

EastBay



Q1 08

ECONOMIC OUTLOOK



**Created for the
East Bay Economic Development Alliance
&
The Contra Costa Council**

**Authored by the
UCLA Anderson Forecast**

For new quarterly forecasts and
monthly updates visit www.eastbayeda.org

The East Bay Report: Clouds Gathering on the Sunny Side of the Bay

Ryan Ratcliff, UCLA Anderson Forecast

January 2008

Summary

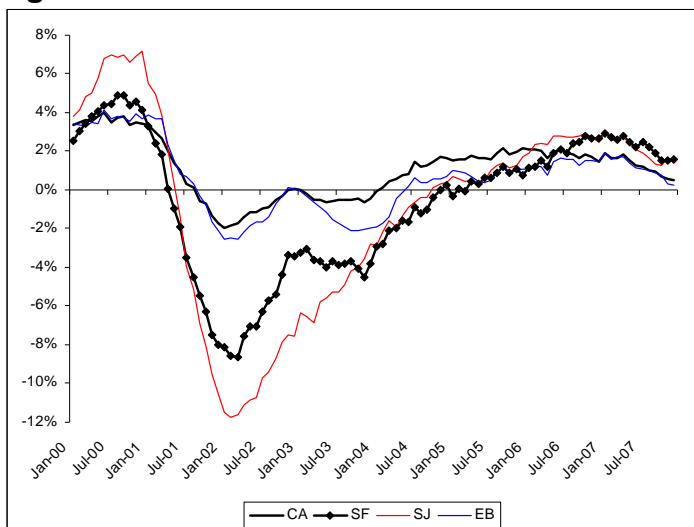
This installment of the East Bay report looks at two issues. First, we close the book on 2007 by making a survey of labor markets trends in the various regions of the Bay Area. Even though the Bay Area has come down a bit from the rapid pace of technology job growth in 2006, it remains one of the fastest growing regions in California. Unfortunately, the East Bay has now slipped into the bottom half of the state's job growth rankings, as the combination of an above average exposure to real estate weakness and the Bay Area's overall slowing has created overall job loss at the end of 2007 -- a first since the dark days of the tech bust. However, we can't entirely close the book on 2007 for a few months -- all of this employment data will be substantially revised in March, and these revisions will be the primary focus of next quarter's report. We use an alternative survey to make some educated guesses about how these revisions will affect the Bay Area's economies: for the most part, it's not good news. In general, real estate weakness is probably even worse than the current numbers indicate. And in a blow that may particularly hurt the Bay Area, the recent small but important gains in Durable Goods manufacturing in San Jose (and to a lesser extent the East Bay) may be overstated in the current data. Of course, these are just guesses -- we really won't know for sure until March.

The second portion of the report focuses on a national issue: will the tax rebate package currently being debated in Congress be the life preserver that keeps the U.S. economy above water in 2008? We offer two conclusions. First, there are several reasons why these tax cuts may not stimulate spending as much as Washington may hope. Second, the stimulus package really doesn't change the fundamental logic of our forecast: as discussed in the summary of our U.S. forecast, our prediction of no recession in 2008 is mostly based on the lack of enough potential job loss to generate recession levels of unemployment. Nevertheless, we acknowledge that the probability of a recession has risen significantly in the second half of 2007, and the combination of fiscal and monetary stimulus provides some welcome insurance against the possibility of recession in 2008.

Labor Market Update

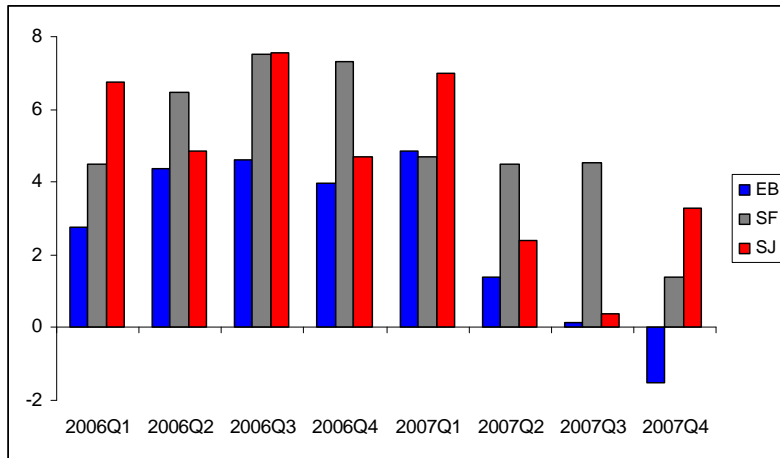
While the Bay Area labor market on balance remains slightly better off than California as a whole, the job market news in the fourth quarter of 2007 was almost all bad. The East Bay / Oakland Metropolitan District (MD) posted overall job losses for the first time since 2004, as real estate related jobs losses swamped small gains in other sectors. Beyond the East Bay, both the San Francisco and San Jose metros have seen job growth in the tech sector slow significantly. However, relatively low exposure to job losses in Construction when compared to the rest of California make the San Francisco and San Jose regions two of the bright spots remaining in the state economy, even with this slowdown in tech job growth. Interestingly, the San Jose MSA was one of the few regions of California to see an acceleration of job creation at the end of the year, fueled by a fourth quarter explosion of Leisure and Hospitality employment. Thus, we can view the East Bay's job market at the end of 2007 as the sum of two parts: the overall slowing in the Bay Area economy, exacerbated by housing weakness. To understand the interaction of these two forces, we'll first focus on some statewide and Bay Area trends, and then talk specifically about how these trends are interacting with the housing weakness in the East Bay.

Figure 1: Year-over-Year Growth in Non-Farm Payroll Employment



Source: CA EDD, UCLA Anderson Forecast

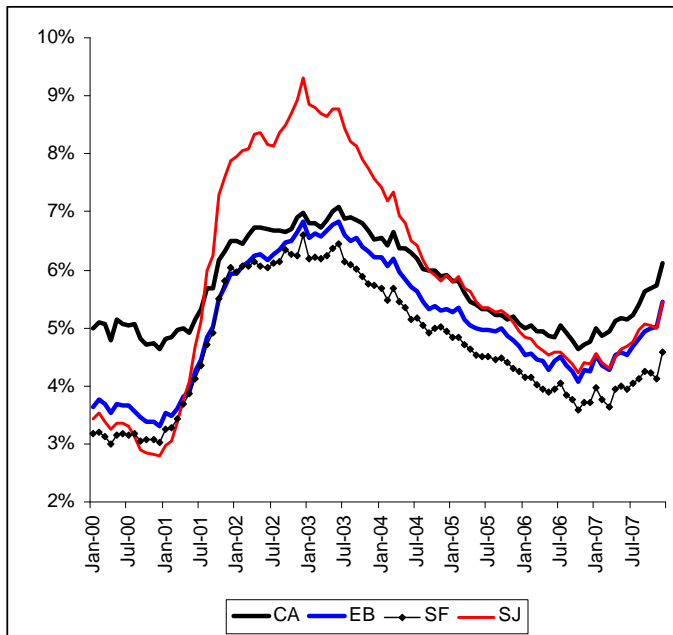
Figure 2: Quarterly Changes in Non-Farm Payroll Employment (1000s SA)



Source: CA EDD, UCLA Anderson Forecast

One of the biggest stories in the state labor market in recent months has been the surge in the unemployment rate, which has risen by 1.3% over the last 12 months to stand at 6.1% at the end of 2007. Bay Area unemployment has seen a similar increase in all three regions, though the level of unemployment continues to be lower than the state as a whole, in stark contrast to 2001. This statewide spike in unemployment has been the cause of much concern, since California's unemployment rate has never risen this fast without a recession. However, there are several suspicious features of this recent increase in California's unemployment rate. For the first three quarters of 2007, California's unemployment rate was rising as the US rate stayed flat – which is also unprecedented. Each of the last two recessions were concentrated in California-specific industries (aerospace and high-tech), yet in both of these recessions US and California unemployment spiked almost simultaneously. It is also quite suspicious that we've seen a recession-like increase in unemployment without an actual contraction of job growth in California: the source of this unemployment spike is fundamentally different than previous increases. In this case, unemployment has been created by the combination of weak employment growth coupled with abnormally high growth in the labor force. With California's population growing at around 1.3% for the past several years, the 2% labor force growth we've seen in 2007 starts to sound like a major demographic shift, or a statistical quirk.

Figure 3: Unemployment Rates (SA)



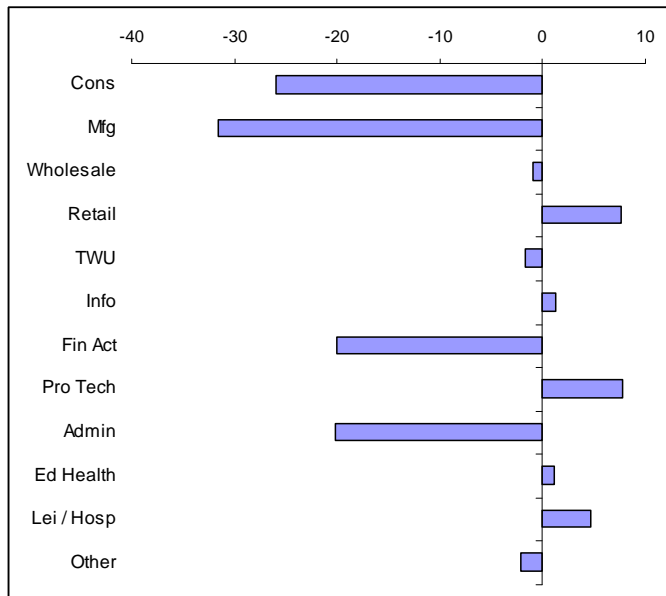
Source: CA EDD, UCLA Anderson Forecast

There's no doubt that the weakening economy in 2007 has resulted in a significant increase in California unemployment. But before we start screaming recession, it's important to recognize that this increase in unemployment is fundamentally different than the increase that has accompanied previous recessions, and looks like it is *in part* a statistical quirk. Perhaps the Bureau of Labor Statistics' (BLS) own estimate of the imprecision of the unemployment estimate is our best guide. The BLS lists the December 2007 unemployment rate for California as 6.1% +/- 0.4% (i.e. the 90% confidence interval for the unemployment rate is 5.7% - 6.5%). This means that even a statistician would concede that the California unemployment rate has increased substantially from the beginning of the year, and is higher than the US rate. Revisions to the 2007 unemployment estimates are due in a few months, and should provide some much need clarity on California's unemployment situation.

Speaking of revisions, we're also very close to the annual revision of California's payroll employment numbers. Before we wade into the industry level detail of recent job growth in the Bay Area, it's worth reiterating that these end of the year estimates will likely be substantially revised in March. However, we can make some educated guesses about

which way the industry level revisions might go at the state level by comparing the official monthly estimates from the Current Employment Statistics (CES) survey with the more detailed but less timely Quarterly Census of Employment (QCEW) and wages. Figure 4 presents the difference in the estimates of sectoral employment between these two surveys for 2007Q2, the most recent period in which they overlap.

Figure 4: Differences in 2007Q2 Estimates of CA Non-Farm Payroll Employment by Sector (QCEW – CES, 1000s SA)



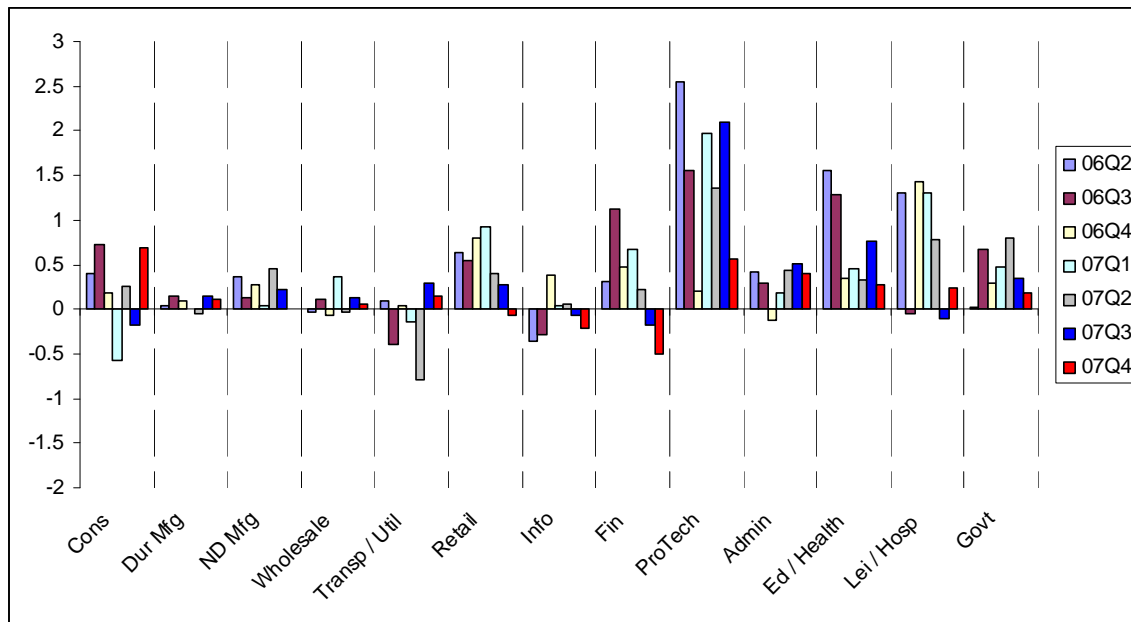
Source: CA EDD, UCLA Anderson Forecast

Since this new QCEW data is also subject to revision, we should treat these estimates fairly cautiously: sectors with negative numbers (i.e. lower QCEW estimates relative to the official CES numbers) will likely see some negative revisions in March, while sectors with positive numbers will probably be revised up to some extent. Overall, it looks like more sectors will receive negative revisions, which will likely bring down 2007's overall job growth even more than the already weak initial estimates. However, California job growth remained positive in 2007 even when viewed through the QCEW numbers. On a sector by sector basis, it appears that the real estate slowdown took an even bigger bite out job growth than what was initially perceived, with Construction and Financial Activities likely to receive a negative revision in March. The news outside the real estate sectors is also mixed: the recent weakness in Retail Trade and Professional/Technical Services may not be as bad as the

numbers suggest, both the Administrative Business Services and Durable Goods Manufacturing will likely see substantial negative revisions. Given that Manufacturing is usually implicated with Construction as the major sources of job loss in a recession, this worse-than-expected job loss in Manufacturing is cause for concern.

With these revision caveats in mind, we can now turn to a closer look at recent job growth in the Bay Area. At first glance, the big story in the San Francisco MD has been the major slowdown in Professional/Technical Services job growth in the fourth quarter, moving from the major source of new jobs in the previous three quarters to next to no job growth in the fourth quarter. However, we also saw this pattern in 2006: growth slowed dramatically in the 2006Q4, but came back strong in 2007Q1. Now in 2007Q4, the seasonally-adjusted series once again looks flat, but the raw data still shows steady job growth. This starts to look like we're seeing the beginnings of a change in this industry's seasonal pattern – especially since we're seeing a similar pattern in the San Jose MSA. Otherwise, most of the sectors look like they are extending the slowing trends seen earlier in the year: Financial Activities was the biggest loser in the fourth quarter, but Retail Trade and Information employment also posted very small job losses. Perhaps the biggest surprise was that San Francisco's biggest source of new jobs in Q4 was... Construction?! As we've pointed out in previous reports, at the end of the year it always pays to look at the seasonal variation in Construction first. Once again, it looks like a large part of the growth in seasonally-adjusted Construction jobs is actually a by-product of the slowdown in construction activity. During the boom, construction employment had a very pronounced seasonal cycle, but now that the boom is over, this cycle is not nearly as big. But when the seasonal adjustment is calculated on the basis of history, the smaller than usual decline in Construction employment ends up looking like seasonally-adjusted gains.

Figure 5: San Francisco MD, New Payroll Jobs by Sector (1000s SA)



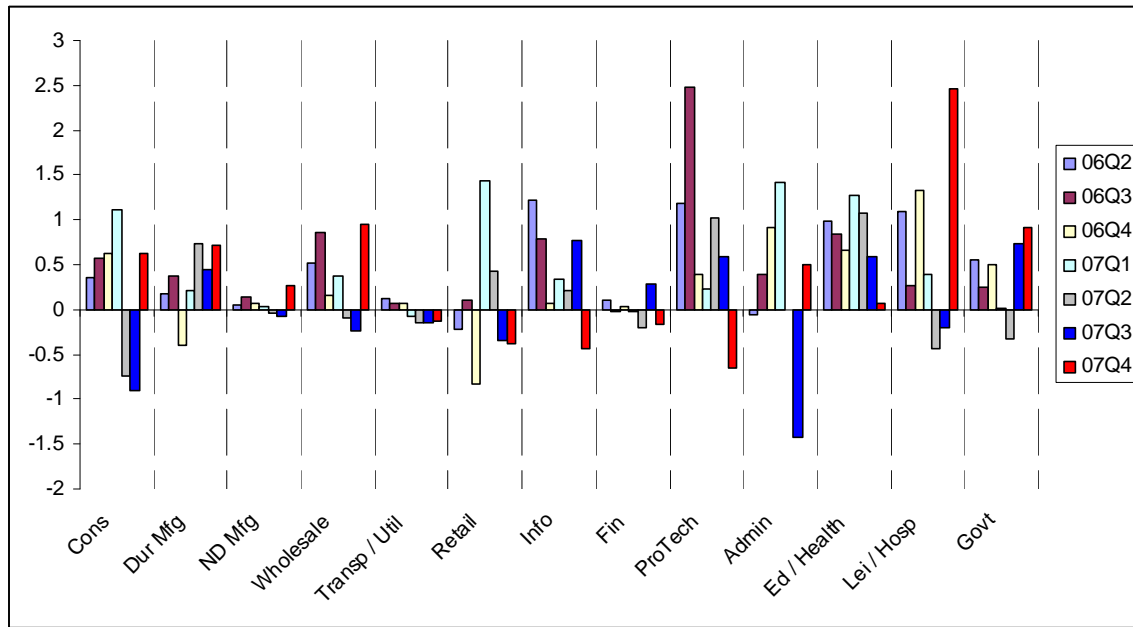
Source: CA EDD, UCLA Anderson Forecast

Bottom line for the San Francisco MD: while there are few seasonal quirks in the data, the overall message is across-the-board slowing. While we are hopeful that we'll see a 2008Q1 recovery in Professional/Technical Services growth, we can't help but worry that some of the slowing in this sector is being driven by a weaker economy.

Many of these same themes are present in the San Jose MSA as well. Professional/Technical Services actually posted job losses in 2007Q4, which lends some credence to our worry that some of this slowdown is based on fundamentals rather than seasonal factors alone – San Jose's 2007Q4 slowdown looks much bigger than the corresponding drop in 2006Q4. Information and Retail Trade also show slightly bigger job declines, but the same basic pattern as the San Francisco MD. Like San Francisco, San Jose also experienced a similar but smaller increase in 2007Q4 Construction employment. One notable difference is that Durable Goods production provided some good news for San Jose, as both Durable Goods Manufacturing and Durable Goods Wholesale Trade saw job growth accelerate in 2007Q4. This surge has not come in any one specific industry (such as Computer and Electronics Product Manufacturing), but rather is the accumulation of small gains in just about every durable goods category. And while this good news must be

tempered a little with our previous discussion of the potential downward revisions to the Durable Goods Manufacturing, the corresponding health in Wholesale Trade for Durable Goods sector suggests that some of these gains may have some staying power.

Figure 6: San Jose MSA, New Payroll Jobs by Sector (1000s SA)



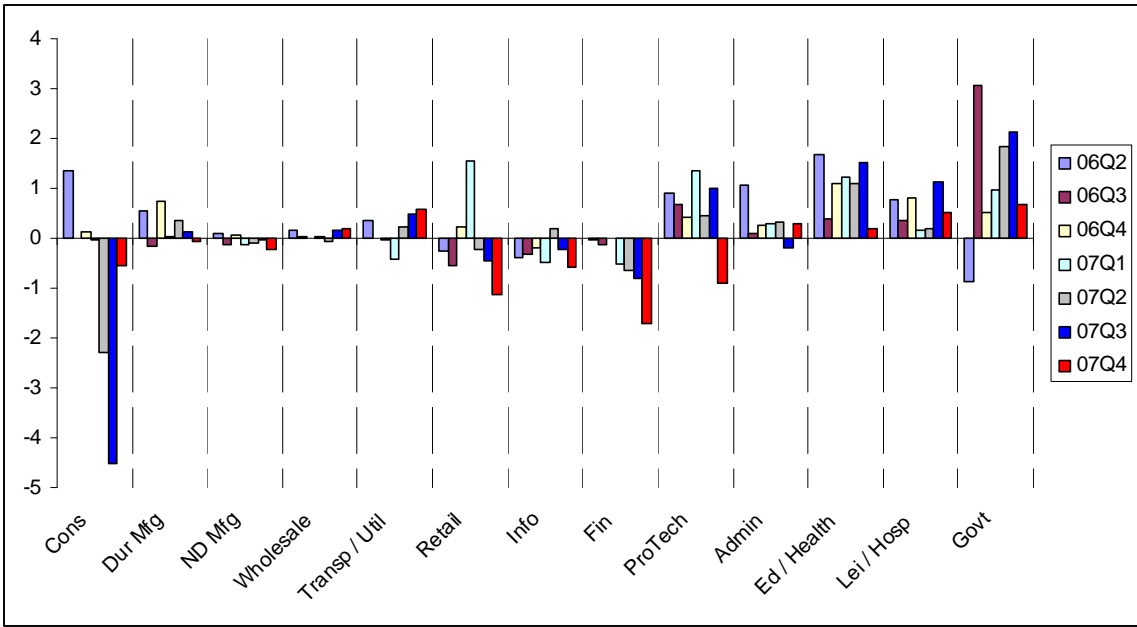
Source: CA EDD, UCLA Anderson Forecast

The big news for San Jose in Q4 was the explosion of Leisure and Hospitality employment, which generated more than twice the job growth of any other sector. Unfortunately, this too has a seasonal explanation: Food and Drinking Establishments in San Jose saw a smaller than usual decline in employment, rather than an outright increase. A less than expected seasonal decline is still good news, but it hardly marks the beginning of a tourism boom in San Jose. The bottom line for San Jose is very similar to San Francisco: slower growth across the board, tempered by a couple of bright spots. The positive growth in durables-related industries is certainly a welcome dose of good news amidst the slowing, but it remains to be seen how this industry will fair in the March revisions.

Not surprisingly, the East Bay at the end of 2007 can be viewed as combination of wider Bay Area trends combined with the metro's above average exposure to the real estate slowdown. The East Bay's story has to start with Construction: everything else pales in comparison to the 7,000-plus jobs lost in this sector in the last three quarters. As in other Bay Area regions, a small gain was posted in 2007Q4 Construction employment, driven

largely by the fact that the typical contraction of employment in 2007Q4 didn't occur thanks to the job losses in the previous quarters. Job losses in Financial Activities also accelerated substantially in 2007Q4, fueled largely by real estate related finance losses. Outside of the East Bay's real estate woes, the rest of the economy looks similar to the rest of the Bay Area: small job losses in Retail and Professional/Technical Services, with across the board slowing in most other sectors. There is one small dose of good news: the Transportation Warehousing and Utilities sector sustained its trend of small but steady growth even at the end of 2007. The official statistics don't give enough detail to nail down the exact source of these gains, but it seems likely that one way or another this growth can be traced back to the East Bay's ports.

Figure 7: East Bay (Oakland MD) New Payroll Jobs by Sector (1000s SA)



Source: CA EDD, UCLA Anderson Forecast

Bottom line for the East Bay: A slowing Bay Area economy coupled with the Region's prior real estate and construction boom is an unfortunate combination, resulting in an economy that is now underperforming the state as a whole. We look for real estate to continue to be a major drag on the East Bay economy for most of 2008. The important question now is how well the entire Bay Area's recovering specialty industries will fare in the sluggish economy of the coming year.

2008 Tax Rebates: Congress Saves the Day, or Too Little, Too Late?

While there's still quite a bit of debate around whether or not we will actually see a U.S. recession in 2008, almost every observer will agree that we're in for a bumpy ride that includes sluggish GDP growth (the UCLA Anderson Forecast's prediction is 1.9% for 2008), elevated unemployment, and continuing carnage in the financial markets. With this sort of prognosis for 2008, it's no surprise that much of the talk in Washington and on the campaign trail has turned to what the government can do to minimize the damage.

We economists and the Federal Reserve have been fretting about this question much longer than you might think. The decline in housing construction has shaved about 1% off of real GDP growth since mid-2006, which was also around the time the Fed switched from its strategy of slow but steady increases in the Federal Funds rate to standing pat at 5.25%. While the Fed's primary worry in the first half of 2006 was that inflation would continue its slow upward creep out of Bernanke's comfort zone, the increasing weakness in residential investment suggested that risks of further inflation versus an economic slowdown were probably pretty even, leading to this split the difference strategy of staying put at 5.25%.

By summer of 2007, the wave of mortgage defaults and the ensuing financial turmoil seemed to have made up the Fed's mind: the risk of a recession now outweighed the possibility of more inflation, and led the Fed to cut the funds rate by 1% by year's end, with another 1.25% cut so far in January. There's a fair amount of debate among economists about what share of the motivation for these cuts came from shoring up the financial system versus a concern about GDP growth per se. But whatever the motivation, the end result is the same – the Fed has been stimulating the economy since the summer of 2007 in hopes of minimizing the fallout from the housing slump.

Unfortunately, one of the biggest problems with trying to stimulate the economy with lower interest rates is that it takes a long time: 12 - 18 months by some estimates. The path from a Fed Funds cut to the increases in investment and net exports (and potentially consumption) that the textbooks tell us will materialize is long and winding, running through

the connection between short and long run interest rates, the balance sheets of banks, the globalization of capital markets, and even changing attitudes towards risk -- there's many a slip 'twixt the cup and the lip.

So it's in this climate of waiting for some response to six months of monetary stimulus that we come to the current debate about a fiscal stimulus. First, let's review the basics of the stimulus package as agreed to by the House of Representatives (the Senate was still debating at time of press). It calls for 2008's tax rate on the first \$6000 of income (the first \$12,000 of joint income) to be reduced from 10% to 0%, and be distributed as a rebate check. Rebates will also include an additional \$300 per child. There are several provisions for phasing out the rebate for high income payers. While the IRS has been skeptical about their ability to mail this many checks until well after the tax rush, Treasury Secretary Paulson has promised that the rebates can be sent out 60 days after the package becomes law. The grand total for these rebates comes to \$100 billion, with an additional \$50 billion targeted at stimulating investment spending through tax incentives. For reference, nominal GDP was \$13.9 trillion in 2007Q3. Thus, the total tax cuts on the table represent about 0.7% of the total U.S. economy.

Does a tax cut representing 0.7% of the economy have enough "oomph" to offset the weakening components of GDP? Judging from the man-on-the-street interviews, many American feel that an extra \$600 really won't make much of a difference. But the stimulative effects of the tax cut don't stop with that first purchase: the new TV that you buy is income in the pocket of the owner(s) of the TV shop, who go out and spend some of that extra income, giving more income to more people, and so on. When we teach economics, we often like to wow our students with estimates that a \$1 tax cut could be multiplied to \$9 in new GDP when all is said and done, but these estimates ignore taxes and imports and a variety of other ways that extra income can leak out of the system. "Real world" estimates of the tax cut multiplier vary widely: in the popular Data Resources Incorporated (DRI) model, this multiplier varies from 0.2 to 1.2 after four quarters (i.e. that our \$150 billion tax cut will raise GDP anywhere from \$30 to \$180 billion one year out).

There are several reasons for this ambiguity. The first is how the Fed reacts to the fiscal stimulus. If the Fed does nothing, we get the 0.2 multiplier: the tax cut stimulates spending, but increases interest rates as the federal deficit places higher demands on a limited pool of investable funds. The lower spending caused by these higher interest rates offsets much of the fiscal stimulus. If the Fed maintains a constant interest rate (i.e. intervening to keep interest rates from rising), we get the full 1.2 multiplier as government spending no longer “crowds out” other forms of spending. Given the Fed’s recent rate cuts, the 1.2 case seems much more apropos here – with inflation worries taking a back seat, it seems likely that monetary and fiscal policies will both be pulling in the same direction, allowing the tax cuts to have their maximum impact.

However, there’s another complication that could potentially negate much of the stimulative effects of the tax cut: its widely trumpeted temporary nature. Most modern theories of consumer behavior acknowledge some amount of consumption smoothing: consumers use borrowing and lending to keep their consumption levels smooth in the face of income changes. If an increase in income is deemed to be permanent, they will increase consumption by most of the amount of the income increase. If consumers think the increased income is only temporary, they are more likely to save most of the income (or pay off prior debts) in order to turn the windfall into higher consumption over future periods. We last saw this same combination of aggressive interest rate cuts and temporary tax rebates in 2001Q3. Proponents of tax rebates argue that consumption’s contribution to overall GDP growth rose from 0.67% in 2007Q2 to an average of over 2% in the next three quarters. However, we economists are especially vulnerable to the *post hoc, ergo propter hoc* fallacy - - we need to be very careful about mistaking temporal ordering for causation. For instance, the consumption boom in late 2001 was driven in no small part by the 0% auto financing offered in the wake of September 11th. More careful microeconomic studies of the 2001 rebates are largely mixed. One survey analyzed by economists from Michigan (Shapiro and Slemrod) seems to support our worries about consumption smoothing: 78% of respondents said they planned to either save their rebate, or use it to pay off debt. However, another study finds that households spent between 20-40% of the rebates in the quarter the rebates arrived.

While the tax rebates represent the bulk of the stimulus package, there are also two other components of note: a tax incentive for business investment, and a potential increase in the value of mortgages that can be purchased by Fannie Mae and Freddie Mac. The \$50 billion of investment incentives are essentially a tweaking of the accounting treatment of depreciation, and are designed to entice firm's to shift forward purchase of equipment and software – a potentially potent one-two stimulus to business investment when paired with lower interest rates. But even with all of these incentives to increase investment, it will likely prove difficult to entice most firms to expand capacity on the cusp of a period of weaker demand for their products. While these incentives may provide a small boost to investment spending, we remain skeptical that this increase will alter the trajectory of the economy in 2008.

The increase in the purchase limits for Freddie and Fannie are potentially more promising, especially for California (and particularly the Bay Area). The current limit is \$417,000. In the U.S. overall, mortgages eligible for purchase by one of these government sponsored entities (GSE's) account for just under 70% of all mortgages. Of course, \$417,000 doesn't get you very far in California: only 45% of all mortgage here fall under this conforming limit, leaving the majority of home purchases to be financed through private jumbo loans, piggyback loans, etc. Unfortunately, mortgage markets have totally seized up in 2007: virtually the only mortgages anyone is willing to originate anymore are ones that can be sold to the GSEs – no one else is buying. Given California's forced reliance on non-conforming loans, this credit crunch has hit home sales in California harder than just about anywhere else in the U.S. While the exact increase in the conforming limit is still being debated, most of the proposals are an increase to at least \$600,000 – well over the median home price in California, even today. Obviously, there are a multitude of other factors that will keep housing markets weak in 2008. But while this policy won't cure our housing ills overnight, it will go a long way to breaking the financing logjam here in California, which is an important first step in our housing recovery.

So what's the bottom line here? While we find the arguments that much of these rebates will be saved instead of spent persuasive, this summer's potential combination of some increase in consumer spending plus the long-awaited impact of last summer's rate cuts will provide the economy with a much needed boost. However, it's not a silver bullet: even with this stimulus package, we still foresee a very sluggish economy in 2008. We have argued for some time that the housing sector by itself cannot generate enough weakness to create a full-blown, 20th-century-style recession, and we maintain that forecast even now. However, we do acknowledge that the probability of recession is running uncomfortably high, and that Washington's two-fisted approach to stimulating the economy provides some welcome insurance against that chance in 2008.

Conclusions

The outlook for the East Bay in 2008 is mostly gloomy: with the Bay Area's specialty industries slowing and an overexposure to housing weakness, the East Bay economy will likely continue to underperform relative to the overall California economy. As we pointed out, there are some small doses of good news from trade-related activities like Warehousing and Transportation. The employment impact of these sectors is small, but their capital/space intensive nature means that this understates their overall contribution to the local economy. Even so, these industries are a small silver lining in a big dark cloud. And while we think the stimulus packages will not significantly improve matters in either the U.S. or East Bay economies, the potential increase in the GSE's conforming loan limits is probably the policy action most directly helpful to East Bay economy. While it won't cure the East Bay's housing ills overnight, it removes one of the major roadblocks to a housing recovery.

The California Report: Now is the Winter of Our Discontent

by Ryan Ratcliff

Like the national forecast, the central theme of the California forecast remains the same: real estate weakness will create a sluggish economy, but will not be enough to tip the state into a recession. There are, however, a number of state-level developments that have cast doubt on some of the finer points that support our no recession forecast. This installment will concentrate on several of the key recent developments.

Overall job creation for California has come to a standstill. Job loss in real estate-related sectors continues to be the main source of weakness as measured by the official Current Employment Statistics payroll series (CES). But lately, we are also experiencing weakness in retail trade and the normally strong professional business services. Furthermore, an alternative employment survey suggests that these real-estate-related job losses may have been deeper and more rapid than the CES indicates. Known as the Quarterly Census of Employment and Wages (QCEW), this alternative survey gives us an imperfect preview of the annual employment revision to be released in March. However, there is some good news: the QCEW suggests that some of the non-real estate weakness may be revised away in March. On balance, the bad news from real estate wins, with the QCEW showing an even weaker state labor market; however, employment growth still remains positive

California's unemployment rate has risen over 1% since the beginning of 2007—something we've never seen outside a recession. What's more, most of the rise in California unemployment has come while US unemployment has mostly remained flat—again, something we've never seen before. These anomalies make us think that part (but not all) of this increase is likely due to a statistical aberration in the labor force numbers. During most recessions, unemployment rises mostly because overall job growth goes negative. This time, the unemployment rate has risen because weak but positive job growth has been swamped by near record growth in the labor force. This explosion of labor force growth seems a bit suspicious given the gradual slowing of California's population growth. The unemployment rate in California is clearly going up, but the particulars of this increase suggest that it may be somewhat overstated.

News for the state budget is pretty grim. According to estimates from the Legislative Analyst's Office, a combination of revenue shortfalls and unanticipated higher expenditures will not only completely wipe out the \$4.1 billion reserve from the budget, but leaves California with an unprecedented budget deficit in 2008. The inevitable budget cuts make a major slowdown in Government employment growth inevitable in the second half of 2008 and on into 2009. However, we look for a repeat of 2003: private sector weakness will have mostly run its course by the time Government employment experiences a 1% contraction in 2009.

The net result of all these developments? The combination of real estate weakness, government belt tightening and Hollywood labor disputes all create a sluggish economy for most of our forecast, but we still do not see enough systemic weakness for a recession.

Nervous: Why This Time Really IS Different and Why We Will Survive the Near Recession Experience

By Ed Leamer and Patricia Nomura

This is nervous time. Lately, when all the recent economic news is seemingly negative and countless prognosticators are throwing around recession forecasts, we urge you to step back and be calm. The UCLA Anderson Forecast is not calling for a recession. You are right to be concerned, but remain calm. While the housing data are certainly ominous, we do not see a recession in 2008.

Housing is Predicting a Recession

Housing has been a great predictor of recessions, and is issuing a very loud alarm of trouble ahead. Since WWII, almost every time there has been a sharp housing decline, there has been a national recession. Eight out of the ten postwar recessions have been preceded by a sharp housing decline. What is very ominous is that we are in the midst of a housing decline that is every bit as severe as the ones that led into recessions.

Why no Recession Forecast? Because This Time is Different

A recession that is predicted by housing is long overdue. History reveals that the business cycle peak is usually no more than a year later than the housing peak, which would have us in a recession in 2006 Q4 at the latest, when you consider the housing peak to have been 2005 Q4. With seven quarters already behind us, this one is destined to be one of the longest lasting corrections. If we can get through another quarter or two, we will get this behind us and have the very first genuine “housing false alarm” – a major housing decline without a recession.

Another unique situation has been caused by innovations of subprime mortgages in the form of greatly reduced lending standards. This in turn has created a whole new class of borrowers, of which many are now walking away from their homes. And contrary to traditional thinking, it's not because they lost their jobs. Since they can no longer rely on double-digit home appreciation to leverage against, they can no longer afford their homes. For many, homeownership may not still exist, but at least their jobs still do. This is different, too.

In the past, the story of manufacturing during and after recessions is trim and fatten, creating a V shaped cycle. This time, we are seeing an L shaped trend in manufacturing jobs. In the 2001 recession, we did a major trimming of 3 million manufacturing jobs, but since then, there has been no fattening. Today, manufacturing jobs are still below their levels at the start of the expansion in December 2001. We have never experienced anything like this before. Because of this, coupled with an extremely weak recovery in overall payroll jobs, the economy is not primed for major job loss. We have never tipped into recession with such a dismal performance on the job front during the boom period. This time, things really are different.

Optimism Ahead

The current weakness in housing has been completely offset by strength in our external accounts: rising exports and weaker imports. The substantial weakening of the dollar especially relative to the Euro is the first step in ensuring that the correction of our external deficit continues. We expect to see the recession in housing to stay in the housing market and not be a catalyst of major job loss outside the construction and finance sectors. The negative from housing will likely abate by late 2008, while exports are likely to be strong for years to come. Though consumer spending may weaken (depending in part on the outcome of the tax rebate debate), much of that problem will be passed on to other countries through weaker U.S. imports. Overall growth will be sluggish, but no recession.