2013: Impediments and Opportunities

NAIOP Economic Outlook

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REGION TRACK
Regional Economic Forecasting and Analysis
Objectives:

1. Update the status of the U.S. recovery
2. Which impediments remain a risk to the recovery?
3. Secondary keys to the recovery
4. Forecasts and key assumptions
Recovery remains steady (but unspectacular) and broad-based improvement across a range of indicators.

Source: Bureau of Labor Statistics, Bureau of Economic Analysis, Census Bureau
Entering a new round of industry sector rotation in 2013
Most services sectors strong, goods have slowed

**Strength:**
State and local government rebounding
Skilled professional and business services
Health care – recession-proof?
Export industries – particularly agriculture and manufactured exports
Supply Chain: retail / transportation / warehousing / wholesale
Eating & drinking / leisure & hospitality

**Weakness:**
Construction / Manufacturing / Mining – softness in 2\textsuperscript{nd} half of 2012
Federal government – much is Postal Service
Telecommunications
Publishing
Areas of tourism remain weak
Big states are once again leading in # of jobs
Largest gains in TX, CA, OH, NY, FL
But regional growth patterns still present
Mountain, energy, and in-migration states leading: CO is all three
Colorado: leading or national-like?

Non-Farm Wage & Salary Employment

Jan-08 = 100.0

- TX
- UT
- CO
- U.S.
- CA
- NM
Serious impediments to recovery remain in place

The major economic issues we face will require more than short-run policy tactics to resolve:

1. Real estate / bank mortgage portfolios
2. Fiscal contraction
3. Deleveraging
4. International shocks: Euro area financial/fiscal crisis, slowdown in China and other developing regions
1. Residential Real Estate is a Four-Headed Beast
it will not be easy to defeat

Residential collapse hit economy on several fronts:

1. Collapse in sales – business activity (bottom found)
2. Construction halt – key cyclical sector (bottom found)
3. Housing price decline/foreclosures/delinquencies – wealth effects (ongoing)
4. Mortgage losses/restricted lending – financial system distress (ongoing)
1a. Delinquency and foreclosure pipeline remains full
no easy resolution, but peak behind us

Delinquent Mortgages
Millions of Housing Units

Source: Mortgage Bankers Association and Barclays
1b. Residential lending remains a problem for banks
mortgage portfolios still flat, delinquency rates elevated

Source: Board of Governors of the Federal Reserve System
2. U.S. Fiscal Cliff is Really Fiscal Mt. Everest
this will be a really long climb

**Prediction**: economic growth trumps deficit >> stop-gap action

**Outcome**: economic growth trumps deficit >> stop-gap action

- **Tax Changes**: reinstate payroll taxes, income tax increase and capital gains/dividends increase for $400K/$450K filers, AMT cuts extended, and limits on deductions for $250K/$300K filers, estate taxes up for $5Mil+ filers

- **Spending Cuts**: any potential cuts pushed out 2 months

Budget process does not end with this agreement

The experience in Europe with sharp spending cuts will continue to shape the U.S. budget process
3. Deleveraging is a **slow** painful process

govt. borrowing has more than offset private sector deleveraging

![U.S. Credit Market by Sector](chart.png)

Source: Board of Governors of the Federal Reserve Z.1
4. What Would Cause a U.S. Recession?

international shocks at top of list

Another recession is a real possibility in the coming 9-12 months (but <25%)

Most likely triggers:

- Euro area meltdown coupled with China weakness
- U.S. policy mistake (federal budget)
- natural market forces: 3+ years into recovery
4a. European fiscal crisis will drag into 2013. Resumption of growth is a real possibility by year-end.

**Euro Area GDP Growth Remains Negative**

Quarter-over-quarter percent change

Source: Organization for Economic Co-operation & Development (OECD)
4b. Data suggest China is past the bottom bank lending has resumed growth

<table>
<thead>
<tr>
<th>Year</th>
<th>Quarter</th>
<th>Growth Rate (%)</th>
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<tr>
<td>2011</td>
<td>Q1</td>
<td>2.2</td>
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<tr>
<td></td>
<td>Q2</td>
<td>2.5</td>
</tr>
<tr>
<td></td>
<td>Q3</td>
<td>2.4</td>
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<td></td>
<td>Q4</td>
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<td>2012</td>
<td>Q1</td>
<td>1.5</td>
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<tr>
<td></td>
<td>Q2</td>
<td>2.0</td>
</tr>
<tr>
<td></td>
<td>Q3</td>
<td>2.2</td>
</tr>
</tbody>
</table>

Source: National Bureau of Statistics of China
CRE is no longer a risk factor to recovery
now following general economic conditions, lending resumes

Source: Board of Governors of the Federal Reserve System: Senior Loan Officer Survey
Fed Will Hold the Course in 2013
full employment at any cost? yes

Rates will remain exceptionally low as long as:

1. unemployment concerns dominate inflation worries
2. asset prices (real estate and stock prices) remain semi-soft
3. Bernanke deems it useful to eliminate the investor notion of a risk-free asset with positive yield (savers are a problem)
4. from “… mid 2015” to open-ended in the Dec. FOMC language (6.5% jobless target)

Growing number of FOMC members voicing a desire to end QE early: half said by mid 2013
Will 2013 be the Transition Year?
if so, where will the fuel come from?

1. Continued Fed accommodation
2. No chaos from fiscal cliff
3. Soft energy prices
4. Steady, but unspectacular, job gains
5. Greatly improved bank balance sheets
6. Low debt service for households
7. Housing bottom
8. Early stages of European resolution / China rebound
2013 U.S. forecast point estimates

**Federal Reserve** (central tendency Dec. 2012)
- GDP: 2.3-3.0% in 2013
- Unemp: 7.4-7.7% in 2013
- 3.0-3.5% in 2014
- Unemp: 6.8-7.3% in 2014
- 3.0-3.7% in 2015
- Unemp: 6.0-6.6% in 2015
- *core CPI inflation remains at or below 2.0% through 2015*

**Wells Fargo**
- GDP: 1.5% in 2013
- Unemp: 7.8% in 2013
- 2.4% in 2014
- Unemp: 7.6% in 2014

**WSJ Consensus**
- GDP: 2.3% in 2013 *(up)*
- Unemp: 7.5% Dec 2013
- 2.8% in 2014
- Unemp: 7.0% Dec 2014

**RegionTrack**
- GDP: 2.5% in 2013
- Unemp: 7.3% Dec 2013
- GDP: 3.0% in 2014
- Unemp: 6.8% Dec 2014
Forecasting strategies are applicable to business planning

Errors that are becoming increasingly likely in 2013:

• Ignoring the evidence that there really is a recovery underway
• Overreacting to data noise
• Confusing the adjustment process with structural change in many segments of the economy
• Overestimating the importance of external shocks
• Focusing on tactical government policy actions rather than the markets and economic mechanisms at work
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