The Anemic U.S. Recovery

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Review of Main Take-Aways from 2009:

• Downturn once viewed as U.S. real estate driven

• De-leveraging was the more general culprit

• De-leveraging was a global, not local, phenomenon
Causal links, as once perceived:

U.S. real estate boom led to inevitable bust
  ↓
Mortgage security values fell
  ↓
Write-downs drained bank capital
  ↓
Weakened banks quit lending
  ↓
Lack of credit led to an economic contraction
  ↓
U.S. contraction proved contagious globally
More likely Causal links:

Global investors undervalued risk starting in 1990s

Demand for risky securities outpaced sustainable levels

U.S. real estate reversal the “canary in the coal mine”

Global de-leveraging is pummeling asset values

Global risk “revulsion” is contagious/self reinforcing

Forces from “paradox of thrift” dwarf policy response

Correction brings this ratio more in line with a plausible long-term trend.

Bubbles?

Excessive pessimism?
* Both financial and real estate values fell this time, versus 2000 stock drop.
Asset value collapse was across all categories, not just real estate.

Asset price declines were broad-based, though current bounce led by stocks.

* Asset value collapse was across all categories, not just real estate.
Credit market collapse across all categories, not just mortgages.

Liability decline also broad-based.

* Credit market collapse across all categories, not just mortgages.
* Real estate lending only “chased” construction down, and didn’t “lead.”
C&I Loan growth also just “chased” inventories lower, and didn’t “lead.”

Re-intermediation with the start of the credit crunch.

Rapid contraction in loan growth now.
* No tendency for the U.S. to have “led” the world economy downward.
* The U.S. actually seemed to “chase” the industrialized economies down.
Going Forward: The drivers for 2010

• Recovery on a slow trajectory from a June trough

• All GDP components to underperform… but housing!

• Pace of expansion hinges on businesses, not consumers

• Highly stimulative policy a mixed blessing

• Yields to rise, curve to flatten, spreads to narrow
An unusually modest recovery, given current Fed forecasts, and our own.
Housing in the “ball park” of a normal cyclical rebound.

Y/Y Real Residential Investment Growth in the Last Seven Cycles
Includes Each Expansion and Ensuing Downturn

Rebound actually adhering, thus far, to a notably normal cyclical bounce. Sustained contraction at recession-pace

* Housing in the “ball park” of a normal cyclical rebound.
Y/Y Real GDP "Ex-Housing" Growth in the Last Seven Cycles
Includes Each Expansion and Ensuing Downturn

* GDP “ex-housing” is tracking a notably anemic expansion thus far.
Remarkably weak business fixed investment is the main culprit.

* Remarkably weak business fixed investment is the main culprit.
* The Fed’s balance sheet is frighteningly large. Will they exit on time?
* The Treasury’s balance sheet is hopeless. Can Congress recover?

* Stimulus II left a powerful blowout for government finances.
Sovereign yields to rise, curve to flatten, spreads to narrow.

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Summary:

• Downturn due to de-leveraging, not housing
• De-leveraging was a global, not local, phenomenon
• Recovery on a slow trajectory from a June trough
• All GDP components underperforming but housing!
• Pace of expansion hinges on business, not consumers
• Highly stimulative policy a mixed blessing
• Yields to rise, curve to flatten, spreads to narrow