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**
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

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

GDP Declines in Post-WW II Recessions

Duration of Post-WW II Recessions
**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
Changes in Employment, TUS

Sept '08 vs. Sept '07 000s

-5 -4 -3 -2 -1 0 1 2 3 4 5

Educational and Health Services
Government
Natural Resources and Mining
Financial Activities
Manufacturing
Information
Professional and Business Services
Leisure & Hospitality
Other Services
Trade, Transportation and Utilities
Construction

Nonfarm Job Growth
Metro Tucson

% growth

121008060402009896949290

8 6 4 2 0 -2 -4

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

Households: Net Financial Investment as % of Personal Income

12 8 4 0 -4 -8

70 75 80 85 90 95 00 05 10 05 10 0
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

Retail Sales Growth, TUS
(retail, restaurant & bar, food, and gasoline)

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

Housing Recessions Compared
Residential Permits, AZ
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

Components of Population
Annual Change, TUS

Economic Outlook Luncheon 2009-10

Population Growth
Metro Tucson

Annual Change in Pop & Jobs
Metro Tucson
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

Economic Outlook 2009/2010

The University of Arizona’s Twenty-Eighth Annual Forecast Luncheon
What a Difference a Year Makes!

Gerald J. Swanson, Ph.D.

Professor of Economics
Thomas R. Brown Professor in Economics Education
Eller College of Management

The Core Problem

Crisis in Confidence
- Confidence in our financial institutions
- Confidence in our economy

The Economic Backdrop

Domestic Recession
World Recession

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!
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%

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

Growth

Third Quarter 2007 4.9%
Third Quarter 2008 decrease 0.3%

2008 officially in recession.
Deflation is on the radar.

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.
Aggregate Demand

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

- $C =$ Consumption
- $I =$ Investment
- $G =$ Government Spending
- $X =$ Net Exports (exports-imports)

Consumption Spending

Consumers heading for the trenches.

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

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.

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!
**Investment Spending**

**Businesses Have Slammed on the Breaks**

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

**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.

**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
Government Spending
Government is there to save everyone!
- Financial firms
- Car manufacturers
- Farmers
- Home owners
- Insurance companies
- State governments

Government Spending
U.S. Federal Government Deficit FY 2008
Actual 2008 Deficit = $455B - RECORD
Initial Projection FY08 $305B

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!

Foreign Trade
Last year, dollar down against all major currencies.
Now dollar is gaining strength.
Why?
Other major economies are in decline.
Foreign Trade

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

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.

Monetary Policy

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

Monetary Policy

Ben Bernanke’s gun is out of bullets!

So he is now using arrows.

To fight:
- Unemployment
- Financial crisis
Monetary Policy
Losses spreading beyond mortgages.
- Credit cards
- Car loans
- Commercial loans
- Student loans

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?

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

New question:
Will you return my money?

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%
Monetary Policy
The Federal Reserve has become a giant commercial bank.

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

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.

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.
The Plan

Why do we do it?
We had no choice!

Was it a good plan?
NO!

Is it working?
Barely!

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

Conclusion

It is going to get worse before it gets better!

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

Unemployment will continue to increase.

Retail sales will continue to decline.

Housing market will continue to weaken.

Exports will decrease.
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

Conclusion
Go out and shop for those wonderful bargains!

HAPPY HOLIDAYS!