

UCLAAnderson  
**FORECAST**



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*To Recede or Not to Recede?*

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# The Questions for Today

- ◆ What's a recession?
- ◆ Does it matter if we meet the technical definition of recession?
- ◆ Are we in a recession?
- ◆ What comes after the slowdown?
- ◆ What does this all mean for California and the East Bay?

# What is a recession?

- ◆ Two consecutive quarters with negative GDP growth?
- ◆ Official recessions are determined by a committee of Ph.D. economists affiliated with the National Bureau of Economic Research.

The logo for the National Bureau of Economic Research (NBER) features the letters "NBER" in a large, bold, serif font.

NATIONAL BUREAU OF ECONOMIC RESEARCH

A recession is a significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in real GDP, real income, employment, industrial production, and wholesale-retail sales. A recession begins just after the economy reaches a peak of activity and ends as the economy reaches its trough. Between trough and peak, the economy is in an expansion. Expansion is the normal state of the economy; most recessions are brief and they have been rare in recent decades.

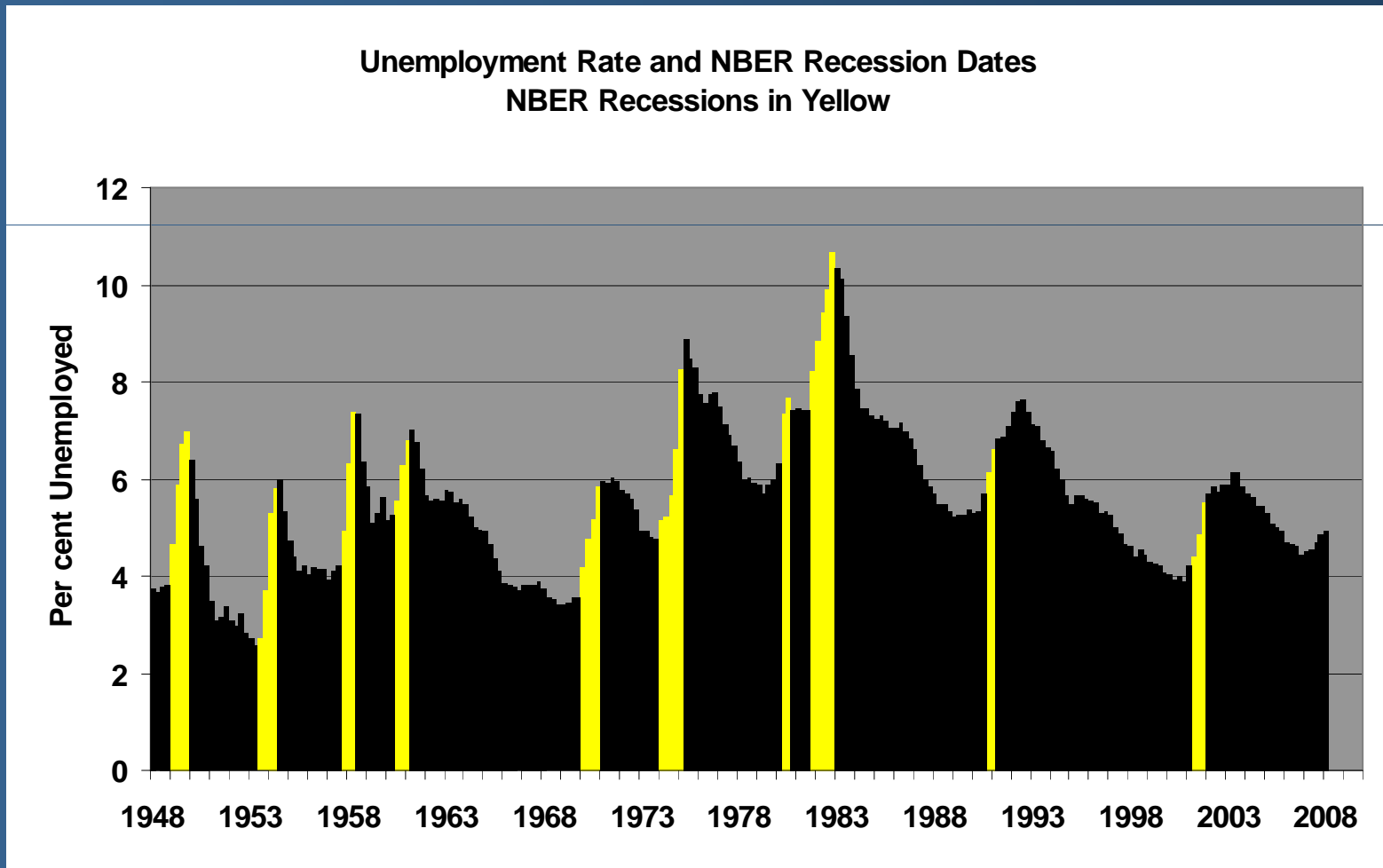
# That's Confusing

- ◆ What do those folks at the NBER actually do with that vague definition?



# What's a Recession?

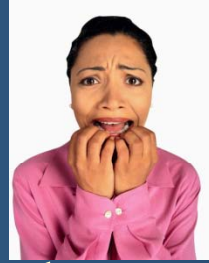
## *A Sharp Rise in Unemployment*



# The Right Definition: Idleness

- ◆ A recession is a short-lived disease that causes a sharp rise in idleness of labor and capital. Among the symptoms of this disease are declines in output, revenues and profits, and rising delinquencies, defaults and bankruptcies.
- ◆ The shape of a recession is V, with sharp losses of jobs followed by a sharp recovery.
- ◆ The first stroke of the V lasts about 3 quarters, and the whole episode is over in 2-3 years.
- ◆ A recession is a national disease, with some locations suffering more than others.

# Does it matter?



- ◆ If we are in a recession, the unemployment rate will elevate to at least 6 percent by the end of the year.
  - At least a million and a half jobs will be lost.
  - Those lost jobs will make the situation in housing even worse.
  - Banking will suffer even more problems.
  - There will be lot more distressed debt.
- ◆ A Forecaster's most important job is correctly to foresee recessions.
  - There are three kinds of episodes: normal growth at the rate of 3% per year, a recession at the rate of -1% per year, and a recovery at the rate of 4% per year.

# What predicts recessions?

- ◆ Troubles in housing
  - We have a collective bipolar disease.



# Recession Facts

*Housing has been a great predictor*

## ◆ False Negatives

- 2001 Internet Comeuppance
- 1953 DOD Downturn

## ◆ False Positives

- 1967 – Vietnam War
- 1953 - Korean War

# Recession Facts

## *Ordering of Downturns*

- ◆ Homes
- ◆ Cars (Durables)
- ◆ Business Equipment
- ◆ Business Structures

Homes and Cars are  
Leading indicators

# What Kind of Slowdown?

- ◆ *Recession hardly begun.* A typical V-shaped recession with a rapid recovery and back to normal in 2009.
- ◆ *An extended “serial” adjustment.* After two years of problems in housing beginning in 2005 we will move on to deal with problems in consumer durables. The serial not-parallel nature of the adjustment makes it less severe but more long-lasting.
- ◆ *Wall Street famine.* The deepest and longest downturn since the Great Depression as the banking sector, desperate to repair troubled balance sheets, terminates business and consumer lending just as it terminated mortgage originations in 2007.

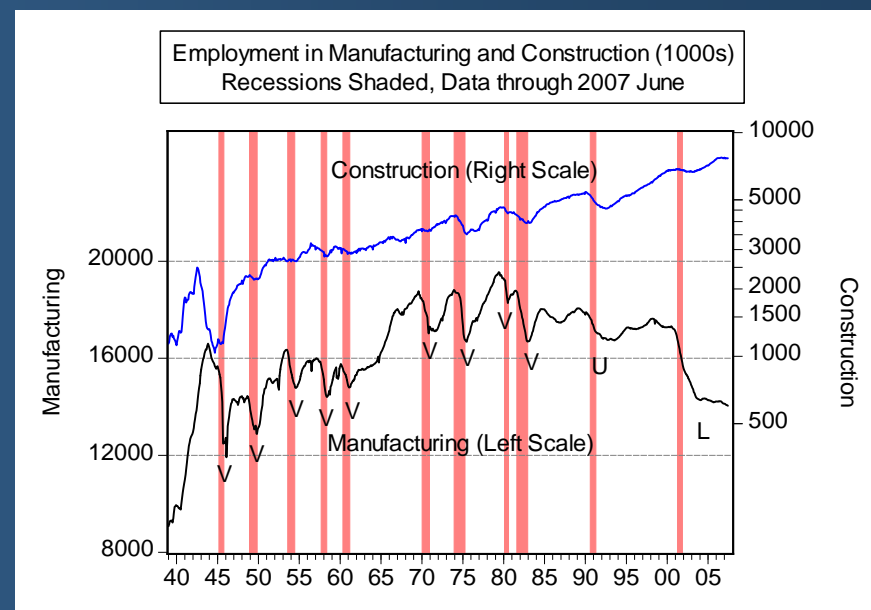
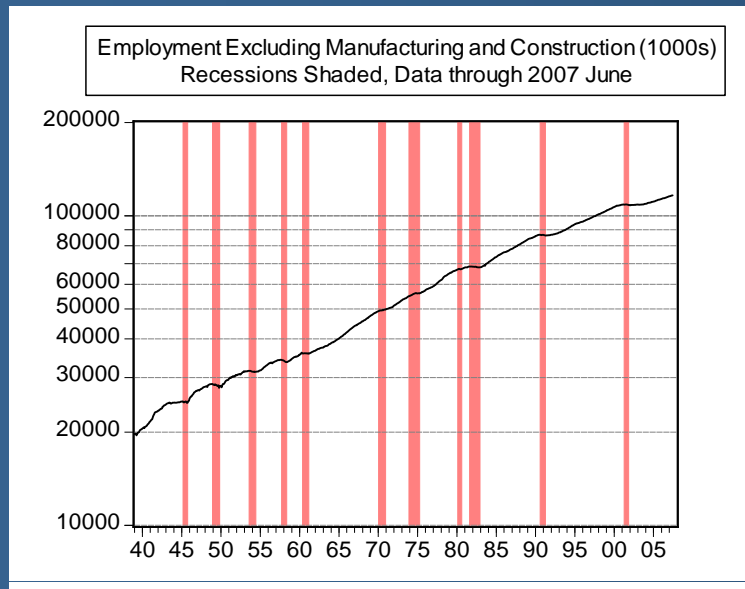
# Our View

- ◆ This time will be different.
  - This time what happens in housing stays in housing.



# Our no-recession view

- ◆ Disconnect Between Housing and Labor Market
- ◆ Disconnect between employment cycle in manufacturing and construction



# You make the call

◆ No problem



◆ Worrisome



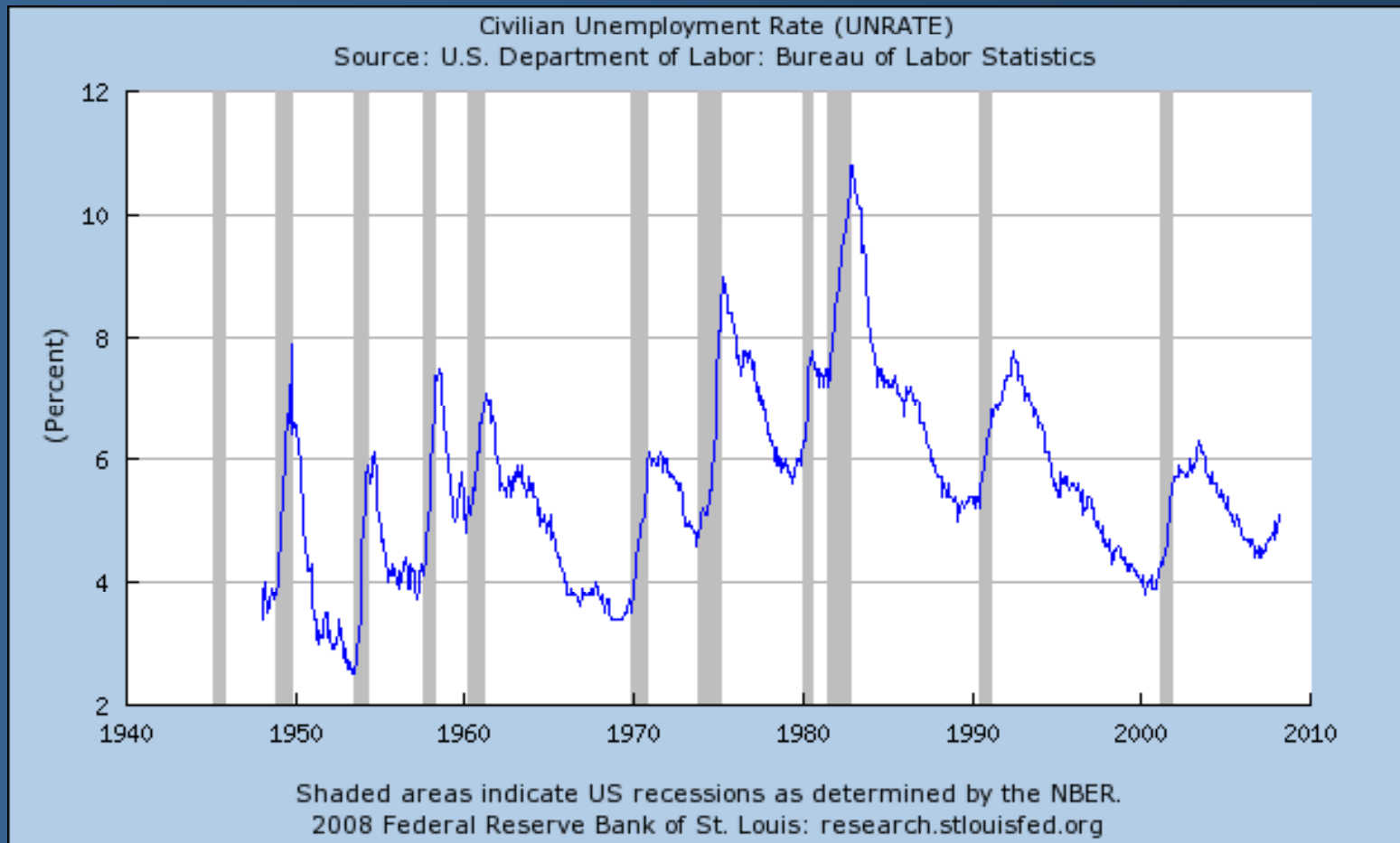
◆ We are really ill already.



◆ Housing related

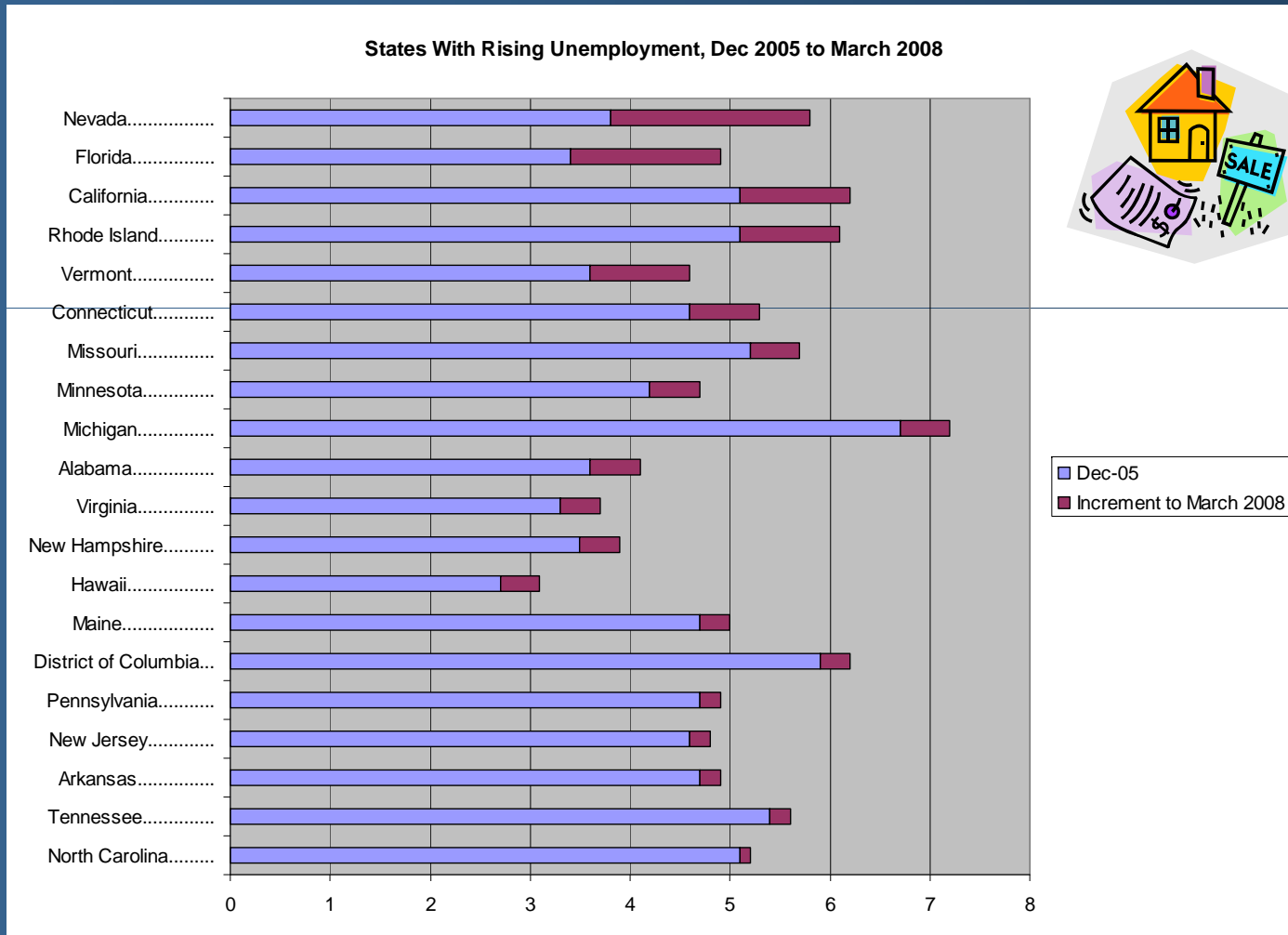


# Unemployment Rate



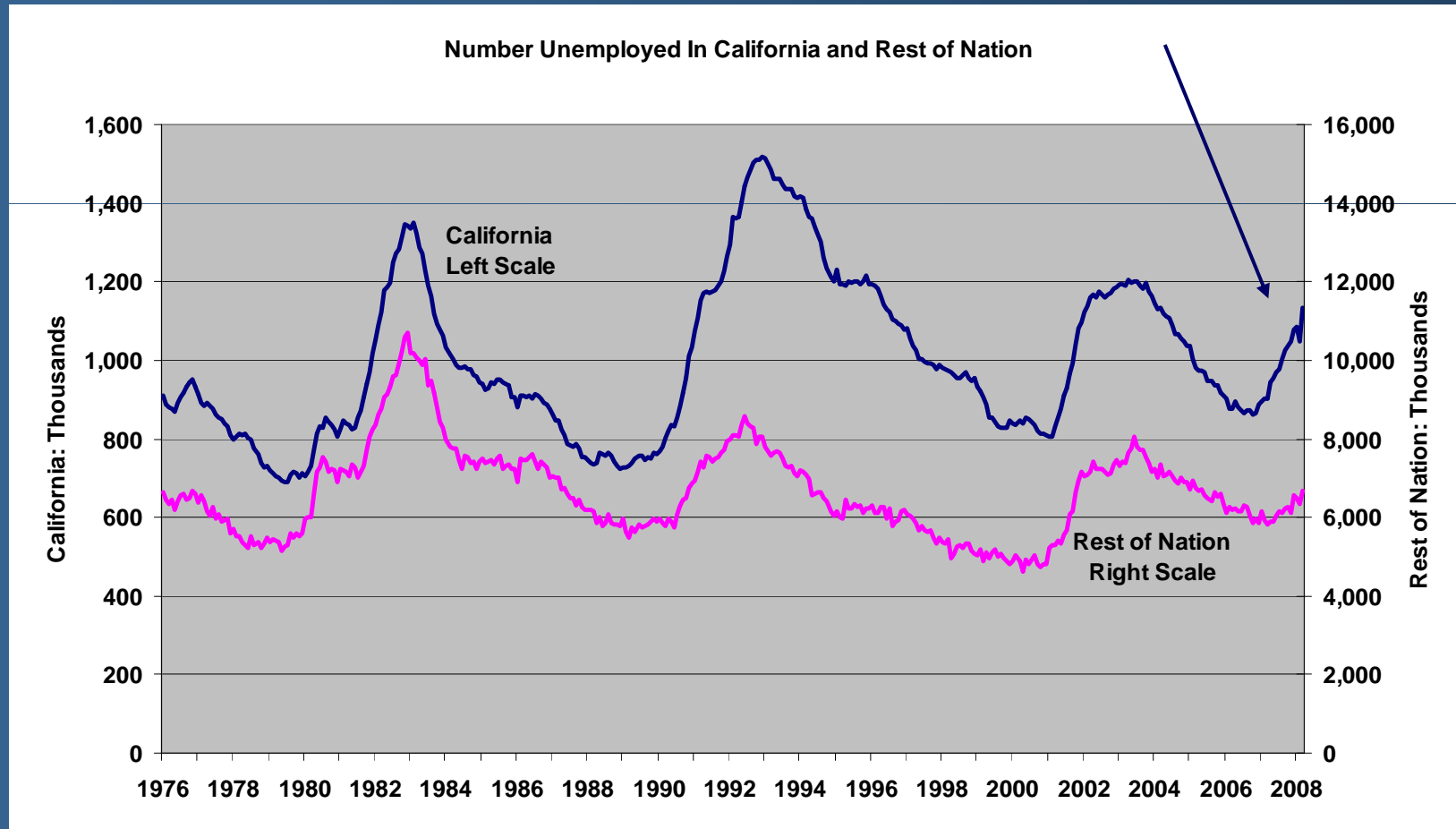
# But Only 20 States Have Been Experiencing Rising Unemployment

*December 2005 – March 2008*

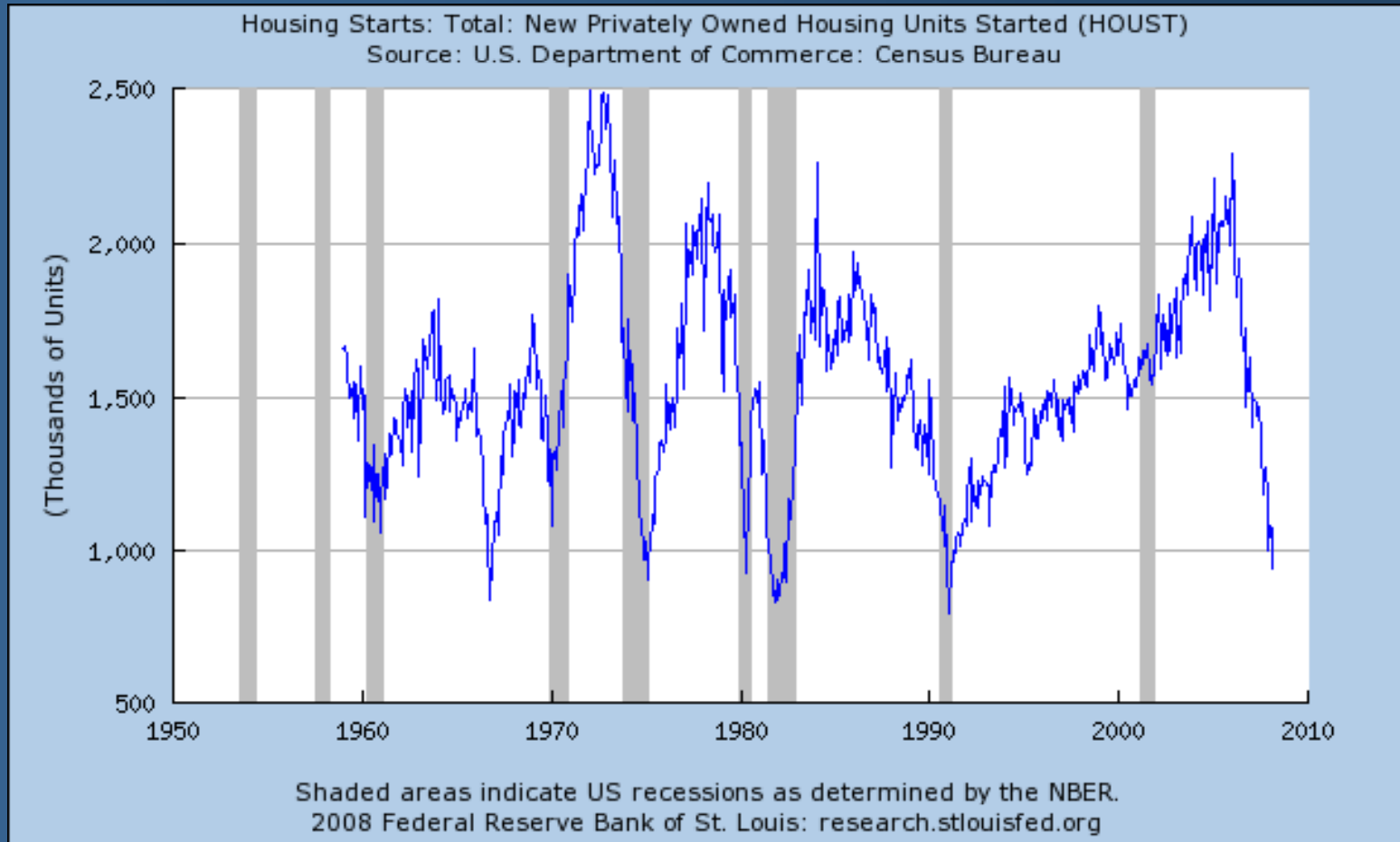


# Number Unemployed

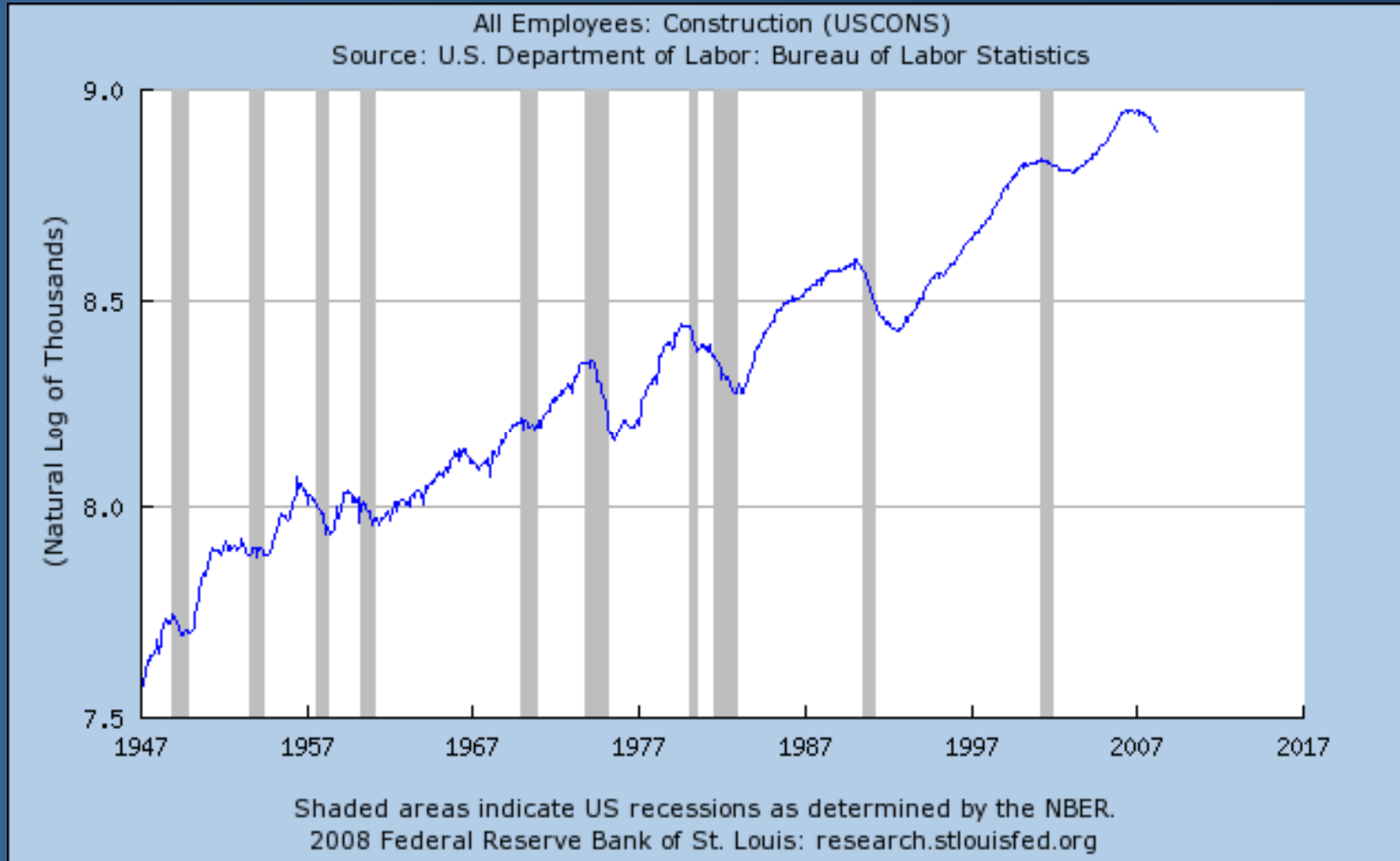
*More than ever before,  
this is a California problem*



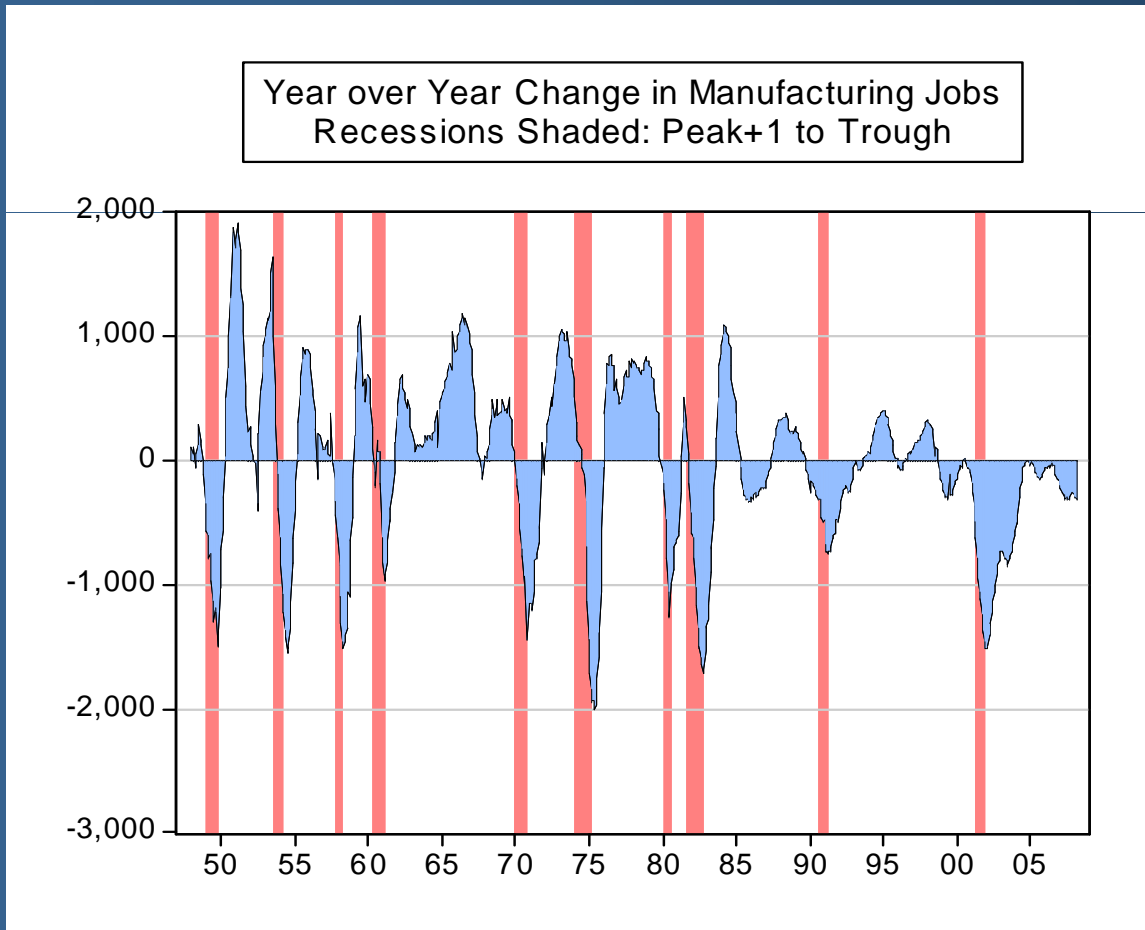
# Housing Starts



# Construction Jobs



# Year-over-Year Change in Manufacturing Employment

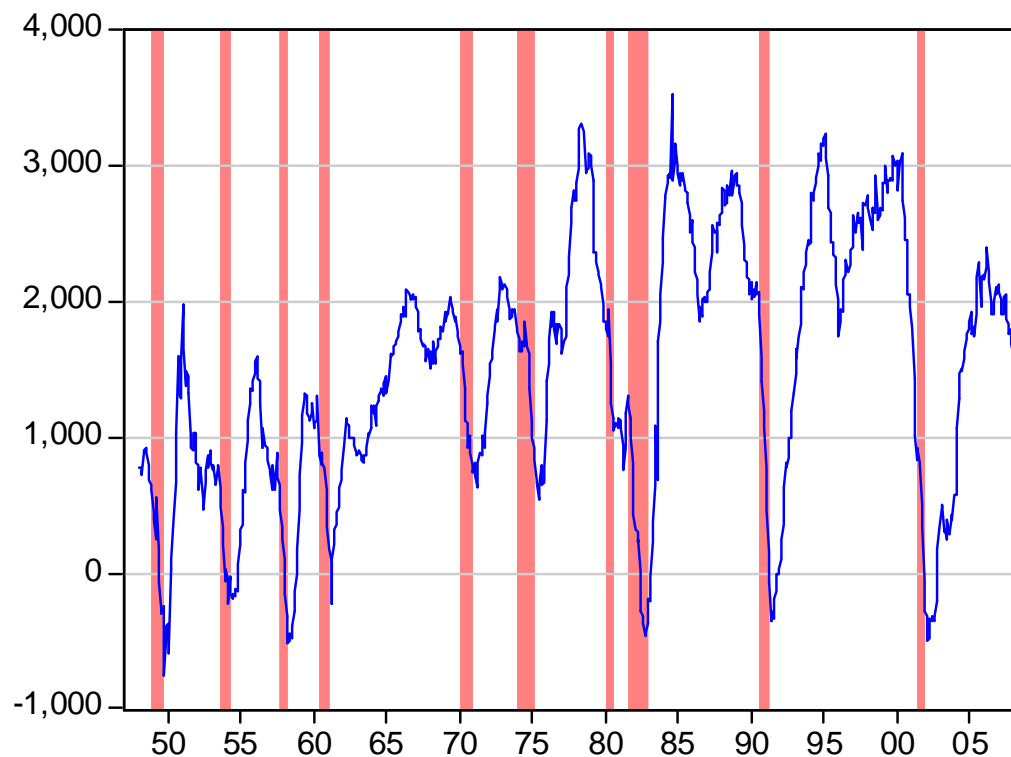


# Year over Year Change In Other Jobs

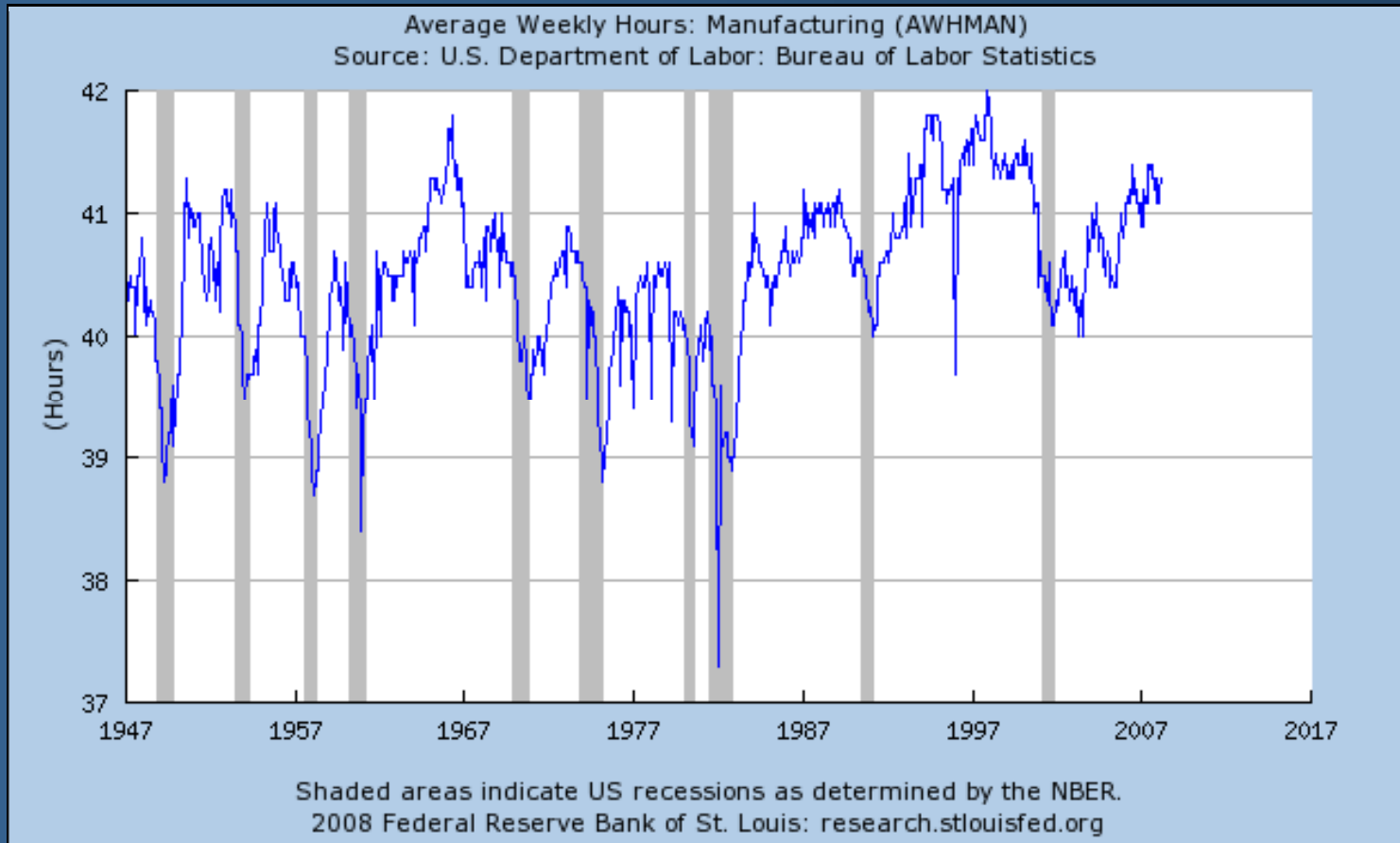
Jobs excluding manufacturing and construction



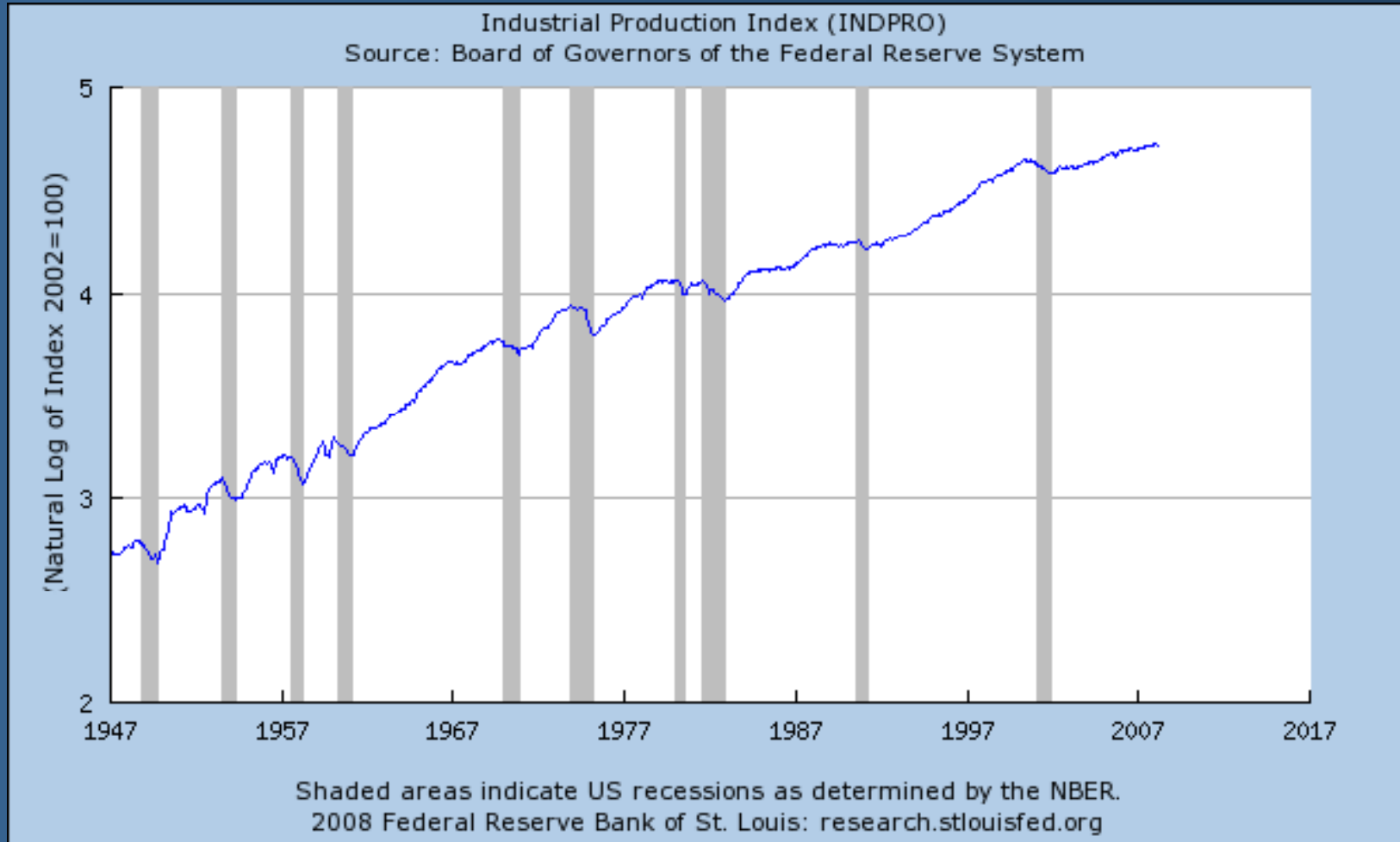
Year over Year Change in Jobs exc Manufact and Constr  
Recessions Shaded: Peak+1 to Trough



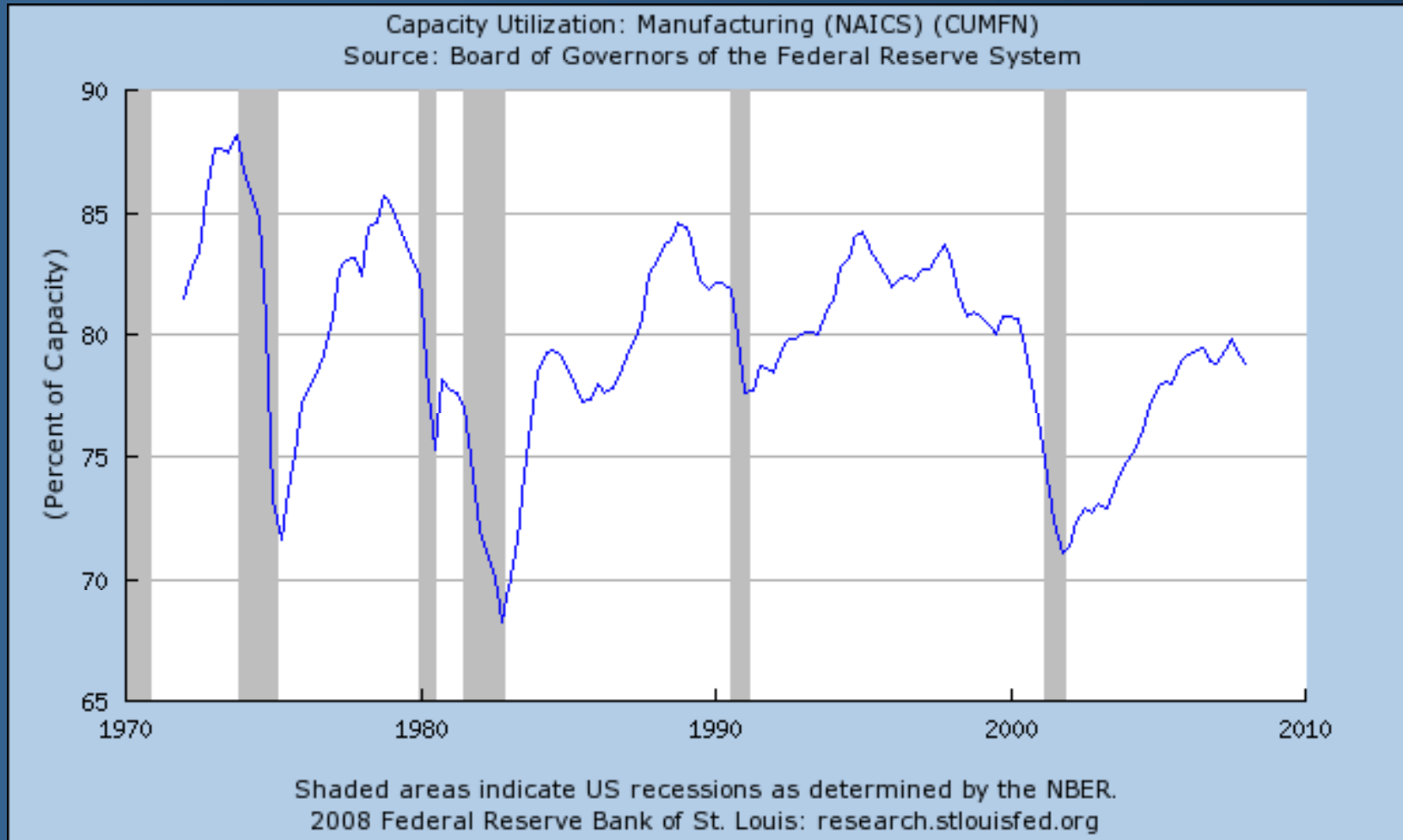
# Weekly Hours in Manufacturing



# Industrial Production



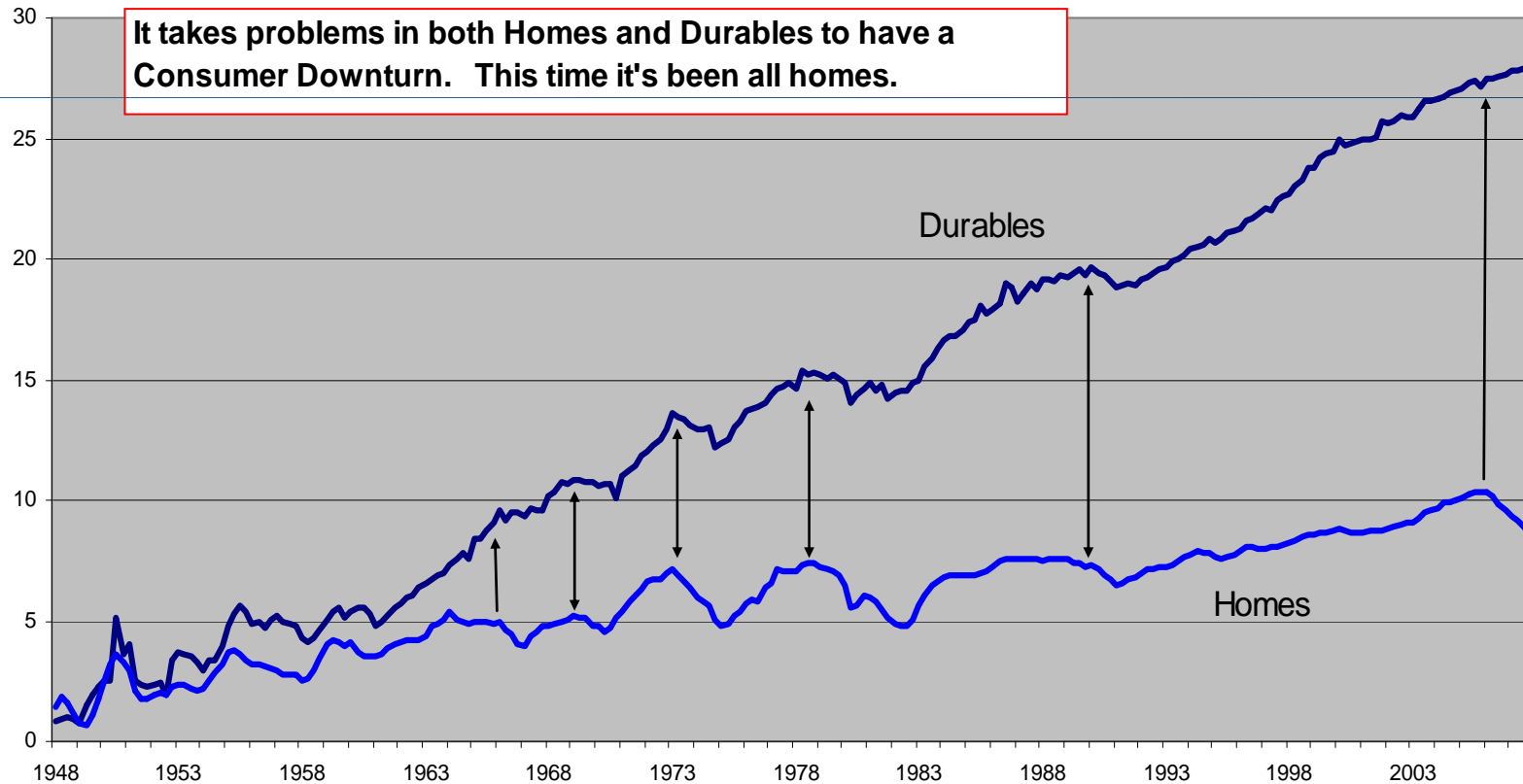
# Capacity Utilization in Manufacturing



# The Consumer Downturn Has Not Yet Begun(2007Q4)



**Cumulative Contributions to GDP Growth:  
Homes and Durables**



# Our No Recession Hypothesis

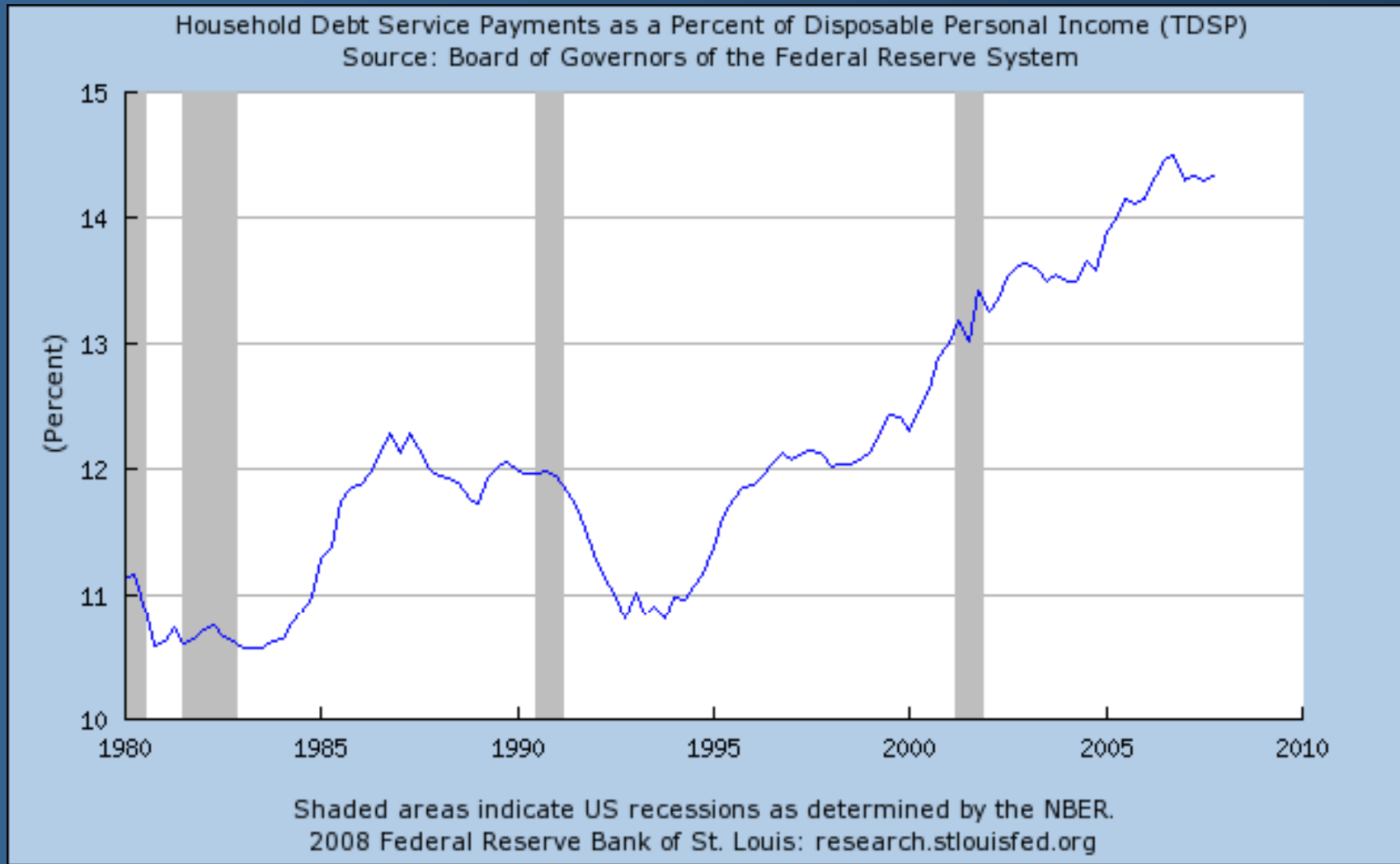
- ◆ Still intact, with manufacturing weathering the difficulties
- ◆ Needs a few more months of data to confirm.

## What Kind of Aftermath?

- ◆ *Back to normal* with GDP growth at 3% and employment growth at 2%.
- ◆ *The future isn't what it used to be.* An extended period of sluggish growth as overspent, heavily in debt consumers finally tighten their belts and start saving for retirement, given the reluctant realization that our homes are not as valuable as we thought, amidst growing unwillingness by foreign lenders to fund a life style we cannot afford

# Structural Adjustment Ahead

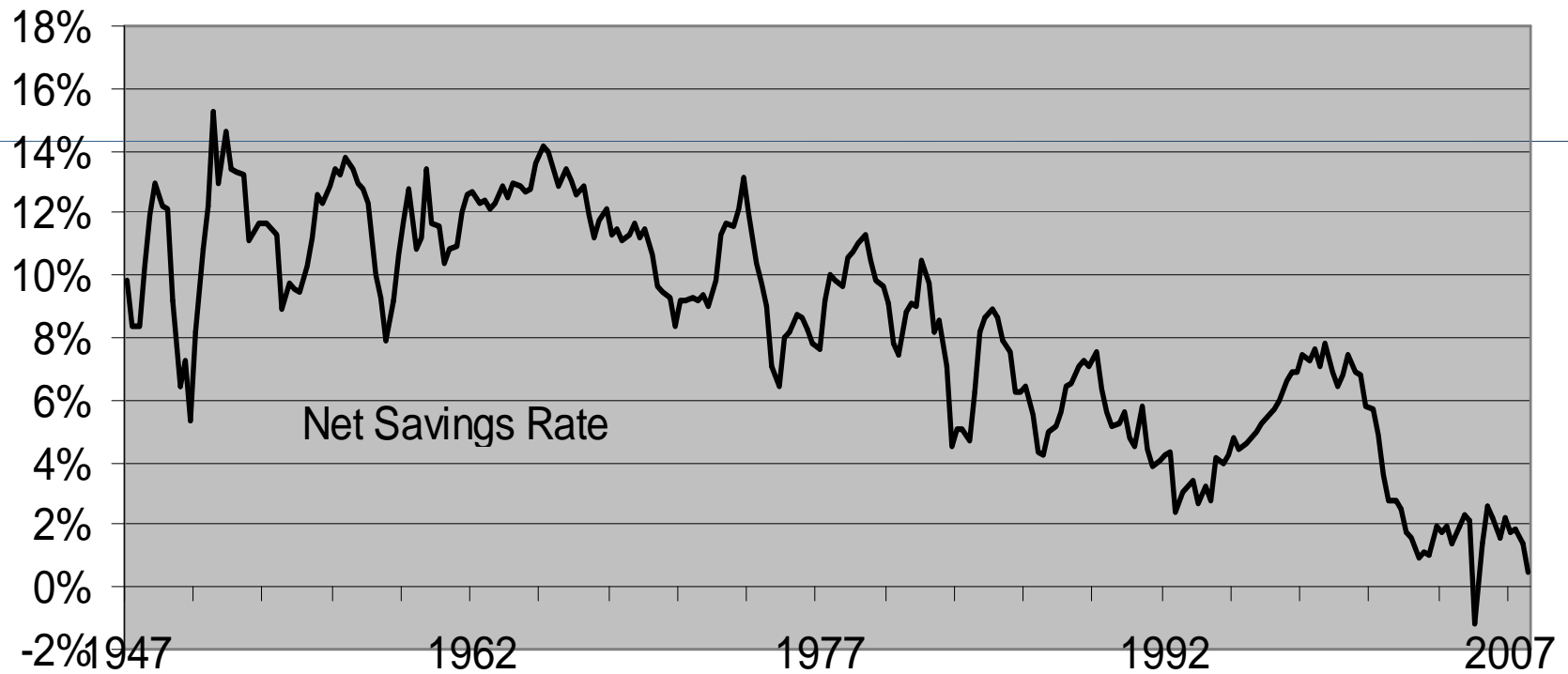
## *Debt Service*



# Structural Adjustment Ahead

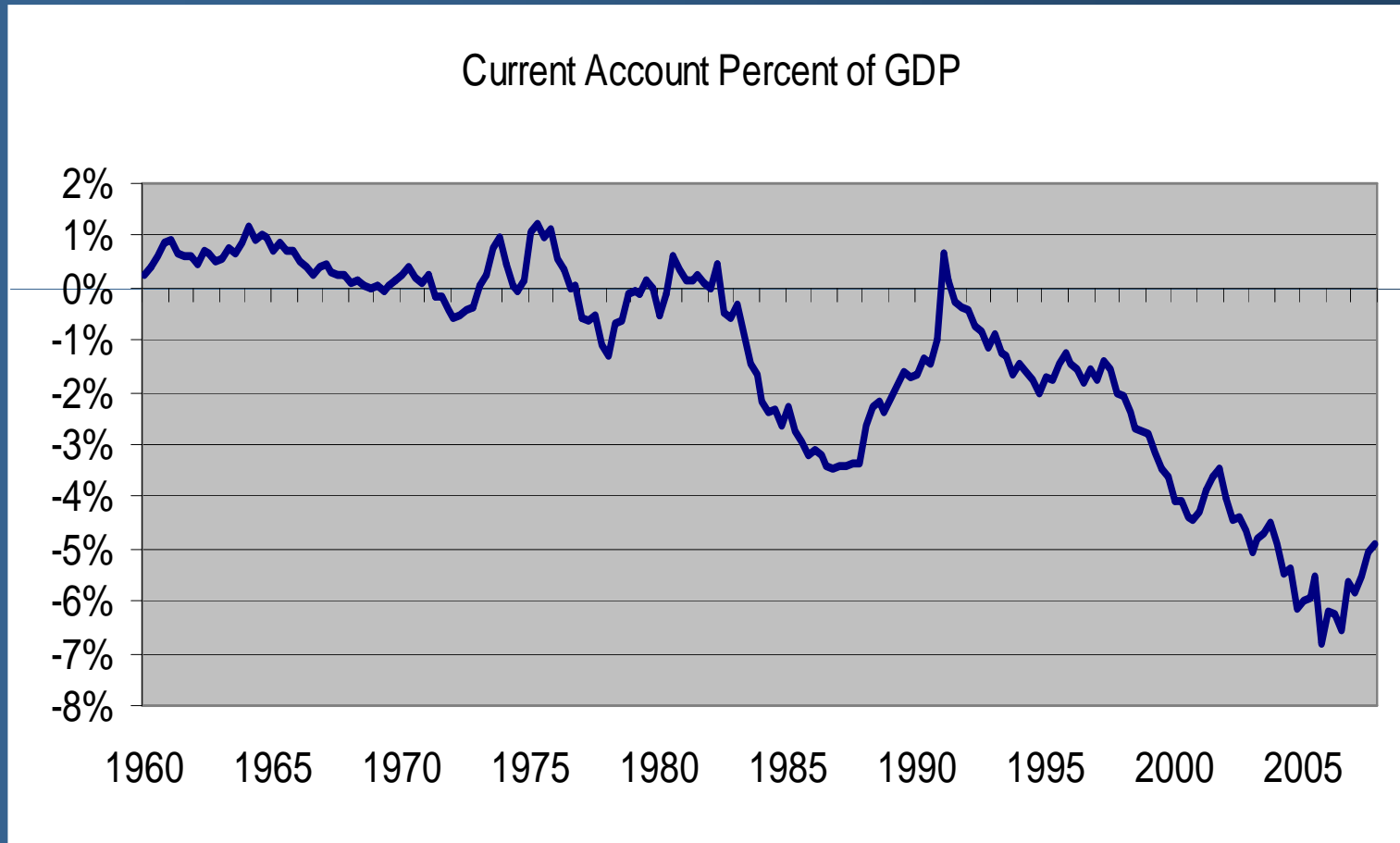
*No Savings*

Savings Rate: Net of Depreciation



# Structural Adjustment Ahead

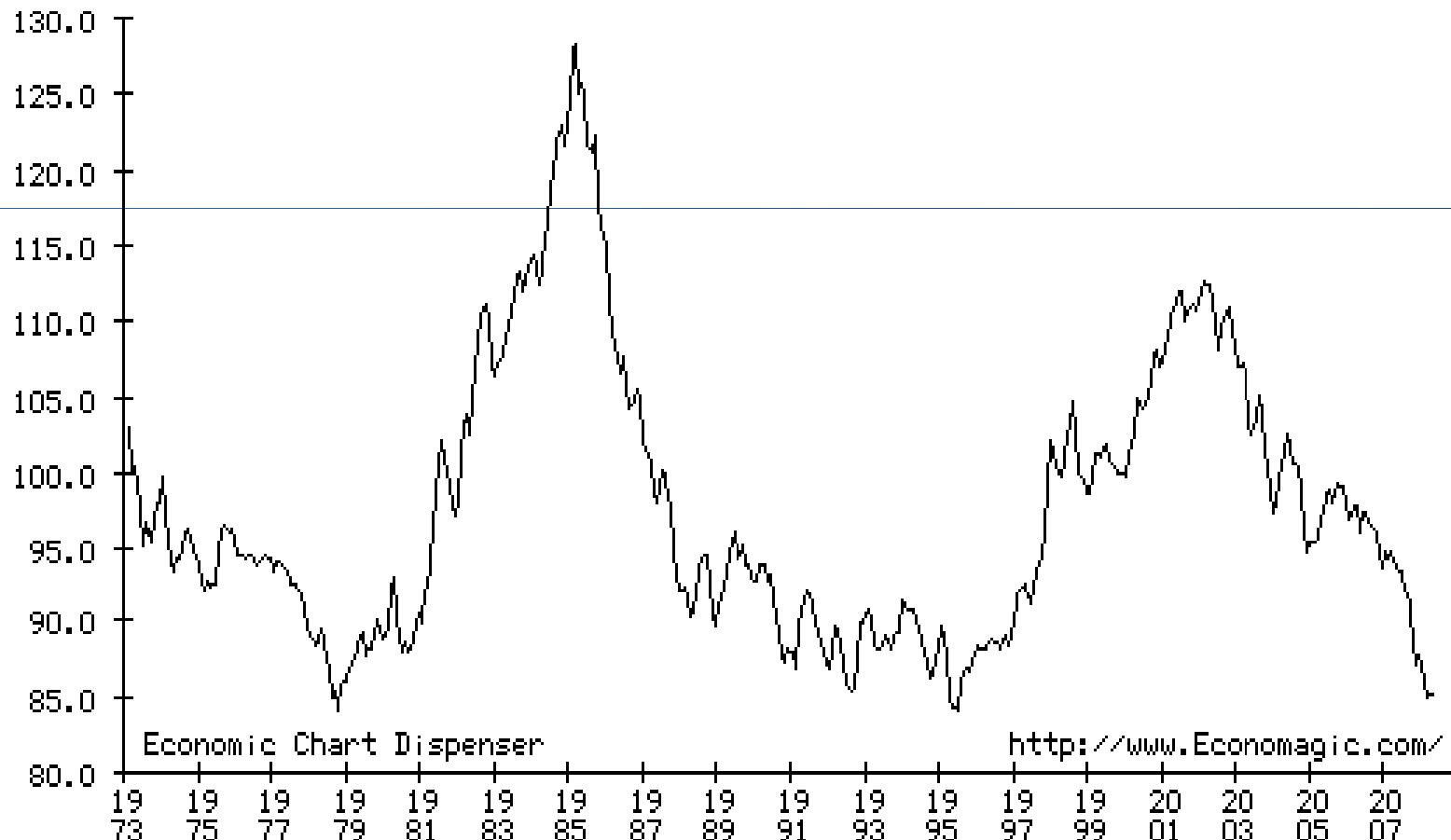
## *External Deficit*



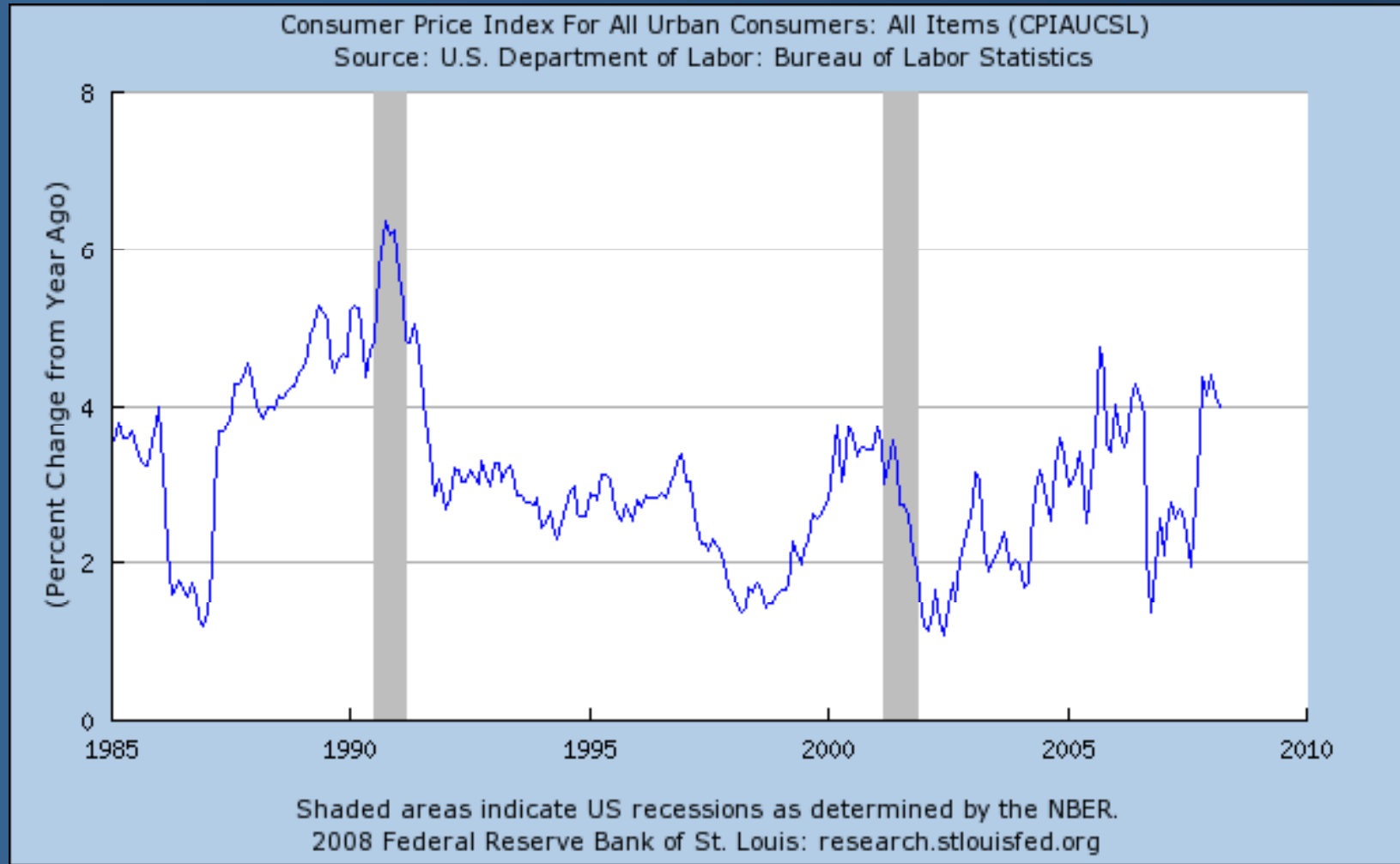
# Structural Adjustment Ahead

*Dollar already devalued*

## Dollar Index: Price-adjusted Broad



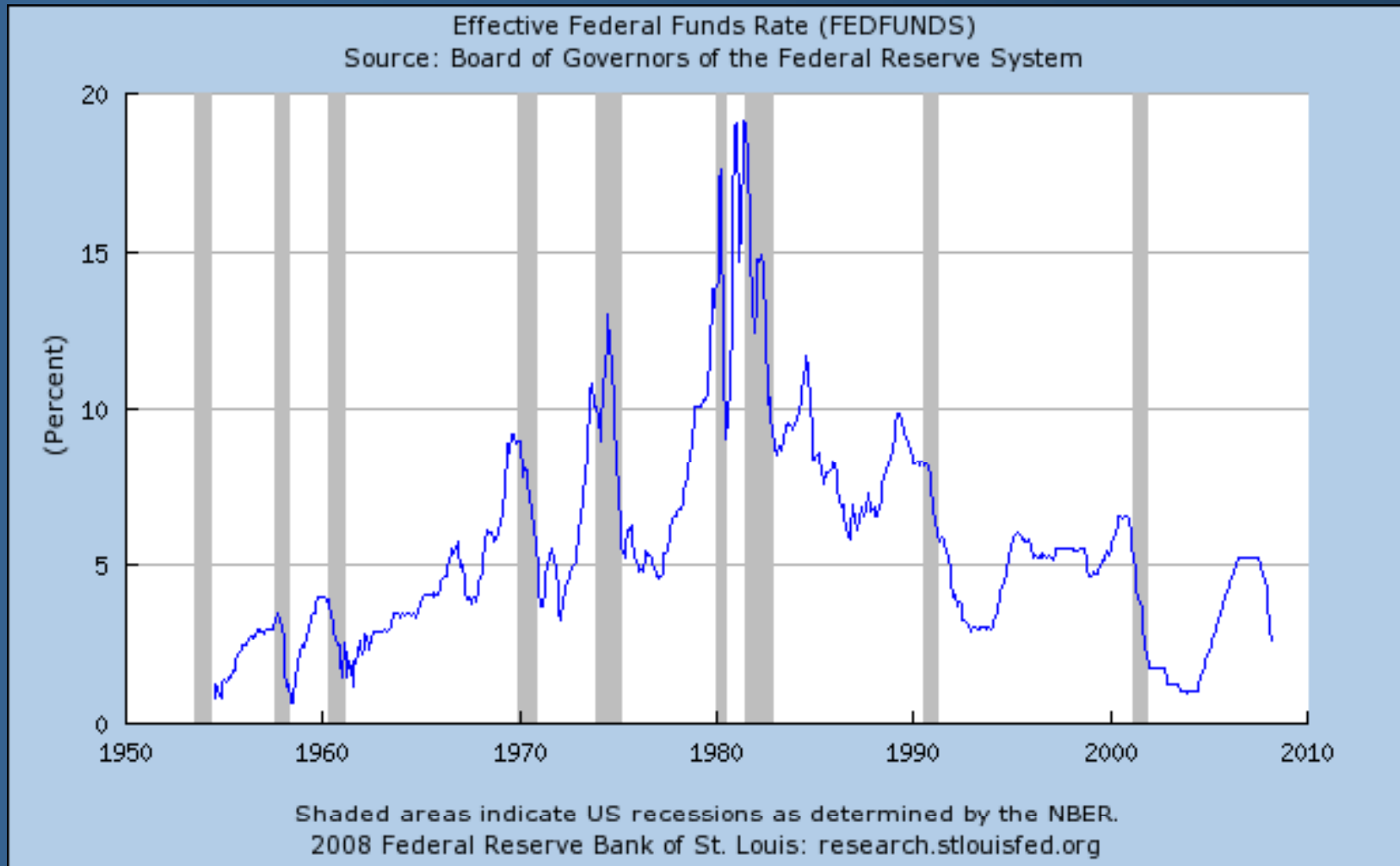
# What should the Fed do? Inflation is getting worrisome.



# This time is different

- ◆ A sluggish economy is causing inflation
- ◆ Can you think why?

Don't expect those rates to stay low for long.

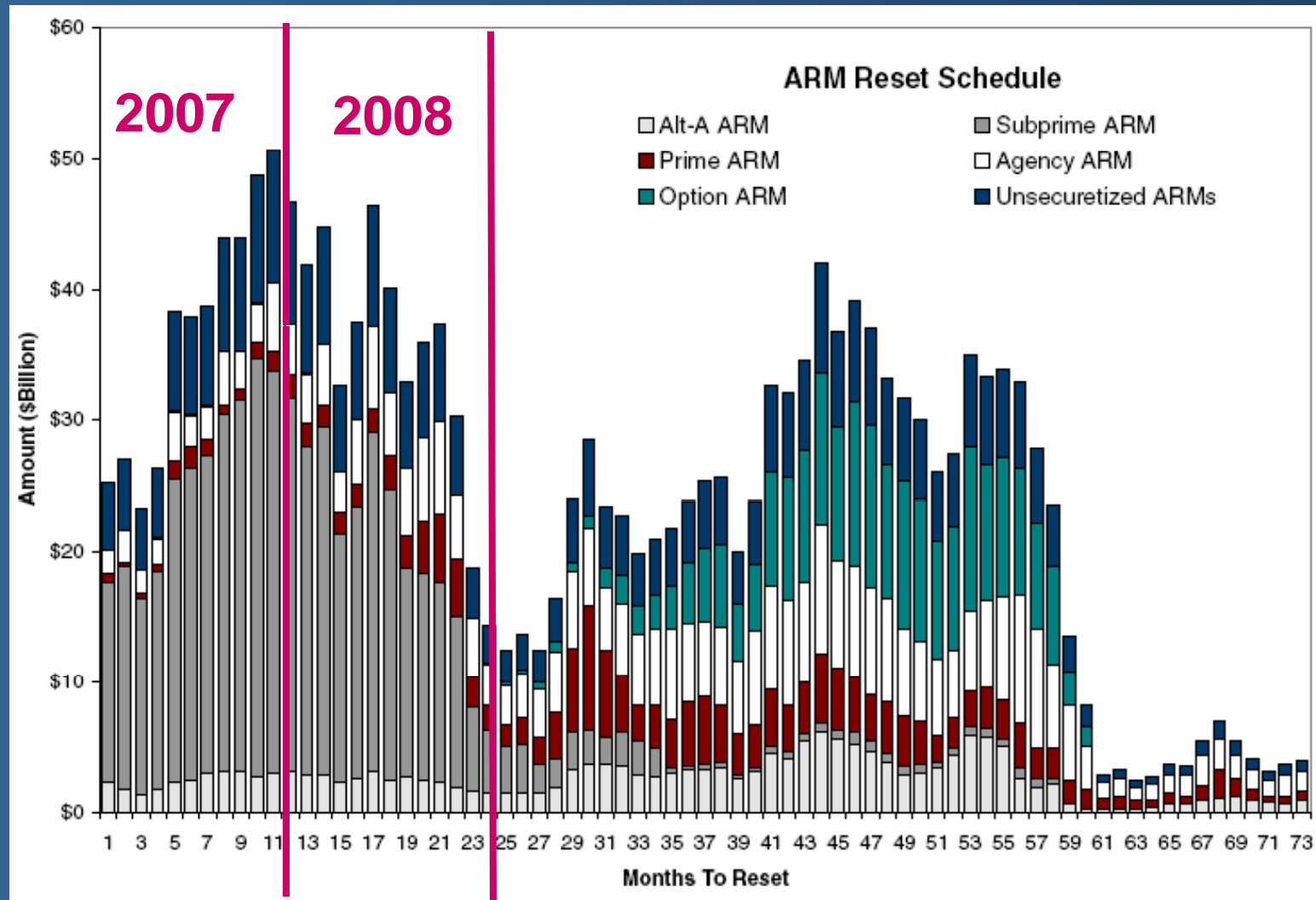


# What's Ahead for Housing?

- ◆ The market needs buyers
- ◆ Buyers need a sense of urgency
  - Mortgage rates that are low but going up
  - Home prices that are going up, not down

# Resets Coming to a Neighborhood Near You

## Subprime Resets Peak in Dec 2007

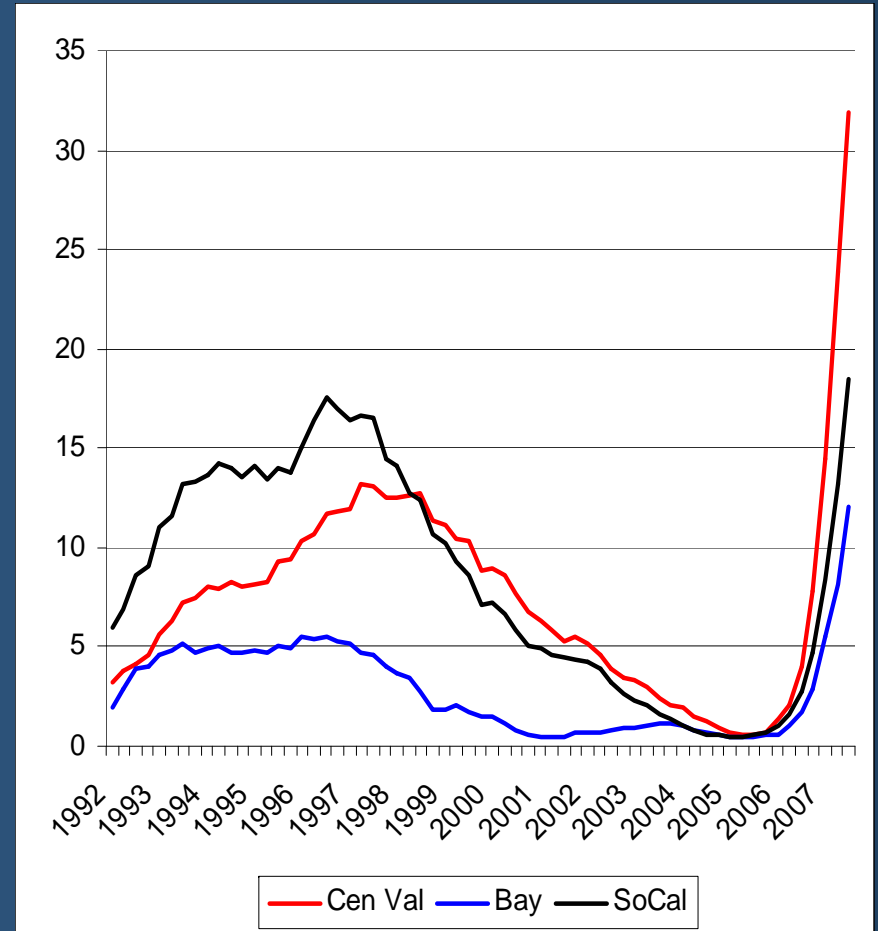
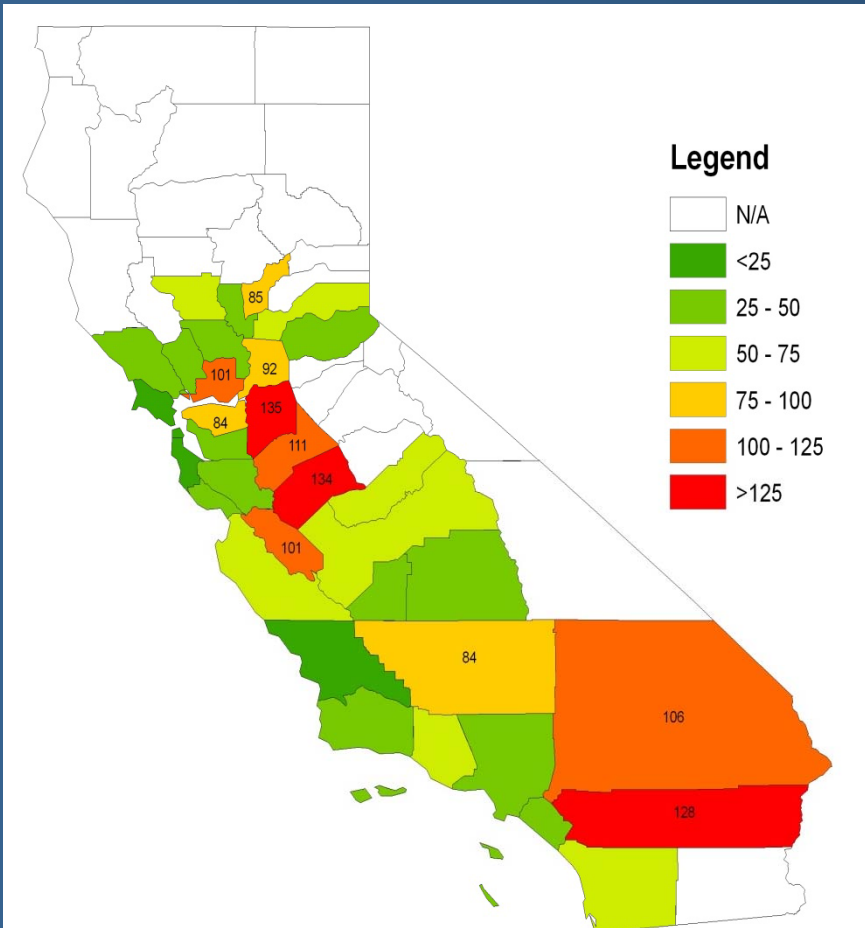


Source: Credit Suisse

# ARM-ageddon continues in CA

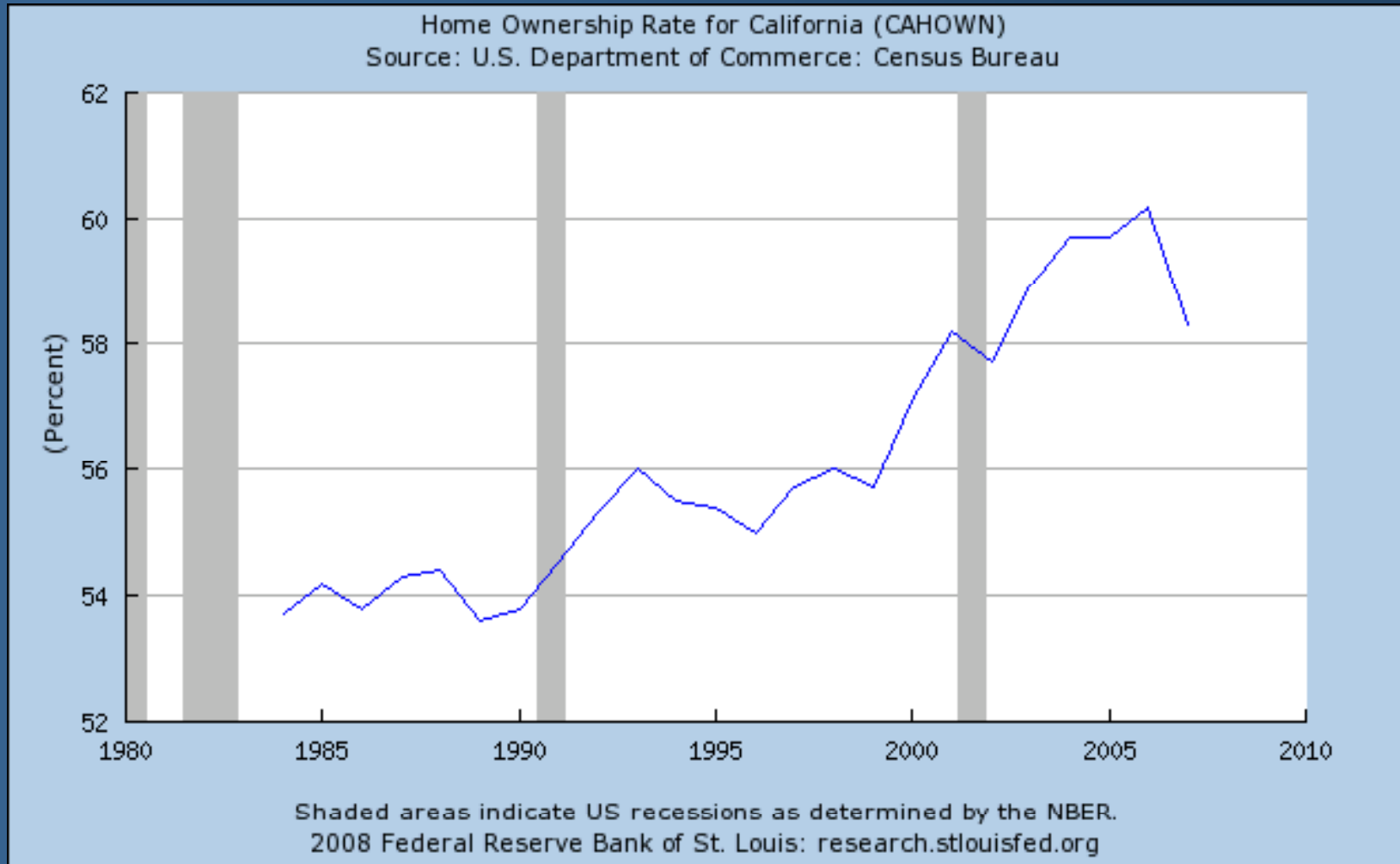
07Q3 NoDs / 10k Households

Trustee Deeds of Sale  
per 10k Households




# California Homeownership Rates

## *Enough, already*




## Six scenarios: Build your own forecast (2B is ours)

### ◆ The Nature of the Slowdown

- 1. Recession just begun. A typical V-shaped recession with a rapid recovery and back to normal in 2009.
- 2. An extended “serial” adjustment. After two years of problems in housing beginning in 2005 we will move on to deal with problems in consumer durables. The serial not-parallel nature of the adjustment makes it less severe but more long-lasting. 
- 3. Wall Street famine. The deepest and longest downturn since the Great Depression as the banking sector desperate to repair troubled balance sheets terminates business and consumer lending just as it terminated mortgage originations in 2007.

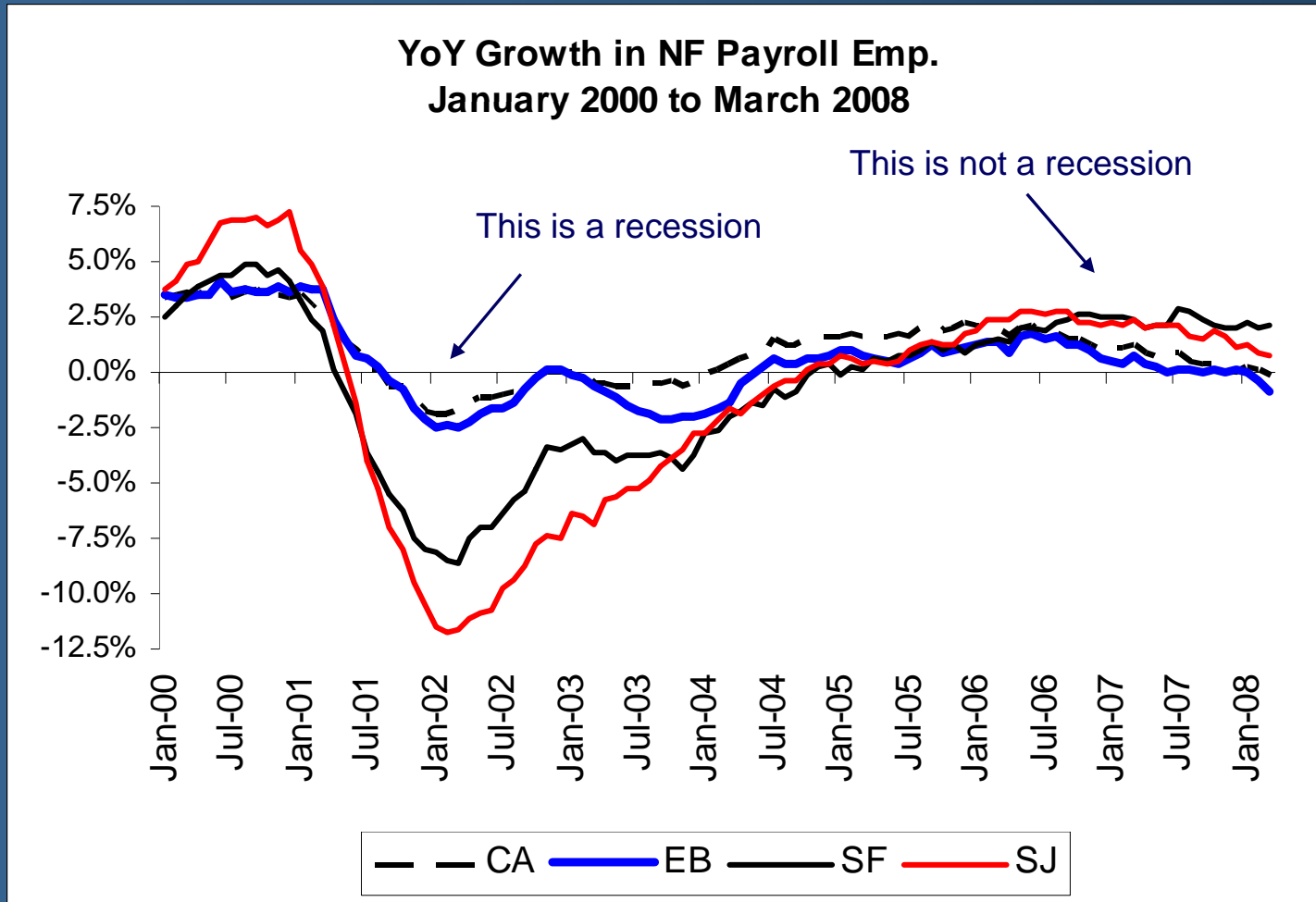
### ◆ After the Slowdown

- A. Back to normal with GDP growth at 3% and employment growth at 2%
- B. The future isn't what it used to be. An extended period of sluggish growth as overspent, heavily in debt consumers finally tighten their belts and start saving for retirement, amidst growing reluctance by foreign lenders to fund a life style we cannot afford and the realization that home prices aren't coming back any time soon. 

# The East Bay

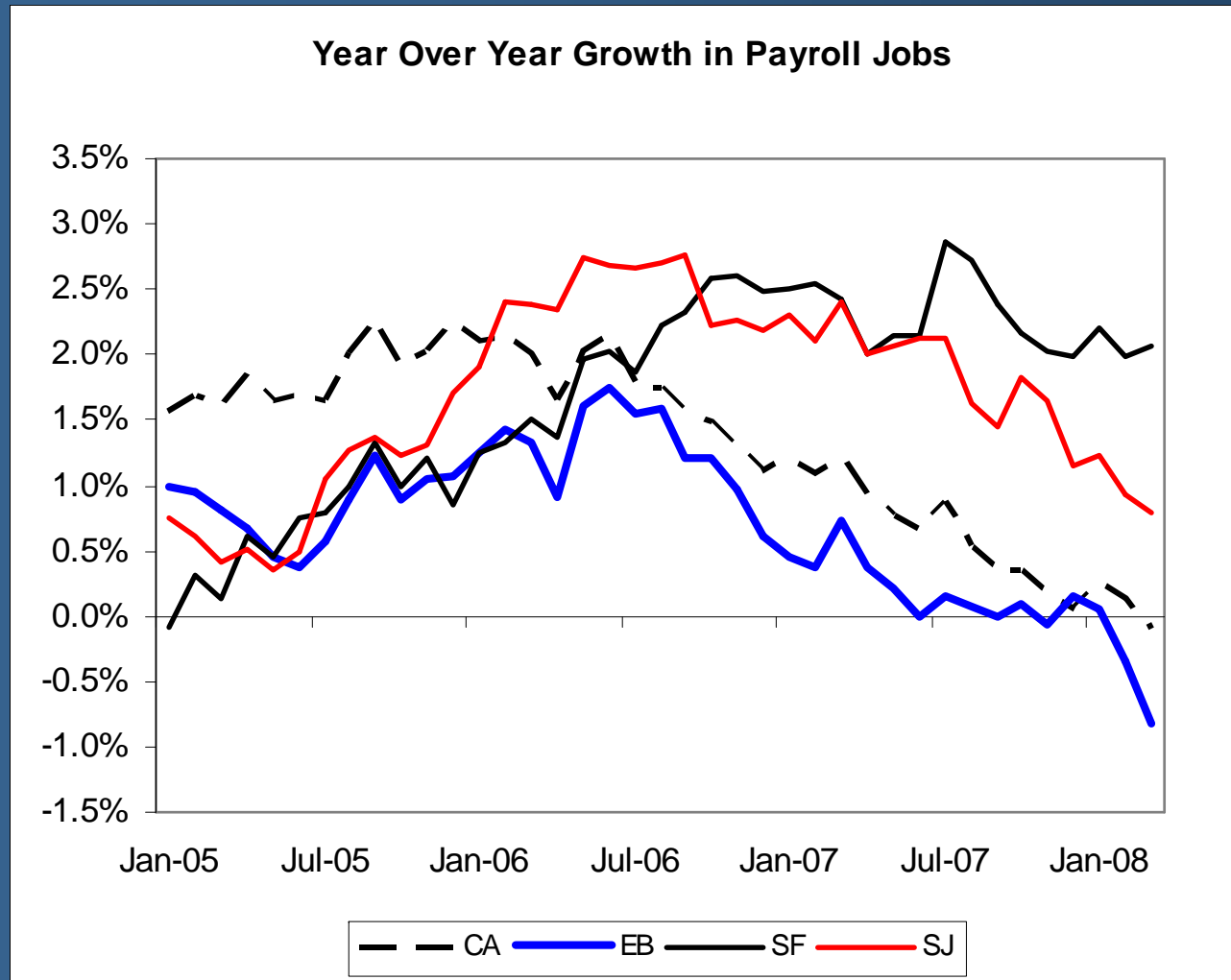


# What's a Recession?



# Closer Look at Recent Data

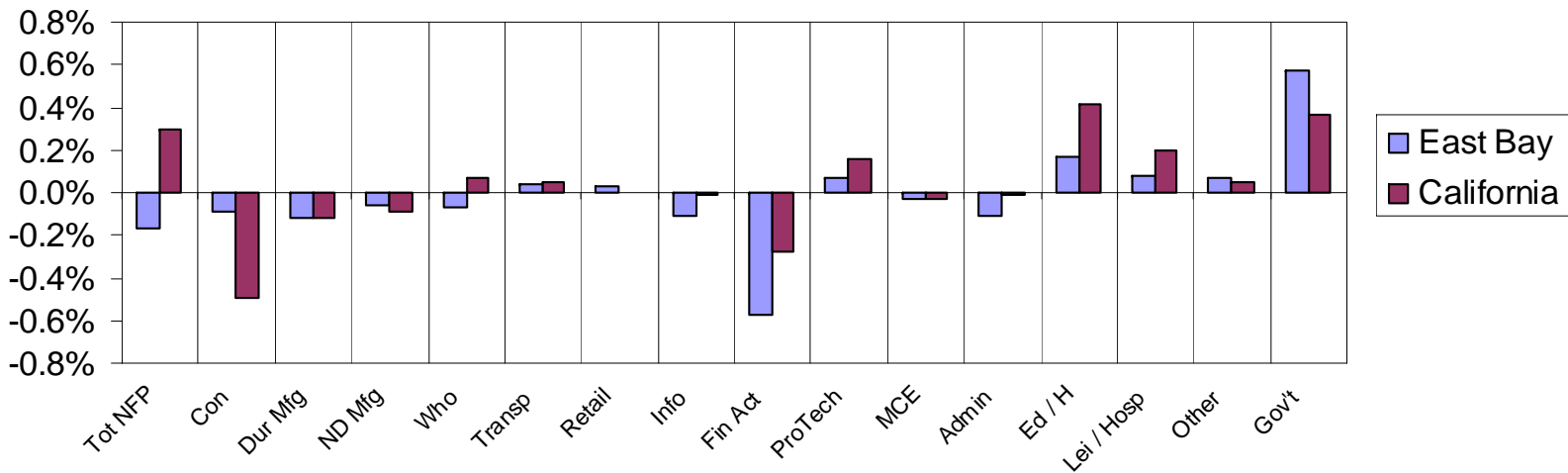
## *It's An East Bay Problem*



## For California The Problems are Construction and Finance *The East Bay Is Different*

- ◆ East Bay Problems especially severe/weak in
  - Financial Activities
  - Professional/Technical
  - Education and Health Care
  - Leisure and Hospitality
- ◆ Doing relatively well in
  - Construction
  - GOVERNMENT

**Job Gains as a percent of December 2006 Total**



# Latest Foreclosure: Never say Never



# It's Always Darkest Before the Dawn

