



BEACONECONOMICS

Depr ??

# ~~Recession~~ Economics



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# Last Year's Outlook

## Big Picture Summary



- Positives

- Manufacturing / Inventory Cycle
- Productivity still good, fundamental
- Exports and the World Economy

- Negatives

- Housing has not hit bottom, will
- Consumers will slow spending
- The external accounts / financial impact

- 2008 Overall Forecast

- Recession Almost Certain
- #1 indicator: Consumer spending
- #2 indicator: The US Exchange Rate

## NBER says U.S. recession began December 2007

Mon Dec 1, 12:20 pm ET

WASHINGTON (Reuters) – The U.S. economy slipped into recession in December 2007, the National Bureau of Economic Research's business cycle dating committee announced on Monday.



# What is a Recession?

## ◎GROWTH COMES IN TRENDS AND BENDS

- The trend is long run growth driven by demographics, productivity, investment, public policy, etc.
- Bends are short run fluctuations around the trend driven by some imbalances

## ◎A RECESSION IS A NEGATIVE BEND

- “Two quarters negative growth” rule confuses the symptoms with the disease
- Caused by some shock to the economy that causes rapid changes in aggregate demand, factor markets can't clear
- Unemployment rises, capacity utilization falls creating a negative feedback loop
- Recovery is a given, but the process is painful



# Public Opinion Meter



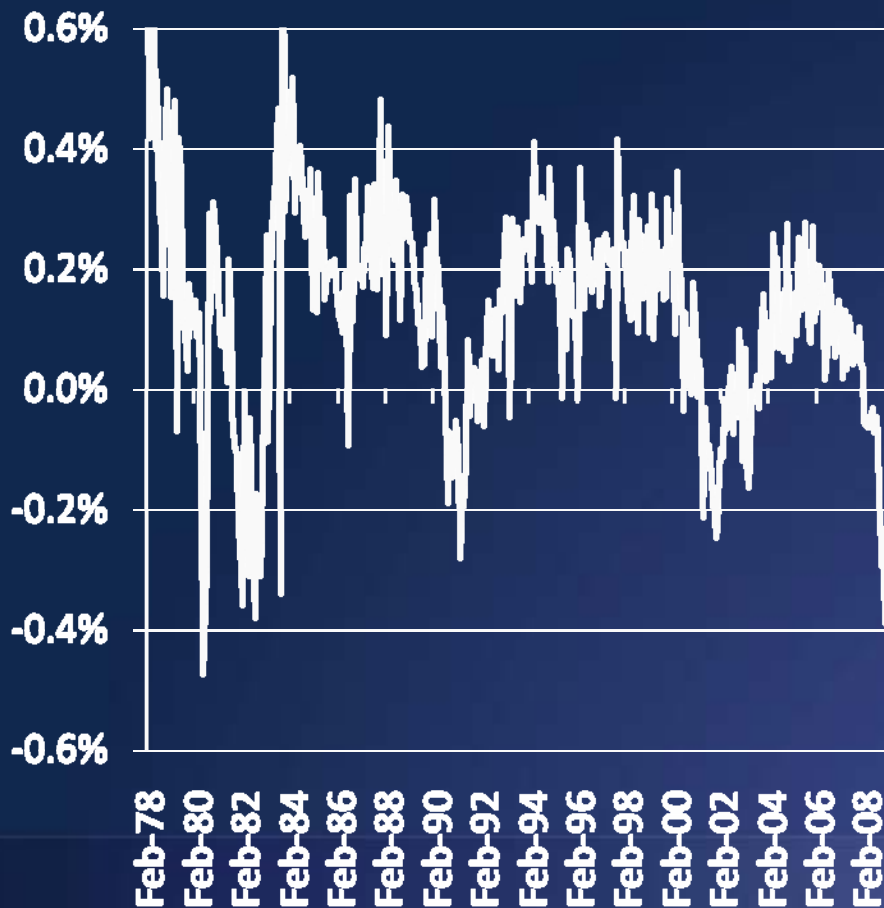
# So what's going on?

- **Wall Street troubles mean to California', its 'what California troubles mean for Wall Street'**
  - Recession was already fully underway, even if many economists and politicians remained in deep denial
- **What went wrong**
  - The big three imbalances: housing, finance, and the consumer
- **Where from here?**
  - Things are bad.. But not THAT bad! So far the numbers are 'normal' bad...
  - Recovery is a given, the timing of it is not
  - The big issue: the state and local fiscal situation

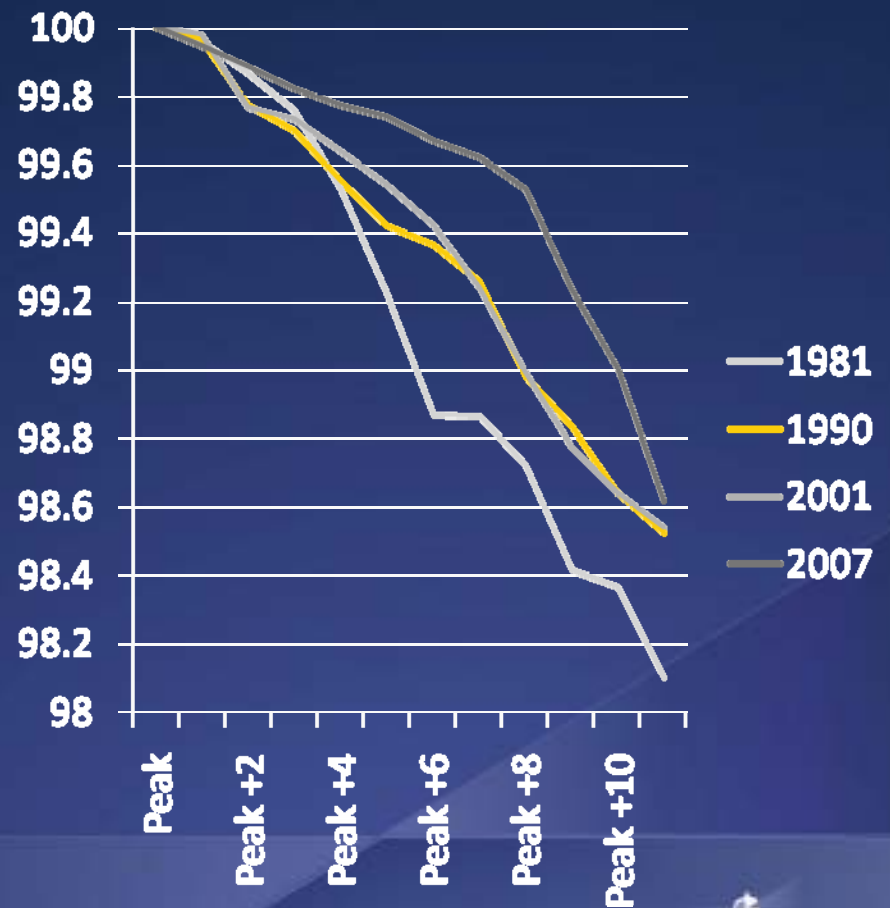


# Labor Markets

## Monthly Payroll Changes

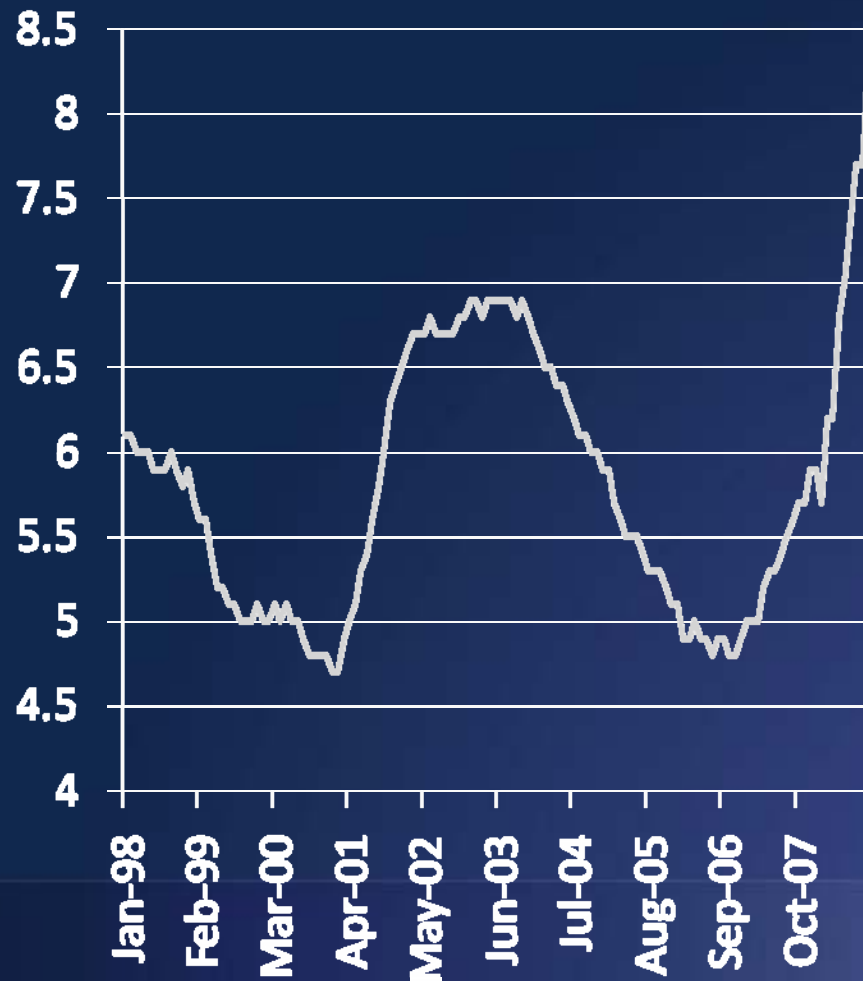


## Cumulative Losses from Peak



# Unemployment Rate

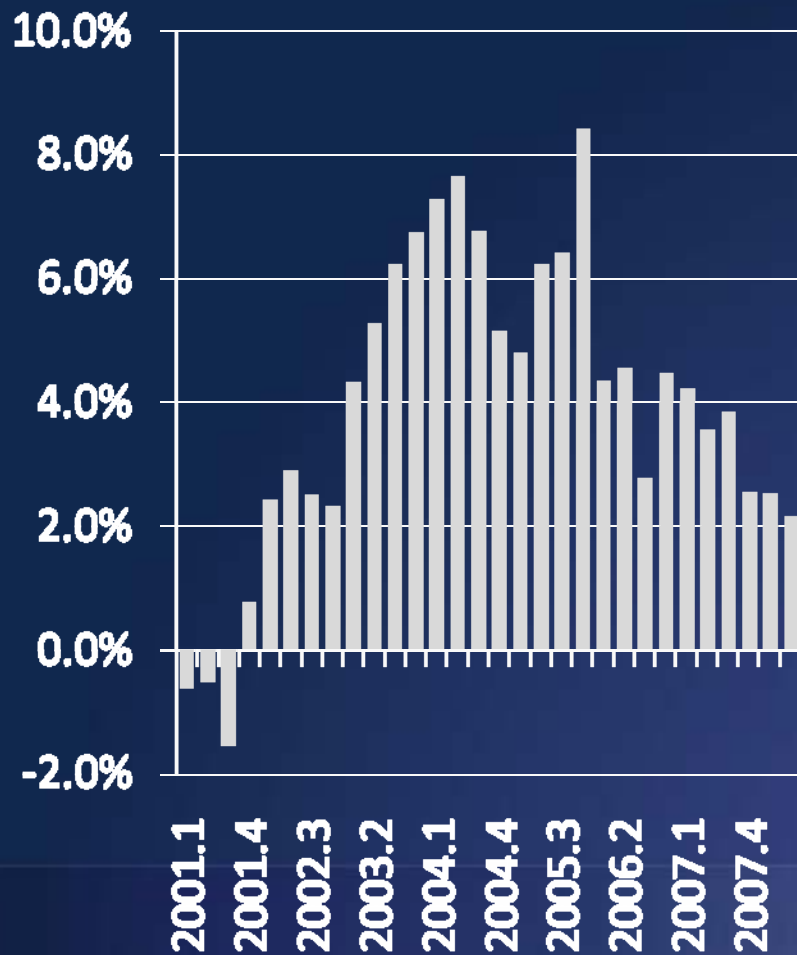
## California



	Nov08	Nov07	Nov06
California	8.2%	5.7%	4.8%
<u>Southern California</u>			
Los Angeles	8.3%	5.3%	4.5%
Santa Ana-Anaheim	6.1%	4.2%	3.4%
San Diego-Carlsbad	6.9%	4.9%	4.0%
Inland Empire	9.8%	6.4%	5.1%
<u>Bay Region</u>			
East Bay	7.2%	5.0%	4.4%
San Francisco	5.7%	4.1%	3.7%
San Jose-Sunnyvale	7.1%	5.0%	4.5%
<u>Central Valley</u>			
Sacramento	8.1%	5.7%	4.8%
Stockton	12.1%	8.7%	7.4%
Fresno	12.2%	9.0%	8.0%
Bakersfield	10.7%	8.6%	7.4%

# Income in the state

## Personal Income Growth



## US Indexes

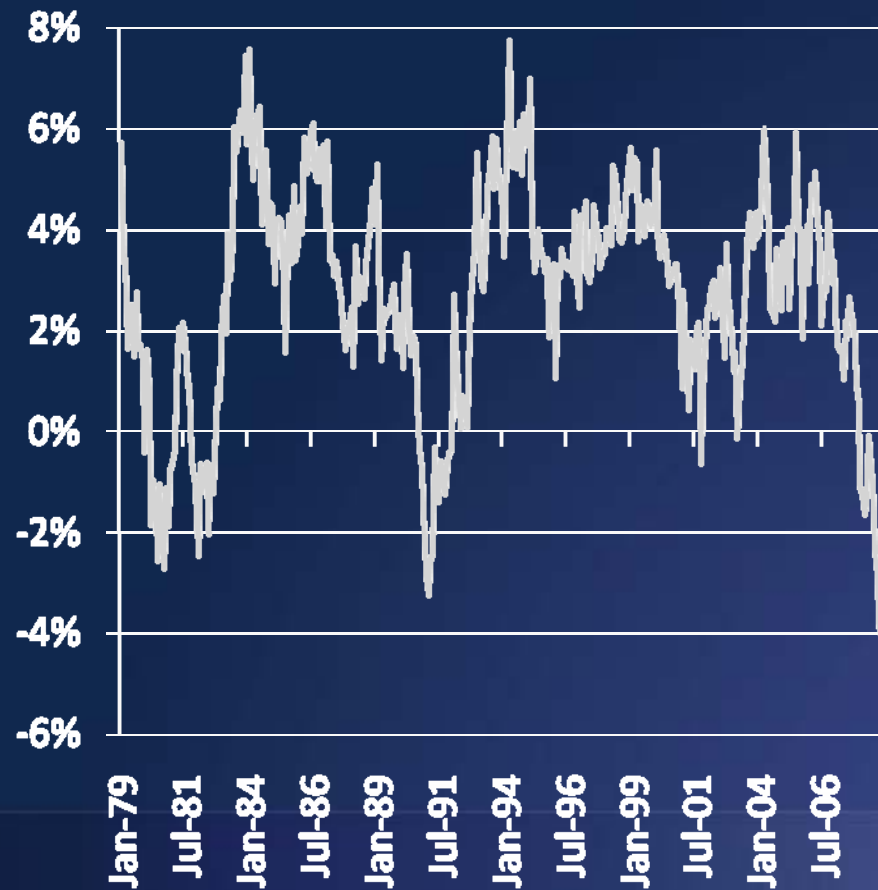


- Dow Jones Industrial Average
- NYSE Indexes
- S&P 500

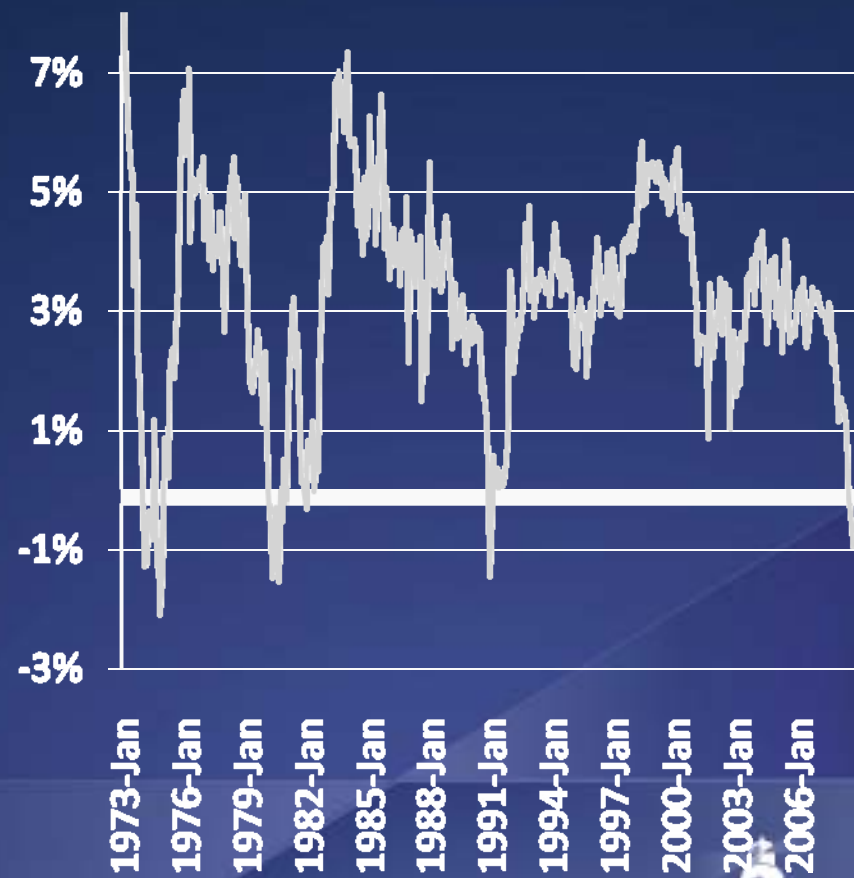


# Consumer Spending

**Real Retail Sales Y-o-Y  
Growth to Oct**



**BEA Real Consumer Spending  
Y-o-Y to Oct**



# See it in public revenues...

## Taxable Sales Growth



## New Vehicle Registrations



# The 3 Imbalances

## 1. The Housing Imbalance

*The collapse of the pyramid*

## 2. The Financial Imbalance

*The Credit Bubble*

## 3. The Consumer Imbalance

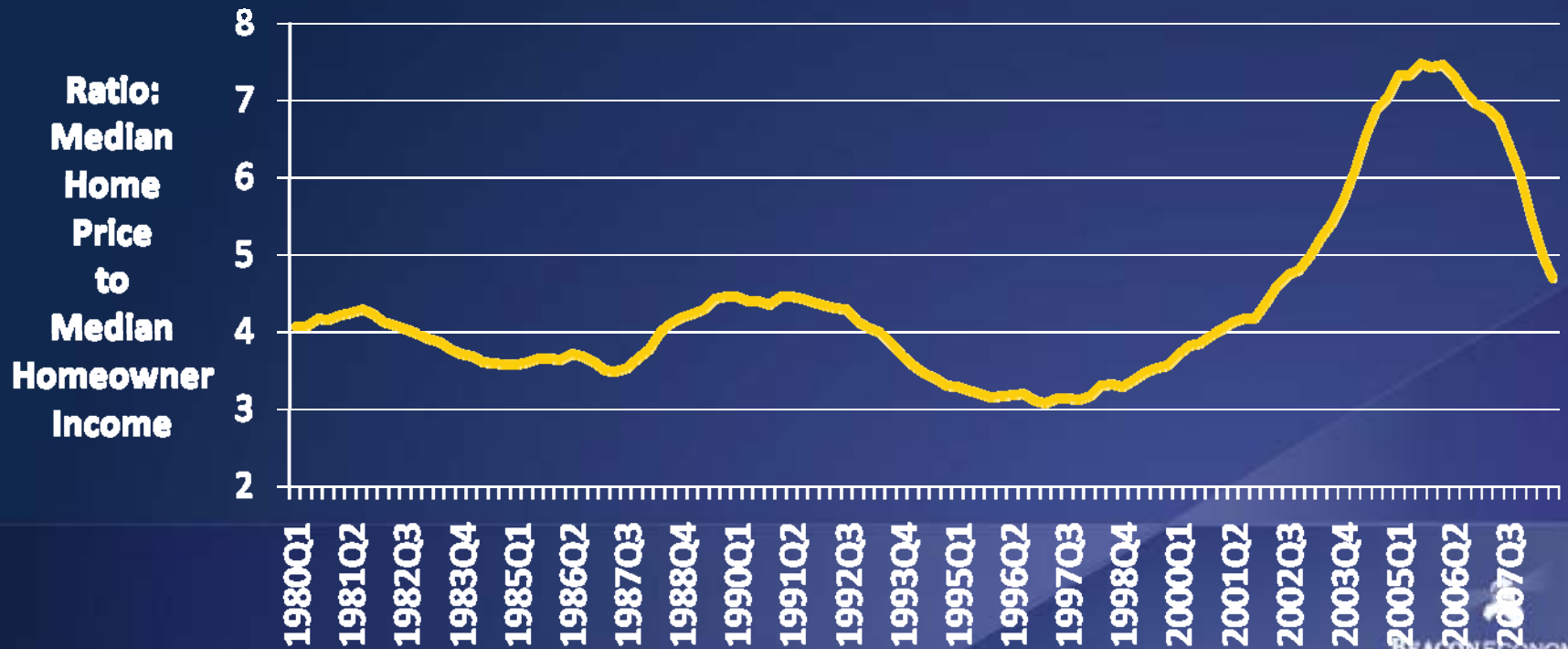
*Too much spending*



# Housing Insanity

## Affordability

	1999	1999	1999	1999	2006	2006	2006	2006
San Diego	\$231	\$62,537	\$25,397	40.6%	\$601	\$78,150	\$58,170	74.4%
Los Angeles	\$199	\$62,118	\$21,879	35.2%	\$577	\$78,949	\$55,847	70.7%



# Recovery on the way?

	Sales Volume			Median Price		
	Nov-07	Nov-08	%Chng	Nov-07	Nov-08	%Chng
Los Angeles	4,468	5,037	12.7%	\$499,000	\$340,000	-31.9%
Orange	1,567	2,177	38.9%	\$582,750	\$400,000	-31.4%
Riverside	2,503	3,719	48.6%	\$360,500	\$220,000	-38.3%
San Bernardino	1,719	2,385	38.7%	\$330,000	\$185,250	-43.9%
San Diego	2,400	2,673	11.4%	\$440,000	\$305,000	-30.7%
Alameda	985	1,182	20.0%	\$565,000	\$355,500	-36.9%
Contra Costa	879	1,423	61.9%	\$528,500	\$265,000	-49.9%
Santa Clara	1,317	1,120	-15.0%	\$678,000	\$450,000	-33.6%
San Francisco	479	340	-29.0%	\$814,750	\$648,000	-20.5%
San Mateo	504	398	-21.0%	\$780,000	\$580,500	-25.6%
Solano	313	596	90.4%	\$375,550	\$234,500	-37.6%
Sonoma	363	449	23.7%	\$470,000	\$310,000	-44.4%

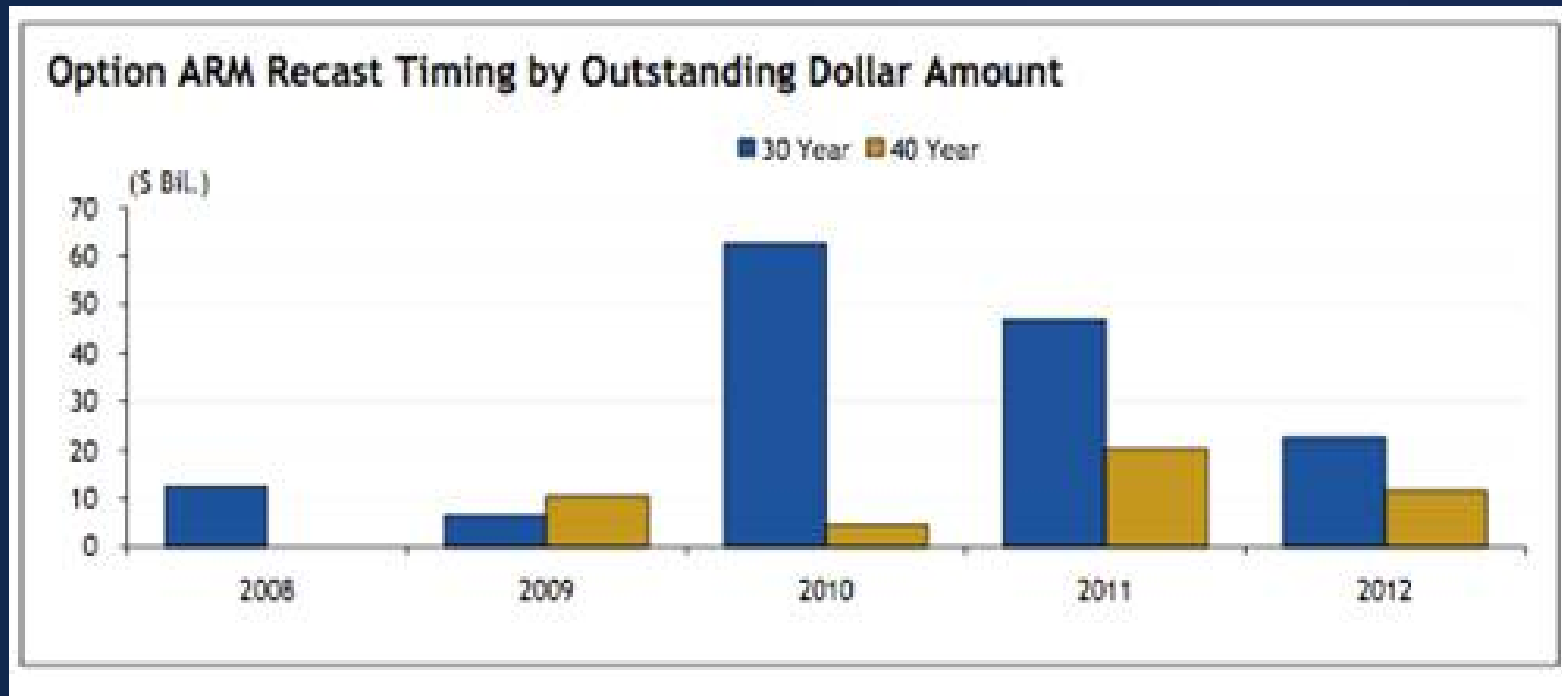


# Foreclosed homes: mounting

	Default	Auction	REO	Total	% HH
Los Angeles	22637	10243	42557	75437	2.2%
Riverside	12797	5305	30934	49036	6.5%
San Bern.	11354	4411	24484	40249	5.9%
San Diego	9031	4102	19910	33043	2.9%
Sacramento	6294	2877	17133	26304	4.8%
Orange	6883	2824	11813	21520	2.1%
San Joaquin	3991	1775	11937	17703	7.8%
Contra C.	4493	1818	11141	17452	4.4%
Alameda	4192	1501	8301	13994	2.5%
Kern	3685	1593	7967	13245	4.9%
Stanislaus	3005	1208	8043	12256	7.1%
Santa Clara	3296	1392	6034	10722	1.7%
Fresno	2846	1058	5968	9872	3.2%
Solano	1938	1023	4909	7870	5.3%
Merced	1513	666	4564	6743	8.1%
Ventura	2056	875	3638	6569	2.4%
Monterey	1420	750	3072	5242	3.8%



# Its not over...

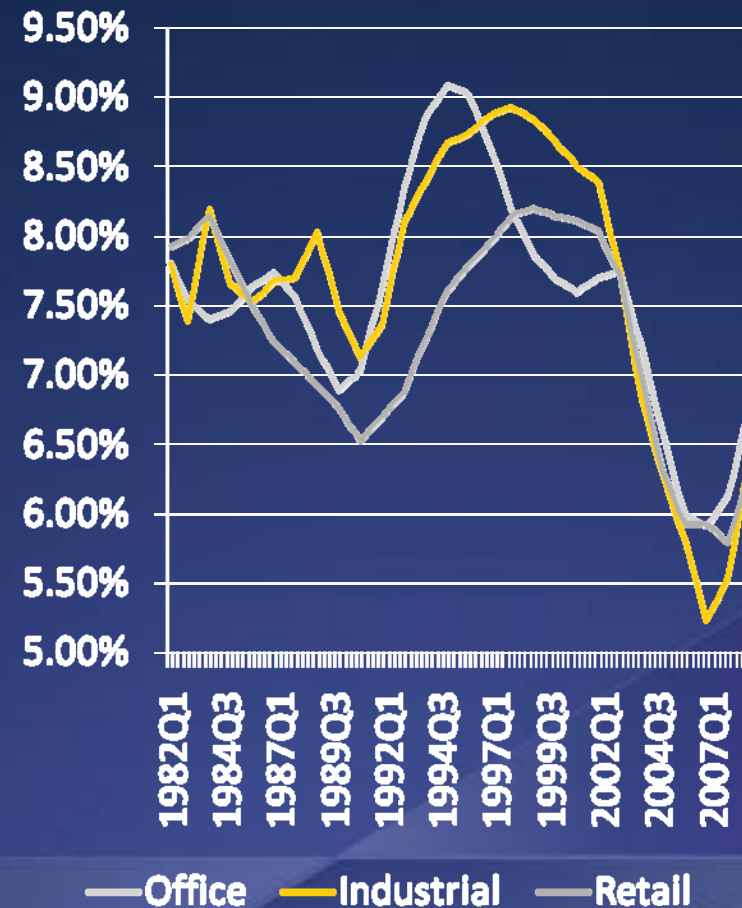


Expect high foreclosure rates  
right into the next decade...

# Commercial is following

	Office		Retail	
Inland Empire	15.5%	3.6%	15.8%	3.0%
Los Angeles	12.7%	0.8%	8.7%	0.6%
<b>Orange Co.</b>	<b>17.1%</b>	<b>3.7%</b>	<b>4.5%</b>	<b>1.2%</b>
San Diego	14.1%	1.3%	3.8%	0.9%
	Apartment		Warehouse	
Inland Empire	5.8%	1.3%	5.3%	1.7%
Los Angeles	5.2%	0.6%	4.4%	0.7%
<b>Orange Co.</b>	<b>4.5%</b>	<b>1.0%</b>	<b>6.9%</b>	<b>0.9%</b>
San Diego	4.1%	0.6%	8.4%	0.3%

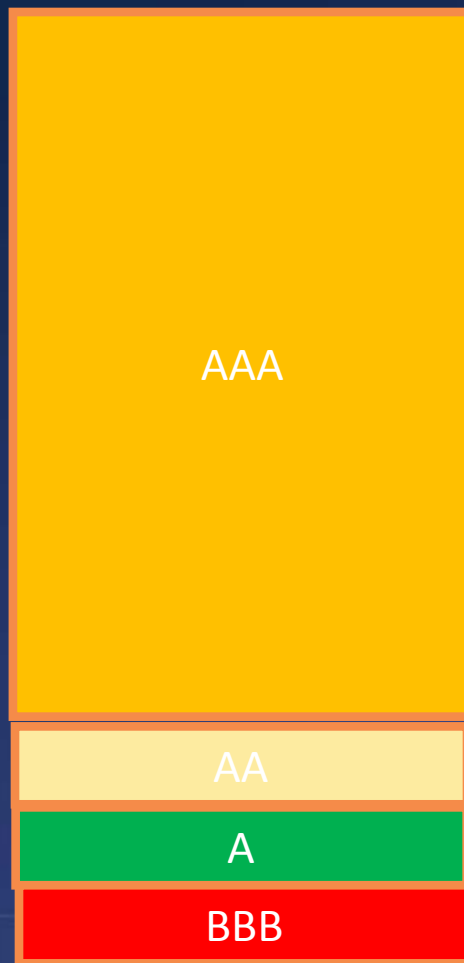
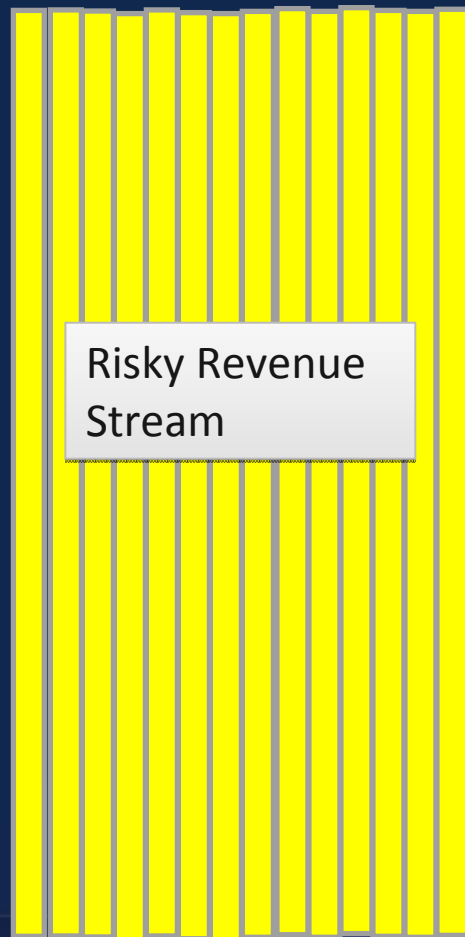
## OC Cap Rates



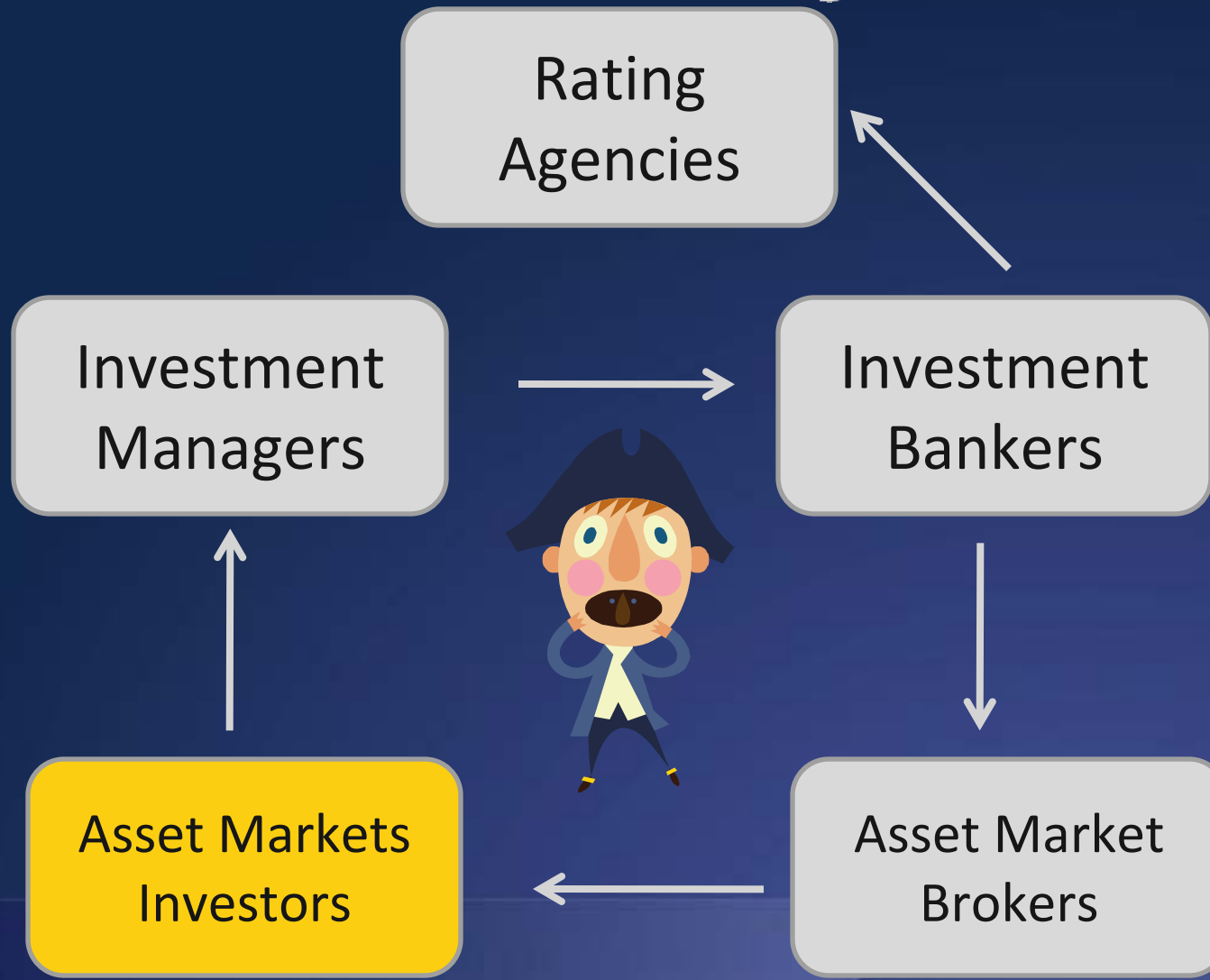


# The Financial Imbalance

## The CDO "Revolution"

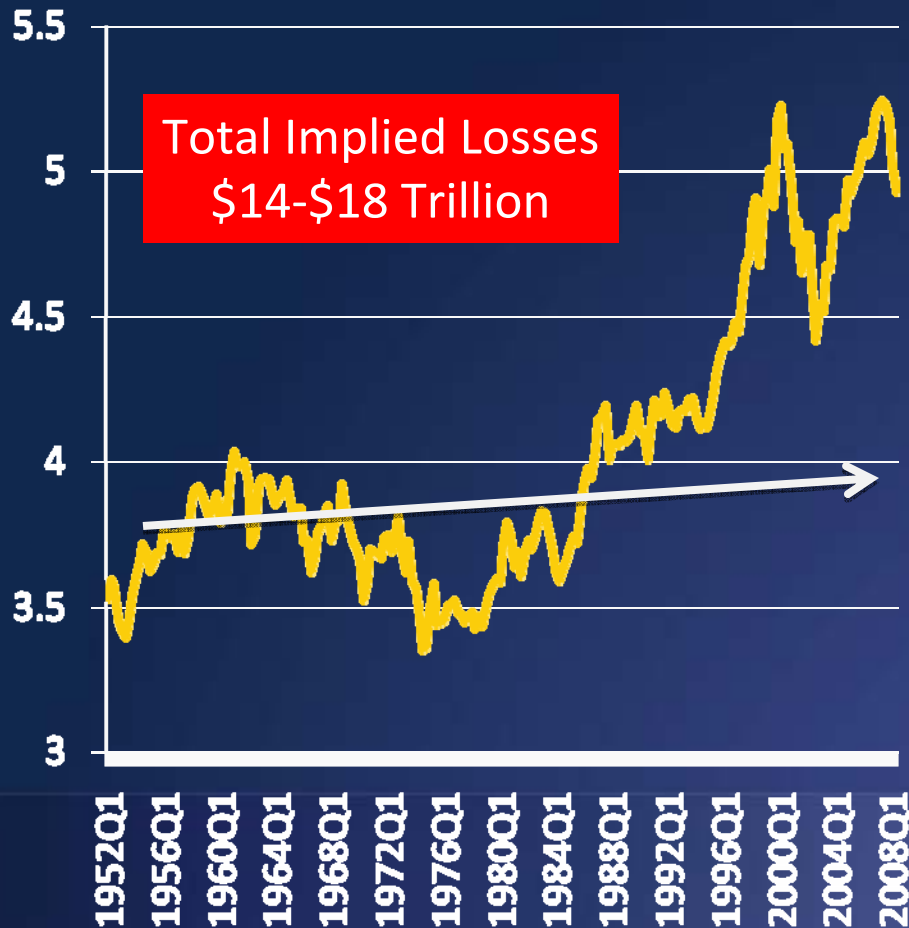


# The credit cycle

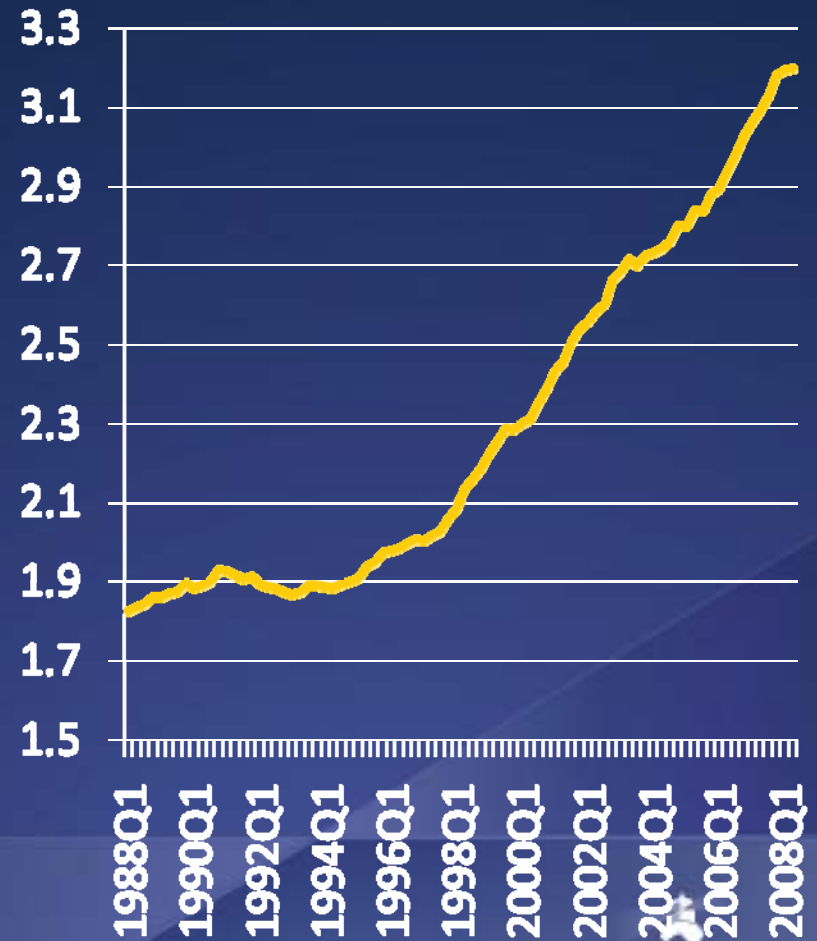


# The national bubble

**National P/E Ratio  
(F-o-F Assets / GDP)**

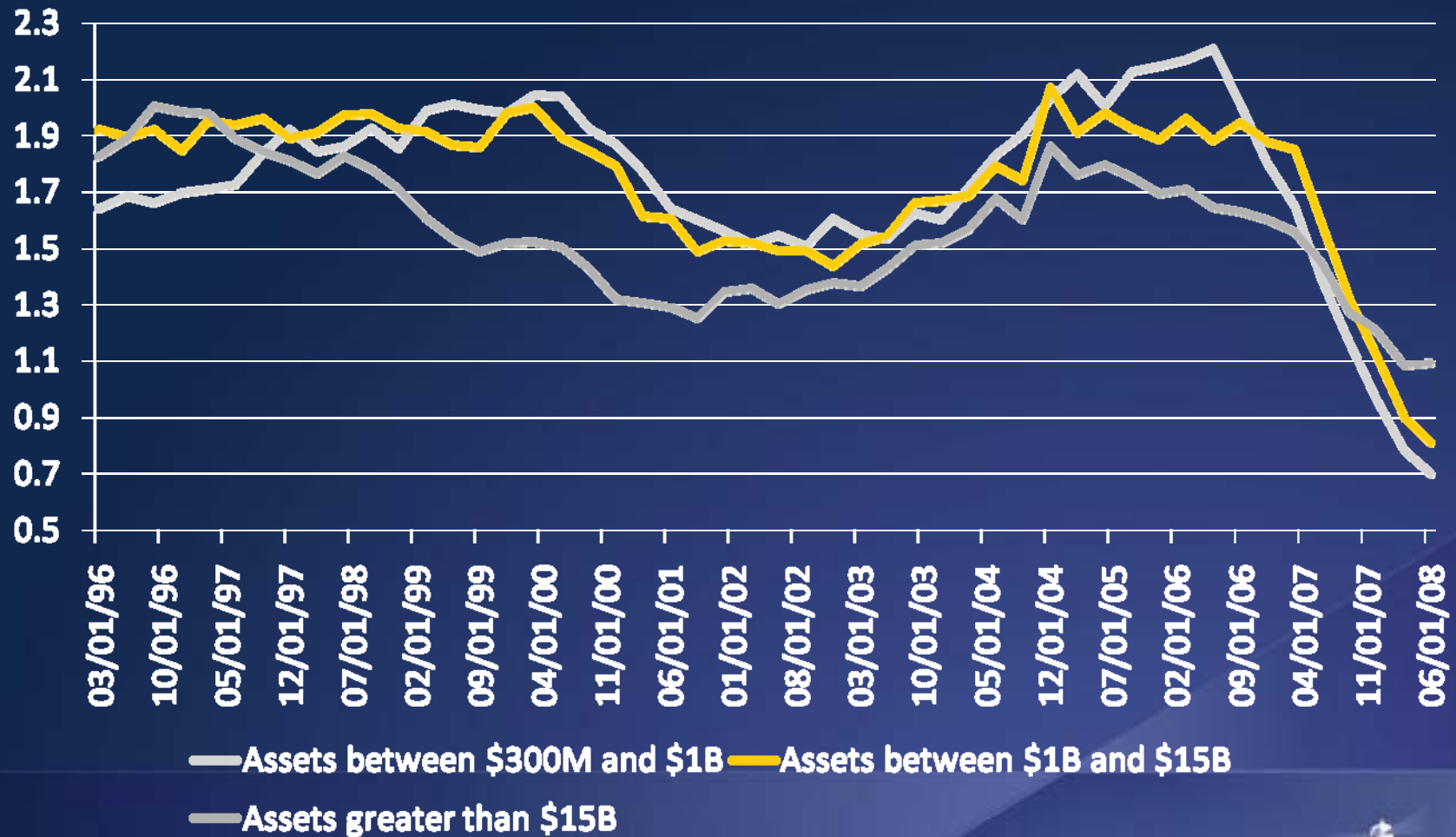


**Non-Federal Credit / GDP**



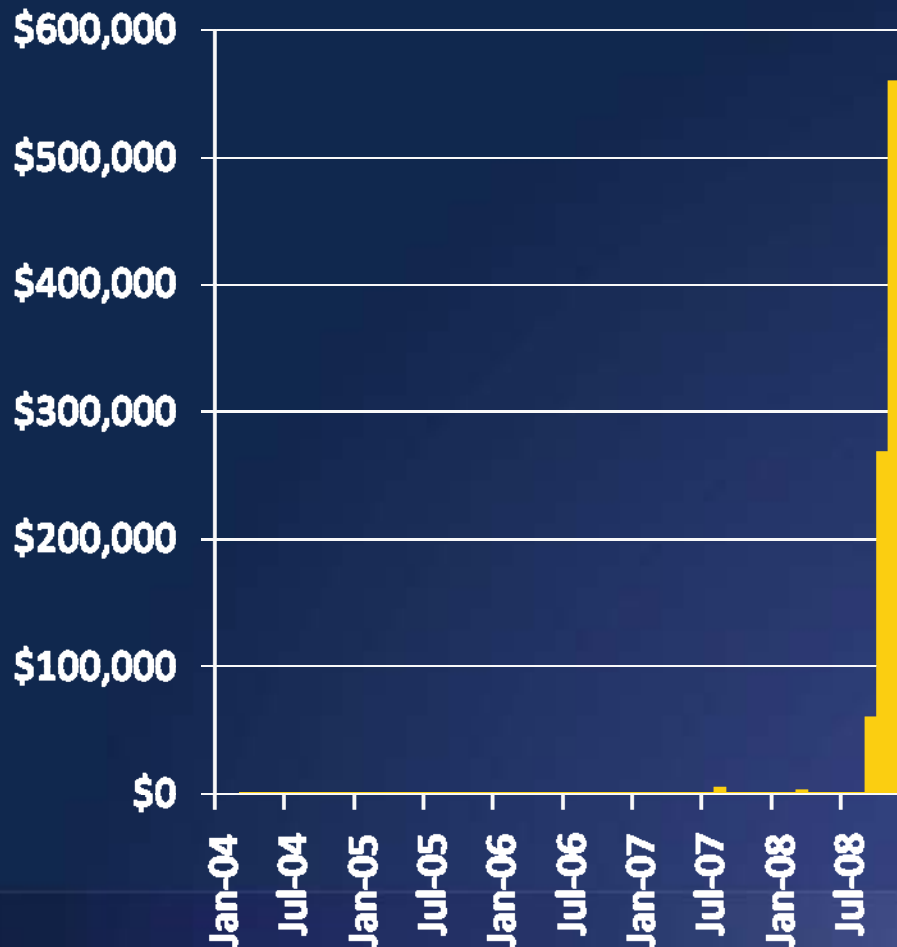
# Bank Issues

## Loan-Loss Reserves to Delinquent Loans



# Fed and Treasury Policy

## Bank Excess Reserves (\$Mll)

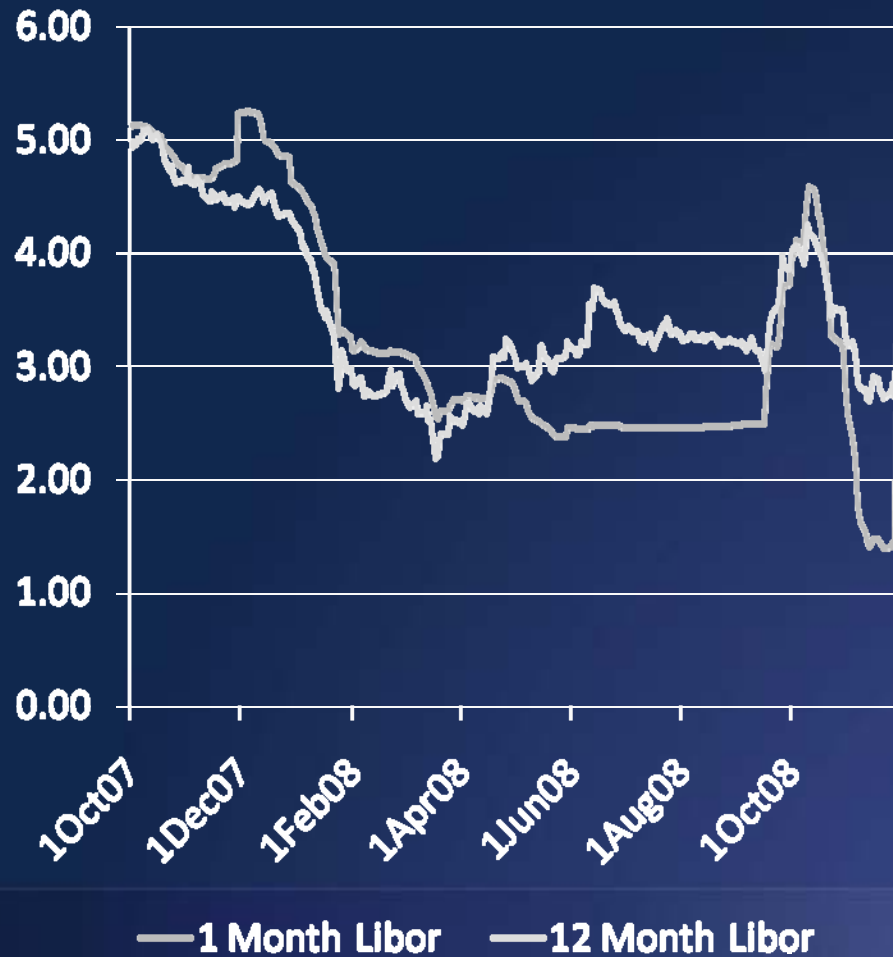


## Monetary Base (\$mil)

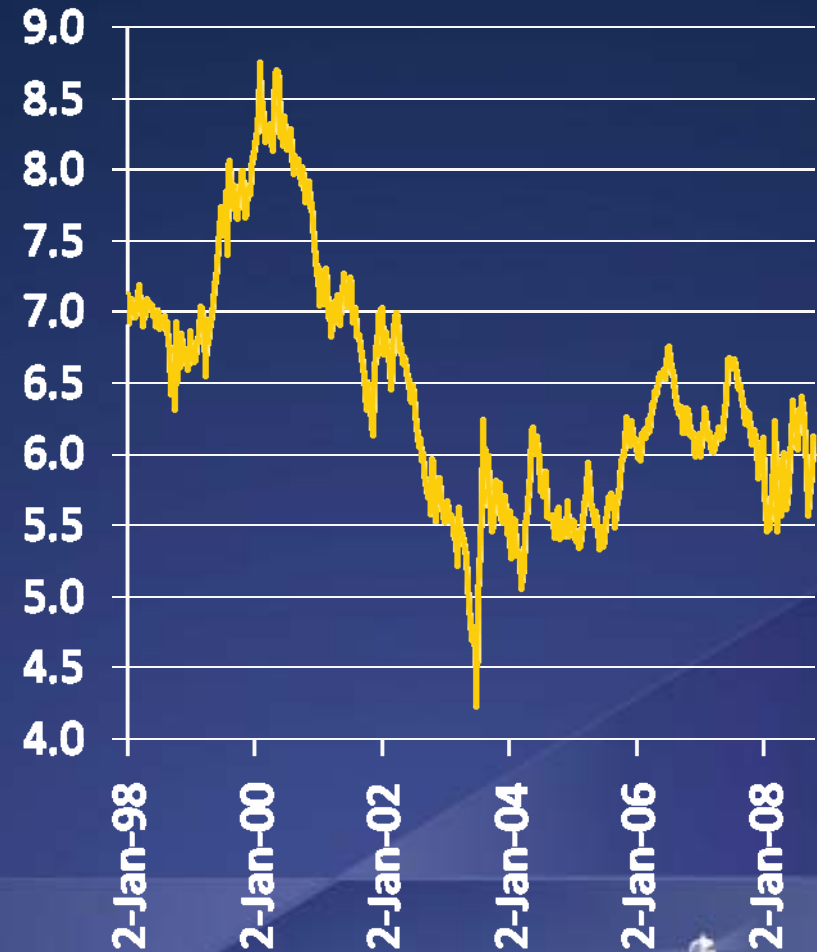


# Financial markets stabilizing...

## LIBOR



## 30 Year Conventional



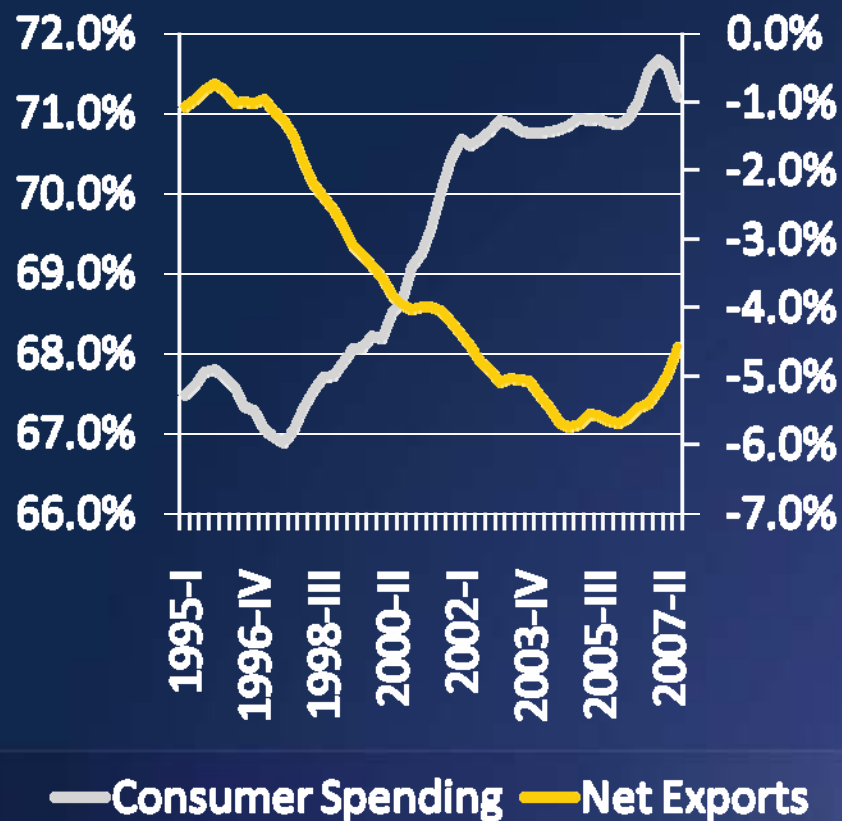
# Still, no Taste for Risk

BAA – 10 Year T-Bill

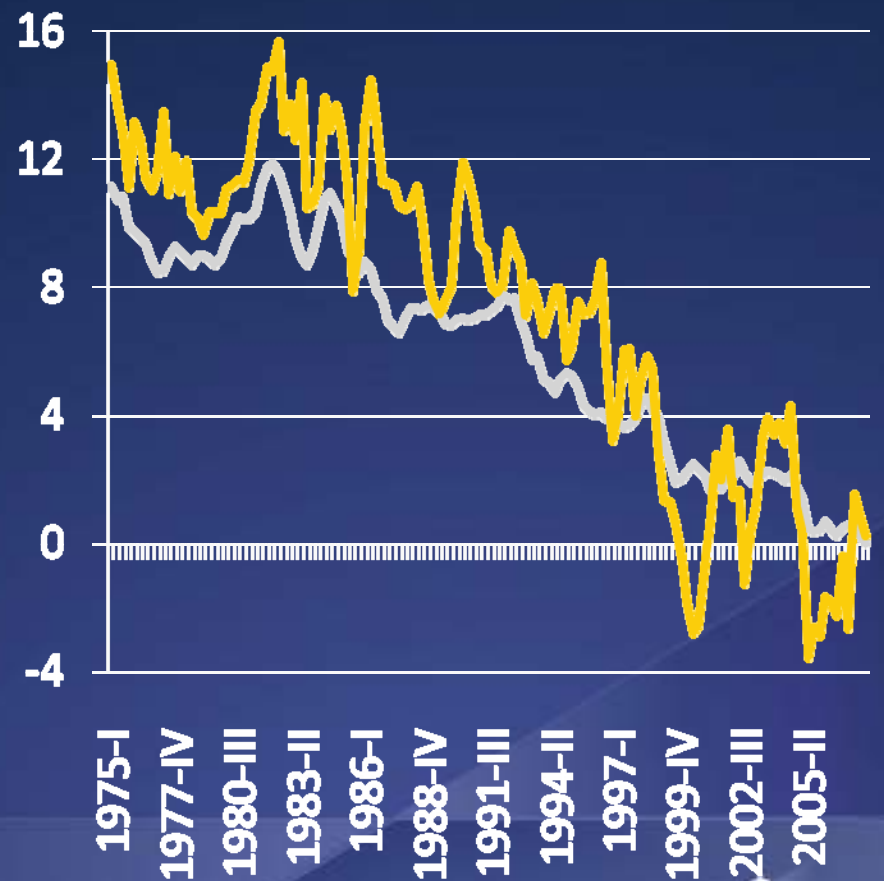


# The consumer imbalance...

## Consumer Spending and Net Exports as share of GDP



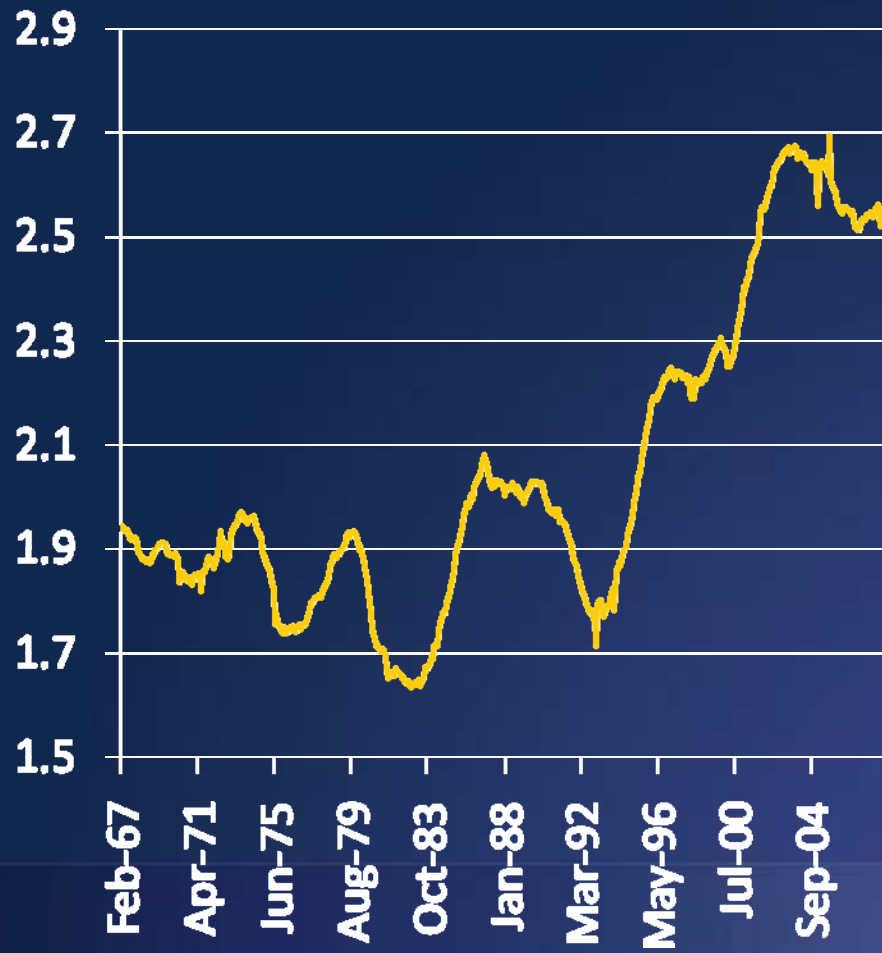
## Savings Rate as % of DPI





# The Consumer Debt Load

## Installment Credit / DPI

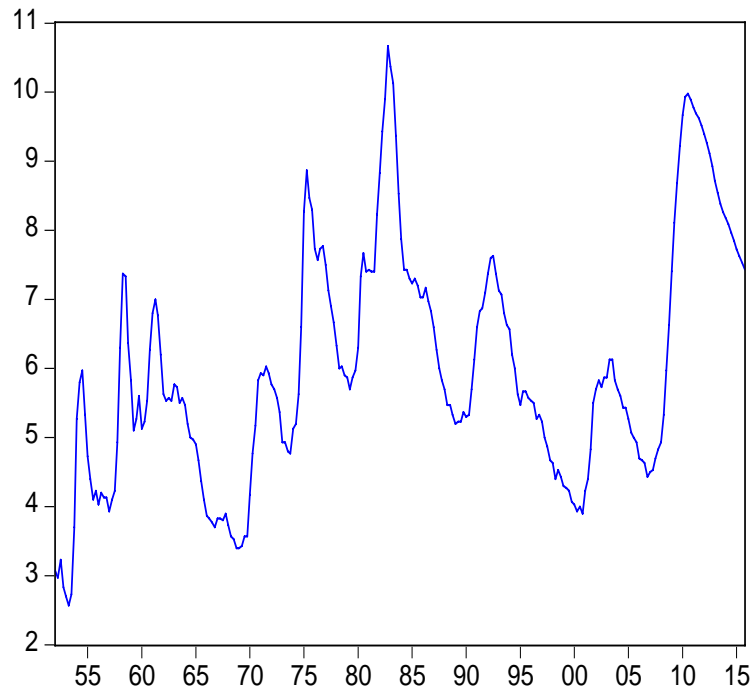


## Debt Servicing (% DPI)

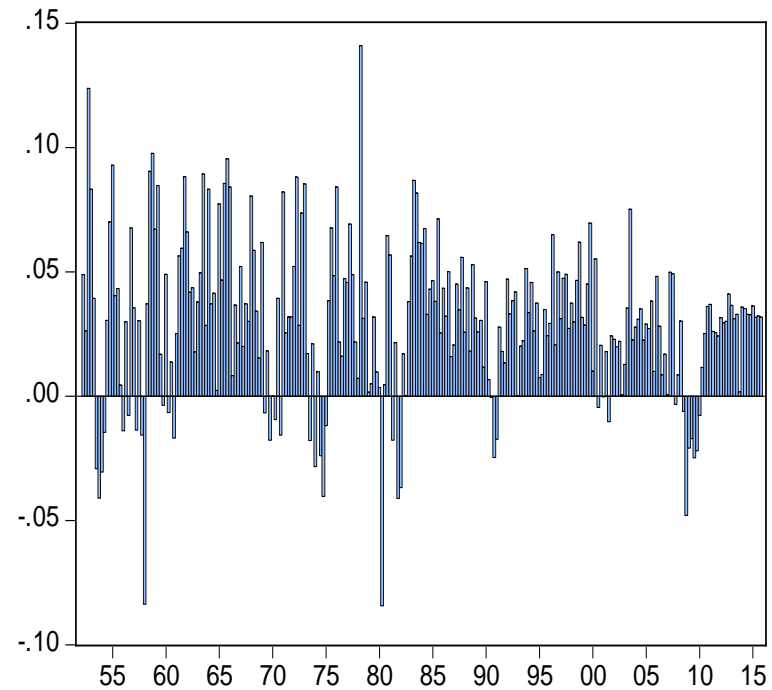


# Worst Case Scenario: Peak to Trough -3.7%

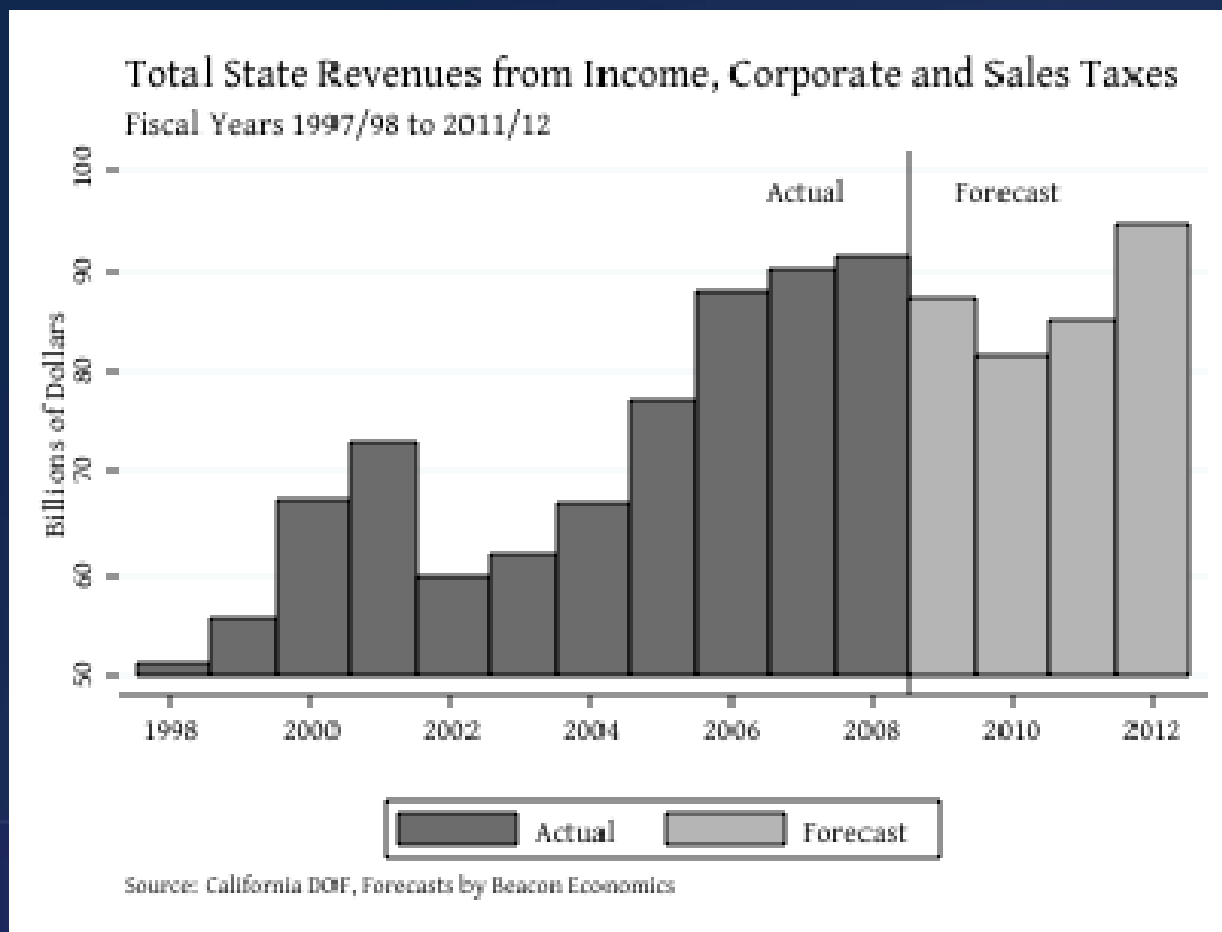
Unemployment



GDP Growth



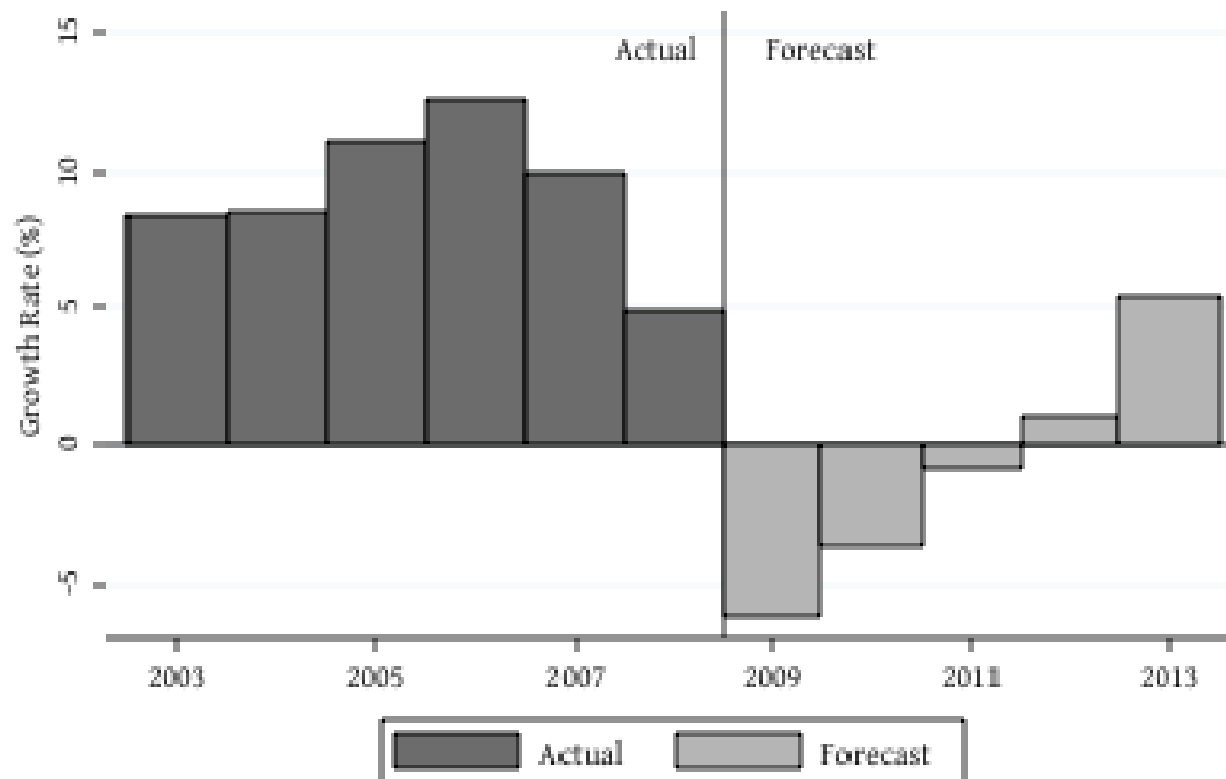
# What does it mean? Tough times for the budget



# Budget Issues: Local

## California Property Tax Revenue Forecast

2003 - 2013



Source: California BOE, Forecasts by Beacon Economics

# What does it mean?

- **Short run: a cash crunch**
  - The state will run out of cash late February at the current pace
- **Long Run: no quick fix**
  - The hits to the budget are long run, next year will be worse
- **REFORM IS DESPERATE NEEDED!**
  - California's problems can be easily fixed with the right political will





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