

# Economic Outlook

## 2010/2011

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

Economic Outlook Luncheon 2010-11




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## Overview

- National outlook
  - Recession is over, but slow recovery
- Arizona still contracting
  - Will lag behind U.S. during recovery
- 3 keys to the outlook
  - Labor markets
  - Housing markets
  - Crisis in state government


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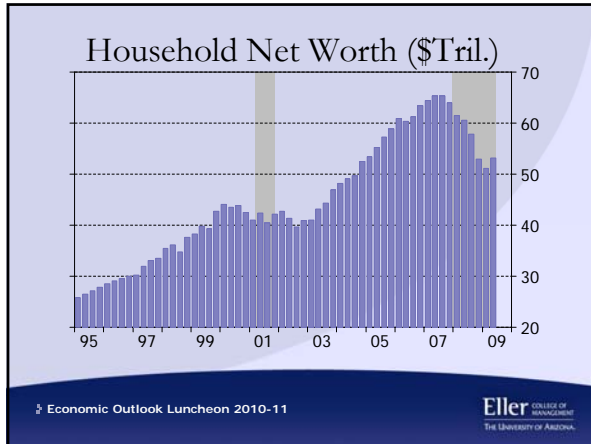


## National Outlook

- Recovery will be slow
  - Deep recessions normally followed by strong recoveries, BUT recessions involving financial crisis are typically slow to recover
  - Dampened by constrained credit markets and poor fundamentals for consumer spending
  - Credit markets require more time to heal
  - Consumers are weary
    - Consumption won't be a driver
    - Household net worth has declined by \$14 trill.

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### Arizona's Economy

- The hardest hit state?
  - Job growth ranking = 50<sup>th</sup>
  - Personal income growth = 41<sup>st</sup>
  - State revenue growth = 43<sup>rd</sup>
  - Fiscal peril – second only to California as worst
  - Residential foreclosures = 4<sup>th</sup>
  - Homeowners with negative equity = 2<sup>nd</sup>

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### Job Growth thru October 2009

rank	state	% change vs year ago
50	Arizona	-6.8%
49	Michigan	-6.3%
48	Nevada	-6.0%
45	Oregon	-5.2%
44	Idaho	-5.2%
40	California	-4.6%
35	Florida	-4.4%
33	Colorado	-4.3%
26	Utah	-3.8%

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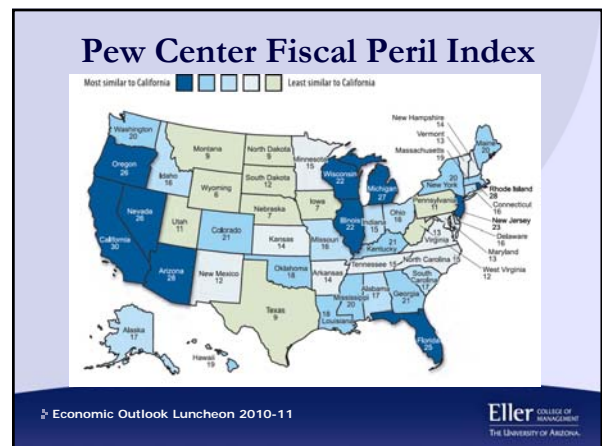
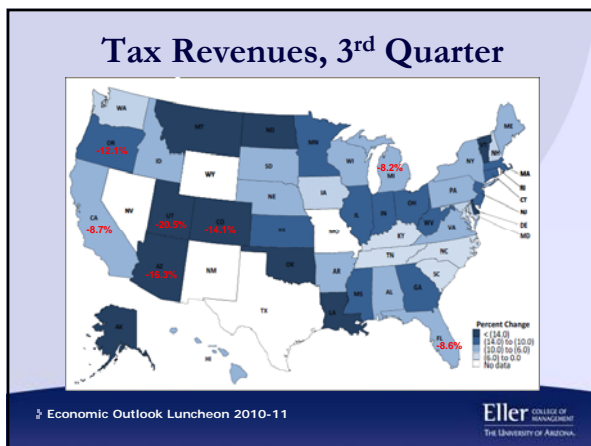
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### Personal Income Growth thru 2q09

rank	state	% change vs year ago
50	Nevada	-5.4%
46	Florida	-3.7%
45	Michigan	-3.6%
44	Idaho	-3.4%
41	Arizona	-3.3%
40	California	-3.3%
33	Utah	-2.7%
31	Colorado	-2.5%
15	Oregon	-1.4%

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### Residential Foreclosures 3q09

rank	state	1 for every X homes
1	Nevada	80
2	California	156
3	Florida	168
4	Arizona	200
5	Idaho	255
7	Michigan	275
10	Utah	385
11	Colorado	421
16	Oregon	509

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### Proportion of Homeowners With Negative Equity 3q09

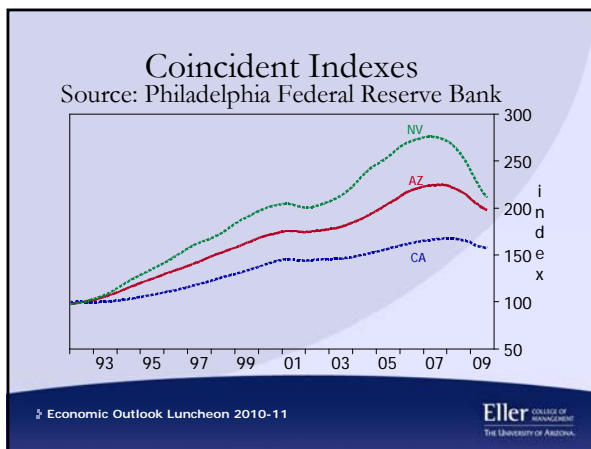
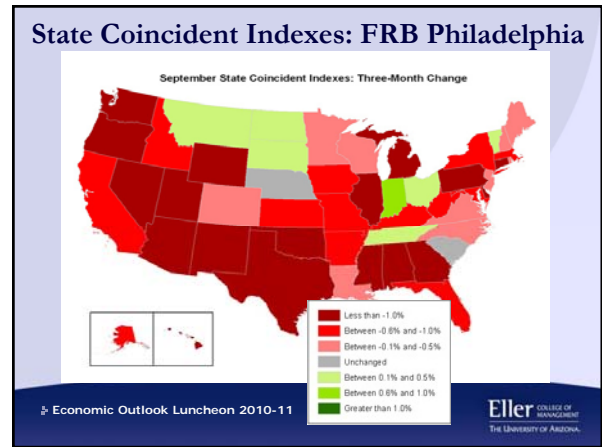
rank	state	Negative equity share (%)
1	Nevada	65.0%
2	Arizona	47.9%
3	Florida	44.7%
4	Michigan	37.3%
5	California	34.7%
10	Idaho	19.7%
11	Colorado	19.0%
14	Utah	18.3%
23	Oregon	13.8%

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### Arizona's Economy

- The recession continues
  - Federal Reserve Bank of Philadelphia's state coincidence index
    - Based on
      - nonfarm employment
      - average hours worked in manufacturing
      - Unemployment rate
      - Inflation adjusted wage and salary disbursements
    - AZ one of 18 states with losses greater than 1% during three months ending September

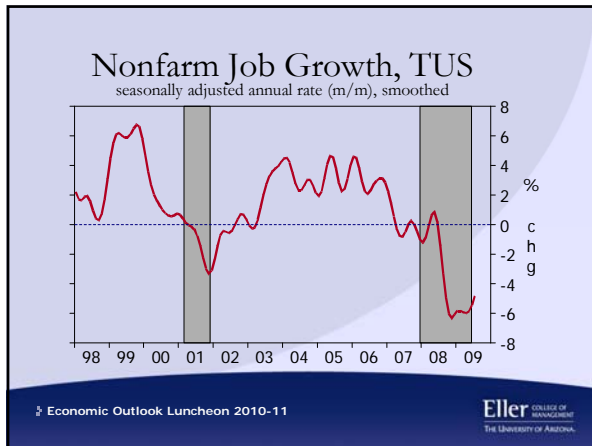
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### Metro Tucson's Economy

- Nonfarm employment peaked in March 2007
  - 26,000 jobs have disappeared, 6.7%
    - Statewide 275,000, 10.3%
- Still declining at 4-5% annual rate in Sept.

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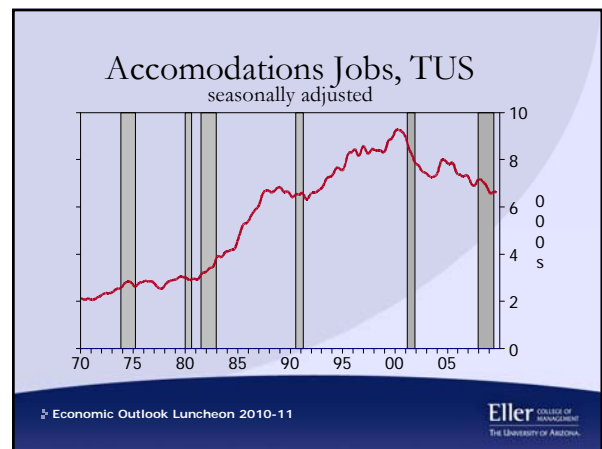
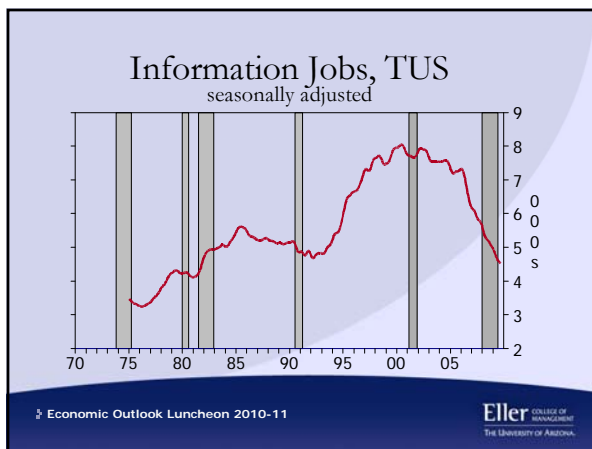
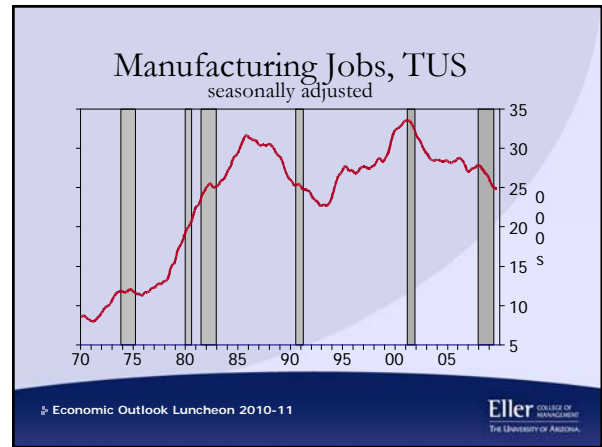
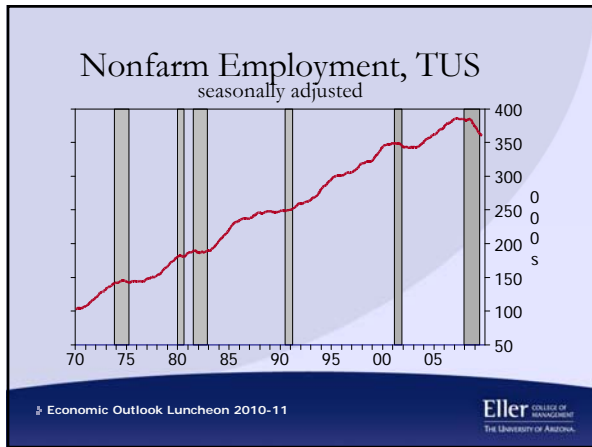


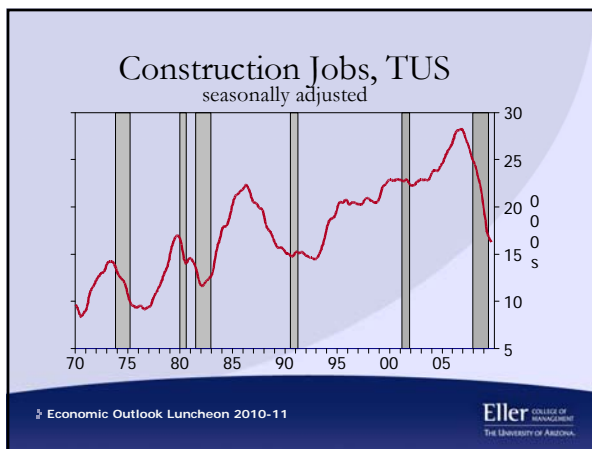
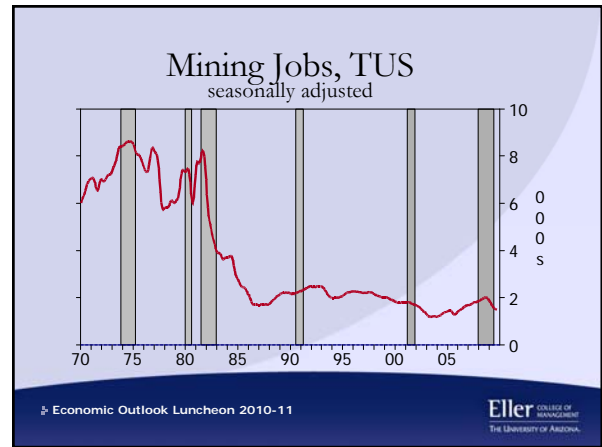
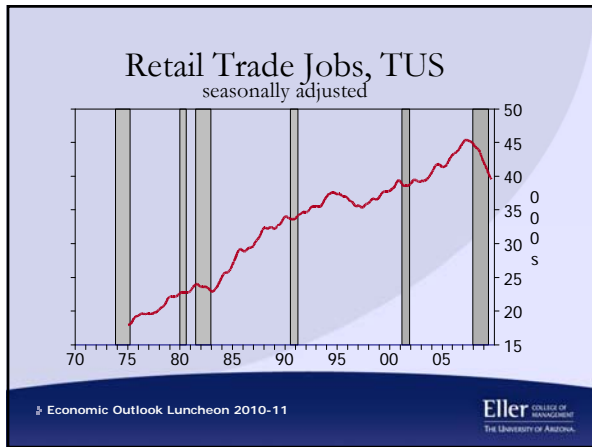
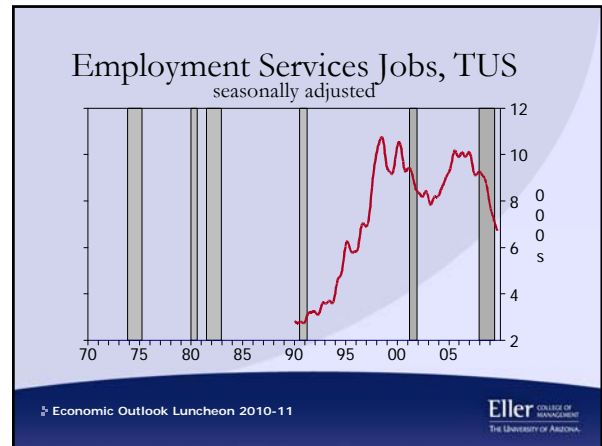
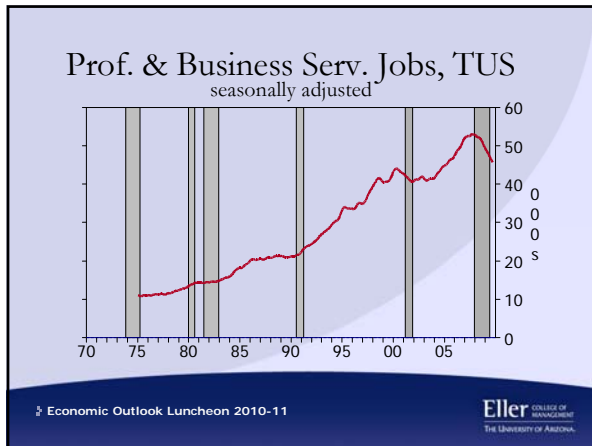
### Metro Tucson's Economy

- Job losses are widespread
  - All sectors but health services are shedding jobs
  - Some categories have fallen to mid-1990 levels

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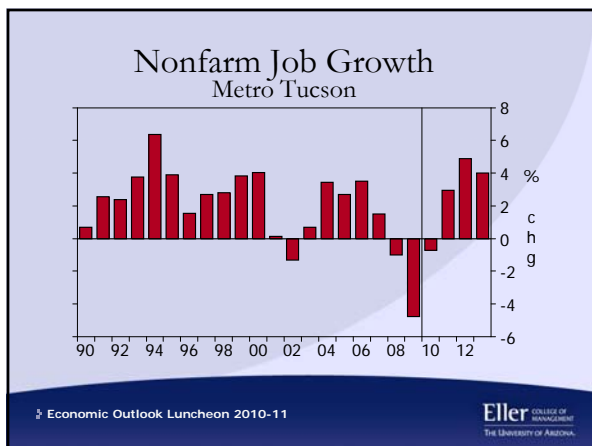
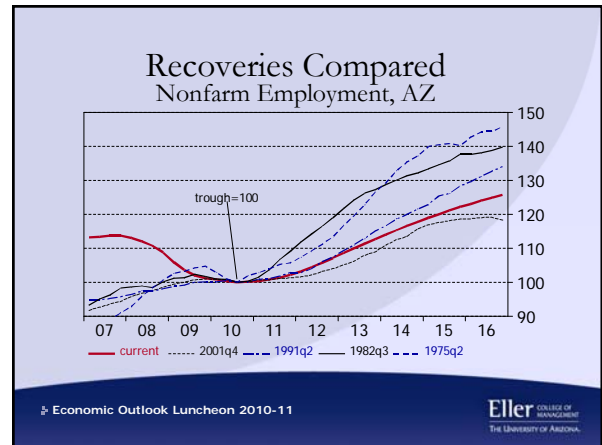
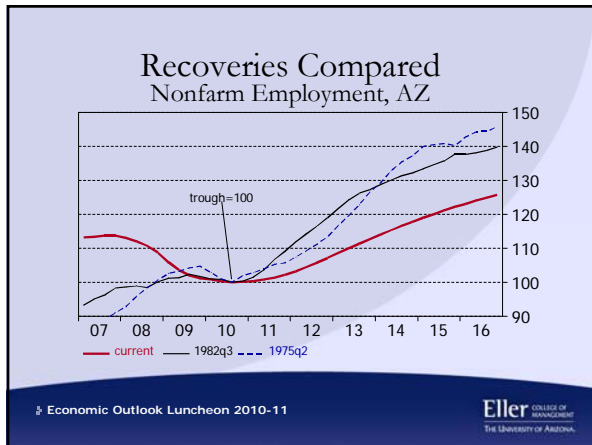
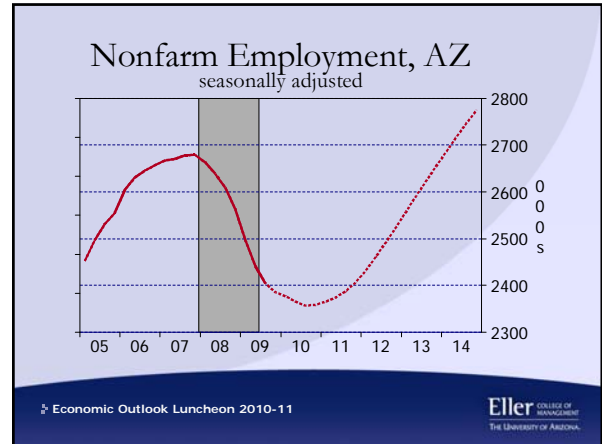
### Industry Employment During the Recession Metro Tucson

	chg 000's	since peak percent	peak month	lead (lag) # months
Nonfarm	-26.0	-6.7%	Mar. 07	-
Construction	-12.0	-42.3%	Nov. 06	4
Professional & Business Serv.	-7.4	-13.9%	Oct. 07	(7)
Trade, Transportation & Util.	-7.4	-11.4%	May 07	(2)
Manufacturing	-2.9	-10.5%	Dec. 07	(9)
Information	-2.8	-38.3%	Jan. 06	14
Government	-2.4	-2.9%	Sep. 08	(17)
Financial Services	-2.0	-10.5%	Mar 07	0
Leisure & Hospitality	-1.9	-4.7%	Sep. 06	6
Other Services	-0.6	-3.9%	Apr. 06	11
Mining	-0.5	-26.4%	Aug. 08	(17)
Health Services & Private Ed.	4.4	8.0%	still growing	(33)

### Outlook for Jobs

- When will nonfarm employment begin to recover?
- How long will it take to regain all the jobs lost?



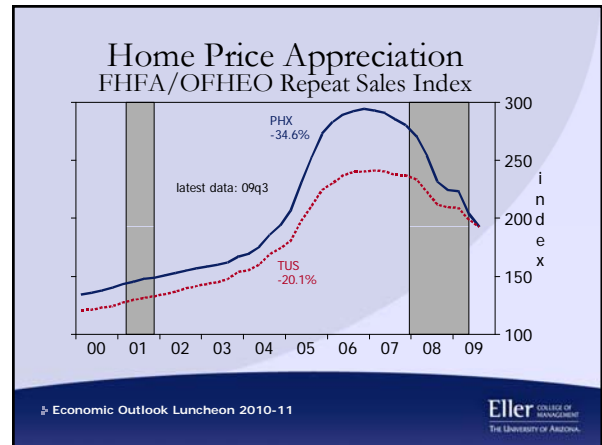
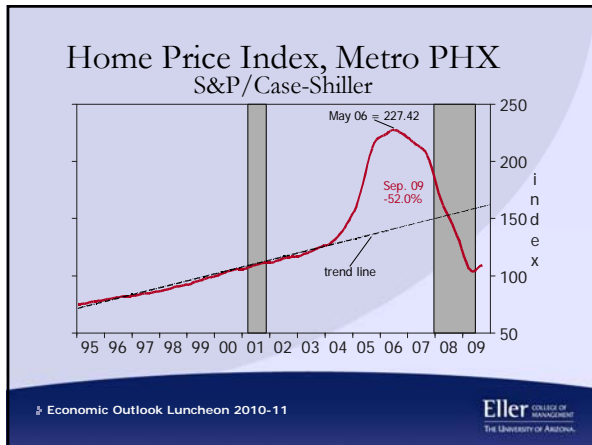
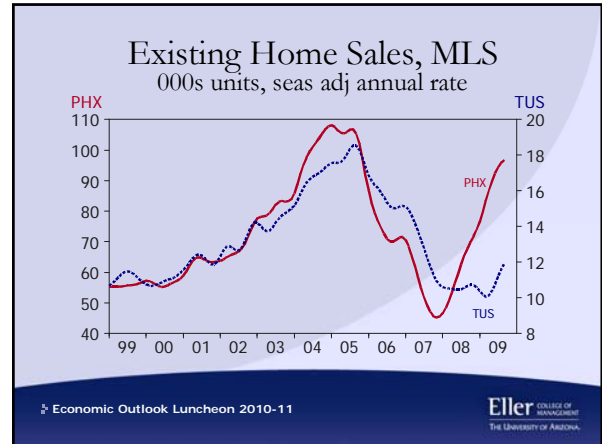
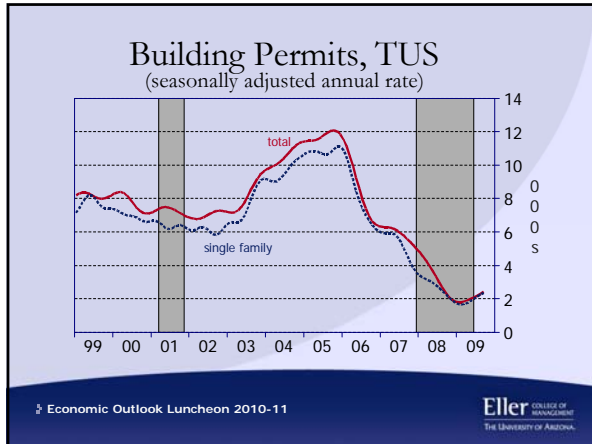


### Consumer Spending Brightens

- Retail sales has bottomed out  
– Expect modest increases in 2010





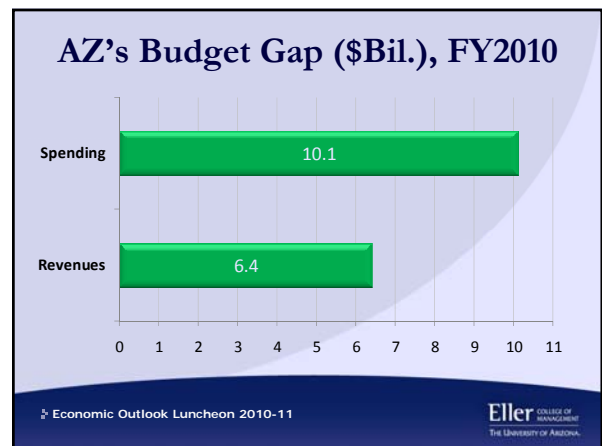


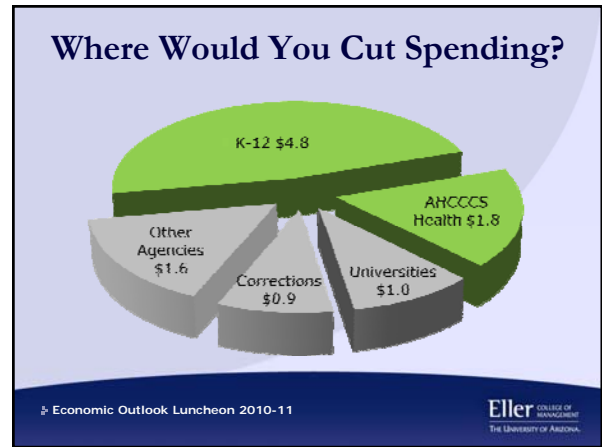
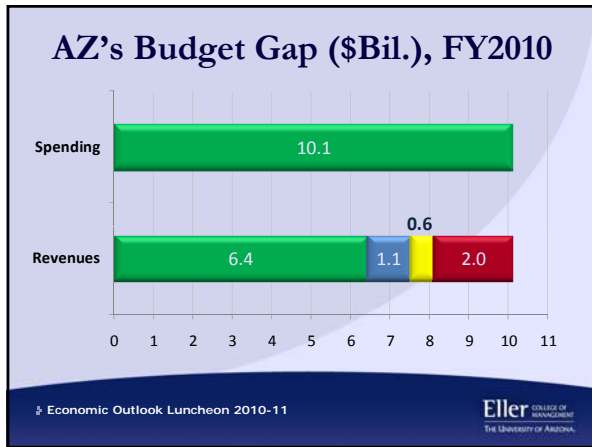
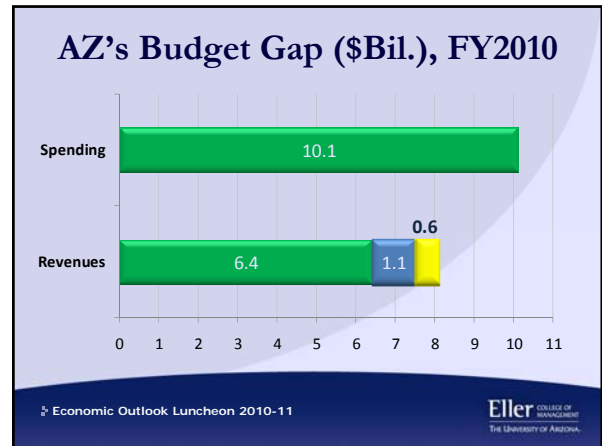
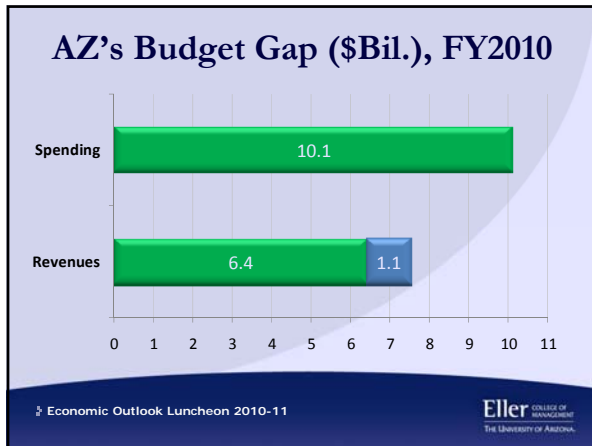
### Crisis in AZ State Government

- AZ is facing one of the largest budget gaps in the nation
  - Currently about 20%
- Increases in spending
  - New “safety net” programs
  - Voter mandated
- Permanent tax cuts since mid-90s based on transitory revenue = \$2.6 billion annually
  - Better choice: budget stabilization fund

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### Crisis in AZ State Government

- Arizona Town Hall findings (November)
  - “An immediate, temporary revenue-raising response is imperative”
  - “Developed economies, as in Arizona, must rely on innovation and technological progress in order to maintain economic growth. Education and research and development are keys, while cost factors, including tax burden, are of lesser importance to economic development.”

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### Crisis in AZ State Government

- But you can't raise taxes without hurting the economy!
- Arizona Town Hall
  - “State and local government taxes have only a small effect on economic growth”
  - “Tax reductions boost economic growth only when the burden is high”
  - Tax cuts simply lower revenues

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### Crisis in AZ State Government

- Arizona Town Hall findings (November)
  - Tax burden in AZ is low and declining
    - “Compared to the size of the Arizona economy, ongoing general fund revenue has fallen since the early 1990s, and is now the lowest on record.”
  - State and local government revenue ranks
    - 50<sup>th</sup> on a per person basis
    - 39<sup>th</sup> on a per dollar of personal income basis

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### Crisis in AZ State Government

- Arizona Town Hall findings (November)
  - Obstacles to closing the gap
    - Voter mandated spending without funding
    - Mismanagement of tax base
    - Ideological roadblocks
    - Super-majority required to raise taxes

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### Crisis in AZ State Government

- Solutions
  - Additional spending cuts
    - Over the past couple of years, largest spending cuts in history have been enacted totaling \$1.1 Billion
  - layoffs, shuttering agencies
    - You could lay off all state employees and not begin to close the gap
    - Eliminate all but K-12 and AHCCCS?

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### Crisis in AZ State Government

- Solutions
  - Referendum on temporary sales tax increase?
  - Borrowing
  - Issue IOUs
  - ?

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### Near Term Outlook

- Recovery will proceed slowly
  - Residential foreclosures and high inventories
  - State & local government spending
  - Commercial real estate construction
  - Weak consumer spending
- Unemployment will top 10% (AZ) in 1<sup>st</sup> quarter
  - retreat slowly, 2014 before dips below 6%
  - Metro Tucson's rate runs 1% lower
- Nonfarm payrolls will bottom in 3<sup>rd</sup> quarter 2010
- Public sector shrink through 2011, lag behind

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### Near Term Outlook

- Retail sales will increase by 4.1% in 2010
  - Double-digit increases in 2011
    - primarily replacement demand
    - frugality is “in”
- 2010 Census of Population will find
  - Metro Tucson 1.035 million
  - Metro Phoenix 4.4 million
  - AZ 6.6 million people

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### Near Term Outlook

- Construction industry will continue to shed jobs
  - Dip below 16,500 in 2010 (27,900 in 2006)
- Homebuilding has turned the corner but there is little upside potential until 2011-12
  - At least 25,000 vacant homes currently
- Commercial real estate still in early stages of down cycle, foreclosures lie ahead

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### Near Term Outlook

- BAD NEWS: a long way to go to repair extensive damage that's been done
- GOOD NEWS: the "Great Recession" is coming to an end and healing will begin soon

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## Economic Outlook

### 2010/2011

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### State of the Economy

## Gerald J. Swanson, Ph.D.

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

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### The Economic Backdrop

## "The Great Recession"

### Why?

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### Unemployment

December 2007	4.7%
November 2009	10.0%

High unemployment will continue through next year.  
Currently over 15.4 million unemployed.

We lost 7.8 million job since the recession started.  
*The most since 1945!*

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### Unemployment

Includes Discouraged Workers  
Workers Forced to Work Part-Time.

Estimated Unemployment Rate = 17.5%

Average work week has fallen to 33 hours.

Does not include those people who are working below their skill level.

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### Unemployment "MANCESSION"

There is still a gender gap.

Unemployment rate


November 2008	November 2009
Men 6.9%	Men 10.4%
Women 5.9%	Women 8.2%

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### Unemployment

#### Problems

- This high unemployment is largely structural rather than cyclical.
- Many of the jobs are gone forever.

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### Inflation

October 2009


All item 0.1%

Core 0.3%

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### Inflation

	Today	Year ago	%change
Oil	\$74.00	\$39.00	90%
Gold	\$1149.00	\$769.00	49%
Silver	\$18.00	\$9.85	83%
Platinum	\$1439.00	\$807.00	78%

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### Growth

**GOOD NEWS!**

Third quarter GDP was +3.5%

REVISED now +2.8

Projected fourth quarter GDP +2.2%

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## Productivity

**GOOD NEWS!**

Productivity 2 <sup>nd</sup> Quarter 2009	+6.1%
Unit Labor Cost	-0.3%
Productivity 3 <sup>rd</sup> Quarter 2009	+13.4%
Unit Labor Cost	-6.1%

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## Consumption

Consumer confidence still low

Declined in September

- Consumption -0.6%

Increase in October

- Consumption +0.7%

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## Consumption

Consumers are saving.  
October 2009 4.4%

Consumers are paying down debt at a record pace.  
**18 straight months of declining credit balances.**

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## Investment Spending

- Business confidence low but improving.
- **Inventories are a bright spot.**
- New home building showing signs of life.
- Loans are still difficult to get.

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## Investment Spending

Manufacturing capacity utilization  
October 2009 70.7%

Slowly Improving!  
81% Normal

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## Government Spending

Deficit projection fiscal 2009 was \$490B.

**Actual FY 2009**  
**\$1.4 TRILLION!**

**Projected FY 2010**  
**\$1.5 TRILLION**

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## Deficits and Unfunded Liabilities

“Everyone wants to go to heaven,  
but nobody wants to die!”

-- Songwriters Dorsey & Thomas

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## Government Spending

- Deficit for fiscal 2009 = **10.0%** of GDP
- **3%** of GDP is normally considered safe

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## Monetary Policy

### FEDERAL RESERVE UNDER ATTACK!

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## Monetary Policy

### Mortgage Defaults Will Continue.

More resets to come: \$1.1 trillion in the next 3 years.

We will continue to have record rates of home vacancies for the next year.

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## Monetary Policy

- Our next big problem will be commercial real estate.
- There are \$1.7 trillion of commercial loans on banks books currently.
- Between now and 2012, \$1.4 trillion worth of commercial loans will come due.

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## Monetary Policy

Last Year Fed Funds Rate	0.09%
Today Fed Funds Rate	0.12%

Some banks appear to be stabilizing...

**However:**  
129 have failed in 2009.  
416 banks on probation.

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### Monetary Policy

The Federal Reserve's Balance Sheet has Exploded!

August 2007      \$800 billion  
November 2009   \$2.1 trillion

**BONUS QUESTION**  
Where does the FED get the money to buy these assets?

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### Monetary Policy

**Political Risks**

- Next year is an election year.
- Loss of policy independence.

**Economic Risks**

- Fed waits too long to increase interest rates.  
-- or --
- Increases rates too soon and stalls recovery.

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### Fiscal Policy

**Political Risks**

- Next year is an election year.

**Economic Risks**

- Deficits are not controlled.

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### FACT

A real recovery depends on government demand being supplemented by sustainable sources of private spending.

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### Too Big to Fail

**What does it mean?**

- Private profits and public loses.  
-- or --
- Heads I win, tails you lose.

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### Too Big to Fail

Capitalism without losses is like religion without sins.

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## We Have a Big Overhang of Uncertainty.

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## Uncertainty

- What policies will finally come out of Washington?
- What will happen next in our two wars?
- When will the economy again function without major government intervention?
- When will the state economies start to improve?

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## Possible Barriers to Recovery

1. Consumer
2. Unemployment
3. Households balance sheets
4. State and local governments
5. Tight credit
6. Slow growth
7. Excess capacity
8. Stimulus does not work

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## What Have We Learned?

- Things that can't go on forever eventually stop.
- Houses are not liquid assets.
- Homes are not ATM machines.
- Markets are not always efficient.
- The great moderation of business cycle never happened.

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## What Have We Learned?

- Monetary policy does not always work the way the textbook states it should work.
- John Maynard Keynes is not dead.
- Pork shoulder roasts get more tender the longer you cook them.

AND YES...

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## What Have We Learned?

### Economists are fallible!

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**Conclusion**

**Remember:**

- We are a very optimistic, can-do country by nature.

*Go out there and...*

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*Be Patient...*  
*Be Positive...*

**HAPPY HOLIDAYS!**

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