending

Consumers heading
for the trenches.

Consumer confidence in the tank!
Consumer confidence **lowest in decades.**

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Consumer Spending

In third quarter 2008,
consumers' disposable income
fell at an annual rate of **8.7%**

**The largest drop in records
dating back to 1947.**

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Consumer Spending

Third quarter –
Personal consumption expenditure fell
at an annual rate of **-3.1%**

First three-month drop in 17 years.

Consumer spending is 70% of our
economic activity!

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Investment Spending

Businesses Have Slammed on the Breaks

- Business confidence down
- Inventories up
- New home building on hold
- Loans are difficult to get

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Government Spending

Mid-Year Stimulus had little effect!

Tax revenues are down.
Government spending is up.

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Government Spending

National deficit is at record levels – and going up.

State and local governments cutting spending.

43 states are facing budget deficits.

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Government Spending

Candidates promised:

- Lower taxes
- Another stimulus package
- More spending on infrastructure
- Aid to state and local governments
- Expanded food-stamp program
- Heating assistance
- Extended unemployment insurance
- Loan guarantees for U.S car manufactures
- Mortgages for everyone

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Government Spending

Government is there to save everyone!

- Financial firms
- Car manufacturers
- Farmers
- Home owners
- Insurance companies
- State governments

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Government Spending

U.S. Federal Government Deficit FY 2008

Actual 2008 Deficit = **\$455B** - RECORD
Initial Projection FY08 **\$305B**

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Government Spending

Deficit projection fiscal 2009 was \$490B

First two months of fiscal 2009
Deficit \$401.1 billion (not a misprint)
A World Record!

Revised – Who knows?
New estimate:
\$1 TRILLION OR MORE - FY 2009!

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Foreign Trade

Last year, dollar down against
all major currencies.

Now dollar is gaining strength.

Why?
Other major economies are in decline.

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Foreign Trade

International Monetary Fund predicts
in 2009 global per capita GDP
growth will turn negative.

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Foreign Trade

Five of the largest economies in the
world are in recessions:

US, Germany, Great Britain, France, Japan

Their troubles are spilling over to
the emerging nations.

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Monetary Policy

Is there no limit to the
amount of money the
Federal Reserve can print?

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Monetary Policy

Ben Bernanke's gun is out of bullets!

So he is now using arrows.

- To fight:
- Unemployment
 - Financial crisis

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Monetary Policy

Losses spreading beyond mortgages.

- Credit cards
- Car loans
- Commercial loans
- Student loans

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Monetary Policy

- Last Year Fed Funds Rate 4.5%
- Today Fed Funds Rate 1.0%

- It will be cut again next week
- Is 0% in our future?

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Monetary Policy

Old question:
What will the return be
on my money?

New question:
Will you return my money?

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Monetary Policy

Treasury short-term bill rate 4 week:

Last year 3.2%
Today 0.0%

26 week bill rate:

Last year 3.56%
Today 0.43%

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Monetary Policy

The Federal Reserve
has become a giant
commercial bank.

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Monetary Policy

Federal Reserve Balance Sheet
August 2008 – Total Assets
\$900 billion Government Bonds

December 2008 – Total Assets
\$476 billion Government Bonds
\$1.6 trillion Non-Government Debt

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Monetary Policy

GOOD NEWS!

Federal Reserve and Treasury Department
actions have stabilized several of the
worst-hit markets.

But markets are still out of balance.

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The Plan

Bail out plan.
Rescue plan.
Stimulus plan.
Restore confidence plan.

Step aside plan - let the market work to
determine the winners and the losers.

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The Plan

Why do we do it?
We had no choice!

Was it a good plan?
NO!

Is it working?
Barely!

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The Plan

Do we have an exit strategy for
our unprecedented monetary
and fiscal policy?

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Conclusion

It is going to get worse before it gets better!

Downturn will likely set a new post-war
record for length and depth.

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Conclusion

Unemployment will continue to increase.

Retails sales will continue to decline.

Housing market will continue to weaken.

Exports will decrease.

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Think Positively

1. It could be worse
2. We used to complain how expensive things were – 50% discount the norm
3. Great time to buy a car
4. Foreign travel is cheaper
5. Shopping for a home – make an offer

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Conclusion

Go out and shop for those wonderful bargains!

HAPPY HOLIDAYS!

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