

Revisions, Shocks and Challenges

Central Washington University
Economic Outlook Conference
Ellensburg, Washington
October 25, 2011
John W. Mitchell

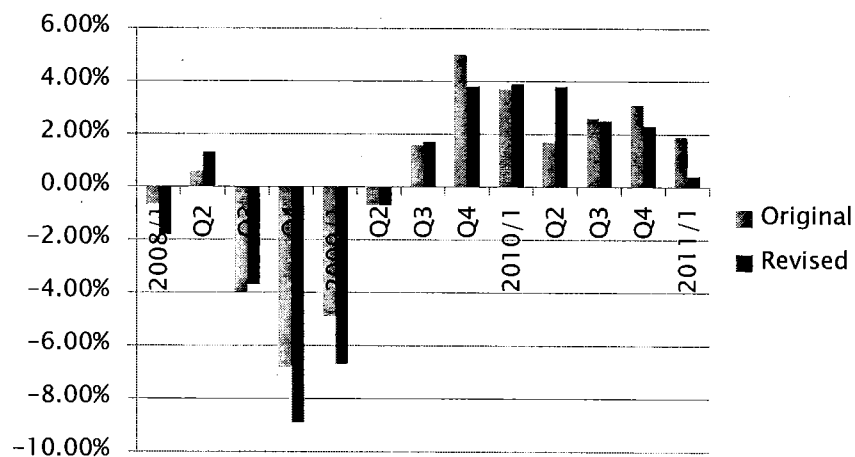
Uneasy Feeling

- ▶ University Students—What Happens Next?
- ▶ Senior Citizens—Living off Savings
- ▶ Pre-Retiree in a Defined Contribution World
- ▶ Young People Watching Parents Struggle
- ▶ Underwater Homeowners/Current on Mortgage
- ▶ Stagnant Incomes
- ▶ Long Term Unemployed
- ▶ Seeing and Participating in Things of Another Time and Place
- ▶ Opportunity to be Squandered or Seized

2011 – Not The Plan

- ▶ 2 Years Into an Upturn–Still not Back to Peak Production
- ▶ Recession Worries Returned
- ▶ Things You Were Not Thinking About on New Year’s Day:
- ▶ Earthquakes
- ▶ Fukushima Daiichi
- ▶ Greece/Italy/Spain
- ▶ US Downgrade
- ▶ Mortgage Rates Got Below 4%
- ▶ Annual Inflation at 3.9%
- ▶ Super Committee
- ▶ Arab Spring–Gadhafi Gone
- ▶ Occupy Wall Street, Portland, Seattle etc..
- ▶ Rumors of China, India etc. Helping Europe
- ▶ Ashton Kutcher on “Two and A Half Men”

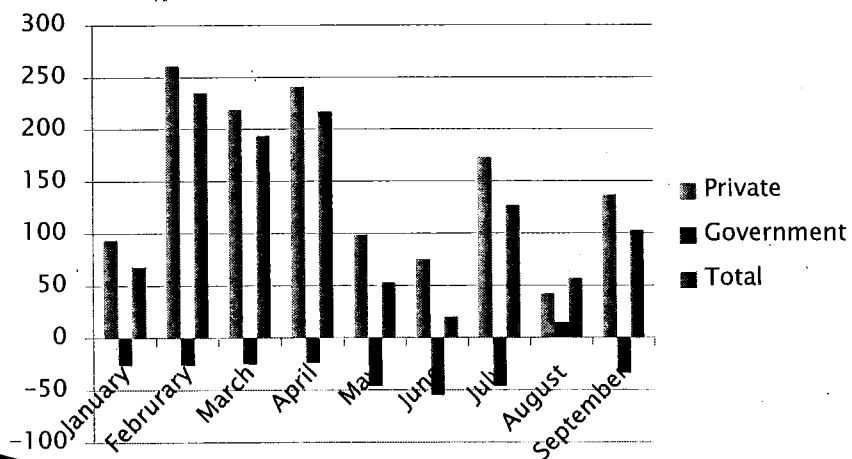
Worse–Better–Worse Revised GDP Growth (7/29)



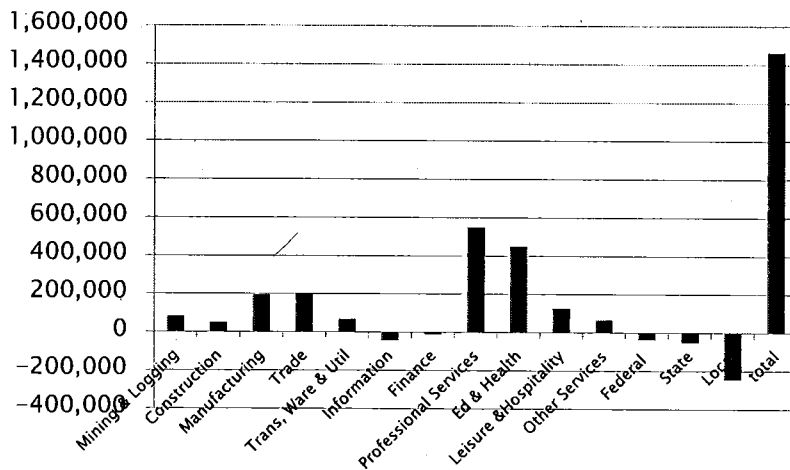
Real GDP (SAAR) Commerce Department Q4-2010 to Q2-2011

	Q4 10	Q1 11	Q2 11
GDP	2.3%	.4%	1.3%
Consumption	3.6	2.1	.7
Equip & Software	8.1	8.7	6.2
Non-Res Structures	10.5	-14.3	22.6
Residential	2.5	-2.4	4.2
Federal	-3	-9.4	1.9
State and Local	-2.7	-3.4	-2.8
Exports	7.8	7.9	3.6
Imports	-2.3	8.3	1.4

2011 Nonfarm Payroll Employment Change Private and Government (,000 SAAR) Source: BLS

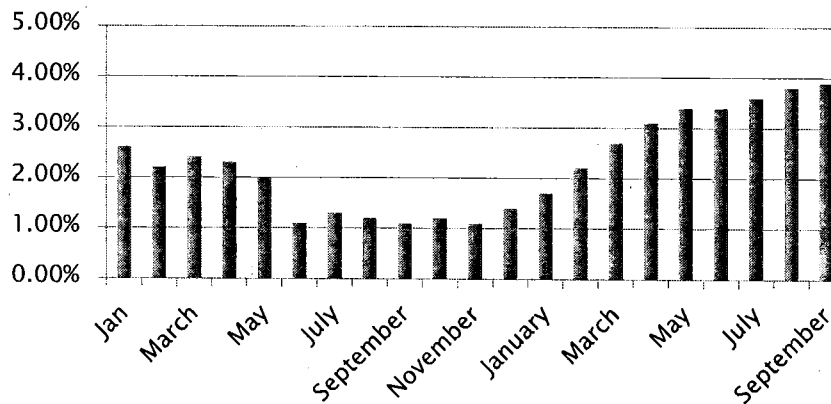


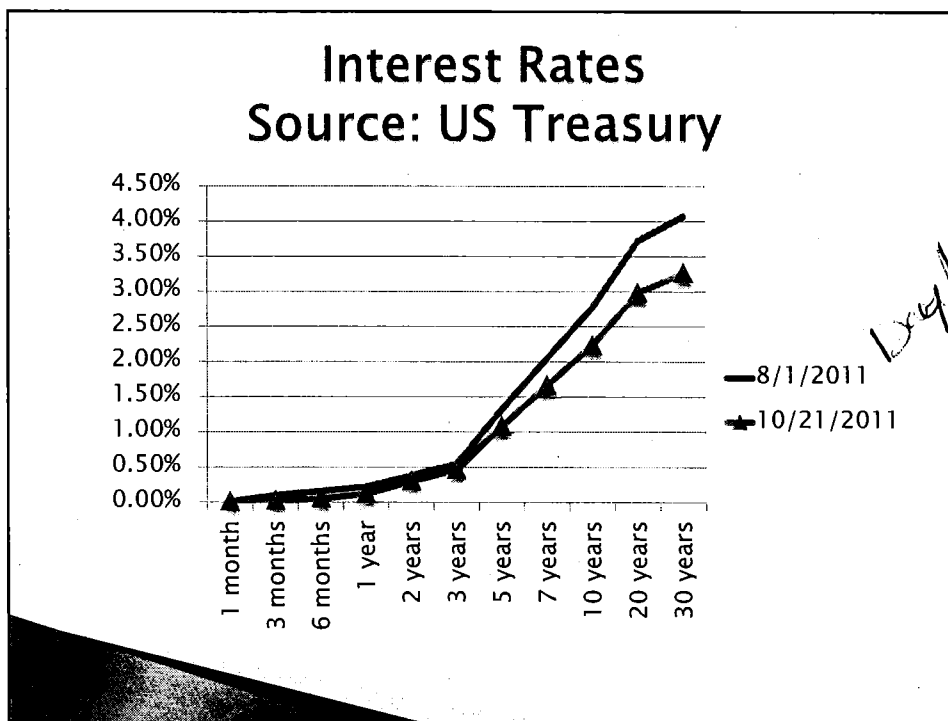
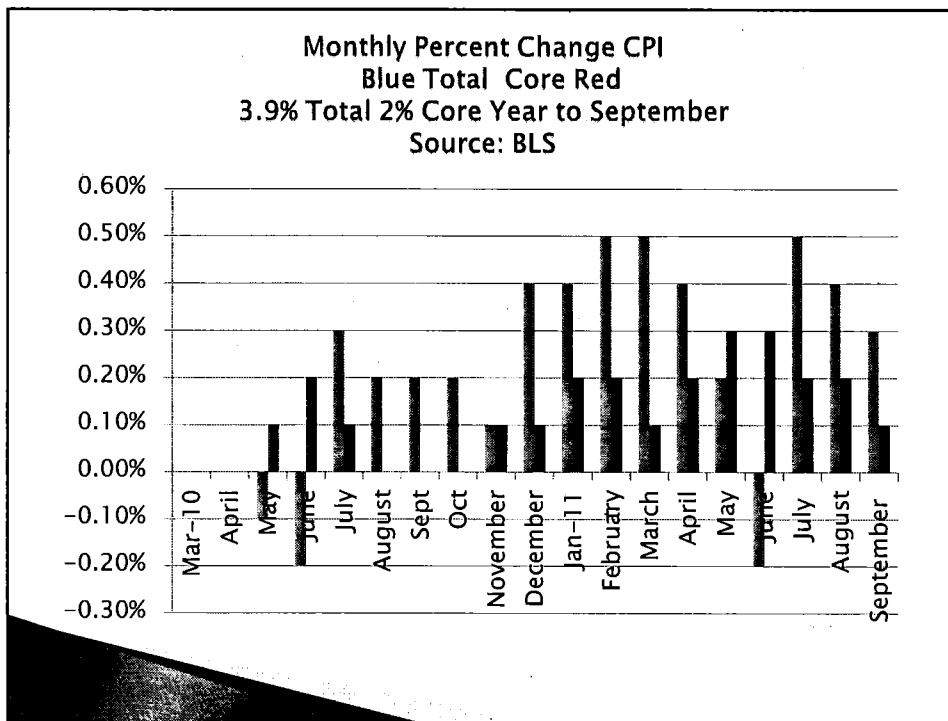
Annual Job Change September, 2010-September, 2011 (1.1%)



Year Over Year Consumer Price Index January, 2010 to September, 2011

Source: BLS





Rates

Since Dec 2008

- ▶ Short Term Rates Zero
- ▶ Trillion Dollar Deficits
- ▶ Equity Market Volatility
- ▶ Flight to Safety-Greece
- ▶ European Attempts to Fix Problems
- ▶ Other Nations Holding Reserves
- ▶ Federal Reserve Holdings and Shifts-Twist

Crosscurrents

Things to watch + keep an eye on

Reducing debt burden

- ▶ Consumers-Weak Earnings Growth, Deleveraging, Employment Slowly Rising, Wealth Declines, Financial Volatility
- ▶ Business Investment- Recent Strength Equipment and Software, Good Earnings, Uncertain Outlook
- ▶ State and Local-Weakness
- ▶ Trade-High Levels of Activity, Competitive, Worry about Global Slowdown-China, Europe, Trade Agreements Passed, China Bashing
- ▶ Federal- Fading Stimulus, Clock Running for November 23rd, New Jobs Plan Proposed

taxes structure

super committee

Prospects

- ▶ GDP Growth Consensus Range in 2011 1.2–1.9% in 2012 .4% to 3.1%
- ▶ Inflation Range 2.1%–3.5% in 2011 and 1.4% to 3.2% in 2012
- ▶ Fed on Hold Until Mid 2013
- ▶ Recession Risks Increased (Carl Dietz)
- ▶ ECRI versus Consensus

*Projected
Slow growth*

lower inflation next yr

-WOW

*Economic
Research
Institute*

Drags, Headwinds, Challenges

- ▶ Oil/Food Again
- ▶ Housing
- ▶ Deleveraging *Reducing debt load*
- ▶ Wealth Declines
- ▶ European Financial Problems/Global Slowing
- ▶ State and Local Governments
- ▶ Federal Fiscal Uncertainty
- ▶ Credit Market–Back to the Future–Swinging Pendulum
- ▶ Uncertainty/Fear

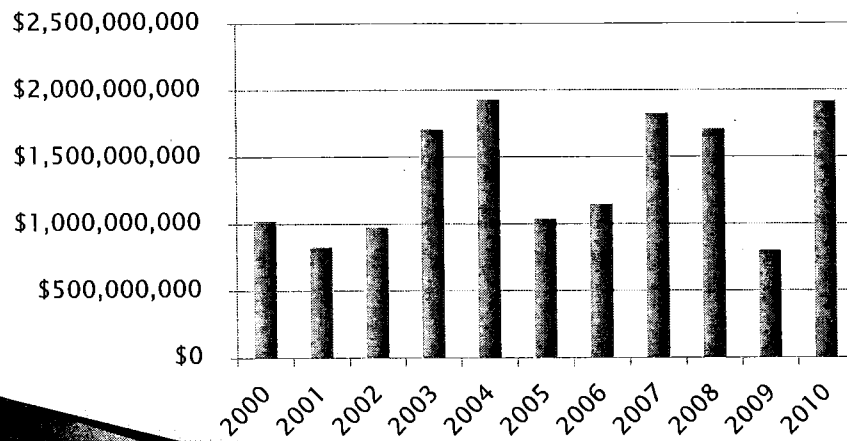
WOW

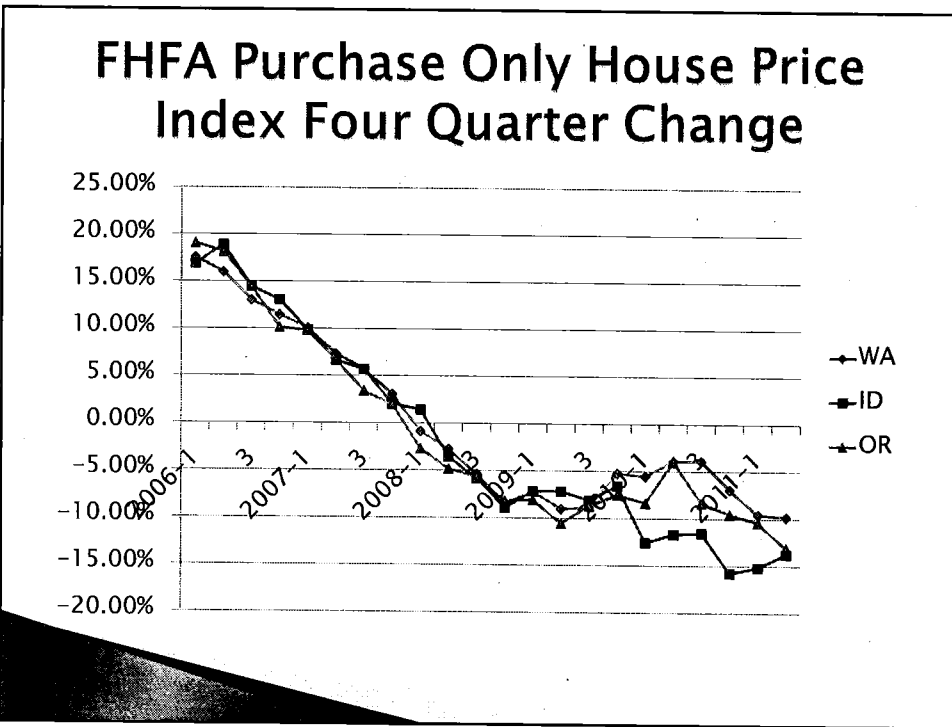
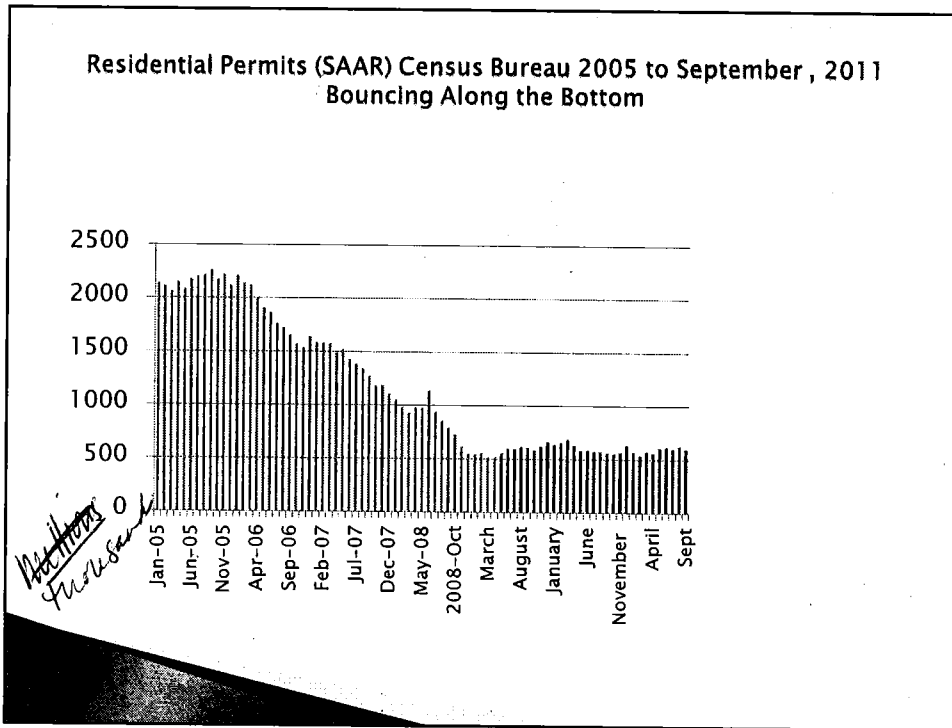
Energy Shock 6.0

- ▶ 12 Months to September Gasoline up 33.3%
- ▶ Food at Home up 6.3%
- ▶ Demand Inelastic
- ▶ Spending Patterns Changed
- ▶ Equipment Values Changed
- ▶ Search for Supplies. Increase Production

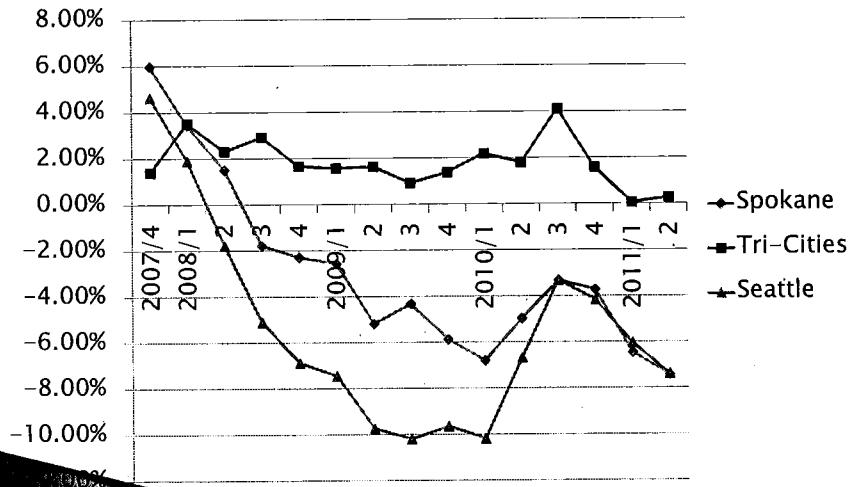
Washington Net Farm Income 2000-2010

Source:USDA





House Price Index Since The Economy's Peak (4/2007)



Recent Housing Bullets

- ▶ Foreclosure and Past Due Mortgages 12.54%
MBA
- ▶ Case Shiller Home Prices at Summer 2003 Levels
- ▶ September Existing Home Sales in Sept up 11.3% over the Year-Down from August-Distressed 30 % of Sales
- ▶ CoreLogic 22.5% of People With Mortgages Underwater, 17.2% in Washington, Seattle 16.5%, Nevada 60.4%, CA 30.2%- 75% of Underwater Have Above Market Rates

Foreclosed

Housing

How Does It End?

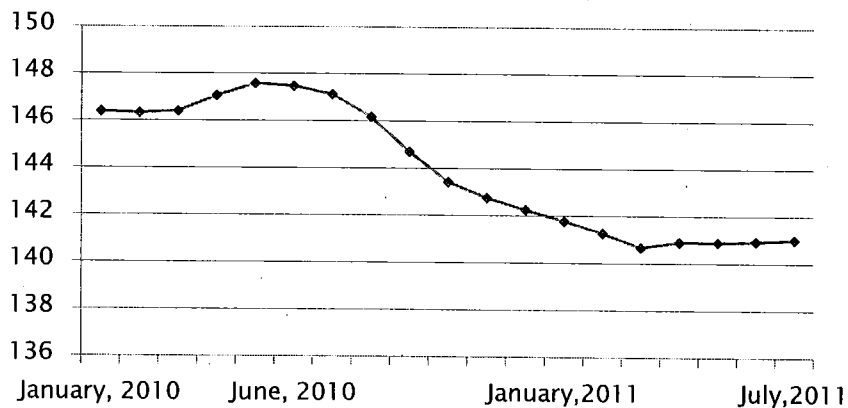
- ▶ Minimal New Construction
- ▶ Price Declines and Rising Affordability
- ▶ Increasing Employment and Household Formation
- ▶ More Renters
- ▶ Transaction Changes—GSE's? Banks?
- ▶ Buy a House Get a Green Card ?
- ▶ Time

- ▶ Glimmers: Price Stabilization, Rent versus Buy Incentives

Gov. Sponsored Enterprises

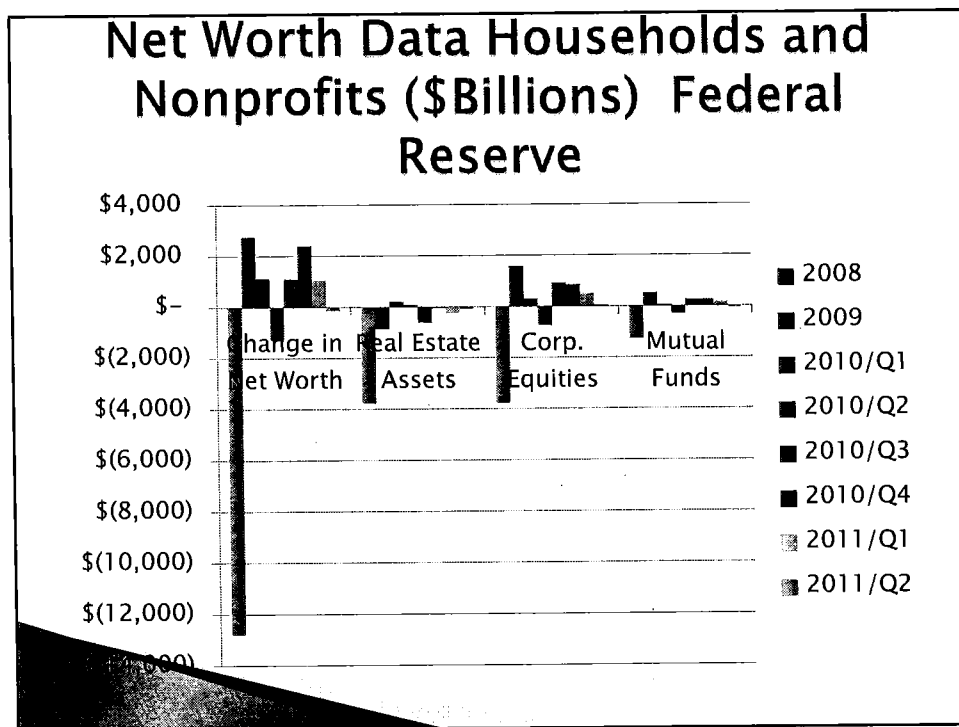
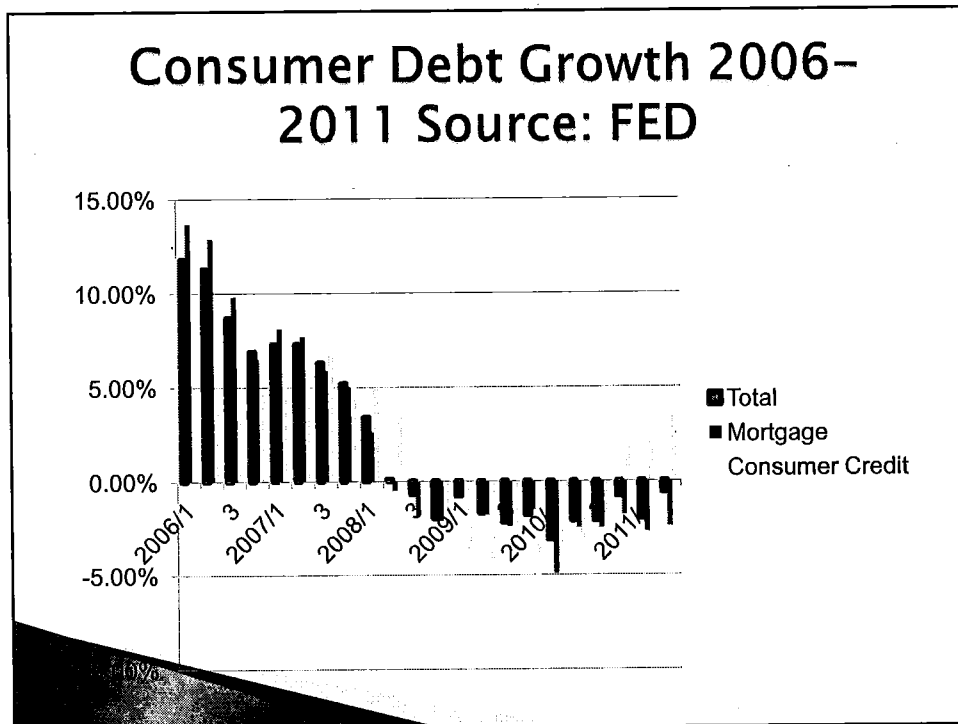
Case Shiller 20 City Composite
 January 2000=100
 April 206.84 Peak

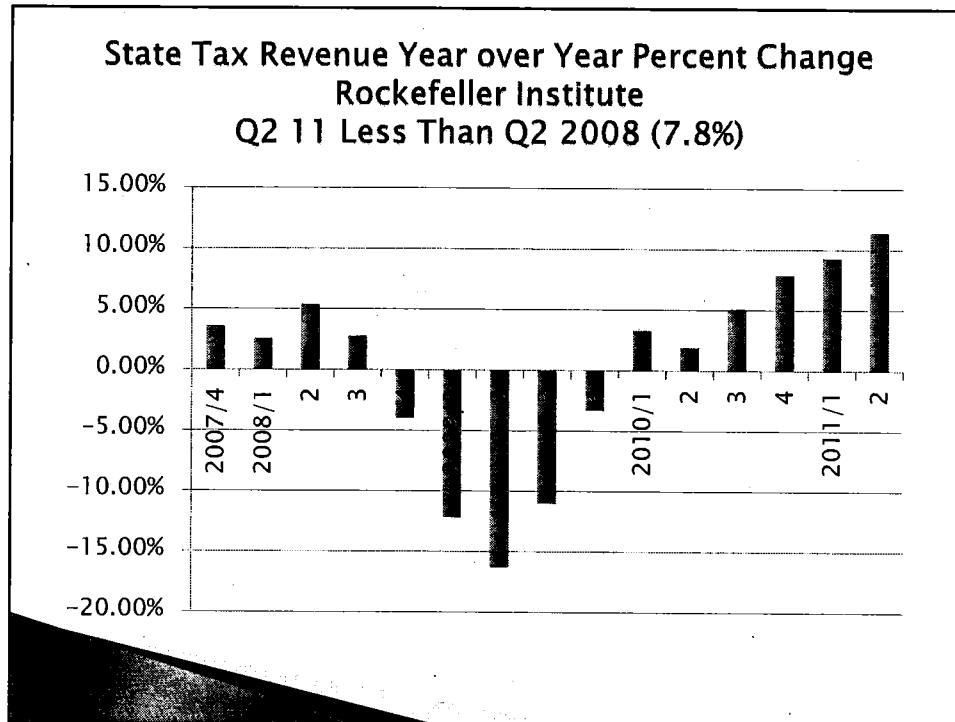
Source: S & P



Review of same home reviews

April 2010 246

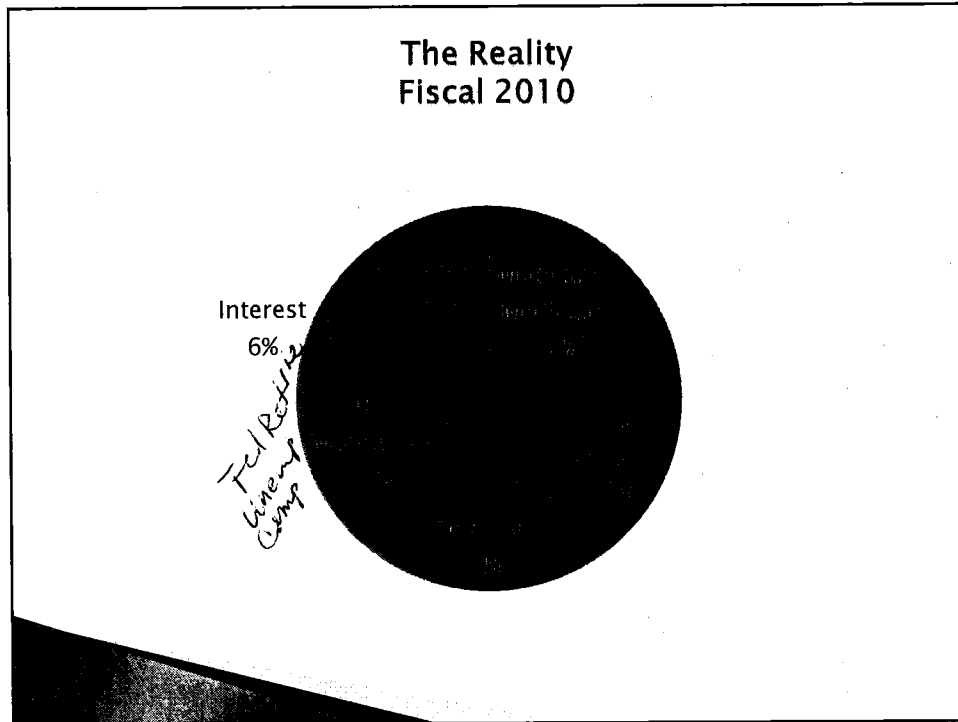




The General Theory (1936) John M. Keynes

- ▶ Most, probably, of our decisions to do something positive, the full consequences of which will be drawn out over many days to come, can only be taken as a result of animal spirits—of a spontaneous urge to action rather than inaction, and not as the outcome of a weighted average of quantitative benefits multiplied by quantitative probabilities.
- ▶ Apocalyptic Prognostications, Regulatory Explosion—Medical, Dodd Frank, EPA, Debt Uncertainty—European Problems
- ▶ Deer in the Headlights Confidence Fairy

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*Congressional
Budget
Office*

Long Term Fiscal Issues

- ▶ CBO June Debt to GDP 40% in 2008, 2011 70%, Alternative Scenario 100% by 2021
- ▶ Healthcare and SS 15% GDP in 25 Years—Over the last 40 Years all Federal Spending excluding interest averaged 18.5%
- ▶ Crowding Out
- ▶ Risk of Sudden Fiscal Crisis (See Greece)
- ▶ Ability to Offset Weakness ◀
- ▶ Other Spending Constrained to Pay Interest

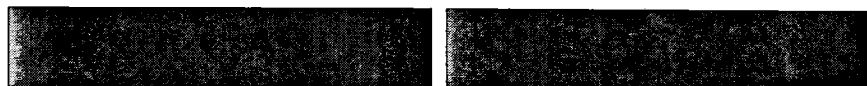
S&P Report

- ▶ “ More broadly, the downgrade reflects our view that the effectiveness, stability and predictability of American policymaking and political institutions have weakened at a time of ongoing fiscal and economic challenges to a degree more than we envisioned when we assigned a negative outlook to the rating on April 18, 2011.”

Policy Conundrums

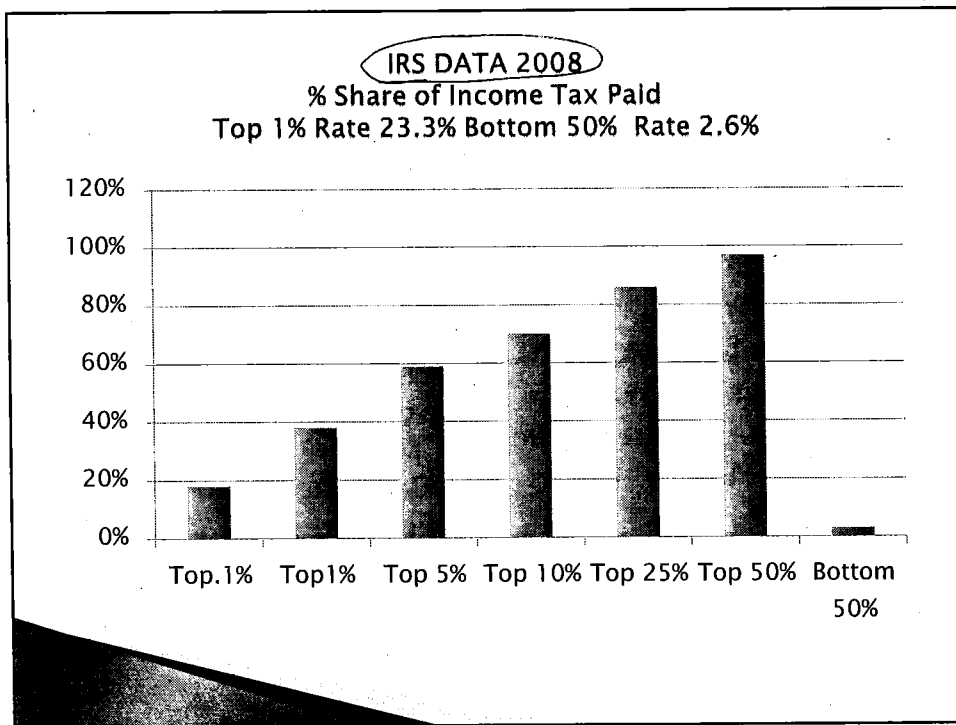
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|--|---|
| ▶ MONETARY POLICY | ▶ FISCAL POLICY |
| ▶ Zero Rate Bound | ▶ Debt/Deficit Focus |
| ▶ Savers, Seniors, Pensions? | ▶ Short Term versus Long Term Problem |
| ▶ Manage Balance Sheet | ▶ President’s Plan–What Pieces Might Emerge? |
| ▶ Interest on Reserves | ▶ Super Committee (PwP) |
| ▶ Bernanke: Jackson Hole and Testimony: No Panacea | ▶ “Moment of Truth” and Debt Reduction Task Force |

Program w/ possibility



“Moment of Truth” Simpson-Bowles Report

- ▶ Discretionary Spending Cuts *mit/won't*
- ▶ Comprehensive Tax Reform—Reduce Rates, Broaden Base Simplify—Reduce Tax Expenditures
- ▶ Health Care Cost Containment
- ▶ Mandatory Savings —
- ▶ Social Security Reform
- ▶ Process Change



Policy

- ▶ End of 2011 if Nothing Happens?
- ▶ Go Ahead One Year-What happens at the end of 2012 if Plan Passed ? Scheduled Expirations
- ▶ Unwinding the Monetary Policy Actions-When and How?
- ▶ Super Committee-Home Run, Strike out or Something Between-The Time Might be Right

Job Growth Update -August 2011 Data- Year over Year Change-42 States Up

- | | |
|------------------------|---------------------|
| ▶ North Dakota 1 | ▶ New York 22 |
| ▶ Wyoming 2 | ▶ Pennsylvania 25 |
| ▶ Utah 3 | ▶ Idaho 26 |
| ▶ Texas 4 | ▶ South Carolina 27 |
| ▶ Oklahoma 5 | ▶ South Dakota 28 |
| ▶ Vermont 6 | ▶ New Mexico 29 |
| ▶ Massachusetts 7 | ▶ Colorado 31 |
| ▶ New Hampshire 8 | ▶ Connecticut 41 |
| ▶ Michigan 9 | ▶ Virginia 42 |
| ▶ Arizona 10 | ▶ Maryland 43 |
| ▶ Alaska 11 | ▶ Kansas 44 |
| ▶ Washington 12 | ▶ Nevada 45 |
| ▶ Nebraska 13 | ▶ Alabama 46 |
| ▶ Minnesota 14 | ▶ Missouri 47 |
| ▶ Louisiana 15 | ▶ Delaware 48 |
| ▶ Oregon 16 | ▶ Indiana 49 |
| ▶ Hawaii 17 | ▶ Georgia 50 |
| ▶ Ohio 18 | |
| ▶ Iowa 19 | |
| ▶ Maine 20 | |
| ▶ California 21 | |

*Arizona
State
University
Research*

Takeaways

- ▶ Time that cries for Leadership–Cusp of Major Decisions
- ▶ Risk of Recession has Increased
- ▶ Where is the Strength going to come from?
- ▶ Long Term Issues have become Short Term Issues
- ▶ “After the Fall” Scenario *Aug 2010* *Reinvents*
- ▶ We always tend to underestimate the resilience of the US economy.