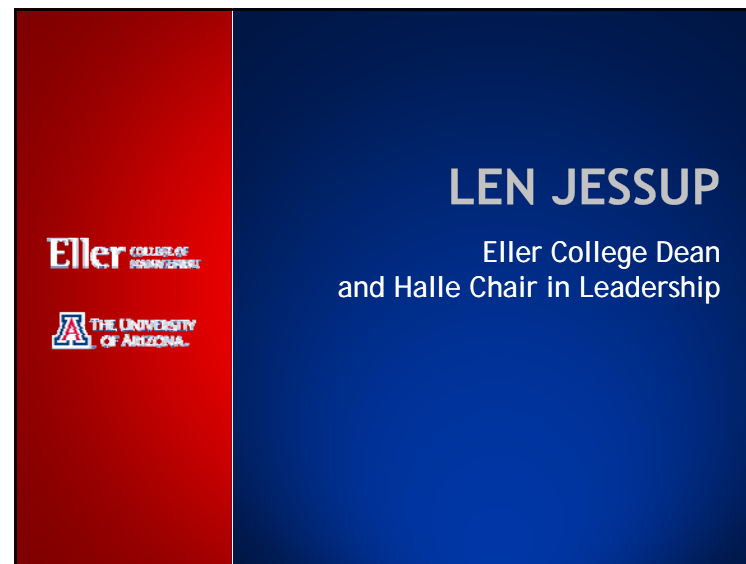


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**BREAKFAST WITH THE
ECONOMISTS: MID-YEAR
ECONOMIC UPDATE**

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Eller COLLEGE OF MANAGEMENT
THE UNIVERSITY OF ARIZONA

LEN JESSUP

Eller College Dean
and Halle Chair in Leadership



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Director
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Research Center



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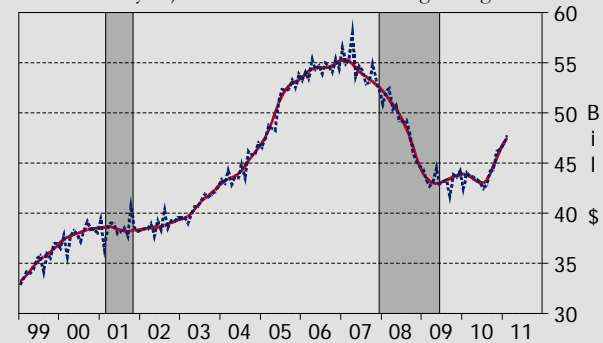
OVERVIEW

- Consumers boost spending
- Employment continues to languish
- Housing markets are still distressed
- Mobility remains at decades low
- Census 2010 results
 - Smaller, older but young, more diverse, overbuilt
 - Population declined during the recession
- State balances its budget
- Slow recovery ahead



Retail Sales, AZ

seasonally adjusted annual rate and moving average



HOW IS THIS POSSIBLE?

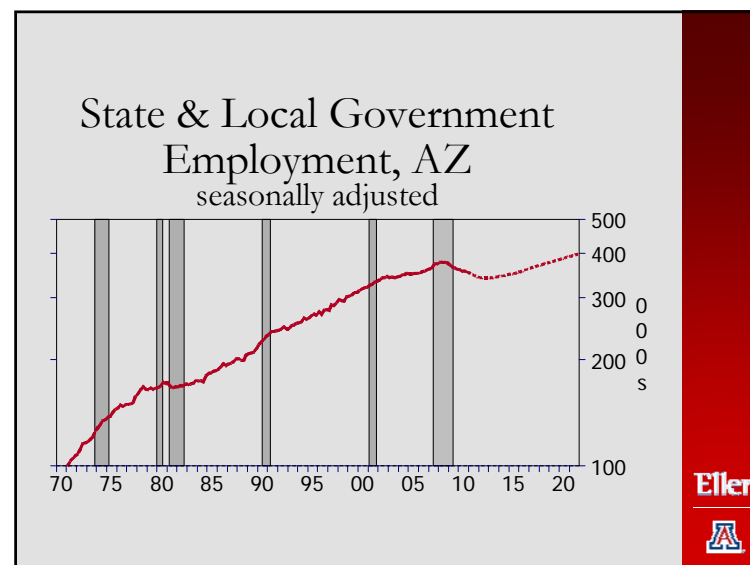
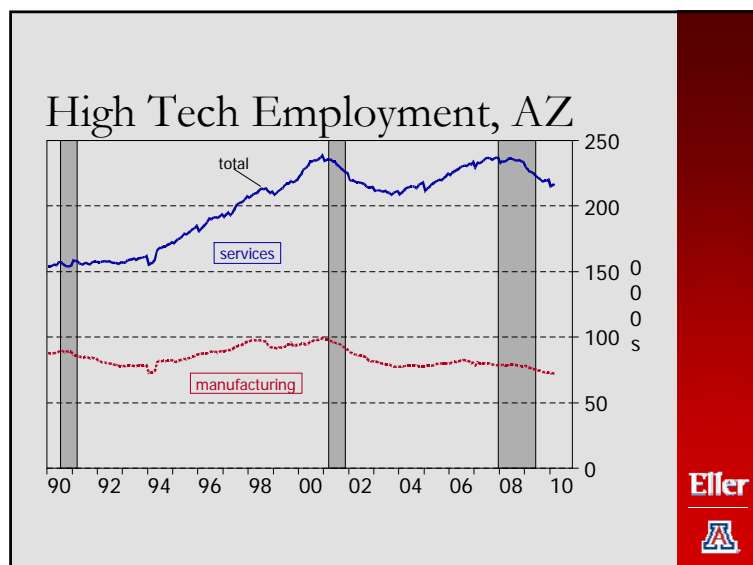
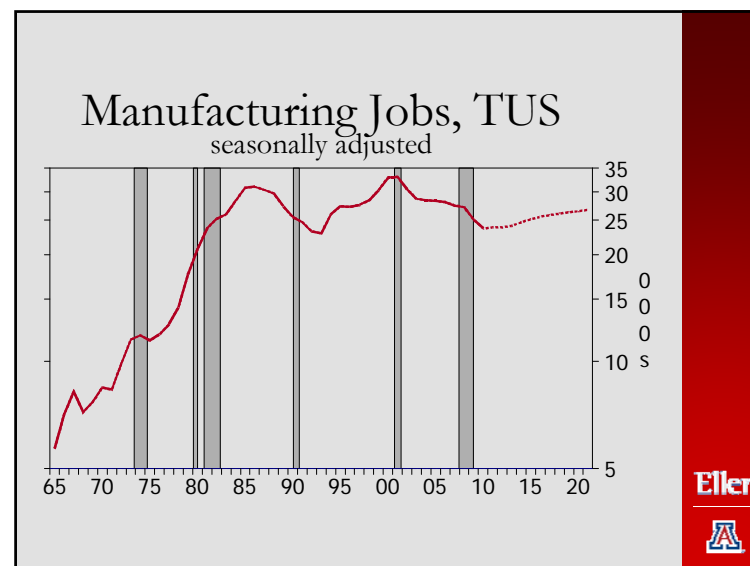
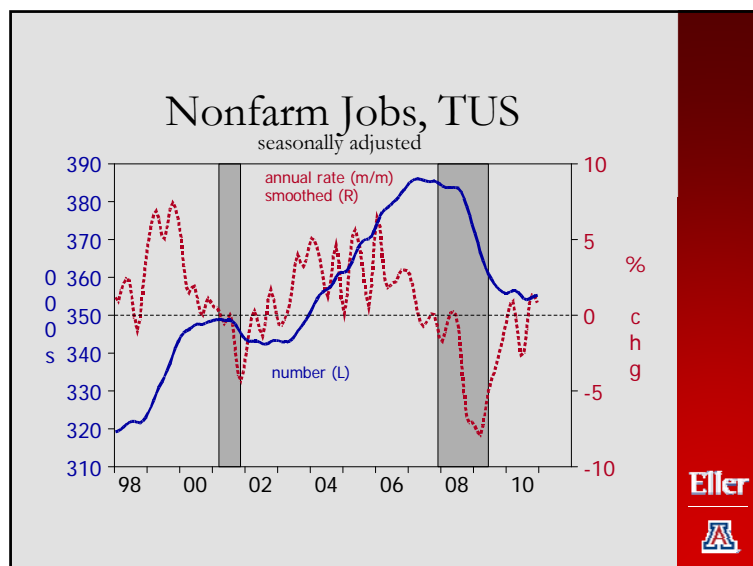
- No boost from wages, employment
- Personal income is up 5% from year ago
 - Nearly all from higher transfer payments
 - Reduction in payroll taxes
- Release of pent up demand?
 - consumers finally pulling the trigger
 - Spending savings, taking on debt
- Link to housing?

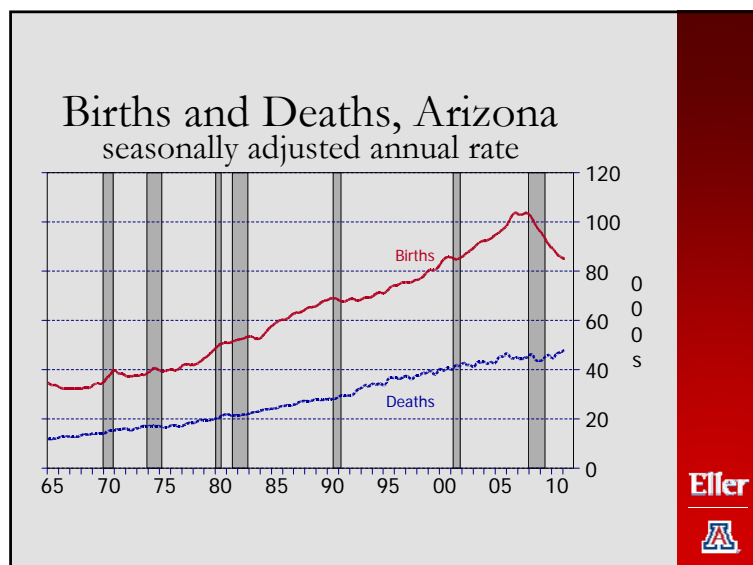
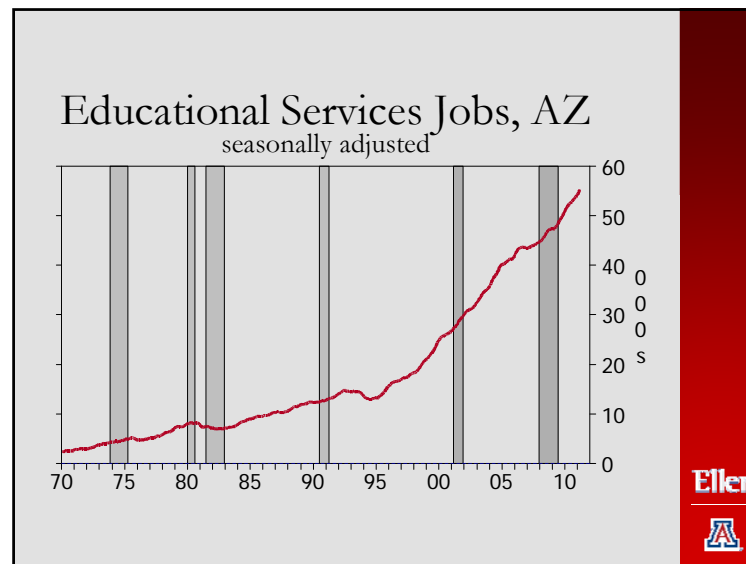
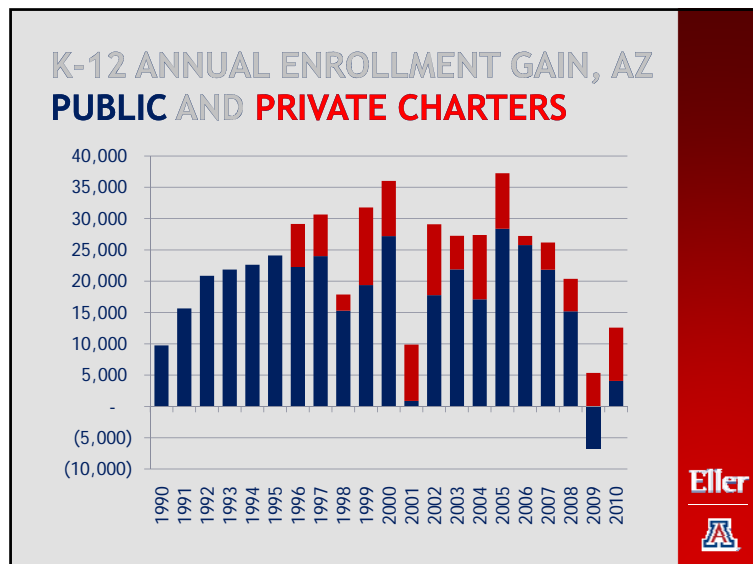


AZ'S JOB MARKETS

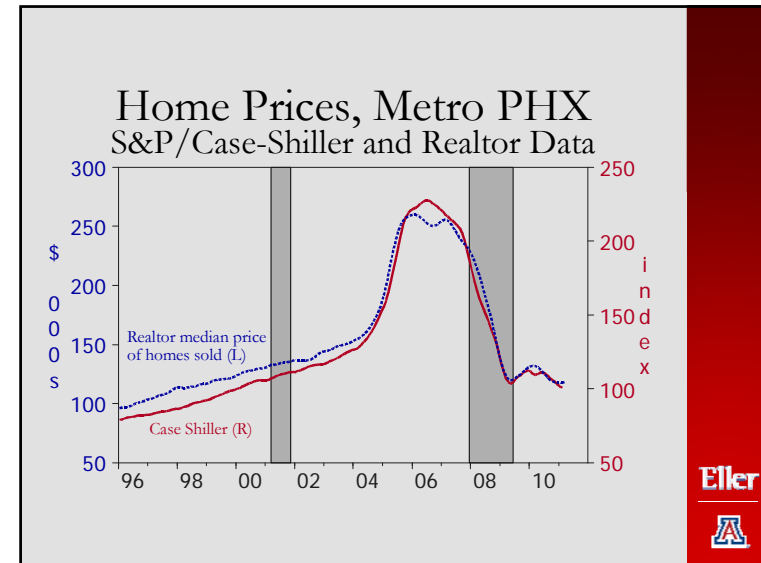
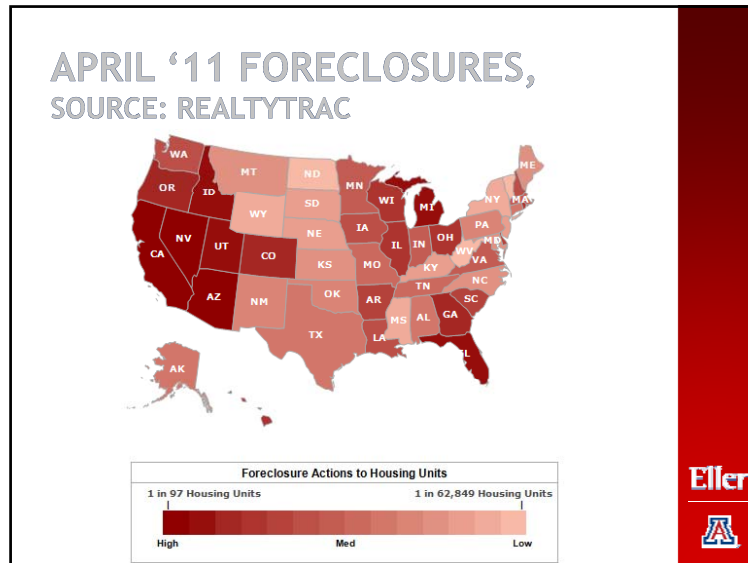
- Published estimates revised downward
- Nonfarm employment peaked in Aug. 2007
 - 312,400 jobs disappeared, 11.7%
 - PHX lost 243,800 or 12.7%
 - TUS down 35,100 or 9.1%
- Employment bottomed in September 2010
 - AZ added 23,500 thru March (6 months)
 - PHX added 18,800
 - TUS up 2,500





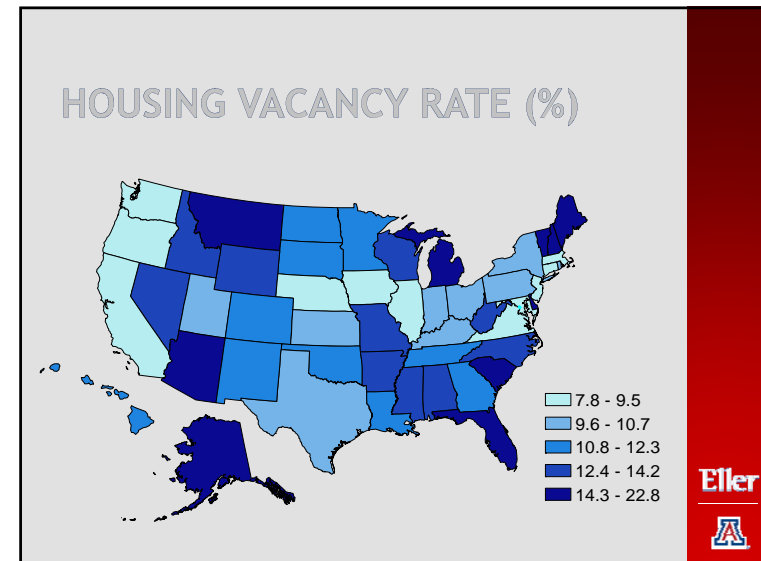


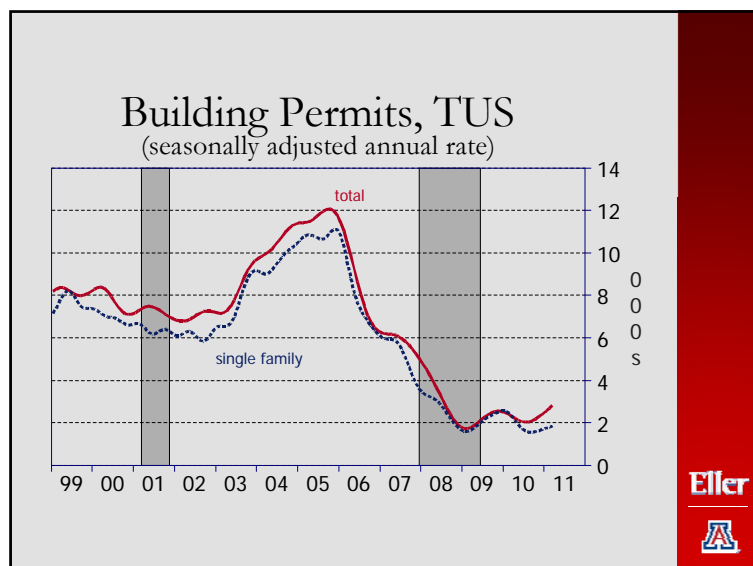
- ### REAL ESTATE
- Housing fundamentals are very poor
 - Foreclosures remain elevated
 - AZ ranked 2nd worst in 2010 (NV worse)
 - Half of AZ homeowners with mortgage have negative equity
 - Same for states that are sources for in-migrants to AZ
 - Mobility of the population severely restricted
 - Home prices are still falling
 - Vacant inventories are sufficient to house a whole decade of population growth!



VACANT HOUSING UNITS U.S. CENSUS, 2010

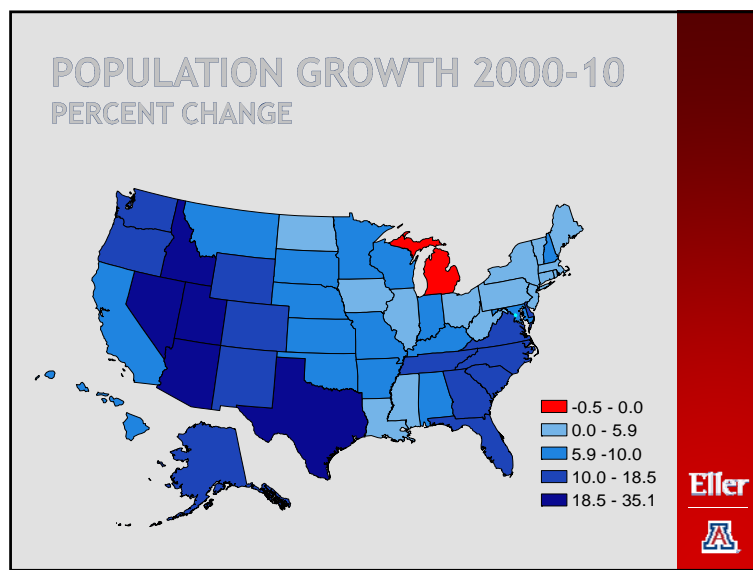
Area	Total Number	Vacant	Percent
Arizona	2,844,526	463,536	16.3
Apache County	32,514	9,743	30.0
Cochise County	59,041	8,176	13.8
Coconino County	63,321	16,610	26.2
Gila County	32,698	10,698	32.7
Graham County	12,980	1,860	14.3
Greenlee County	4,372	1,184	27.1
La Paz County	16,049	6,851	42.7
Maricopa County	1,639,279	227,696	13.9
Mohave County	110,911	28,372	25.6
Navajo County	56,938	21,280	37.4
Pima County	440,909	52,249	11.9
Pinal County	159,222	33,632	21.1
Santa Cruz County	18,010	2,573	14.3
Yavapai County	110,432	19,529	17.7
Yuma County	87,850	23,083	26.3





CENSUS 2010 RESULTS

- State-wide count was 6.4 mil
 - 262,000 lower than Census Bureau estimates
 - Metro PHX = 235,704 short (3.8 mil)
 - Metro TUS = 45,023 short (980,263)
- Either population declined or a large number of residents were not counted
- AZ still 2nd fastest-growing over decade
 - 16th largest state



2010 POPULATION U.S. CENSUS BUREAU

- Arizona is 16th largest state, 6.4 mil
 - Larger than Colorado - 5.0 mil people
 - Larger than Oregon - 3.8 mil
- Arizona has more than twice the number of people as
 - Utah, 2.8 mil
 - Nevada, 2.7 mil
 - New Mexico 2.1 mil
 - Idaho, 1.6 mil

CENSUS 2010 RESULTS

- We're getting older, but still one of the youngest states
- Population distribution across age groups has become "rectangular"

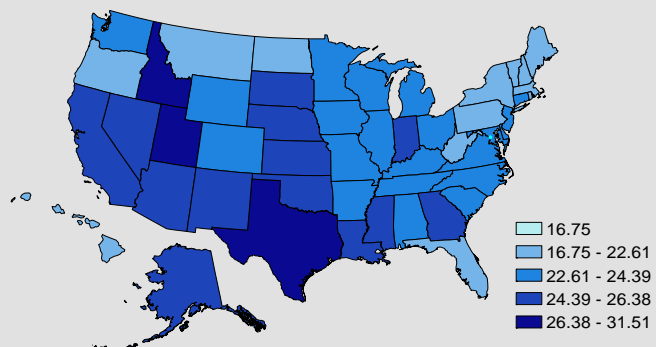


WE'RE GETTING OLDER: MEDIAN AGE, 2010 CENSUS

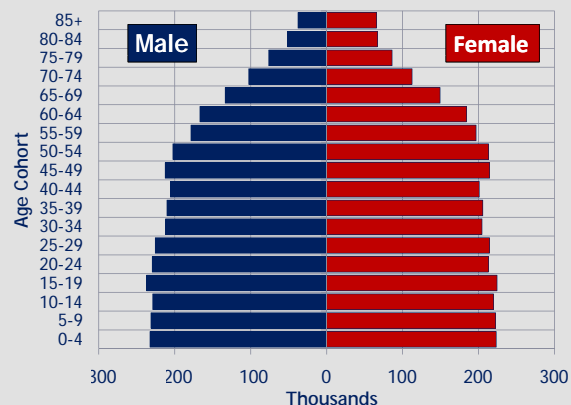
	2010	2000	difference
Arizona	35.9	34.2	1.7
Coconino County	31.0	27.0	4.0
Graham County	31.6	29.6	2.0
Apache County	32.4	30.2	2.2
Yuma County	33.8	30.9	2.9
Maricopa County	34.6	31.8	2.8
Navajo County	34.7	33.0	1.7
Greenlee County	34.8	33.6	1.2
Pinal County	35.3	33.9	1.4
Santa Cruz County	35.6	35.7	-0.1
Pima County	37.7	36.9	0.8
Cochise County	39.7	37.1	2.6
Mohave County	47.6	42.3	5.3
Gila County	47.9	42.9	5.0
Yavapai County	49.2	44.5	4.7
La Paz County	53.9	46.8	7.1

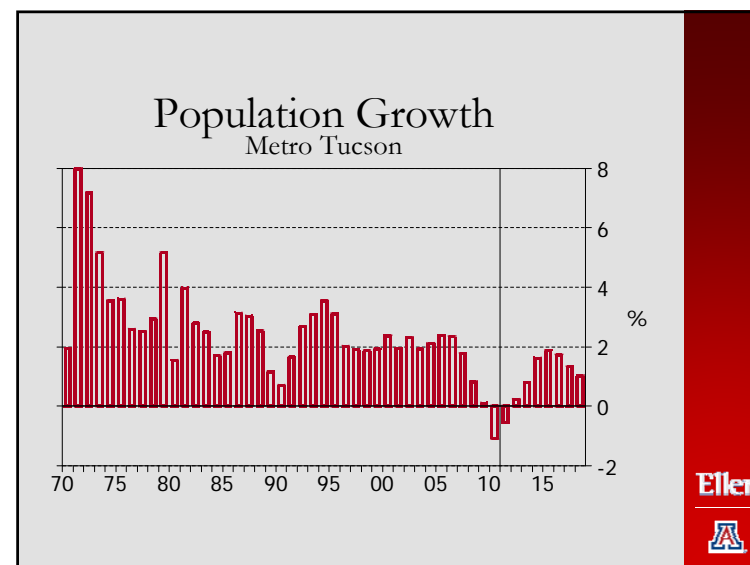
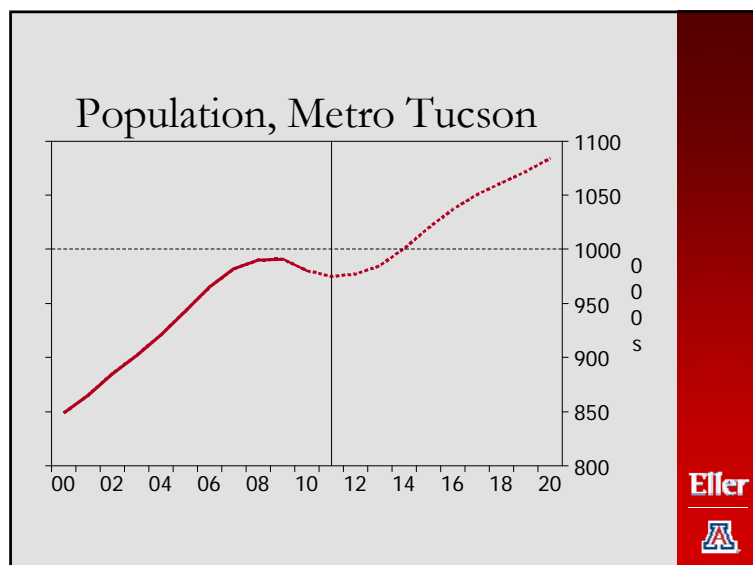
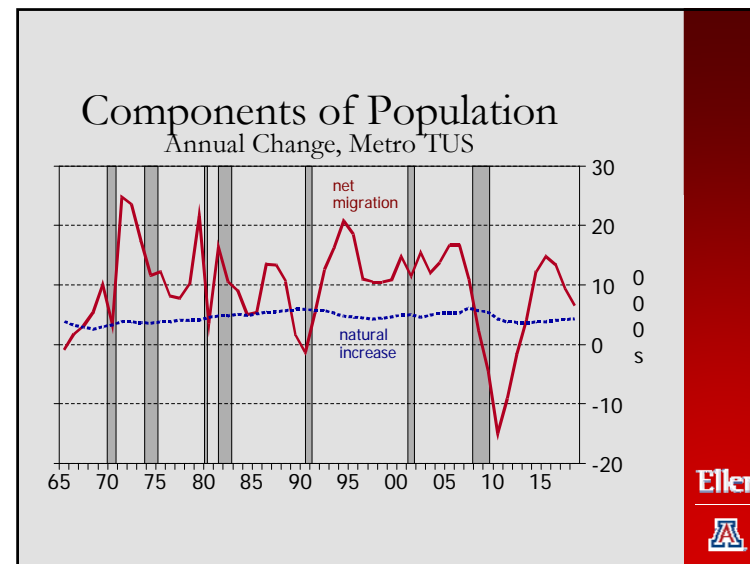
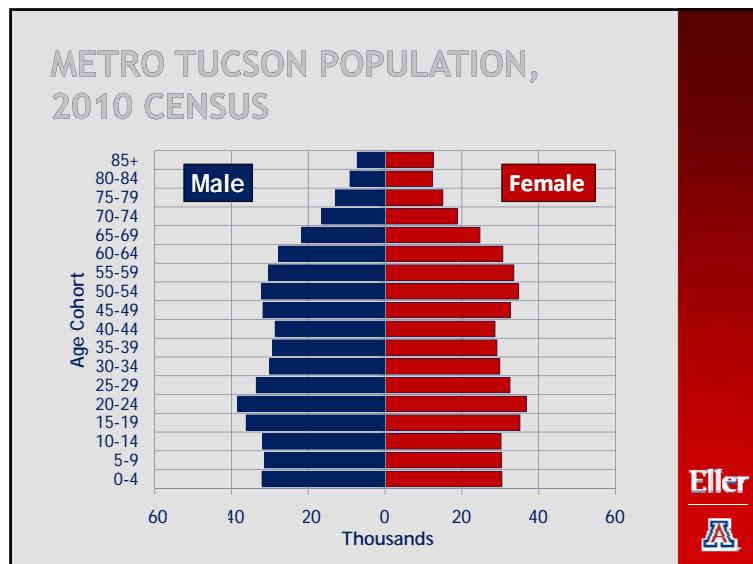


AZ IS THE 6TH YOUNGEST STATE PERCENTAGE OF POPULATION UNDER AGE 18



AZ POPULATION, 2010 CENSUS



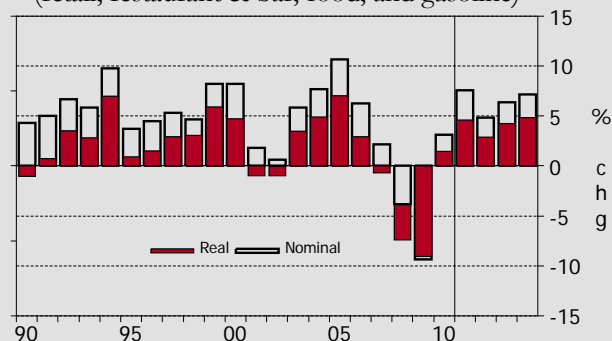


POPULATION GAIN BY DECADE, TUS

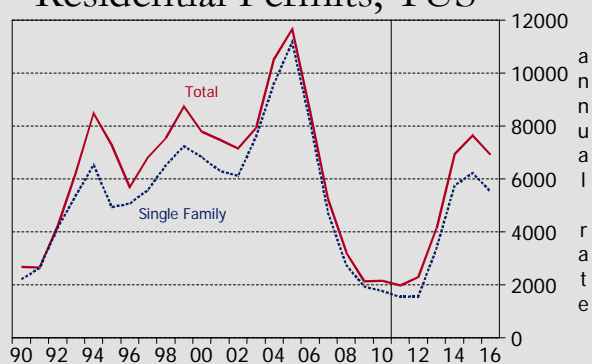
	Population (000s)	Change	Annual Growth Rate (%)
1950	149.0		
1960	269.0	120.0	6.1
1970	351.7	82.7	2.7
1980	531.4	179.7	4.2
1990	668.8	137.4	2.3
2000	848.5	179.7	2.4
2010	980.3	131.8	1.5
2020	1084.1	103.8	1.0



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



Residential Permits, TUS



STATE FISCAL UPDATE

- Legislature addressed in 2011 session
 - FY 10-11 \$543 mil shortfall
 - FY 2012 deficit of \$1.2B
 - Excludes over \$1 bil in suspended formulas
- Prior "solutions" largely temporary
 - FY08-10 totaled \$12.8B
- Expiration of Federal ARRA stimulus money forced permanent cuts
 - \$1.1B total in health care and education
 - Closed the "structural deficit" near term
- Spending has been reduced by 22% since FY08

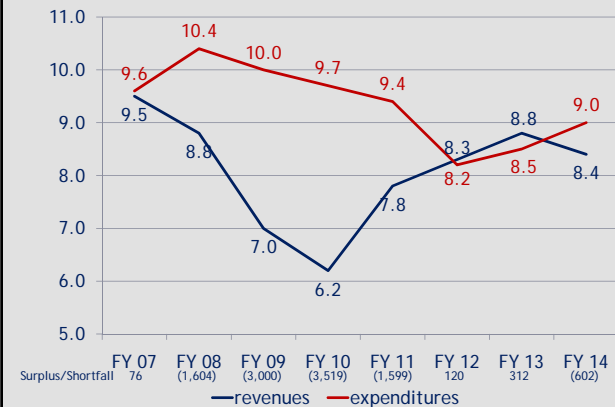


NEWLY-ENACTED BUDGET SPENDING REDUCTIONS, FY 11-12

	Net Reductions (\$ mil.)
Dept. of Education	\$(163)
AHCCCS (Medicaid)	(511)
Dept. of Corrections	10
Universities	(198)
Dept. of Economic Security	(50)
Dept. of Health Services	(97)
School Facilities Board	0
One extra payroll	0
Employee Benefit Savings	(62)
TOTAL	\$1,071



AZ GENERAL FUND REVENUES AND EXPENDITURES (\$BILLIONS)



PRIOR CHART DOESN'T INCLUDE

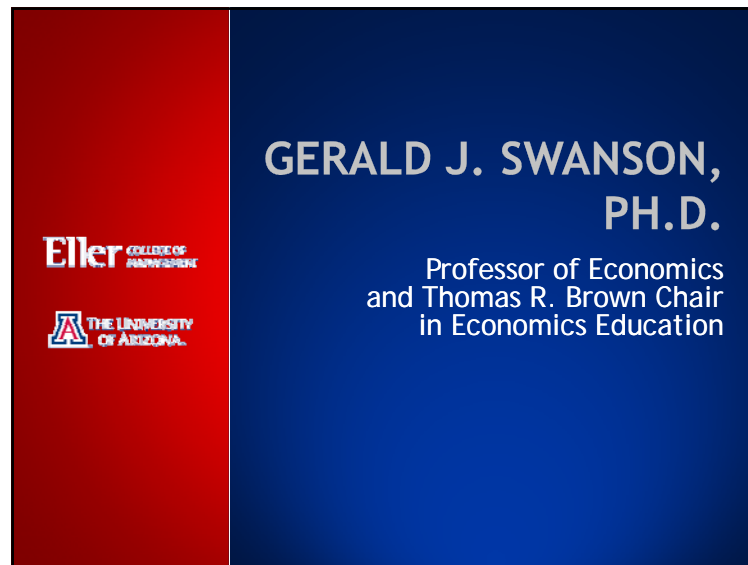
- Effects of the recently-passed "jobs bill" that totals \$538 million in cuts to corporate taxes to be phased in over FY15-18.



NEAR-TERM OUTLOOK

- Mobility of population must improve before
 - Absorb inventory of vacant houses
 - Start building homes
- In 2011
 - Credit markets will slowly improve
 - Spending will bounce
 - Hiring will strengthen
- Recovery accelerates in 2012-2014 but restrained by the drag from
 - Housing & non-residential real estate
 - Public sector spending

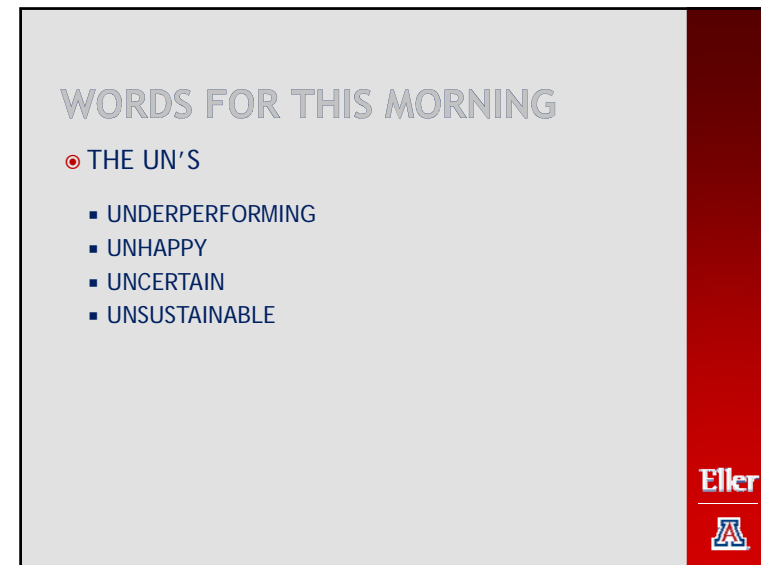




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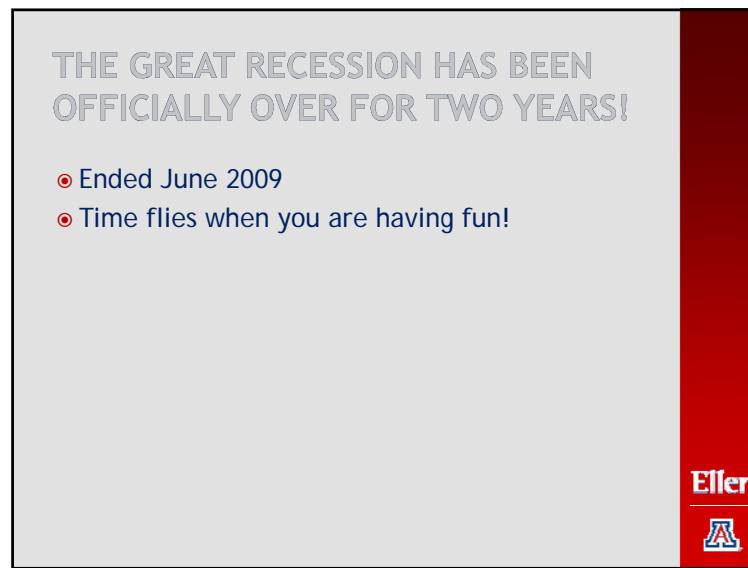
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WORDS FOR THIS MORNING

- THE UN'S
 - UNDERPERFORMING
 - UNHAPPY
 - UNCERTAIN
 - UNSUSTAINABLE

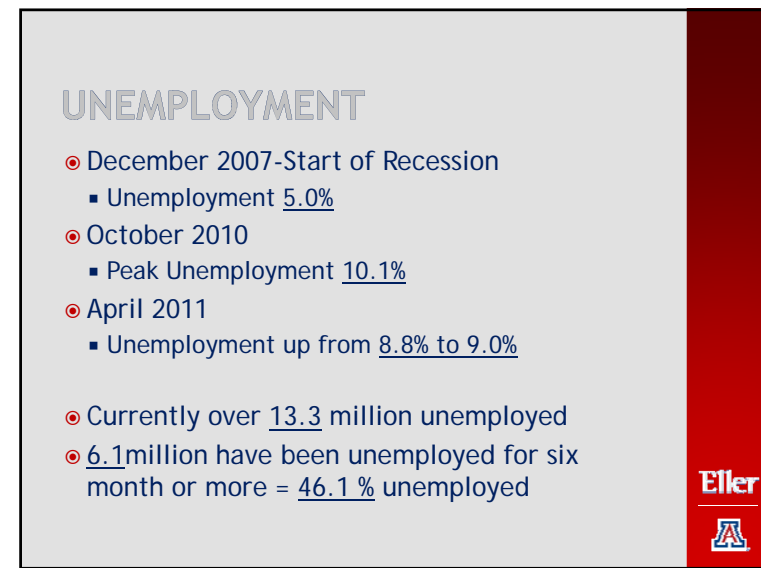
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THE GREAT RECESSION HAS BEEN OFFICIALLY OVER FOR TWO YEARS!

- Ended June 2009
- Time flies when you are having fun!

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UNEMPLOYMENT

- December 2007-Start of Recession
 - Unemployment 5.0%
- October 2010
 - Peak Unemployment 10.1%
- April 2011
 - Unemployment up from 8.8% to 9.0%
- Currently over 13.3 million unemployed
- 6.1 million have been unemployed for six month or more = 46.1 % unemployed

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UNEMPLOYMENT

- Participation Rate
 - % of population over age of 16 in labor force
- April 2011: 64.2% lowest since 1984
- January 2001: 67.2%

- Employment Rate
 - % of population over age of 16 employed
- April 2011: 58.4% very low and declining
- January 2001: 64.4%



UNEMPLOYMENT

- Structural unemployment - April 2011
 - Less than H.S. 14.6%
 - H.S. 9.7%
 - Some college 7.5%
 - Bachelor's or higher 4.5%
 - Teenagers 16-19 24.9%



WOMEN RULE

- More high school graduates than men
- More in college than men
- More seek advanced degrees than men



INFLATION ON THE RISE

- CPI Annual Rate
 - April 2011 = 0.4%
 - 12 month 3.2%
- Core Annual Inflation Rate (no food or energy)
 - April 2011 = 0.2%
- Producer Price Index
 - April 2011 = 0.8%
- Import Price Index
 - April 2011 = 2.2%



INFLATION

- Price increases -June 2010 to June 2011
 - Oil 59%
 - Gasoline 51%
 - Gold 26%
 - Silver 108%
 - Corn 112%
 - Wheat 92%

- How I wished I had invested in commodities!



WE ARE UNHAPPY WITH THE ECONOMY

- The economic recovery is merely sputtering along

- Recent poll
 - 82% said the economy is in poor shape



GROWTH IN GDP UNDERPERFORMING

- An economy that is growing at a very slow pace

2009 GDP	2010 GDP	2011 GDP
Q1 -6.4%	Q1 3.7%	Q1 1.8%
Q2 -0.7%	Q2 1.7%	
Q3 1.6%	Q3 2.5%	
Q4 5.0%	Q4 2.8%	

- Too slow to significantly change unemployment rate



RECESSION RECOVERY

1982	2009
4 th Q 0.3%	3 rd Q 1.6%
	4 th Q 5.0%
1983	2010
1 st Q 5.3	1 st Q 3.7%
2 nd Q 9.3 %	2 nd Q 1.7%
3 rd Q 8.1%	3 rd Q 2.6%
4 th Q 8.5%	4 th Q 3.1%
1984	2011
1 st Q 8.0%	1 st Q 1.8%
2 nd Q 7.1%	



CONSUMPTION

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



CONSUMPTION

- Gas and food prices putting major crimp in household budgets
 - Gas prices up 51% from a year ago
 - Food prices up 3.2% from a year ago
 - Food commodity price index up 17%



INVESTMENT SPENDING

- Uncertainty an issue
 - Business confidence slowly improving
 - Businesses are investing more
 - Corporations are very profitable
 - Productivity has stalled
 - Housing construction very slow



FISCAL POLICY

- Deficit - unsustainable
 - Fiscal 2009 \$1.4 Trillion
 - Fiscal 2010 \$1.3 Trillion
 - Projected 2011 \$1.65 Trillion
 - Projected 2012 \$1.1 Trillion



FISCAL POLICY IS DEAD

- Keynesian policy has played out
 - Tax rebate
 - Stimulus package
 - Auto bailout
 - Cash for clunkers
 - Home buyer tax credit
 - Appliance tax credit
 - Payroll tax cut



FISCAL POLICY - DO THE MATH

- Spending at highest percent since WWII
 - 24.3%
 - Post-WWII Average 20.4%
- Taxes at lowest percent of GDP in 60 years
 - 14.8%
 - Post-WWII Average 18.5%



GOVERNMENT SPENDING

- State and local governments continue to downsize
- Private sector adding jobs
- Government sector losing jobs

- Since 2008
 - States have cut 98,000 jobs
 - Local governments have cut 409,000 jobs



GOVERNMENT SPENDING

- Debt ceiling - hit May 16, 2011
 - Since 1962, the U.S. has reached the debt ceiling 74 times
 - Four times we did not immediately raise the ceiling - but we always eventually did!



FISCAL POLICY

- Mandatory spending
 - 1965 29% of budget
 - 2010 66% of budget
- Add defense
 - 83% of budget
 - 17% discretionary
- 38% of the current budget is financed by borrowing.



FISCAL POLICY - DO THE MATH

- Reducing the deficit
 - Discretionary spending - all those government departments = 17% of budget
 - National defense spending = 17% of budget
- 38% of budget financed by borrowing.



FISCAL POLICY - DO THE MATH

- Interest on the national debt
 - Fiscal 2010 = \$413,954,825,362.17
 - Fiscal 2011 = \$244,476,372,569.22
- Treasury bonds interest rates

	<u>Current</u>	<u>1995</u>
1yr	.21%	5.9%
5yr	1.27%	6.8%
10yr	3.05%	7.1%
20yr	3.9%	7.2%
30yr	4.3%	7.3%



FISCAL POLICY

- Eliminating the deficit
- Cap spending growth
- Cap deficit as percent of GDP



UNFUNDED LIABILITIES

- Mandatory spending
- This is where the money is
 - Social Security
 - Medicare
 - Medicaid
- Total unfunded liabilities for these programs
 - \$107 Trillion



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



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

- December Outlook question:
 - What happens when we hit the debt ceiling?
 - Forced austerity or default
 - We are now facing these choices



MONETARY POLICY

- The printing presses are being turned off
- No more quantitative easing
- Lots of liquidity
- Very low interest rates



MONETARY POLICY

- Zero interest rates for 30 months
 - A record
- Injected approx. \$2 Trillion in excess reserve



MONETARY POLICY

- Hyper-expansionary monetary policy
- The Federal Reserve's balance sheet has exploded!
 - August 2007 \$800 Billion
 - April 2011 \$2.7 Trillion
- Definition of inflation
 - Old definition - changed in 2003
 - New definition



CONCLUSIONS

- We must be patient!
- We must first do no harm!
- Congress and the President must focus on long-run solutions, not election-cycle solutions!



THANK YOU

- Enjoy the long hot and hopefully wet summer!



