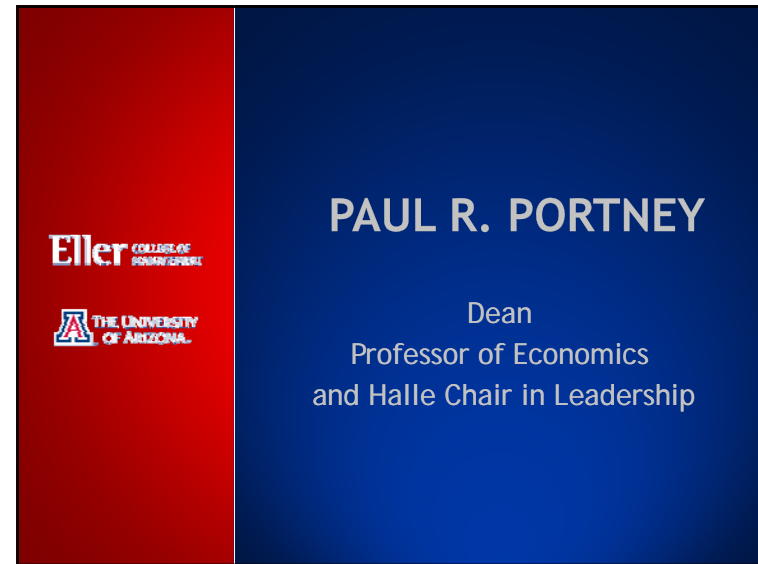




Eller COLLEGE OF MANAGEMENT
THE UNIVERSITY OF ARIZONA

ECONOMIC OUTLOOK 2011-2012

The University of Arizona's Thirtieth Annual Forecast Luncheon



Eller COLLEGE OF MANAGEMENT
THE UNIVERSITY OF ARIZONA

PAUL R. PORTNEY

Dean
Professor of Economics and Halle Chair in Leadership



Eller COLLEGE OF MANAGEMENT
THE UNIVERSITY OF ARIZONA

MARSHALL J. VEST

Director
Economic and Business Research Center



THE UNIVERSITY OF ARIZONA

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60 YEARS

AZ Population 6,395,779
Growth 2000-2009 28.6%
2nd fastest growth in U.S.
AZ Housing Units 2,757,364

CURRENT INDICATORS » ARIZONA'S ECONOMY » ECONOMIC FORECAST » EBR DATABASE

Costs and Contributions to Arizona from "Border Effect"

NEWS

Arizona consumer confidence is again trending upward, according to Behavior Research Center's Rocky Mountain Fall results. October 10, 2010

Costs and Contributions of the "Border Effect": Assessing the economic effects of Arizona's location along the international border with Mexico. July 26, 2010

Professor Gerald Swanson who has been converting stacks of students into burgeoning accountants for over 40 years. Read this special tribute. July 26, 2010

EBR coordinates and contributes to AZ Town Hall: Building Arizona's Future: Jobs, Innovation & Competitiveness. June 8, 2010

EBR's Dr. Alberto Charnoy and Dr. Vera Pavlovskaya-Koch discuss the economic impacts of legal Mexican visitors to Arizona in 2010. July 26, 2010

EVENTS

December 10, 2010
Economic Outlook Luncheon 2011/2012
The economic outlook is crucial to recent events and how growth will emerge from the recession amidst over a year ago. The de-leveraging process is not yet complete. Economic leaders are being given new legislation and rules that affect regulation of financial markets and health care costs. And companies are constrained by a sluggish labor market, tight credit, and high foreclosure rates. The recession may be over, but it certainly doesn't feel like it. What can we expect going forward? Join Paul Portney, Dean Eller College of Management, Marshall J. Vest, Director of the Economic and Business Research Center, and Gerald Swanson, Professor of Economics and Thomas E. Brown Chair of Economic Education, as they sit at the bottom line of the annual, must-attend event.
Register now!

VIEW ALL EVENTS

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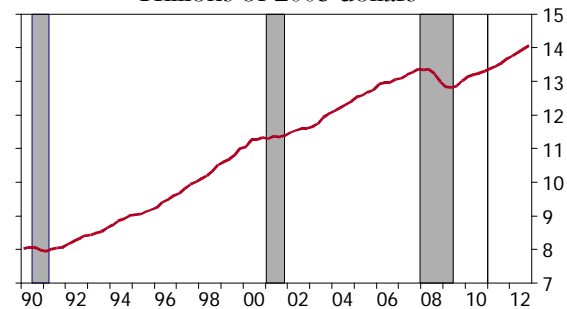
OVERVIEW

- Recovery hit a “soft patch” in 2nd half
- Headwinds have slowed recovery
 - National factors
 - Unique to Arizona
- New tax package ensures stronger pace
- State fiscal update

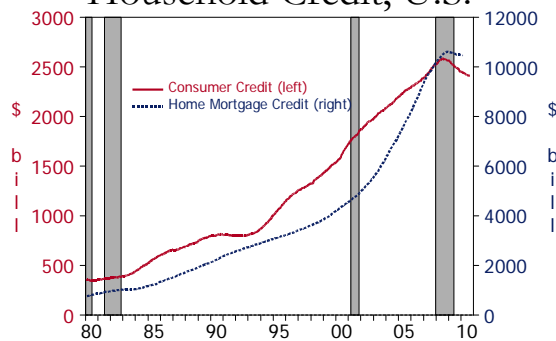


Real GDP, U.S.

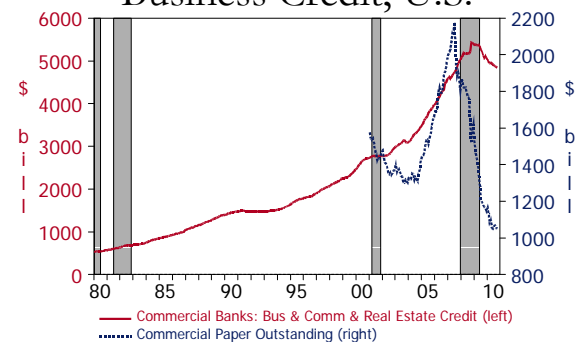
Trillions of 2005 dollars

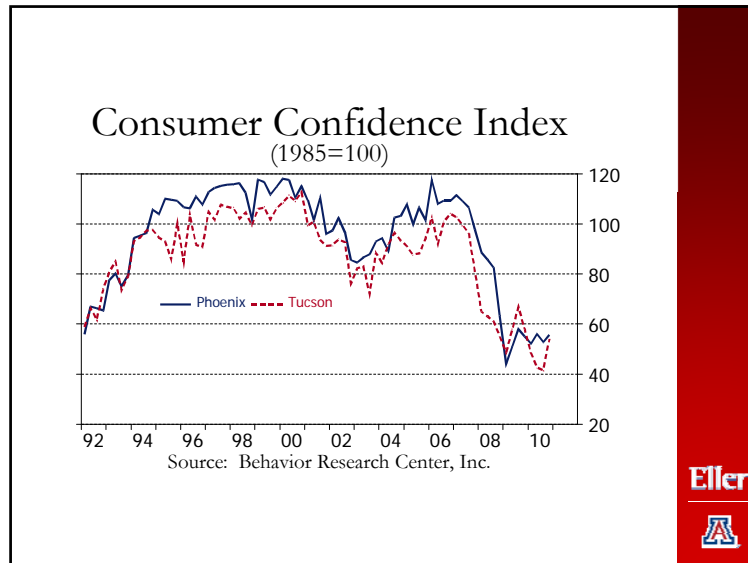


Household Credit, U.S.



Business Credit, U.S.





BUSINESSES ARE CAUTIOUS

- Uncertainty over future taxes
- Rising health care costs
- New financial regulations yet to be written
- Weak demand



HEADWINDS UNIQUE TO AZ

- Enormous inventory of vacant housing
 - 130,000 vacant addresses, 4.9% rate
 - Normal is 1.5%
- Mobility remains at the lowest level in 60 years
 - Credit squeeze and inability to sell house
 - half of AZ homeowners are "upside-down"
- Household formation near zero
 - Doubling up due to poor economy and high unemployment



RESIDENTIAL VACANCIES AZ METROS, SEPT. 2010

Area	Total Number	Vacant	Percent
Flagstaff	49,117	830	1.7
Lake Havasu-Kingman	100,061	7,209	7.2
Phoenix-Mesa-Glendale	1,861,570	91,687	4.9
Prescott	97,710	1,328	1.4
Tucson	454,559	26,826	5.9
Yuma	69,874	2,103	3.0
Metro Arizona	2,632,891	129,983	4.9

Source: U.S. Department of Housing and U.S. Postal Service



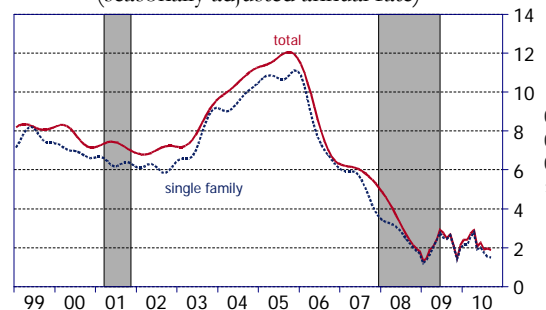
HOUSING STILL AT BOTTOM

- Home-buyer tax credit ended, "payback"
 - Building permits
 - Existing home sales
 - Home prices
 - Foreclosures
 - AZ ranked 3rd worst in October (NV, FL worse)
 - 1 in 165 homeowners received a notice
 - Pinal County 1 in 94, Maricopa 1 in 134, Pima 1 in 264



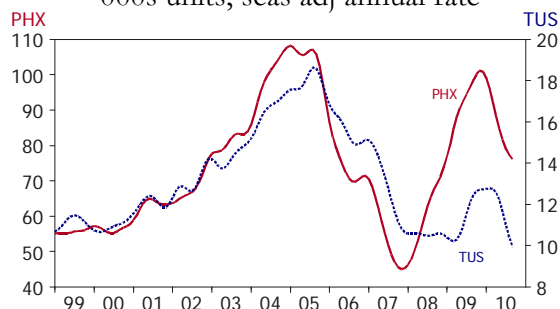
Building Permits, TUS

(seasonally adjusted annual rate)



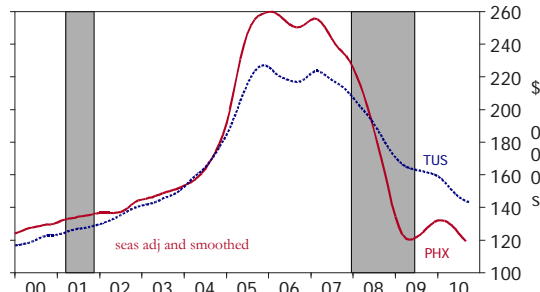
Existing Home Sales, MLS

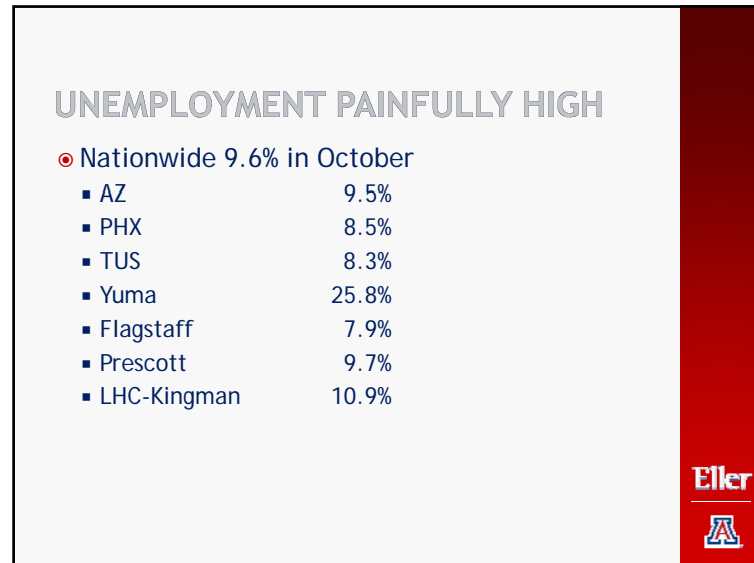
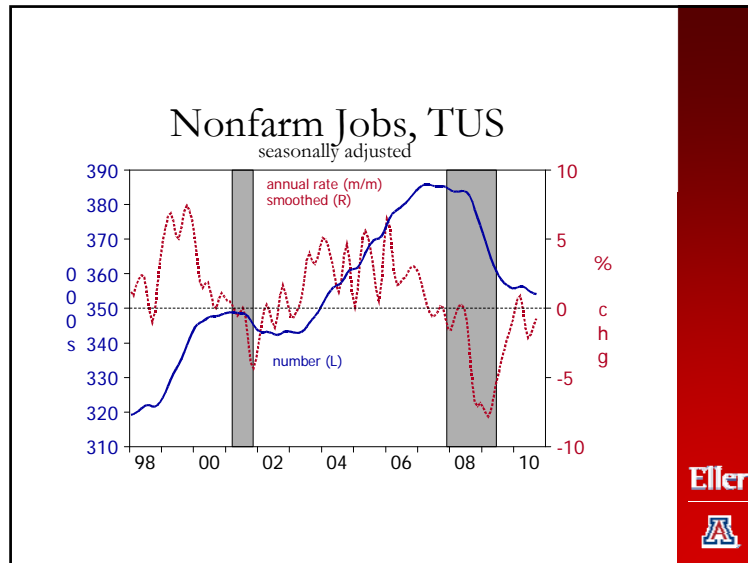
000s units, seas adj annual rate



Median Price of Homes Sold

MLS

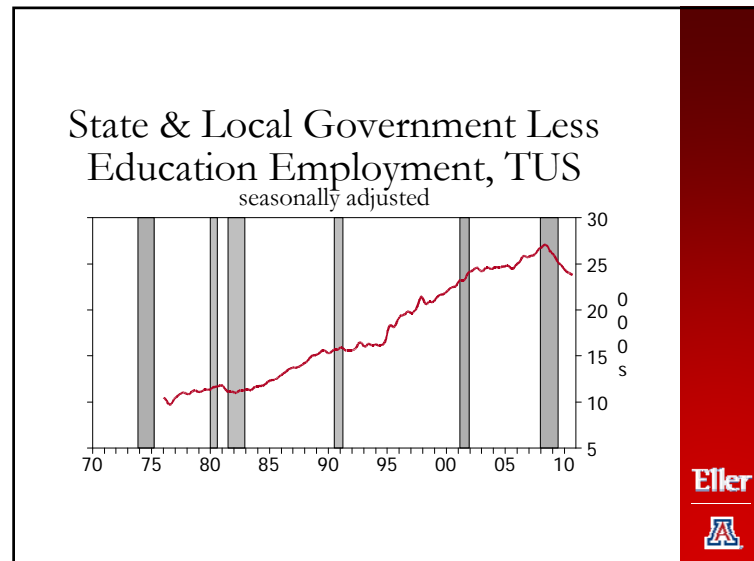


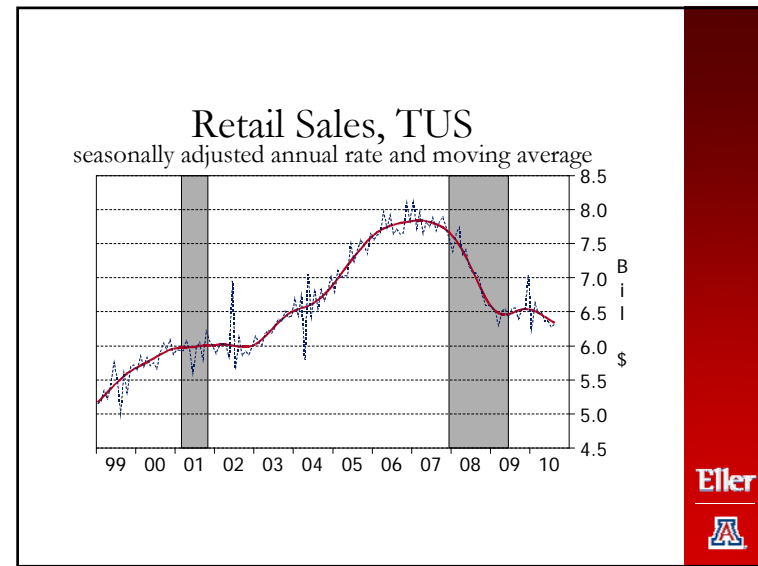
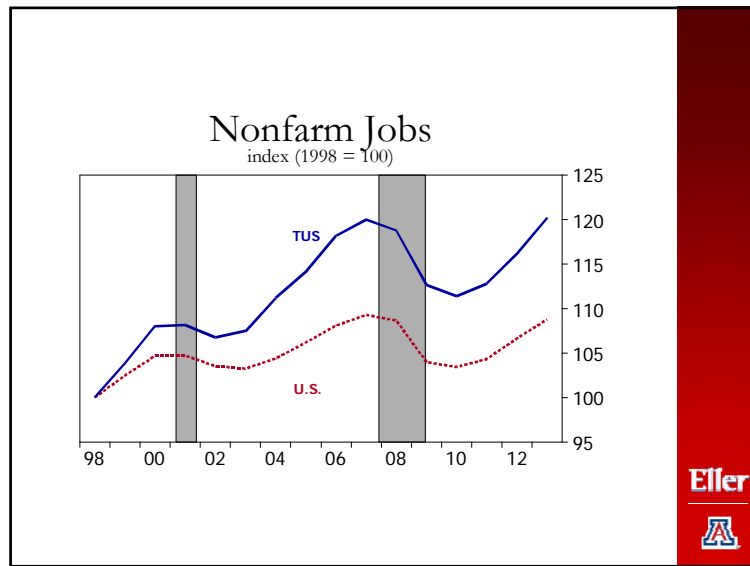
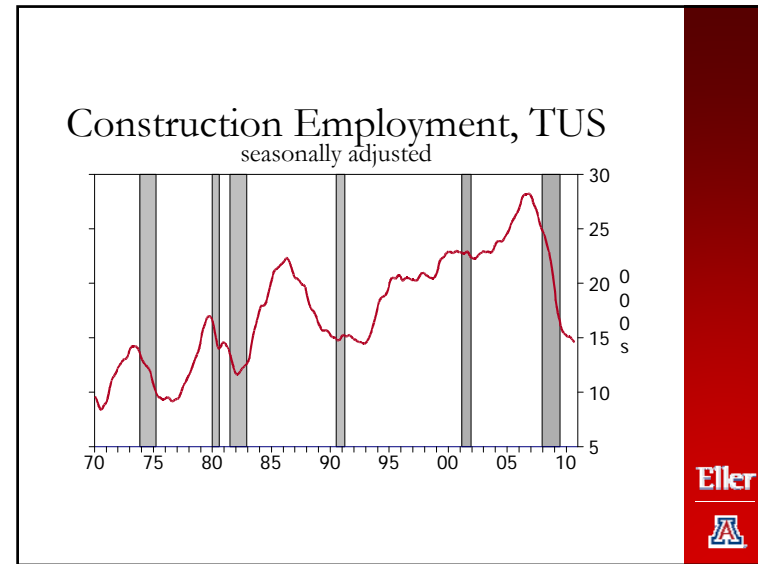
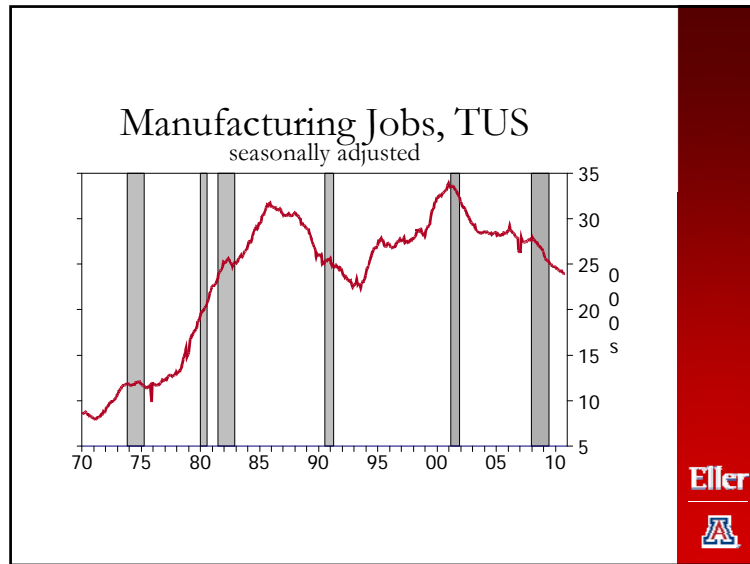


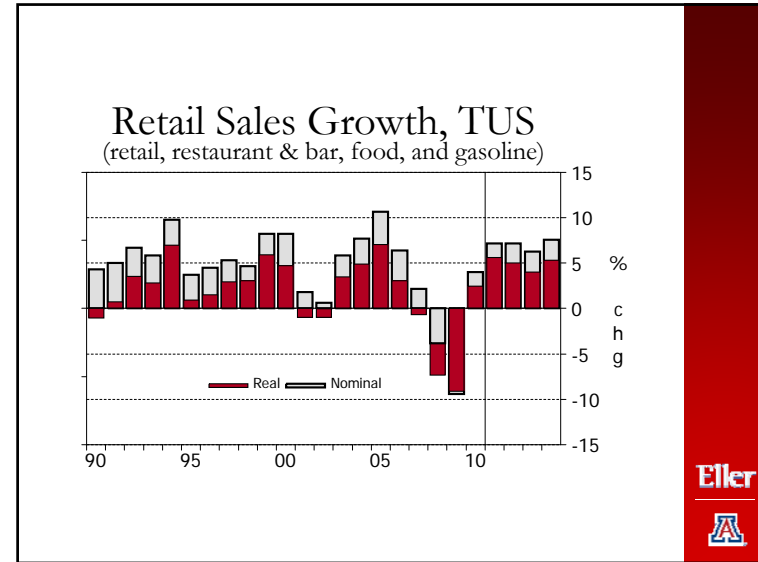
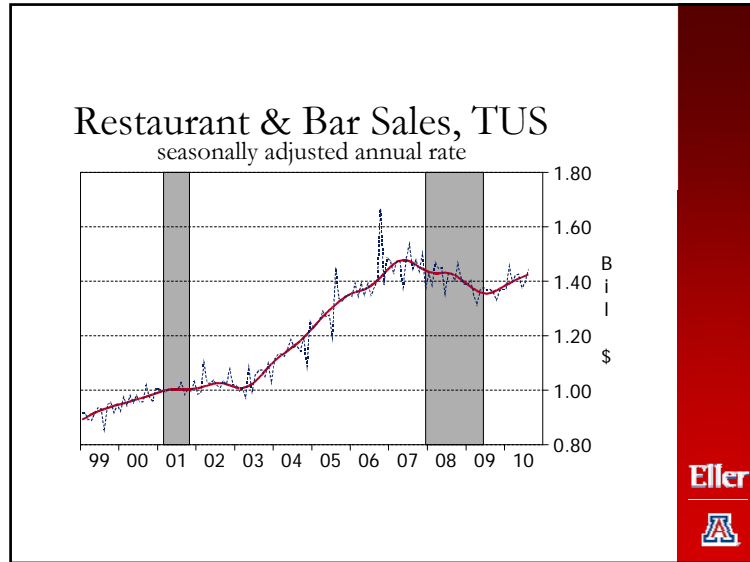
RECENT EMPLOYMENT TRENDS, TUS

Growing	Stable	Declining
Health Care/Soc. Serv.	Information	S&L Non-Ed
Federal Government	Transportation/Ware.	Prof. & Bus. Serv.
Accommodations	Food & Drinking Places	Manufacturing
Mining		Construction
Financial Services		Employment Serv.
		Wholesale Trade
		Grocery Stores
		Clothing
		S&L Education

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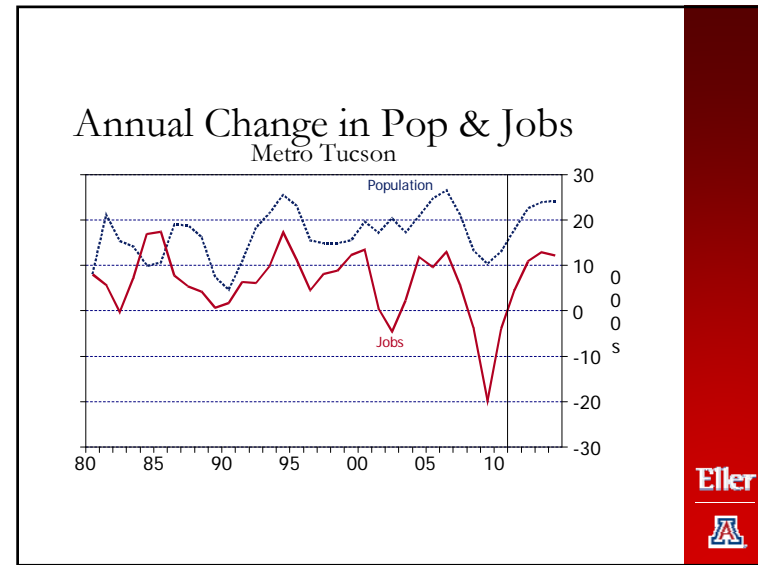






NEAR-TERM OUTLOOK

- Credit creation is key
 - Mobility of population improves
 - Absorb inventory of vacant houses
 - Start building homes
- Modest improvement as 2011 progresses
 - Spending will improve
 - Hiring will strengthen

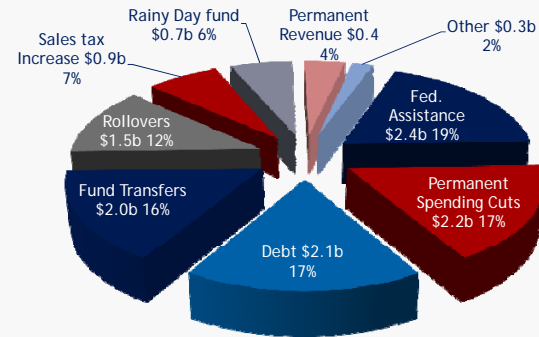


STATE FISCAL UPDATE

- AZ ranks 4th in severity (NV, IL, NJ are worse)
 - 38% shortfall current year (NASBO)
- Current year ending June \$825 mil shortfall
- FY 2012 deficit of \$1.2 bil
 - Excludes over \$1 bil in suspended formulas



BUDGET "SOLUTIONS" (\$12.5 BILLION SINCE FY '08)



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GERALD J. SWANSON, PH.D.

Professor of Economics
Thomas R. Brown Professor
in Economics Education

BELIEVE IT OR NOT

THE "GREAT RECESSION"
HAS BEEN OVER FOR
18 MONTHS!



UNEMPLOYMENT

- December 2007
 - 5.0%
- November 2010
 - Up from 9.6% to 9.8%
- Currently over 15.1 million unemployed
- 6.8 million have been unemployed for six month post WWII record



INFLATION

- CPI Annual Rate
 - November 2010 = 1.6%
- Core Annual Inflation Rate (no food or energy)
- November 2010 = 0.6%

LOWEST RATE EVER!



GROWTH IN GDP

- An economy that is growing at a very slow pace

2009 GDP	2010 GDP
Q1 -6.4%	Q1 3.7%
Q2 -0.7%	Q2 1.7%
Q3 1.6%	Q3 2.0%
Q4 5.0%	

- Too slow to significantly change unemployment rate.



CONSUMPTION

- Consumers are slowly starting to spend again
- Consumers' psyches remain fragile
- Reduced incomes and housing values are still constraining spending



CONSUMPTION

The minimalist consumer

- Consumers are living off of inventory
 - Your food stock
 - Your clothing stock
 - Your transportation stock



CONSUMPTION

- Consumers are paying down debt at lightning-fast pace
 - Record 26 months of declining credit card balances
 - Mortgage defaults
 - Strategic mortgage defaults

THINK -
Debt destruction, not repayment



INVESTMENT SPENDING

- Business confidence slowly improving
- Businesses have over \$1 trillion in cash



INVESTMENT SPENDING

- Manufacturing capacity utilization slowly improving
- Second quarter 2010 74%
- Last year 68%
- 80%+ = Normal



FISCAL POLICY

Deficit

- Fiscal 2009 \$1.4 Trillion
- Fiscal 2010 \$1.3 Trillion

- Projected 2011 \$1.3 Trillion



GOVERNMENT SPENDING

- Lots of federal government stimulus
 - \$787 billion 22 months ago
 - Stimulus impact ending



GOVERNMENT SPENDING

- States are increasing spending
 - Up 5.3% from last year

- States very dependent on federal government subsidies
 - 28% of state total budgets in fiscal 2010

- \$43.2 billion of federal government money used to plug holes in state budgets



GOVERNMENT SPENDING

- Total national debt = \$13.9 Trillion
- Debt held by foreign govts. \$4.2 Trillion
- Debt held by U.S. citizens \$4.7 Trillion
- Debt held by trust funds \$4.6 Trillion
- Debt ceiling is about to be hit - \$14.3 Trillion

Will Congress shut down government?



FISCAL POLICY

- For all practical purposes ...

Fiscal policy is dead!



FISCAL POLICY

- 37% of federal government spending is currently being financed by borrowing

Not sustainable!



FISCAL POLICY

- Mandatory spending
 - 1965 29% of budget
 - 2010 66% of budget
- Add defense
 - 83% of budget
 - 17% discretionary



UNFUNDED LIABILITIES

- 2010 Social Security and Medicare Trustee's Report
 - Medicare unfunded liability \$89 Trillion
 - Social Security unfunded liability \$18 Trillion
- Total unfunded liability \$107 Trillion



DEFICITS AND UNFUNDED LIABILITIES

◦ Solution!

National Commission on Fiscal Responsibility and Reform

- Will its recommendations be accepted?



TITLE OF THE COMMISSION'S REPORT

"The Moment of Truth"



COMMISSION'S GOALS

- Make America better off than it is today
- Don't disrupt fragile economic recovery
- Cut red tape and unproductive government spending
- Protect the truly disadvantaged
- Cut spending we can't afford
- Demand productivity and effectiveness from Washington
- Simplify and reform tax code
- Don't make promises we can't keep



HOW MANY OF YOU WANT TO:

- Increase Social Security retirement age to 69?
- Eliminate mortgage interest rate deduction?
- Increase federal gas tax by 15 cents?
- Cut federal workforce by \$10 billion?
- Lower top marginal tax rate from 35% to 25%?
- Cap defense budget?
- Eliminate earmarks?



FISCAL POLICY

- We cannot grow ourselves out of this deficit.

It is a structural deficit.

- The problem is real and the solution will be painful.



EURO ZONE RISK

- Once there were three little pigs
- Now there are four little PIGS
 - Portugal
 - Ireland
 - Greece
 - Spain
- Why isn't the U.S. in this group?



EURO ZONE RISK

- Euro zone countries do not control their own currencies
 - Can't print money to pay debt
- Result
 - Force austerity budgets
 - OR DEFAULT



COULD THE U.S. FACE A SOVEREIGN DEBT CRISIS?

Forced austerity or default

- No and Yes



WORLD DEFICITS

- 15 major advanced countries' governments, including the U.S., will have to borrow a total of \$10.2 trillion in 2011 (IMF)
- U.S. will have to borrow \$4.2 trillion



MONETARY POLICY

- Not your text book monetary policy

FED IS PUSHING ON A STRING!




MONETARY POLICY

- New policy tools
 - Quantitative easing
 - Interest on bank reserves
 - Zero interest rates



MONETARY POLICY


- QE2 is not a luxury cruise ship
 - \$600 billion big bet
 - Fed targets long-term interest rates
 - Very controversial



MONETARY POLICY


- Reaction to QE2
- Real interest rates

NOMINAL RATE - INFLATION RATE = REAL INTEREST RATE



MONETARY POLICY

- Last year Fed Funds Rate 0.09%
- Today Fed Funds Rate 0.12%
- Can't go lower!
- Some banks appear to be stabilizing
 - 140 banks failed in 2009
 - 149 banks have failed in 2010
- 940 banks on FDIC watch list
One out of every 10 banks!



MONETARY POLICY

- Is the Fed's monetary policy gun out of bullets?
- Zero interest rates for 24 months
- Injected approx. \$2 trillion in excess reserves
- What next?



MONETARY POLICY

- Big question --

Is QE2 the only policy option left to get this economy moving?



MONETARY POLICY

- Hyperexpansionary monetary policy
- The Federal Reserve's balance sheet has exploded!
 - August 2007 \$800 Billion
 - December 2010 \$2.3 Trillion
- Where did the Fed get the money to buy \$1.5 trillion in additional assets?
- Where will it get \$600 billion for QE2?



WE HAVE A BIG OVERHANG OF UNCERTAINTY

- Lots of Angst.



CONCLUSION

- The recession will not be viewed as over until


“The Unemployed Fat Lady Sings”

- No concert scheduled in 2011



CONCLUSION


- We must be patient!
- We must first do no harm!
- We must shift to long-run solutions!
- We must be grateful for what we have!



CONCLUSION

- Thank you!
- Thank you!
- Thank you!
For joining us today

- Go forth and buy those great bargains
Happy Holidays!



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