VIRGINIA EMPLOYMENT COMMISSION

Economic Overview

William F. Mezger, Chief Economist

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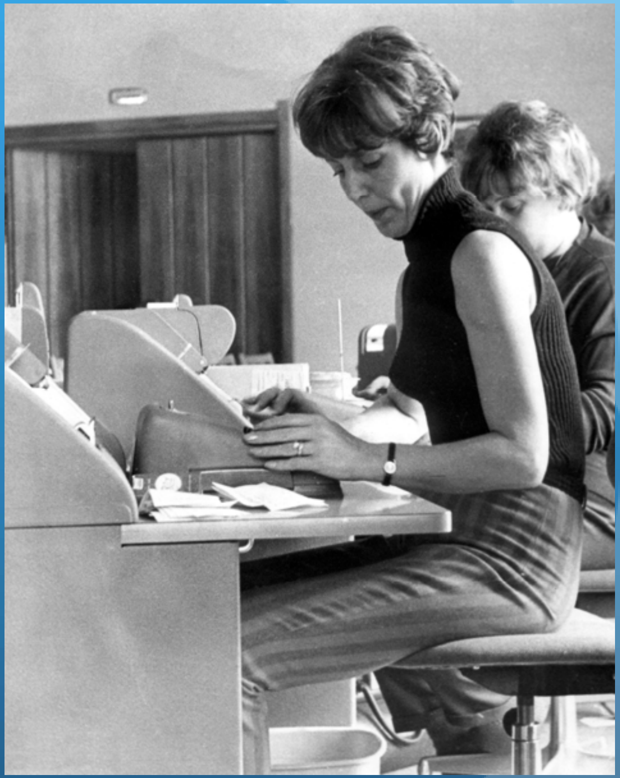
The Recession

- The National Bureau of Economic Research (NBER), the Princeton, New Jersey, group that officially designates recessions in the U.S., on December 1, 2008, declared the U.S. economy had been in recession since December 2007.
- Back a couple of years ago, it appeared the U.S. economy would have a “speed bump” downturn in the “seven” or “eight” year of the decade and by now would have resumed growth.

Historic Patterns

- The U.S. economy has had major downturns in the "0 to three" years of the decade in 10 of the last 11 decades.
- The U.S. economy has also had a slowdown in the "seven" or "eight" year of the decade in five of the last six decades—1957-58; 1967, 1987, 1997, and 2008. Usually the mid-decade slowdowns have been fairly mild and by the "nine" year, the economy is expanding again for a couple more years.



What went *wrong* this time?

- The 2002 to 2007 recovery period had not been as strong as the 1980 and 1990 recovery periods.
  - Gross Domestic Product (GDP)—the sum of the output of the goods and services produced in an economy—has averaged 3 percent growth for the last 20 years.
  - In the 2001 to 2007 period, GDP growth only averaged above 3 percent in 2004.
  - The efforts to overcome the psychological impact of the 2001 recession and 9/11 event caused “too loose” monetary policy—the 1.0 percent Fed Funds rate from November 2001 to June 2004 caused excesses in the real estate and housing markets that we are paying for now.
  - The “trickle down” fiscal policy in the form of the 2003 tax cuts and 2008 tax rebates really did not work as well as was hoped—the jobless recovery.

Excesses in the Housing Market

- The low interest rates caused an upsurge in home building and buying.
- A relaxation in banking regulations and mortgage loan requirements
  - Many bank regulations and safeguards that had been around since the 1930s were discarded.
  - The distinctions between banks, savings and loans, and investment banking sort of blurred.
  - It was thought land values could only go up—if the borrower got into trouble, he could always sell for a profit and pay off the loans.

Excesses in the Housing Market (cont.)

- There was much real estate speculation.
- To make matters worse, the mortgage, once it was issued, became an investment instrument that was packaged with other such instruments and traded around the world until no one knew what they had.
- The Republicans were pushing for "free markets," and the bankers were making lots of money.
- The Democrats were pushing for "affordable housing" and as long as things were going well, looked the other way as regulations were relaxed.
- Consumers used the "new found" home equity to finance other purchases.

Excesses in the Housing Market (cont.)

- Higher interest rates by 2006 and 2007 caused the housing bubble to burst—investors began to retreat from the mortgage-based securities.

- The Federal Reserve tried to solve the problem.
  - Lowered interest rates 8 times from September 2007 to December 2008
  - Forced Bear Stearns Investment Bank to be sold to J.P. Morgan Chase with the Federal Reserve backing the loan
  - Started lending to investment banks

Excesses in the Housing Market (cont.)

- Allowed Lehman Brothers to fail
- Forced the sale of Merrill Lynch to Bank of America
- Forced the takeover of Washington Mutual by J.P. Morgan Chase
- Forced the sale of Wachovia (fifth-largest bank) to Wells Fargo.

Excesses in the Housing Market (cont.)

- Realizing by September 2008 that the problem was too big for it to handle alone, the Federal Reserve teamed up with the U.S. Treasury, which had recently bailed-out the quasi-government mortgage financiers, Fannie Mae and Freddie Mac, and AIG Insurance; and the Federal Reserve and U.S. Treasury went to the U.S. Congress for help.

Excesses in the Housing Market (cont.)

- This help was the **Troubled Assets Relief Program (TARP)** [October 2008].
  - TARP was originally to purchase troubled mortgage assets
  - Now has become more of a bailout of the financial houses
  - Loans to General Motors, Chrysler, and their finance companies

- In fall 2008:
  1. The banks became afraid and stopped lending even to good customers.
  2. Consumers, shocked by high fuel prices, the loss of home equity, and the financial situation, stopped buying—also, they could not get loans.

To Correct the Situation and Restore the Economy—

- Already have TARP—$700 billion (October 2008)
  - ➢ The federal government is now going to assess the problems bank by bank.
  - ➢ The federal government is going to provide the monies to cover the bank's deficiencies in exchange for the bank's common stock.
  - ➢ Impose stronger new checks and regulations on the banks

To Correct the Situation and Restore the Economy (cont.)

- **Homeowners Affordability and Stability Plan**—$75 billion (February 2009)
  - Help 5 million homeowners refinance—those who owe more than 80 percent of value of house
  - Modify loans for another 4 million homeowners
  - Easier to modify mortgage terms during bankruptcy
  - The Treasury will increase its holding in Fannie Mae and Freddie Mac by $200 billion.
  - The size of Fannie Mae and Freddie Mac portfolios will increase.

American Recovery and Reinvestment Act— $787 billion (February 2009)—Virginia gets $4 billion over 2 years

- Raises federal funding ratio of Medicaid from 50 percent to 56.2 percent

- State Fiscal Stabilization Fund created
  - Major part to education
  - General fund benefits such as:
    - Tax cuts to working families and small businesses
    - Education tax credits
    - Infrastructure investments that will create jobs
    - Targeted investments in health care and alternative energy production
    - Support local governments to relieve impact of the downturn
    - Extends EUC through 2009—adds $25 to weekly benefit amount—adds to Trade Act benefits

Two Things Need to be Done for Recovery to Happen

1. A floor under home prices needs to be achieved.
2. Liquidity needs to be restored to the banking system.
   - Big problem is to cover liquidity lost in investment banks

How This Recession Is Shaping Up

- World Economy
  - Rest of world did not recover from 2001 recession until 2006.
  - In 2006, 2007, and 2008, world recovery along with the cheap dollar caused the rest of the world to buy lots of U.S. exports.
  - The financial collapse that started in the U.S., quickly infected the rest of the world's economies.
  - The rest of the world will likely have the worst recession since the 1930s.

How This Recession Is Shaping Up (cont.)

- U.S. Economy
  - Already a *long* recession
    - Started December 2007
    - March 2009 = 16 months
    - Average post-war recession = 10.2 months
    - Longest post-war recessions 1974-75 and 1981-82 = 16 months each

How This Recession Is Shaping Up (cont.)

- Does not appear to be as deep as the 1981-82 recession when unemployment reached 10.8 percent in the U.S. because of a different labor force.
  - Then (1970s and 1980s)
    - Lots of inexperienced young people, minorities, and women entering labor force.
    - More vulnerable factory employment—now in Far East
    - Less services employment
  - Now 2009
    - Aging experienced labor force—baby boomers ready to retire
    - Have had to bring in 3 to 4 million foreign workers per year just to fill jobs
    - Factory employment less than 10 percent
    - More services employment, especially high-end professional/business service, education, and health care

How This Recession Is Shaping Up (cont.)

- A service economy is usually slow to recover because the hiring process just takes longer.

- Do not be misled by media when they say as bad as 1975 or 1982. Realize U.S. nonfarm employment (number of jobs) is 68 percent greater than in 1975 and 44 percent greater than in 1982. Virginia's job base is 113 percent greater than in 1975 and 76 percent greater than in 1982.

Probable Path of Recession

- U.S. GDP growth turned negative in Third Quarter 2008—0.5 percent.
- U.S. GDP growth probably 6.2 percent negative in Fourth Quarter 2008.
- Things will get worse before they get better.
- First three quarters of 2009 likely to be negative—even though stimulus packages have been passed, it takes time for implementation.
- Unemployment is always a lagging economic indicator—last to turn around in both good times and bad.
- U.S. unemployment will probably peak at 9.5 percent for much of 2010. Not get back below 8.0 percent until 2012

Forecast

Percent (except as noted)

	2008	2009	2010	2011	2012
Real GDP growth	1.3	-2.7	2.0	3.5	3.3
Consumer spending growth	0.3	-1.0	2.5	2.5	2.7
Business spending growth	1.8	-15.2	-1.3	13.3	11.7
Federal spending (real)	6.0	4.9	1.4	-2.8	-2.3
State and local government spending (real)	1.2	-0.7	0.5	-0.6	-0.4
Housing starts (million)	0.90	0.55	0.96	1.39	1.59
Existing home sales (million)	4.90	4.27	4.53	5.09	5.91
Light vehicle sales (million units)	13.1	10.4	12.6	14.6	15.5
Nonfarm jobs	-0.4	-3.1	-0.1	1.7	2.0
Unemployment rate (levels)	5.8	8.7	9.4	8.7	7.9
Consumer price inflation	3.8	-1.9	1.7	2.2	2.3
Oil prices ($ per barrel)	100	37	51	61	74
Federal deficit (billion $)	455	1,601	1,197	855	425
Fed funds rate	1.93	0.13	0.40	2.20	3.45

Baseline has 60 percent probability.

Alternatives

- Second Great Depression (20 percent probability)
- Stimulus works better than expected (20 percent probability)

Virginia

- After showing job growth for the first 8 months of 2008, Virginia's job growth average ended up being barely negative for the year with a net loss of 3,900 jobs, or 0.1 percent. The annual benchmarking to the unemployment insurance tax record revealed Virginia averaged 3,757,500 nonfarm jobs in 2008 compared to a 2007 nonfarm employment average of 3,761,400.
- The small decrease was the result of dwindling employment all year in construction and manufacturing and way less than usual seasonal holiday hires in the retail and service industries at the end of the year.

Virginia (cont.)

- Private education and health care, total government, professional and business services, leisure and hospitality, miscellaneous services, and mining all saw job growth. The best job gain was 17,700, or 4.2 percent, in private education and health care.
- In the nine publishable metropolitan areas, three still had net job growth in 2008. They were: Northern Virginia, +4,100, or 0.3 percent; Lynchburg, +900, or 0.1 percent; and Blacksburg-Christiansburg-Radford, +500, or 0.1 percent. Northern Virginia added the most jobs (4,100) with still strong professional and business services and had the best percentage gain (+0.3 percent). Hampton Roads lost the most jobs (-6,800), and Winchester, Virginia/West Virginia, had the biggest percentage decrease (-3.3 percent).

Virginia (cont.)

- It looks like Virginia's unemployment rate average increased from 3.0 percent in both 2006 and 2007 to 4.0 percent in 2008. Initially, the 2008 average was thought to be 4.1 percent. December (5.1 percent) had the highest rate.
- For the future, the projection is for Virginia to lose about 23,000 net jobs, or 0.6 percent, in 2009. With recovery starting in 2010, Virginia is expected to add back 28,000 net jobs for 0.8 percent growth, which would bring nonfarm employment back to the 3,761,000 level it was in 2007. The unemployment rate is expected to average mid-five percent in 2009 and 2010 with the highest periods being first and second quarters 2009 and first quarter 2010.

Virginia (cont.)

- Virginia should have a less severe downturn than the nation because of:
  1. The strong federal government presence and federal contracting here;
  2. Much professional and business services here, although this sector is expected to lose 5,000 jobs in 2009;
  3. The large health care presence in Virginia;
  4. Much employment in public and private higher education.

Questions?