

Economic Outlook for the U.S. and Tennessee

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

Economic Outlook

- Situation and outlook for the national economy
- Situation and outlook for Tennessee

National Situation

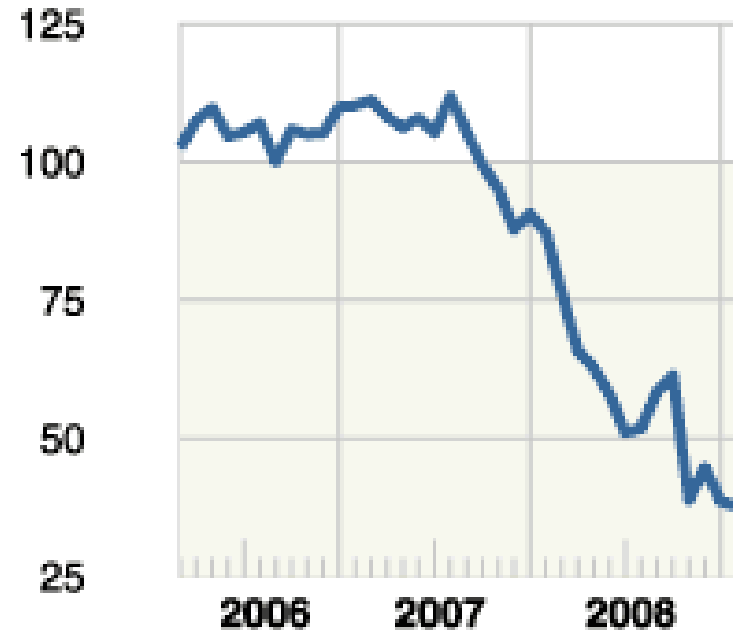
- The U.S. economy is on the ropes.
- Very serious downturn
 - Current unemployment rate 7.6% in Jan 2009.
 - Up one full point during previous three months.
 - Up two percentage points from June 2008.
- Consumer confidence at an all-time low and dropping.
- Manufacturer confidence still shows contraction,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

CONSUMER CONFIDENCE

Index stood at 100 in 1985, its base year



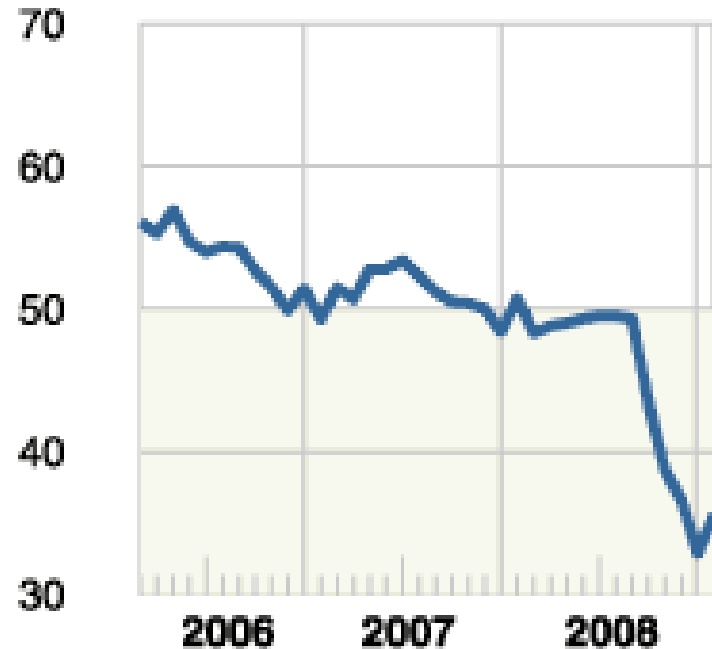
Source: Conference Board

Manufacturer confidence

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

PURCHASING MANAGERS' INDEX

Reading above 50 indicates expansion in manufacturing activity



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.

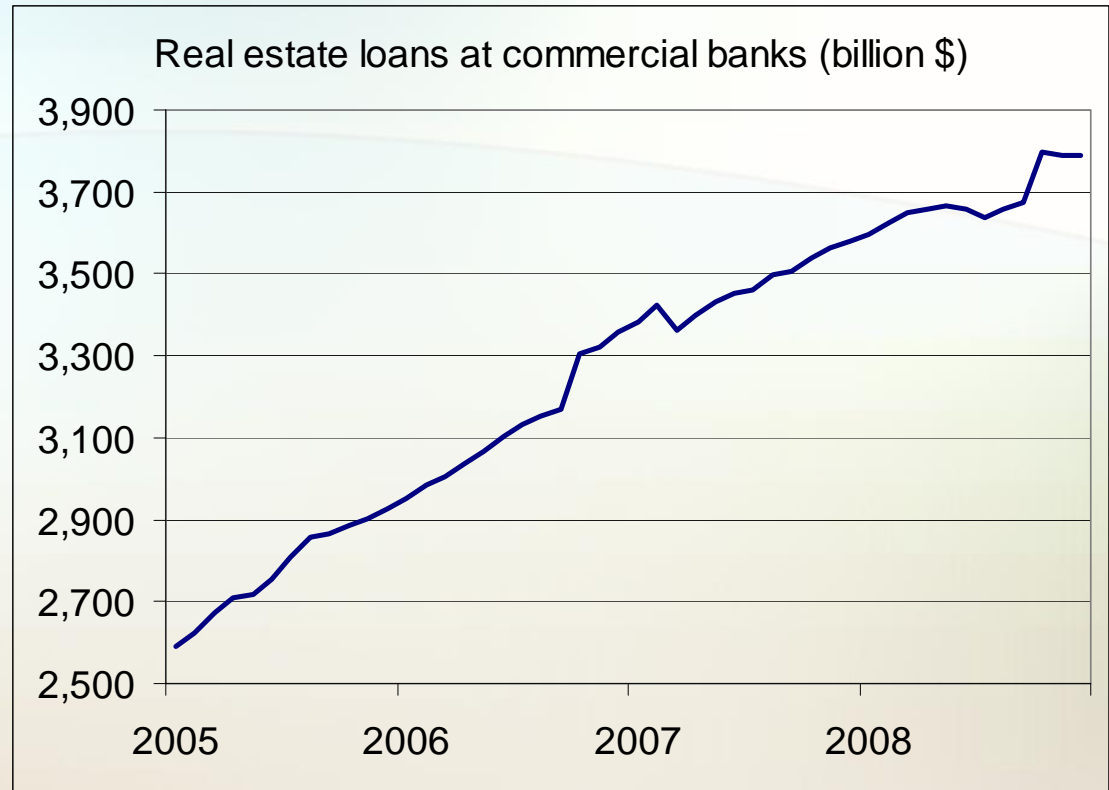


Credit Scarce

- 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.
- 2006-2008, loan securitization dropped by \$1.2 trillion.

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 (stimulus), and
 - Structural policy.

Monetary Policy (Federal Reserve)

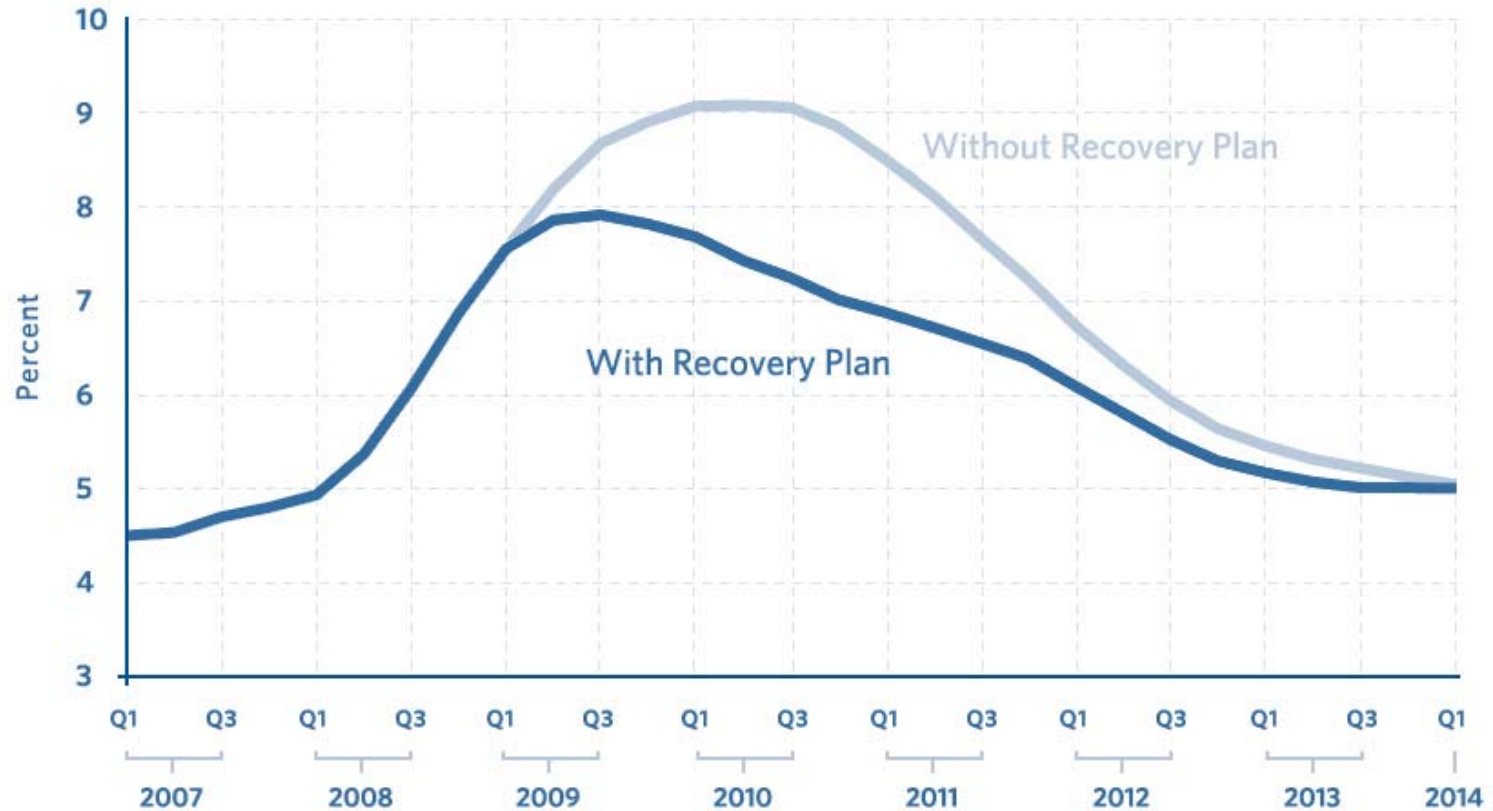
- Liquidity
 - Fed funds rate at 0%.
- Credit
 - Purchasing commercial paper, backing up money market funds.
 - New facility that will lend against high-quality asset back securities (auto loans, student loans, credit cards), restart consumer credit market (TALF).
- Purchase of long-term securities
 - Will purchase \$100 billion Fannie Mae, Freddie Mac debt.
 - Later will purchase \$500 billion guaranteed debt.
 - Should help hold the line on mortgage rates.

Fiscal Policy (stimulus)

- 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

Figure 1
Unemployment Rate With and Without the Recovery Plan



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

Structural policy

- Treasury announced outlines of financial plan last week.
 - Bank stress test
- Obama administration mortgage/foreclosure component this week.

Structural policy

- Administration has announced it will do what is necessary to keep bank system running.
 - Nationalization of large banks?
 - Public already has a stake in the largest banks.
 - May help to move bad assets off the books.
- Period of financial triage is upon us.
 - GM, Chrysler, tire manufacturers, auto parts manufacturers.
 - Picking winners and losers in banking.

Will it be enough?

- Policy needs to pack enough punch to move the economy to the top of the hill.
- Powell Doctrine applied to the economy: go in with overwhelming force.
- Timidity will prolong the downturn.
- Forceful policy needed to revive 'Animal spirits'.



Negatives

- Very poor household confidence
- Very poor business confidence
- Banks still carrying lots of bad assets.
- Deflation may be around the corner.
 - Nightmare for the Federal Reserve.
 - Recurring cycle hard to stop once started.
- Inflation is a medium-term issue (2-3 years out).
- Longer-term issue of crowding out, government debt.

On balance

- Housing market faces 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

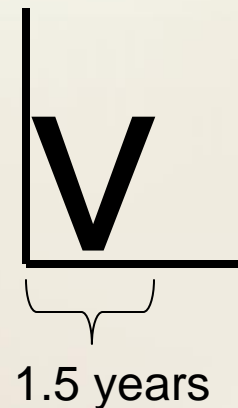
- The economy will recover. But when?
- And what does *recovery* mean?
 - Regaining the previous peak?
 - Better than last year?
 - Better than last quarter?
 - Gradual improvement?
- Which sectors will improve first?

Recovery

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

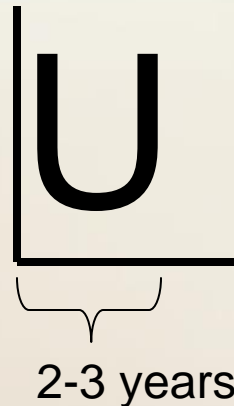
V-Shaped Recovery

- Very sharp decline, followed by a very sharp recovery.
- Most recently occurred in the short 1980 recession.
- Employment falls rapidly, hits bottom, then quickly bounces up.
- Technical inventory recession.



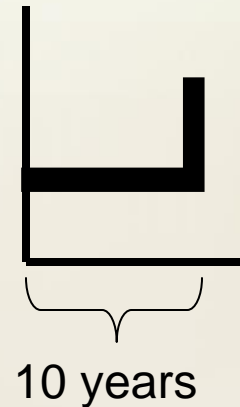
U-Shaped Recovery

- 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.



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 ↑

Tennessee Overview

- Bad news:
 - Negative trends accelerating for most indicators.
 - No bottom yet in sight (for any indicator).
- Good news:
 - You are not in Florida, California, Arizona, Ohio, Michigan, North Carolina, Georgia, South Carolina, or Nevada.

Tennessee Overview

- **Economic indicators**
 - Nonfarm employment: shrinking very rapidly
 - Peaked in December 2007 (2,806,800).
 - Down 64,100 Dec 07-08 (-2.3%).
 - Down 39,800 Sep-Dec 08 (-5.6% annualized).
 - Unemployment rate: on the rise
 - December 2008: 7.9%
 - December 2007: 5.0%
 - 241,000 unemployed, up 90,000 over the year.

Housing Market Report

- Quarterly report for the Tennessee Housing Development Agency.
- Available at www.mtsu.edu/~berc



Tennessee Housing Market

4th quarter 2008

Business and Economic Research Center • David A. Pann, Director • Jennings A. Jones College of Business • Middle Tennessee State University

This quarterly Tennessee housing market report series is supported by a Tennessee Housing Development Agency grant.

Fourth Quarter Economic Overview

Economic conditions in Tennessee continued to deteriorate in the fourth quarter, with just about all major economic indicators shifting more negative in dramatic fashion. For example, total nonfarm employment fell 0.9% from the previous quarter,¹ the sharpest percentage decline since the first quarter of 1982. Most of the jobs lost (65%) occurred in the services-providing sectors, with losses spread throughout every major sector except education and health services. Although losses in manufacturing employment continue, the decline is not as large as experienced during the mild 2001 recession. By sector, seasonally adjusted job losses from the previous quarter include manufacturing (7,700), retail trade (6,000), professional and business services (5,000), transportation and warehousing (2,900), and local government educational services (1,600). These five sectors represent 90% of the net job loss for Tennessee.

1. A quarterly loss of 0.9% is equivalent to an annualized 3.6% rate of decline.

The unemployment rate rose during the fourth quarter to 7.3%, up from 6.9% in the previous quarter. A larger increase was expected; in fact, the fourth quarter increase of 0.4 percentage points was less than half the rise during the previous two quarters. Part of the reason is the fact that some unemployed workers are dropping out of the labor force because they either have become discouraged about finding work or are waiting for the job market to improve. In any event, fewer adults are working or pursuing work, causing the labor force to fall 19,000 from the peak in the second quarter of 2008.

Housing Construction

Single-family construction suffered a severe decline in the fourth quarter, falling to an annual rate of 9,800 permits issued, down 37% from the third quarter and 56% over the year. As shown in Table 2, the South and the U.S. also experienced large declines but not as large proportionally as Tennessee.

Permits issued for multi-family housing offer a modest degree of stability for Tennessee. Multi-family housing regained considerable ground in the third quarter and is down relatively

Table 1. Selected Tennessee employment indicators (in thousands, seasonally adjusted)

	2007.4	2008.1	2008.2	2008.3	2008.4
Employment by Industry (nonfarm)					
Total nonfarm	2,883	2,797	2,765	2,785	2,768
Goods-producing sectors	516	512	508	506	498
Manufacturing	277	274	271	269	261
Services-providing sectors	2,287	2,284	2,276	2,279	2,262
Unemployed	132	168	188	209	221
Total employment	2,901	2,896	2,873	2,831	2,817
Labor force	3,854	3,857	3,858	3,898	3,899
Unemployment rate (%)	5.0	5.2	6.1	6.9	7.3

Source: Bureau of Labor Statistics

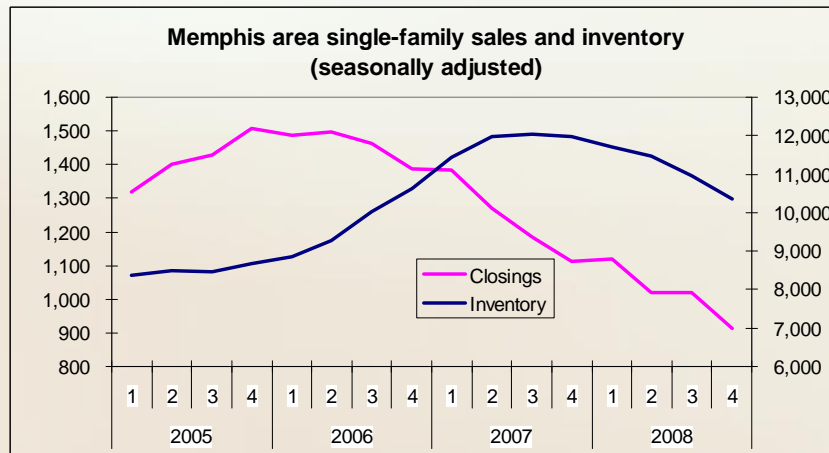
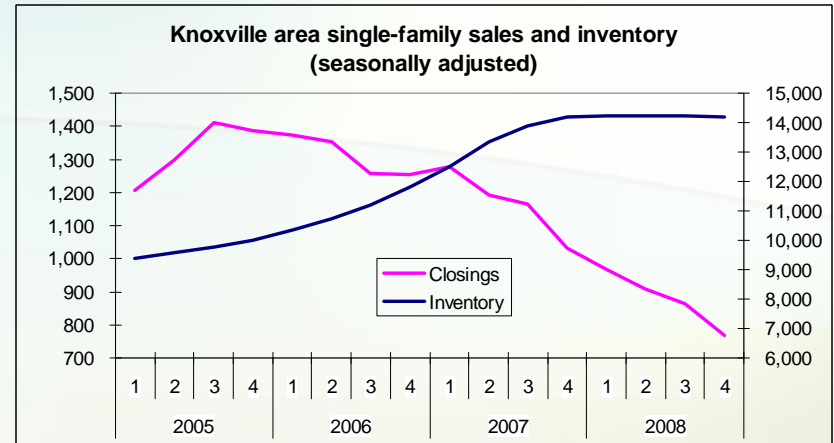
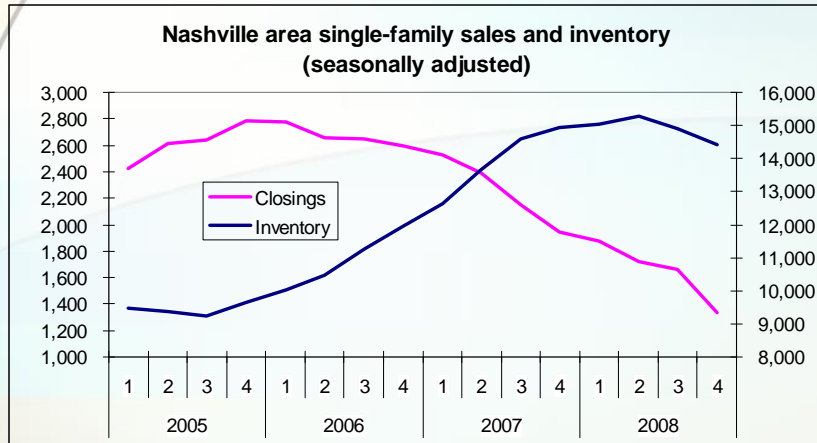
Table 2. Permits issued for privately owned new housing, seasonally adjusted annual rate (in thousands)

Quarter	Single-Family Permits			Multi-Family Permits			Total Permits		
	Tennessee	South	U.S.	Tennessee	South	U.S.	Tennessee	South	U.S.
2007.1	33.2	588.3	1,130.3	6.5	193.3	450.7	39.7	781.7	1,581.0
2007.2	29.6	548.7	1,022.5	7.8	202.8	429.8	38.6	751.5	1,481.3
2007.3	27.4	482.0	931.7	6.4	172.0	403.7	33.8	654.0	1,335.3
2007.4	22.2	389.7	764.8	8.1	169.7	398.0	31.3	559.5	1,168.8
2008.1	18.1	351.7	647.3	5.4	163.3	341.0	23.5	515.0	988.3
2008.2	17.6	331.7	633.5	3.3	141.8	309.5	20.9	473.5	1,002.7
2008.3	15.5	288.7	558.3	5.9	157.3	308.0	21.5	446.0	866.3
2008.4	9.8	213.7	418.8	8.3	108.7	216.7	15.2	314.3	628.7
Change from previous quarter	-37.2%	-26.0%	-25.5%	-7.7%	-36.0%	-30.3%	-29.1%	-29.5%	-27.3%
Change from previous year	-38.1%	-44.9%	-48.3%	-28.9%	-68.7%	-48.8%	-51.4%	-68.8%	-48.6%

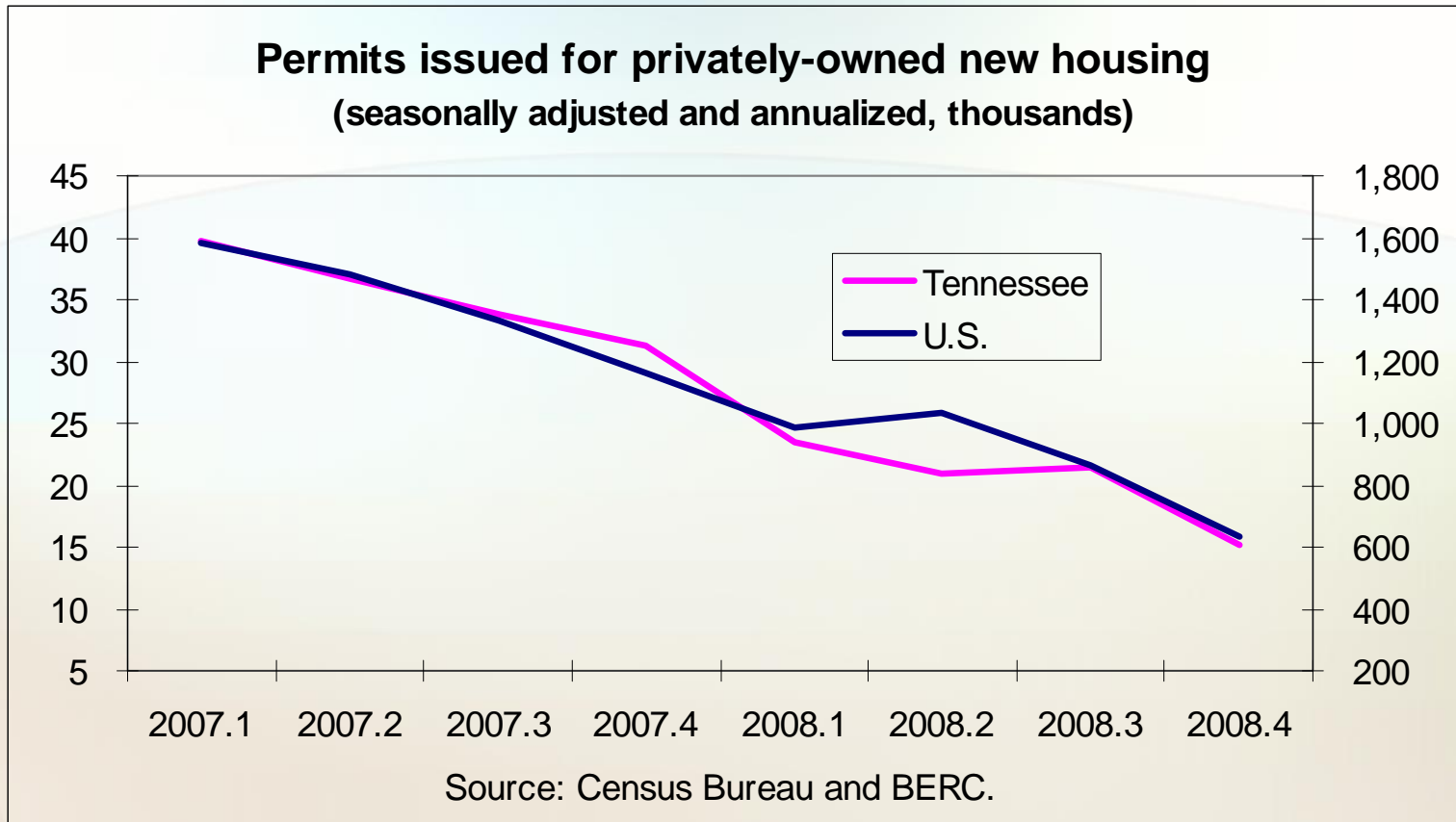
Source: Census Bureau and BEA

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MSA single-family sales and inventory



No bottom yet for housing construction



New foreclosures (RealtyTrac)

- United States: new foreclosures for January 2009 down 10% from December, but remain 18% higher over the year.
- Tennessee: new foreclosures down 5.7% from December and down 13.6% over the year.
- Cause: extensive foreclosure efforts on the part of lenders and government agencies, particularly the Fannie Mae and Freddie Mac moratorium on all foreclosure sales through the end of January.

New foreclosures (RealtyTrac)

- Tennessee had one foreclosure per 744 households, compared with one for 466 households for the United States.
- Tennessee's foreclosure rate in January is 18th highest.

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.

Stimulus in Tennessee

- State estimated to receive \$4.28 billion over the next two years.
- Includes \$593 million for highways and bridges.
- Package expected to create/save 71,000 jobs in Tennessee 2009-2010.
- 11,000 jobs from highway and bridge construction alone (BERC estimate).

Outlook

- Tennessee nonfarm employment trend:
 - 2009: -2.9% (-81,000)
 - 2010: -2.3% (-61,000)
- Factoring in estimated stimulus impact (BERC estimate):
 - 2009: -1.9% (-52,000)
 - 2010: -0.7% (-19,000)

Note: the impact of the stimulus is estimated to create or save 71,000 jobs for Tennessee; we assume 40% of the impact occurs in 2009 with the remainder in 2010.

Uncertainty

- Negative momentum will create more job losses.
- Significant uncertainty regarding the impact and timing of the fiscal stimulus.
- Uncertainty much more downside than upside.

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.