

11-28-2009

The Long Road to Recovery from the recession of 2007: December 2009 Update

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The long road to recovery from the recession of 2007

December 2009 update

Edward (Ned) Hill
Dean, Levin College of Urban Affairs
Cleveland State University

November 28, 2009



World in recession

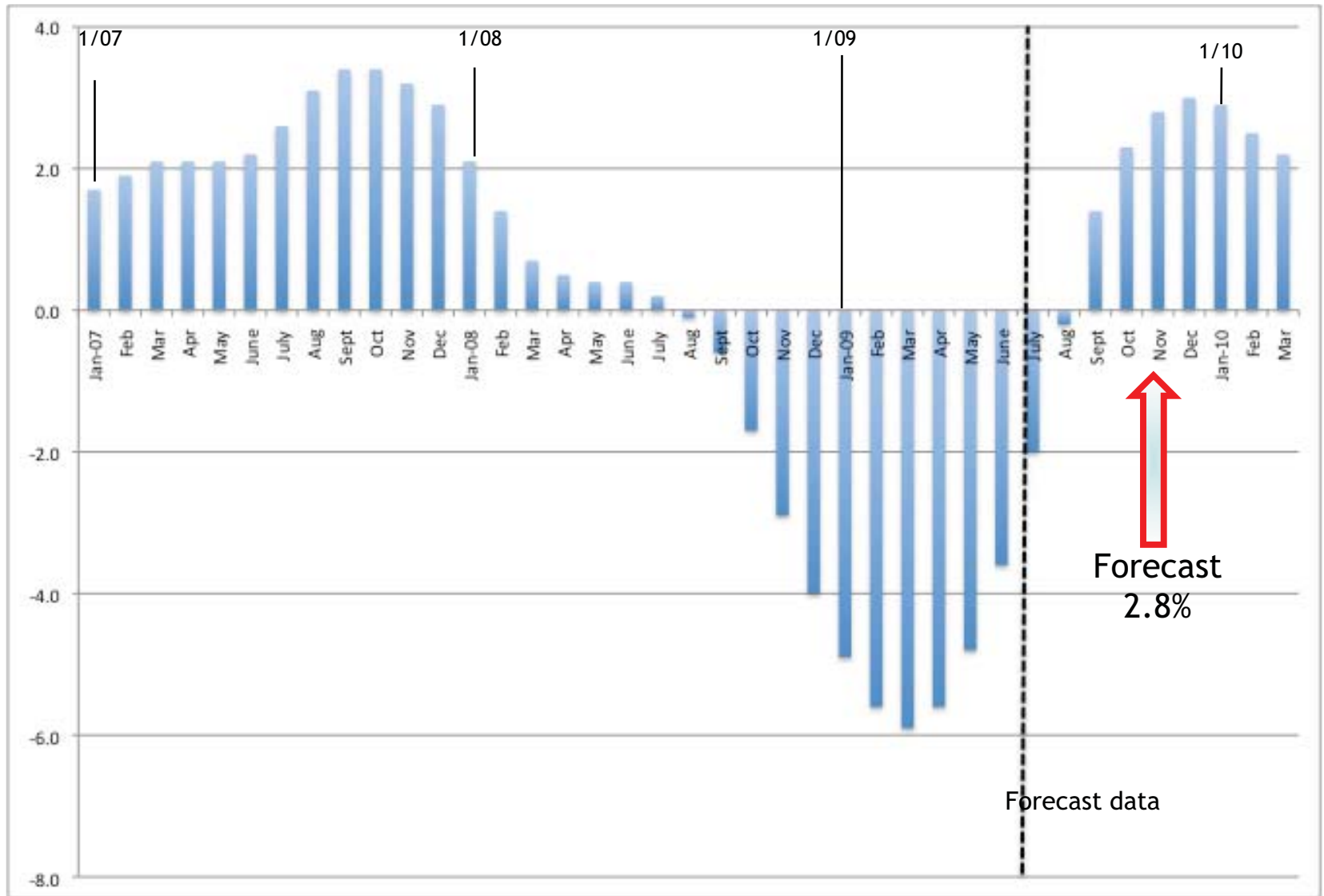
Forecasts

- International Monetary fund:
 - Global growth was negative in 2009, with an expected 1.6% contraction in global GDP
 - Global GDP growth is expected to rebound to 3.1% in 2010 and 4.2% by 2011; driven by China, India, and Korea
- **N. America leads industrial world's recovery**
 - Recovery started in 2009 Q3 (July-September)
 - NAFTA a growing region in 2011—do you believe the numbers for Mexico? It has to be energy.
 - Europe - deeper recession than North America, about 1% point lower
 - Japan - back to economic stupor
- **Recovery in employment growth will lag. In the US:**
 - 1990 recession 9 months long: employment recovered in 32 months
 - 2001 recession 9 months long: employment recovered in 48 months
 - We are in month 19 of the 2007 recession & will it will last for last 22-24 months. When will employment be fully recovered? A guess is 5 years or 60 months.

Recession over? 6 month percent change in GDP

Forecast data from July 2009 on

Forecasts



World in recovery?

Recent forecasts of annual percent change in real GDP

Forecasts

United States

	2009		2010				Annual			
	3	4	1	2	3	4	2009	2010	2011	2012
Survey results										
Economist 11/12/09		3.5					-2.4	2.6		
Forecasters' Survey 11/16/09		2.7	2.3	2.4	2.6	2.9	-2.5	2.4	3.1	3.3
Individual forecasts										
OECD 11/19/09							-2.5	2.5	2.8	
Conference Board 11/11/09	3.5	3.2	1.0	1.8	2.6	2.1	-2.4	2.0		
IMF 10/29/09							-2.7	1.5	2.8	2.6
European Union 10/22/09							-2.5	2.2	2.0	
World Bank 6/29/09							-3.0	1.8	2.5	

Nation	Economist 11/12/09		OECD 11/19/09			EU 10/22/09			IMF 10/29/09			World Bank 6/22/09	
	2009	2010	2009	2010	2011	2009	2010	2011	2009	2010	2011	2009	2010
World									-1.6	3.1	4.2	-2.9	2.0
United States	-2.4	2.6	-2.5	2.5	2.8	-2.5	2.2	2.0	-2.7	1.5	2.8	-3.0	1.8
Euro Area	-3.8	1.2				-4.1	0.7	1.6	-4.2	0.3	1.3	-4.2	1.2
Germany	-4.9	1.6	-4.9	1.4	1.9	-5.0	1.2	1.7	-5.3	0.0			
France	-2.1	1.4	-2.3	1.4	1.9	-2.2	1.2	1.5	-2.4	0.9	1.8		
Italy	-4.9	0.8	-4.8	1.1	1.5	-4.7	0.7	1.4	-5.1	0.2	0.7		
United Kingdom	-4.5	1.3	-4.7	1.2	2.2	-4.6	0.9	1.9	-4.4	0.9	2.5		
NAFTA													
Canada	-2.4	2.2	-2.7	2.0	3.0				-2.5	2.1	3.5		
Mexico	-7.1	3.0	-8.0	2.7	3.9				-7.3	3.3	4.9	-5.8	1.7
Asia													
China	8.2	8.6	8.3	10.2	9.3				8.5	9.0	9.7	6.5	7.5
Japan	-5.7	1.5	-5.3	1.8	2.0	-5.9	1.1	0.4	-5.4	1.7	2.4	-6.8	1.0
South Korea	-1.0	2.8	0.1	4.4	4.2				-1.0	3.5	5.2		
India	5.5	6.3	6.1	7.3	7.7				5.3	6.4	7.3	5.9	8.1
Brazil	0.0	3.8	0.0	4.8	4.5				-0.7	3.5	3.5	-1.1	2.5

Sources: The Conference Board; *The Economist*; OECD, *Economic Outlook, Interim Report*; Survey of Professional Forecasters, Philadelphia Federal Reserve Bank; International Monetary Fund, *World Economic Outlook*

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Sources continued: European Union, *Economic Forecast*; World Bank *Forecast Summary, 2009*

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Economist.com forecast of annual percent change in GDP; forecasts are improving over time

Forecasts

Nation	6/4/09		9/3/09		11/12/09	
	2009	2010	2009	2010	2009	2010
United States	-2.8	1.6	-2.6	2.0	-2.4	2.6
Euro Area	-4.1	0.5	-4.4	0.6	-3.8	1.2
Germany	-5.5	0.5	-5.9	0.8	-4.9	1.6
France	-2.8	0.5	-2.8	0.8	-2.1	1.4
Italy	-4.4	0.3	-5.1	0.4	-4.9	0.8
United Kingdom	-3.7	0.6	-4.2	1.0	-4.5	1.3
NAFTA						
Canada	-2.3	1.7	-2.2	1.8	-2.4	2.2
Mexico	-4.4	1.2	-7.1	2.8	-7.1	3.0
Asia						
Japan	-6.7	0.8	-6.4	1.1	-5.7	1.5
China	6.5	7.3	8.1	8.5	8.2	8.6
India	5.0	6.4	5.5	6.3	5.5	6.3
Brazil	-1.5	2.7	-1.0	2.7	0.0	3.8

How broad was the disruption?

- **Where we were: Liquidity trap, credit crunch**
 - Collateralized debt obligations (CDOs)—mortgage, consumer credit, autos, student
 - Commercial Paper Market
 - Interbank lending, and calls on bank capital
 - Credit Default Swaps (CDS aka: insurance) became the chips at a casino
 - In 2010 the collateralized damage will appear in commercial real estate—you will hear about CCRMO—Collateralized Commercial Real Estate Mortgage Obligations

- **Where we are: Macroeconomic problems affect core domestic sectors**
 - Finance
 - Automobile assembly
 - Housing related: Construction and building materials, Furniture, Logistics
 - Retail--consumer spending
 - Education

Just the facts

Events

- Liquidity trap became evident in Summer 2007; November 2007 interbank lending slows
- NBER—the recession started in December 2007 (Declared in November 28, 2008)
- September 2008 acceleration of bad news and September 15 look into the abyss of frozen credit markets
 - Sept 15 Bank of America announces intent purchase Merrill Lynch
 - Sept 15 Lehman files for Chapter 11 bankruptcy
 - Sept 16 Reserve Primary Fund breaks the buck
 - Sept 16 The Fed advances \$85 billion to AIG
 - Sept 17 SEC bans short selling ban of financial sector stocks
- End of the housing bubble removed \$3.5 trillion in household wealth from 2006 (4) to 2008(4).
- Net worth of households dropped by 20% in 18 months 2007(2) to 2008(4) or \$12.9 trillion
- **Every \$1 lost consumer wealth decreases spending by 5 cents over the next two years (\$322.1 billion per year)**

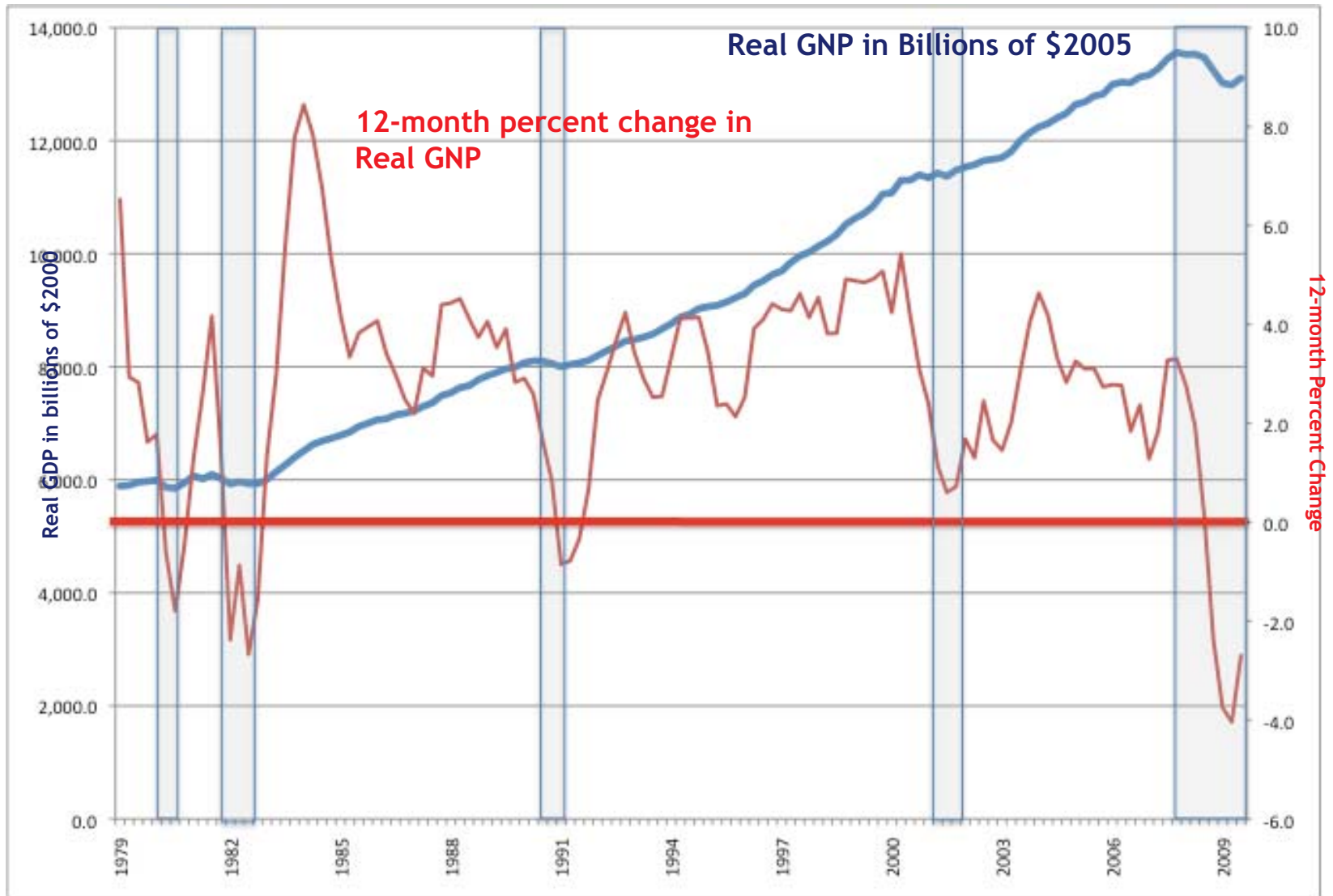
Public policy questions that still require answers

- How big a deficit? How long do you run a deficit?
- Energy—regulate to a goal or create market incentives?
- How do you regulate?
 - Financial transparency or accounting standards?
 - Can we monitor behaviors to rebuild credit culture & savings culture?
 - Banking and moral hazard: What is a bank? Financial markets are governed by a balance between greed and fear. How do we put fear of failure back in?
 - How do you regulate the shadow financial system and ensure transparency
 - Automobiles and fuel prices? Do you regulate by constraining choices or by increasing the price of oil used in motor fuel by increasing the motor fuels tax? Do you use the revenue to support general transportation infrastructure investments?
- When will we increase federal taxes to address the long-term structural deficit?

Gross National Product stops falling in July

Quarterly Real GNP and 12-month percent change in Quarterly Real GNP from 1979(1) to 2009(3)

General performance



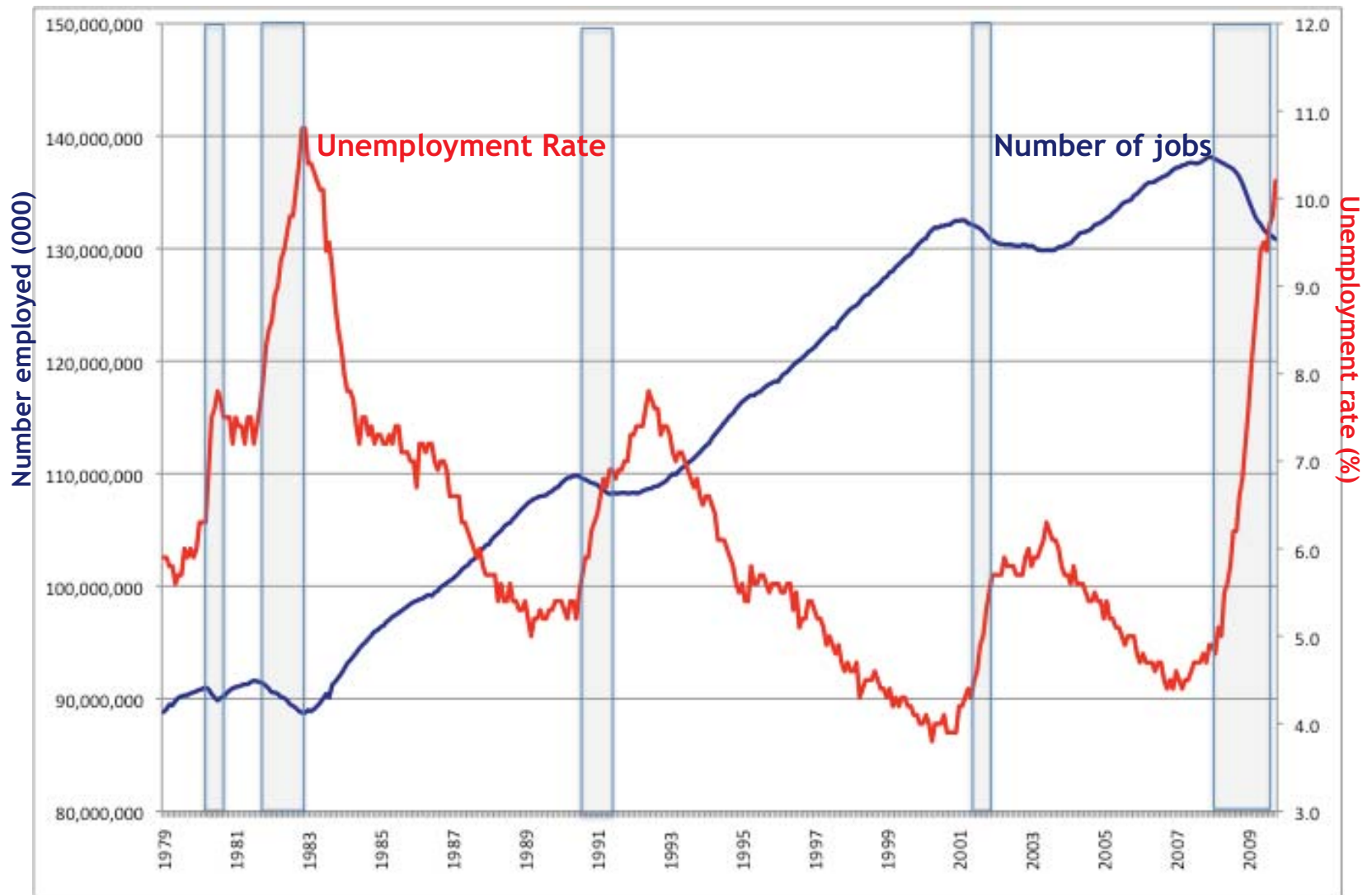
Source: US Bureau of Economic Analysis, National Income and Product Accounts, Retrieved Nov 26, 2009 from FRED, St Louis Federal Reserve Bank. Released November 24, 2009.

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Quarterly data, last data point second quarter of 2009. Recessions are shaded.

Number of people employed in the economy and the Unemployment Rate, monthly 1979 to 2009

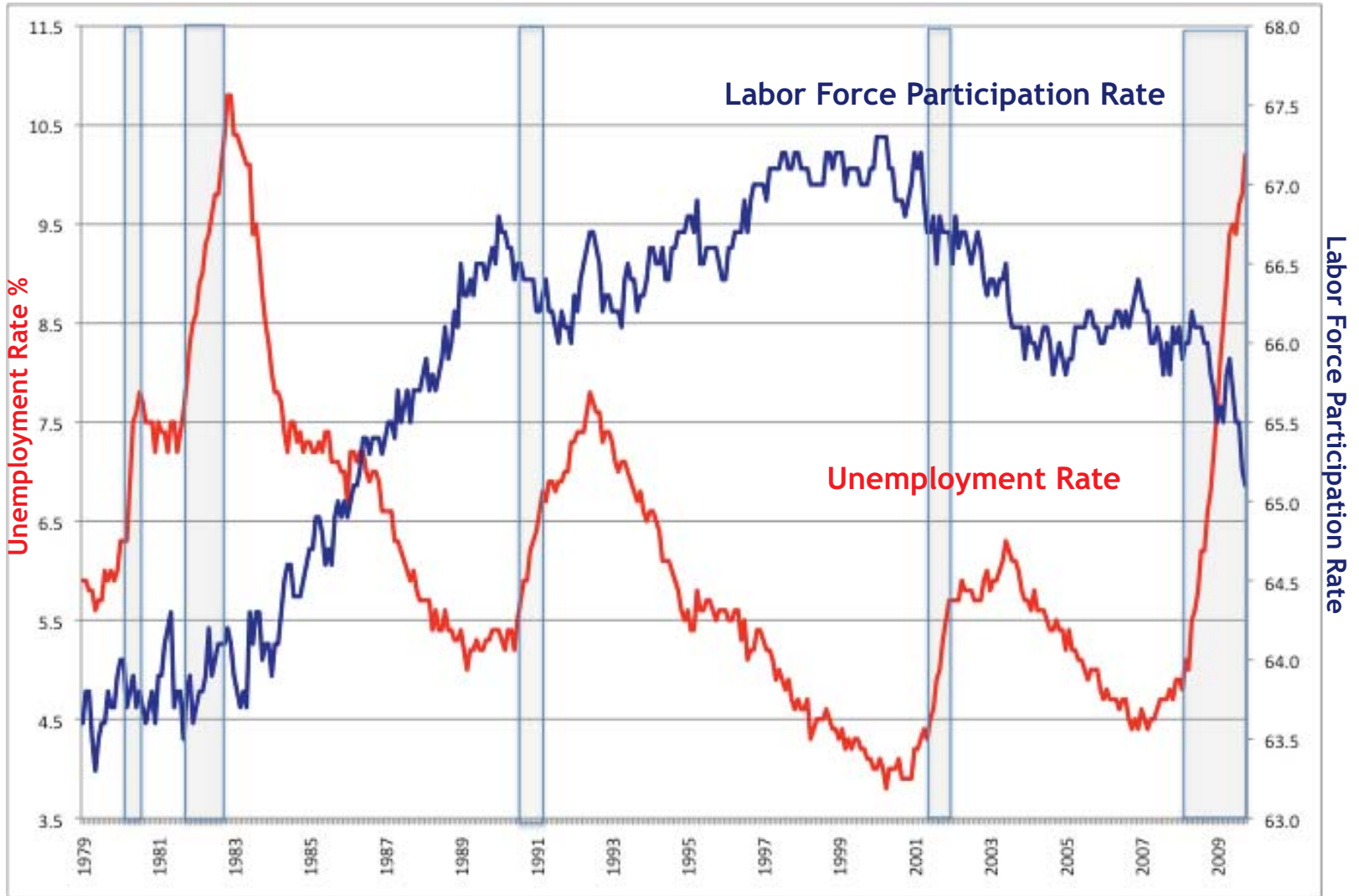
General Performance



Source: US Bureau of Labor Statistics, Current Population Survey, retrieved from FRED, St Louis Federal Reserve Bank Nov 15, 2009. Recessions are shaded; Job are from QCEW data

Monthly Unemployment Rate & Labor Force Participation Rate Recovery will be slow 1979 to 2009

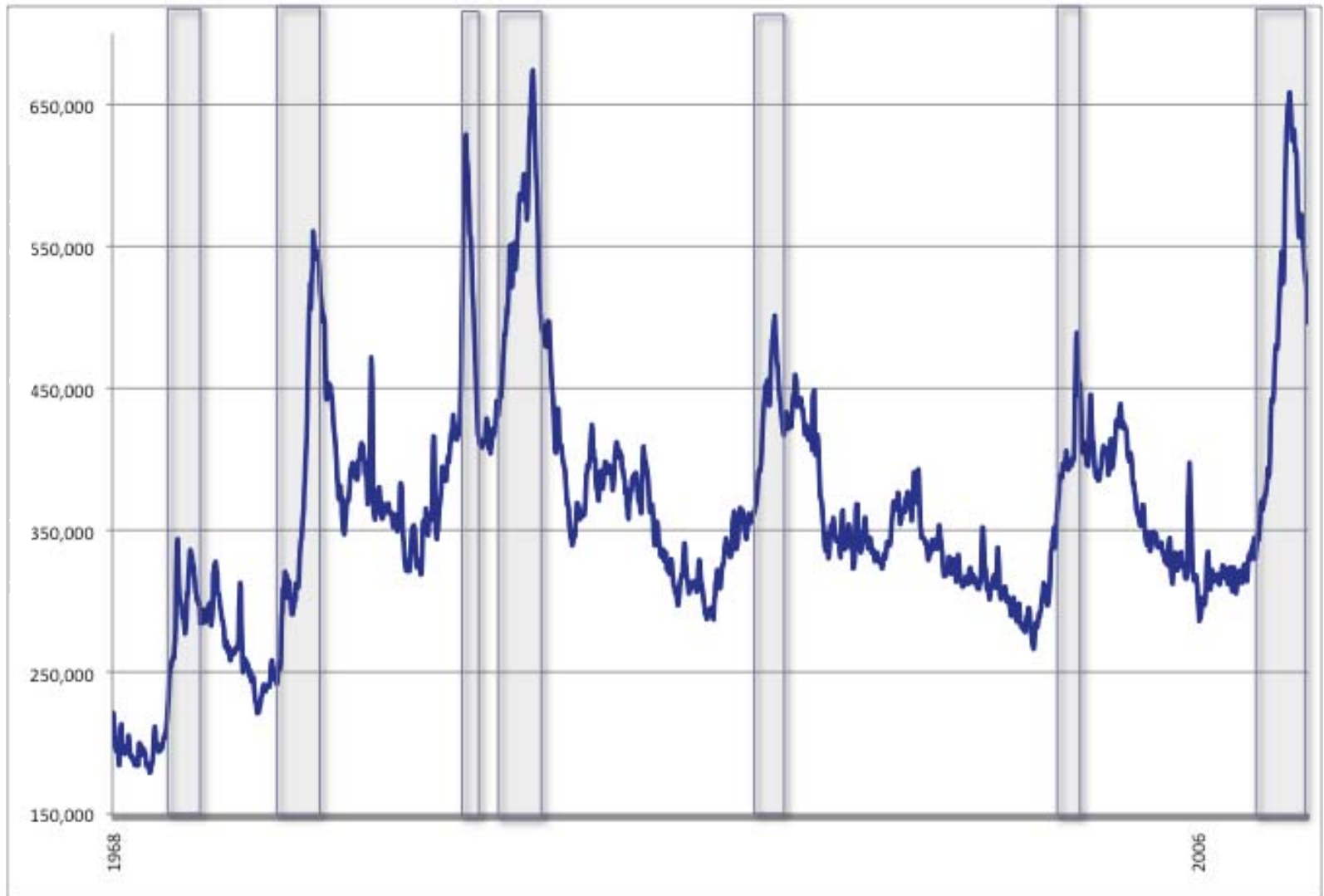
Consequences: Labor market



New Unemployment claims; High but dropping

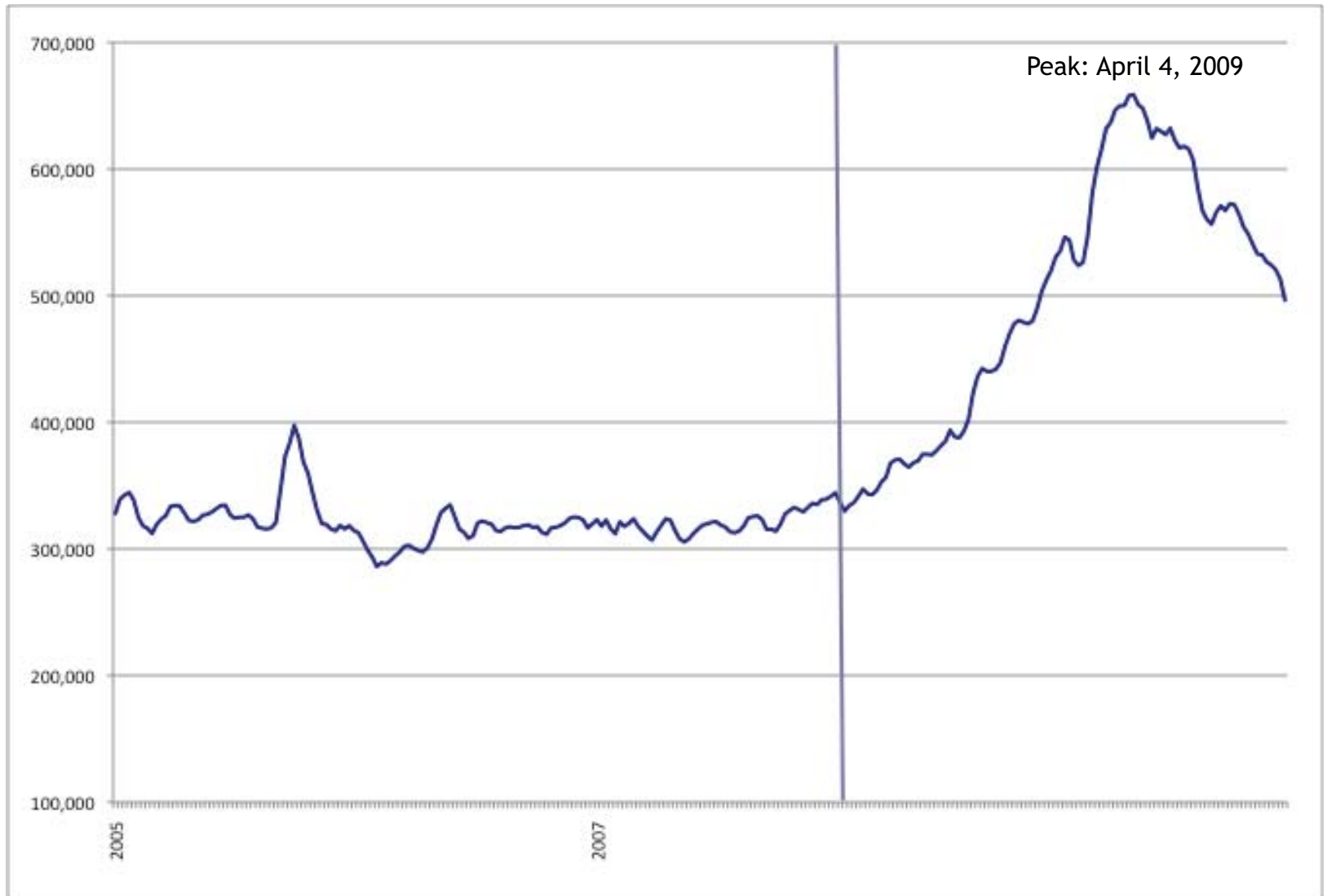
The 4-week moving average of new unemployment insurance claims trends down at the end of recessions

Sign of recovery: Labor markets



A look at the current data: 4 week moving average of new unemployment insurance claims dropping since April 2009

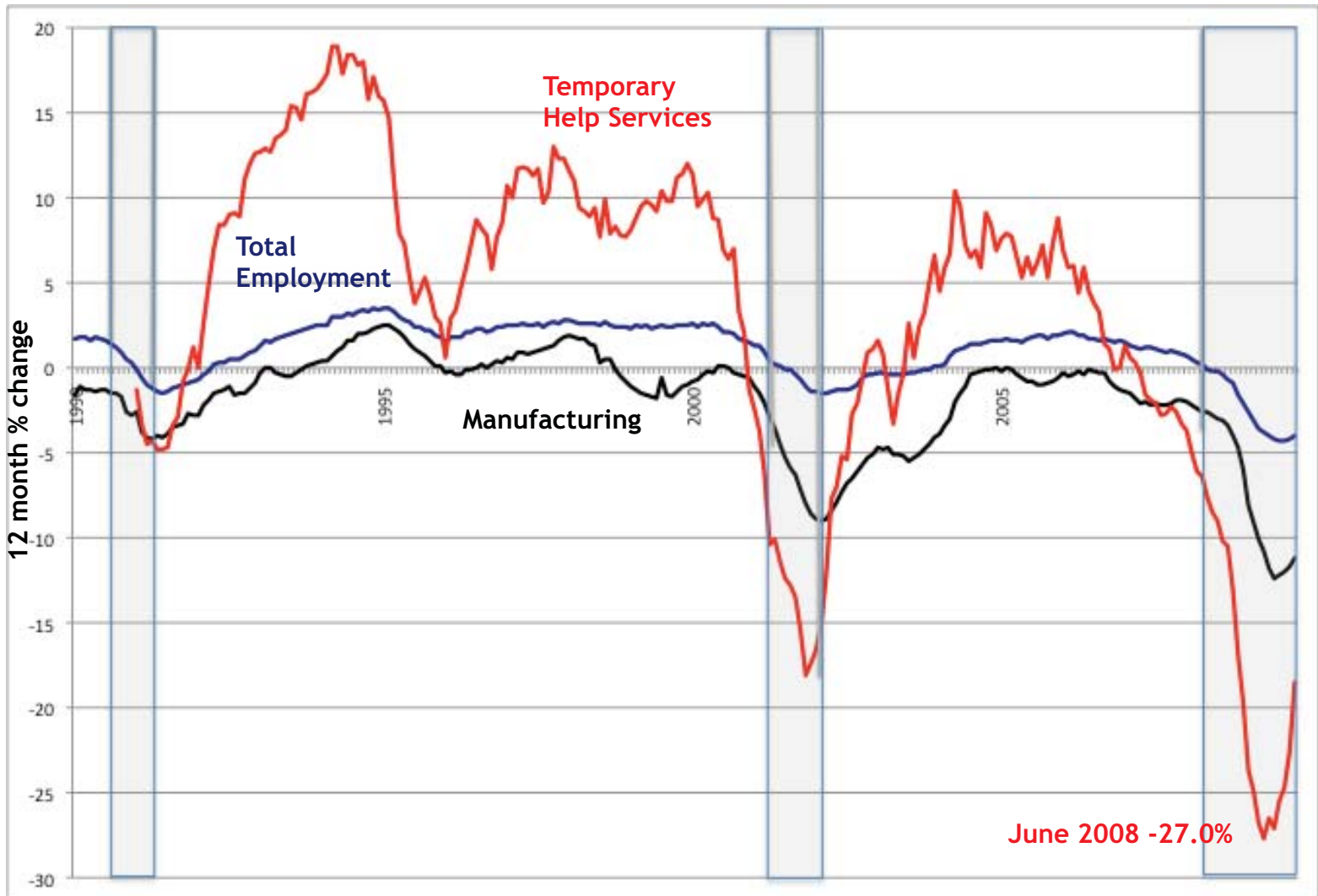
Sign of recovery: Labor markets



12 month percent change in employment

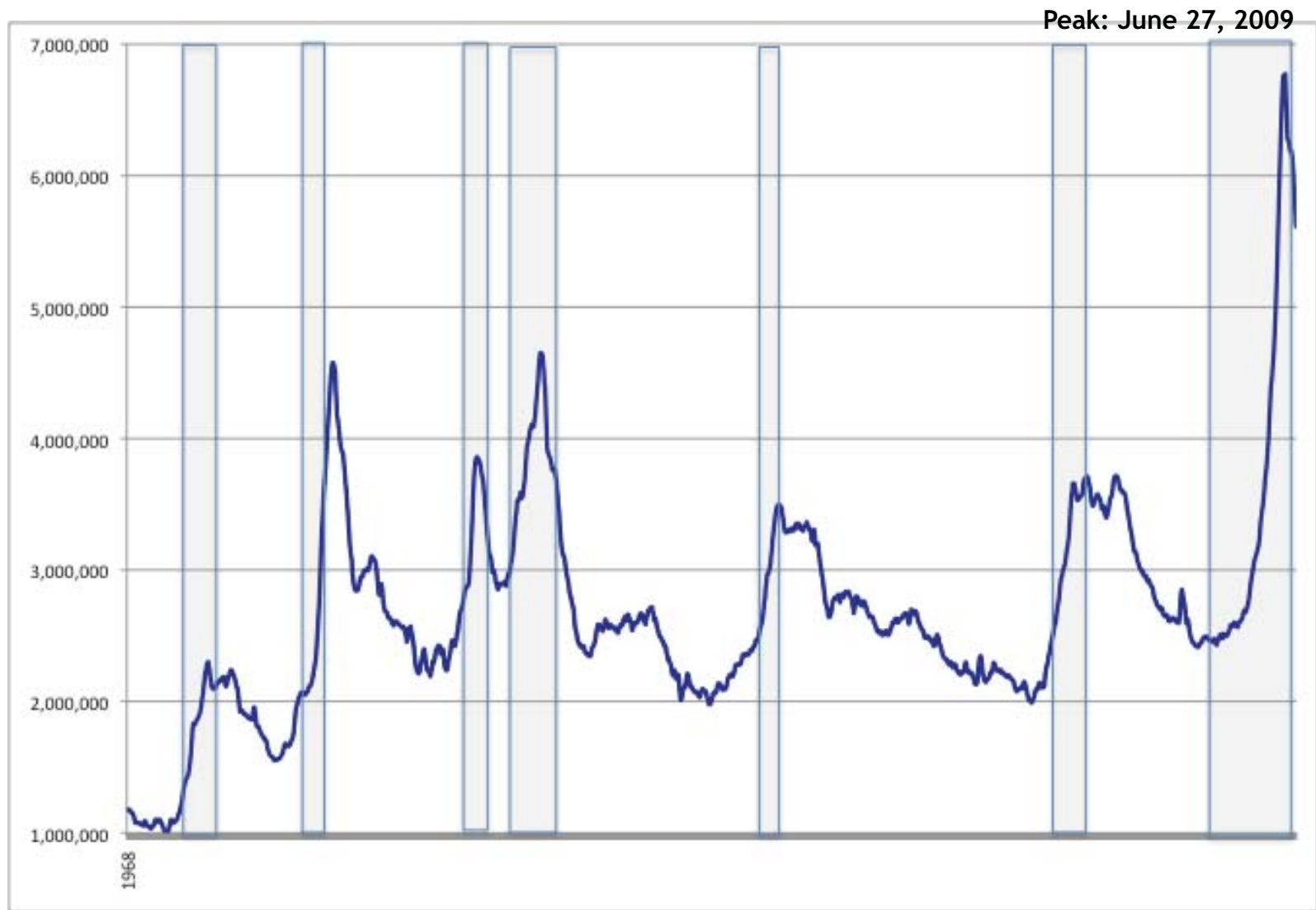
Temporary Help industry often shows turning points

Conclusion: Starting to turn; in recovery; not recovered—still grim



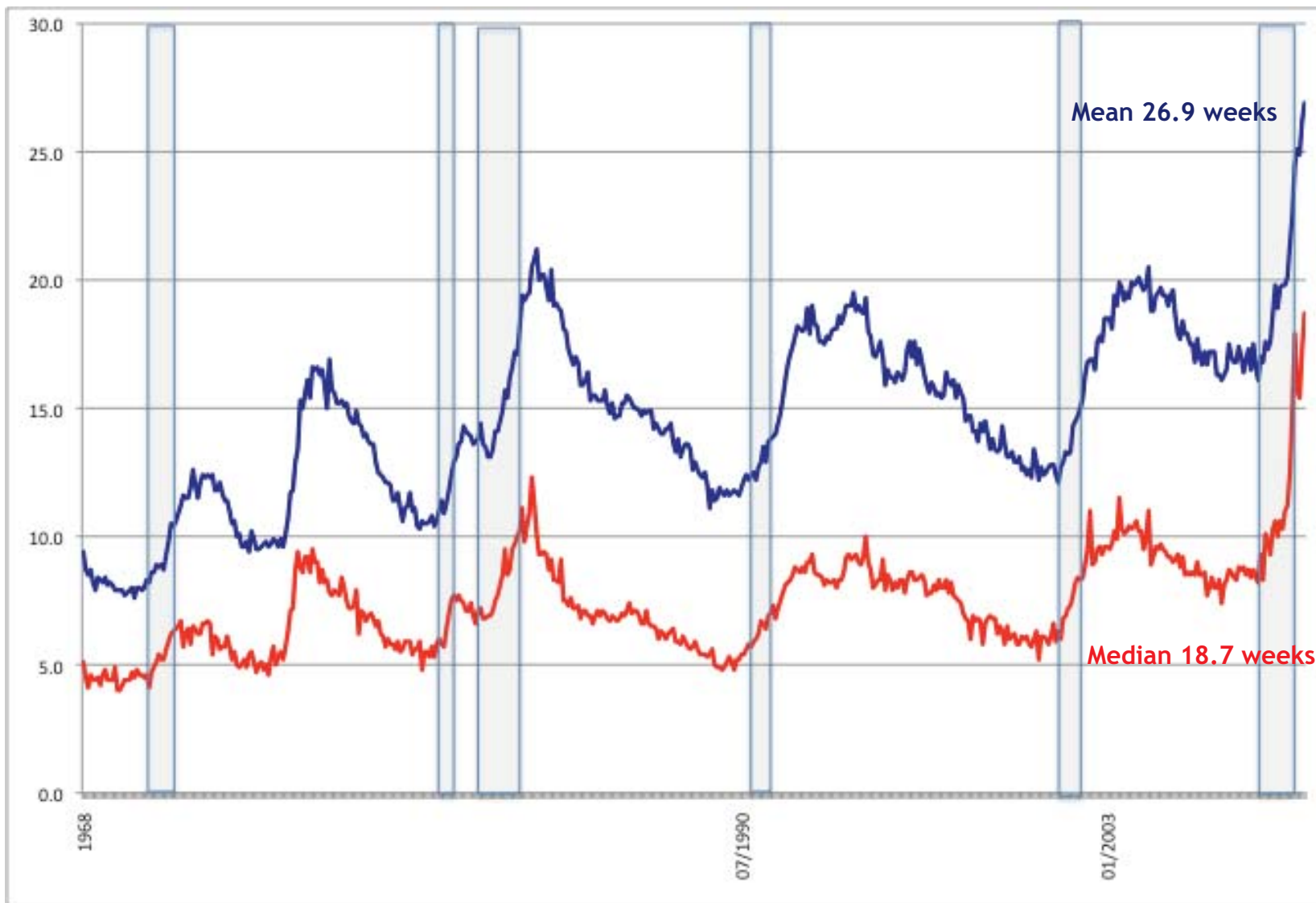
4-week average number of continued unemployment claimants has been dropping since late June

Sign of recovery: Labor markets



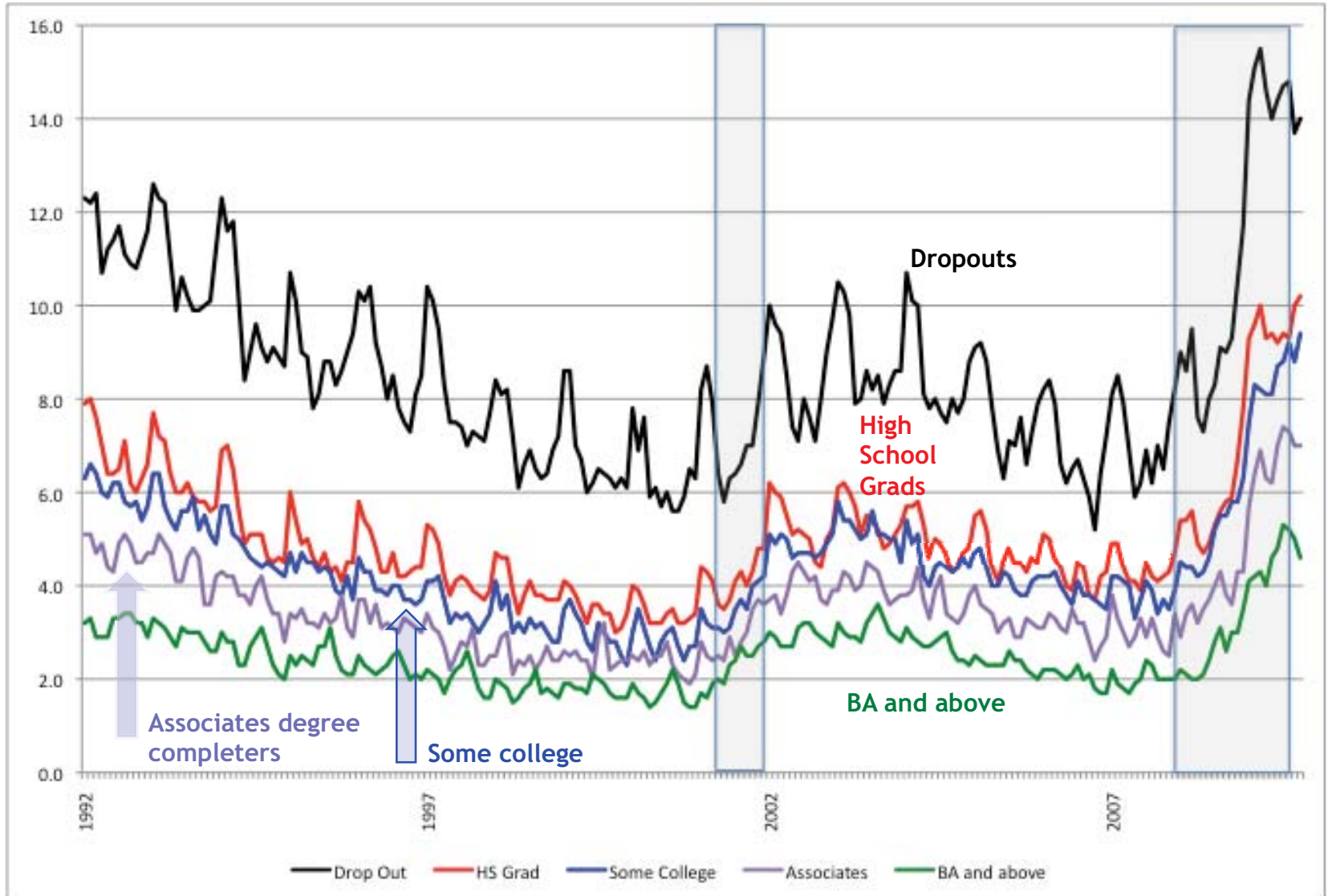
Average duration of unemployment is the highest since the 1960s at 26.9 weeks; Median at 18.7; Not dropping yet

Pain in the labor markets



The economic disadvantage of the unskilled grows and accelerates

Consequences: Labor market



Source: US Bureau of Labor Statistics, Current Population Survey
Retrieved November 18, 2009. Recessions are shaded.

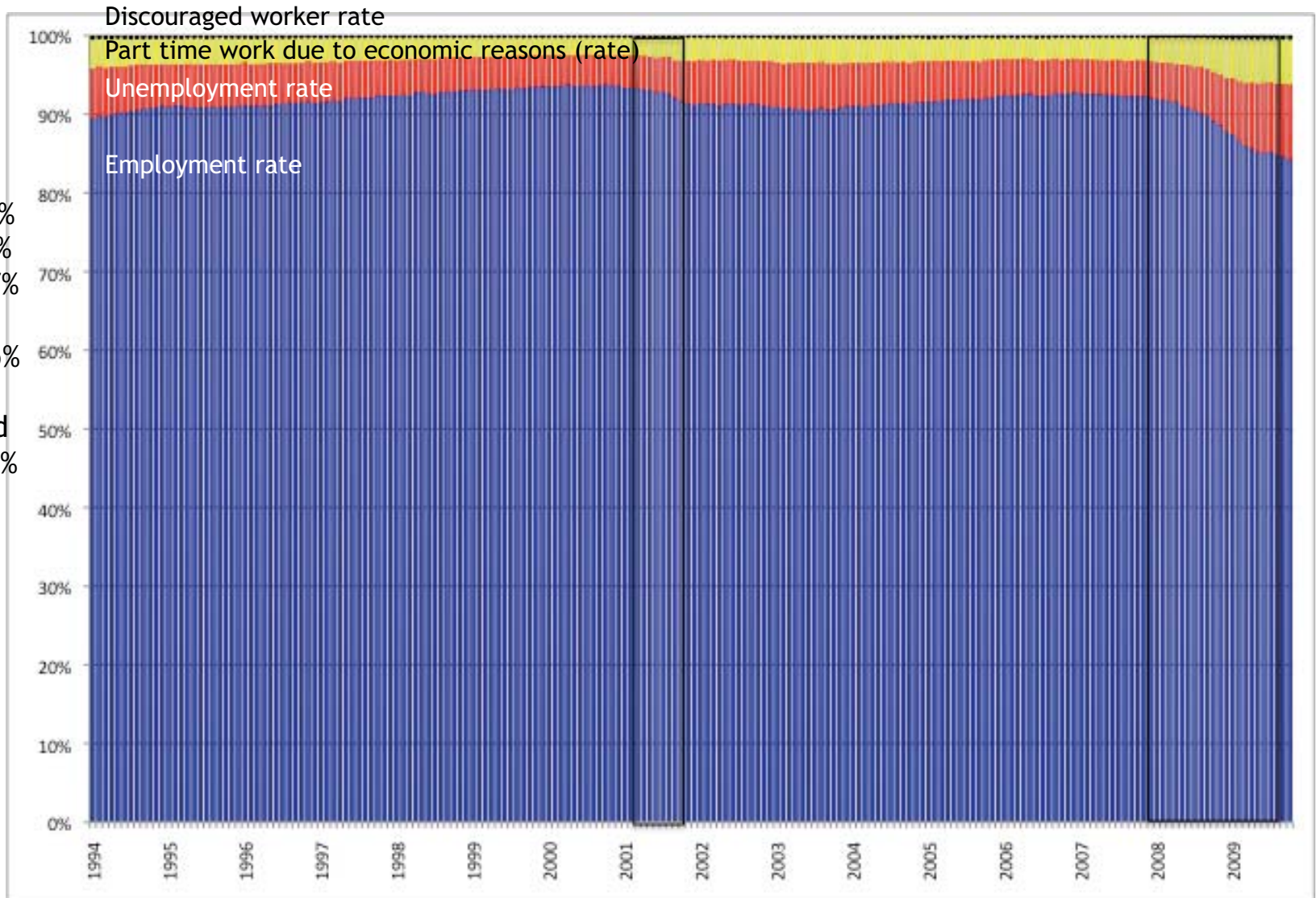
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Monthly unemployment rates by level of educational attainment, ages 25 and above. Monthly data from January 1992 to October 2009

The American labor force: Employed, unemployed, involuntary part time workers and discouraged workers

October 2009

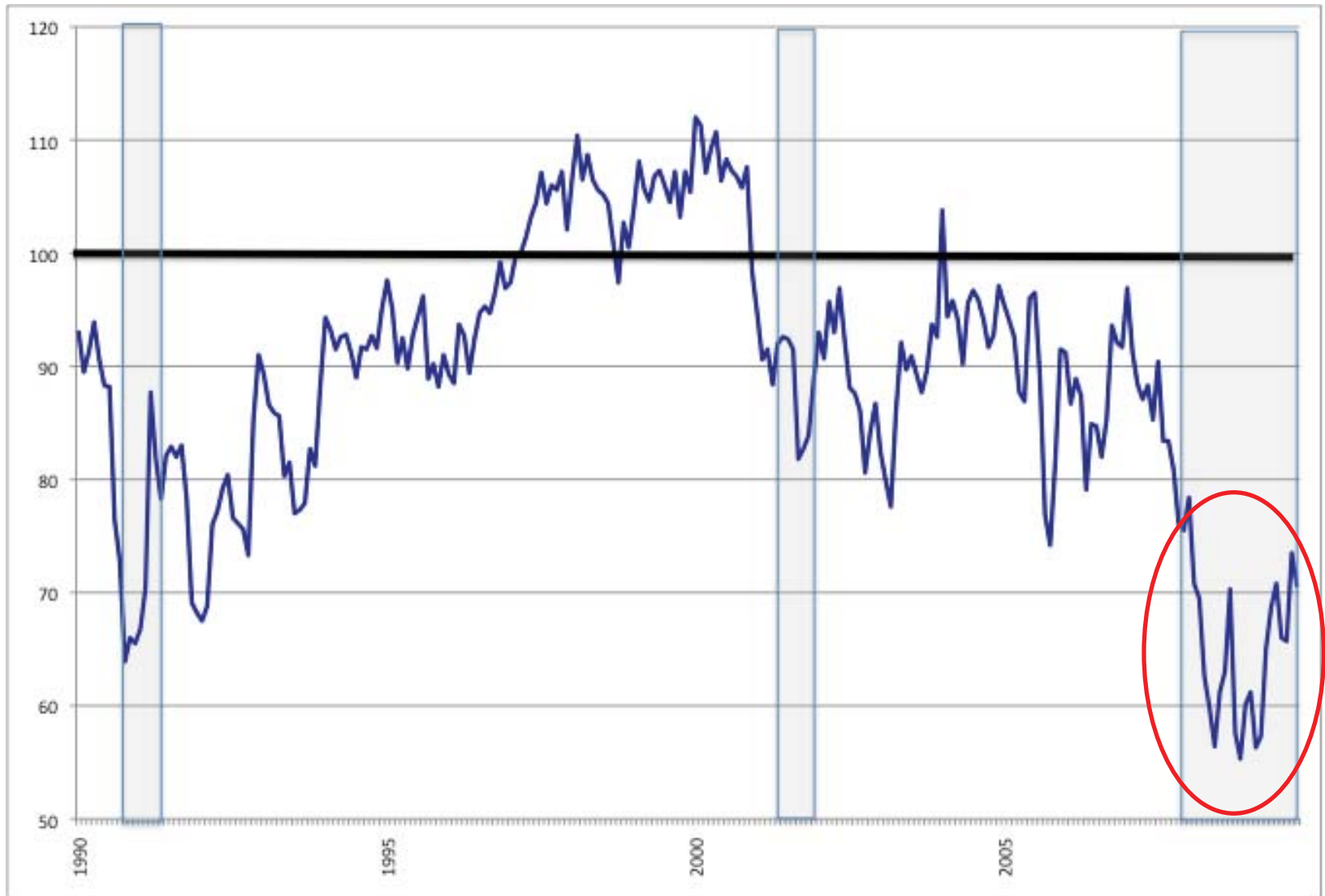
ER 84.3%
 UR 9.6%
 Part time 5.7%
 Discouraged 0.5%
 Underemployed 15.8%



We aren't a confident bunch—but getting better

Consumer confidence drop began in January 2004; Increase March to October

Recovering confidence: consumers



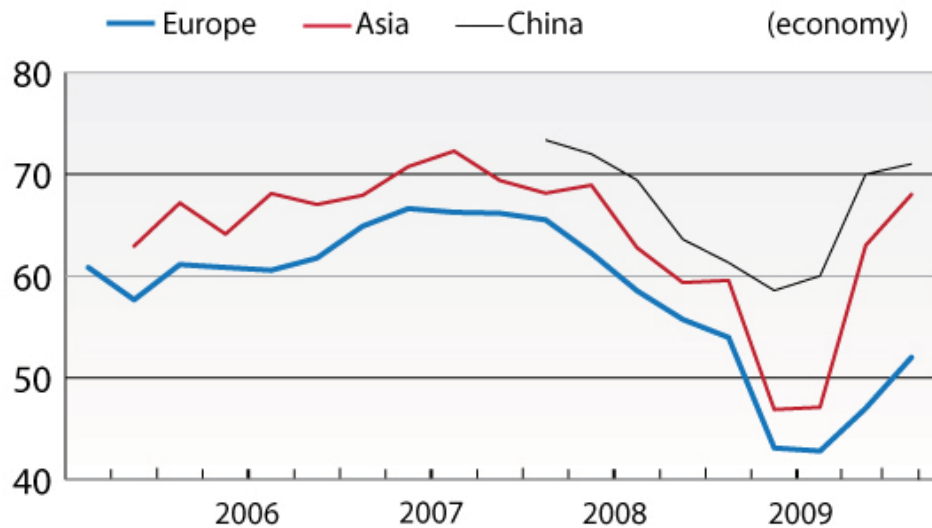
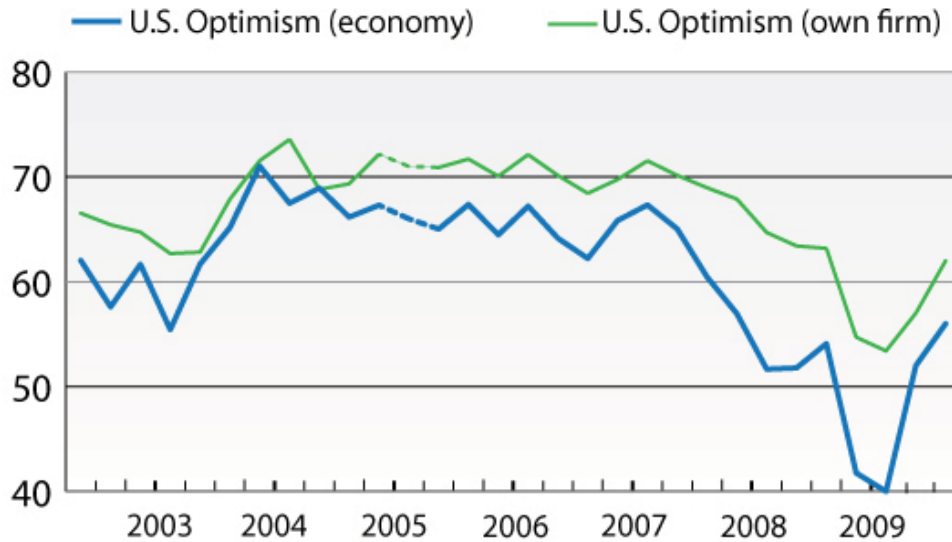
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CFO economic confidence

More confident in their own firm than in the economy in general

Strong business investment to begin in mid-2010?



According to USAToday panel of economist's business investment in the US is projected to start a slow climb in 2010:

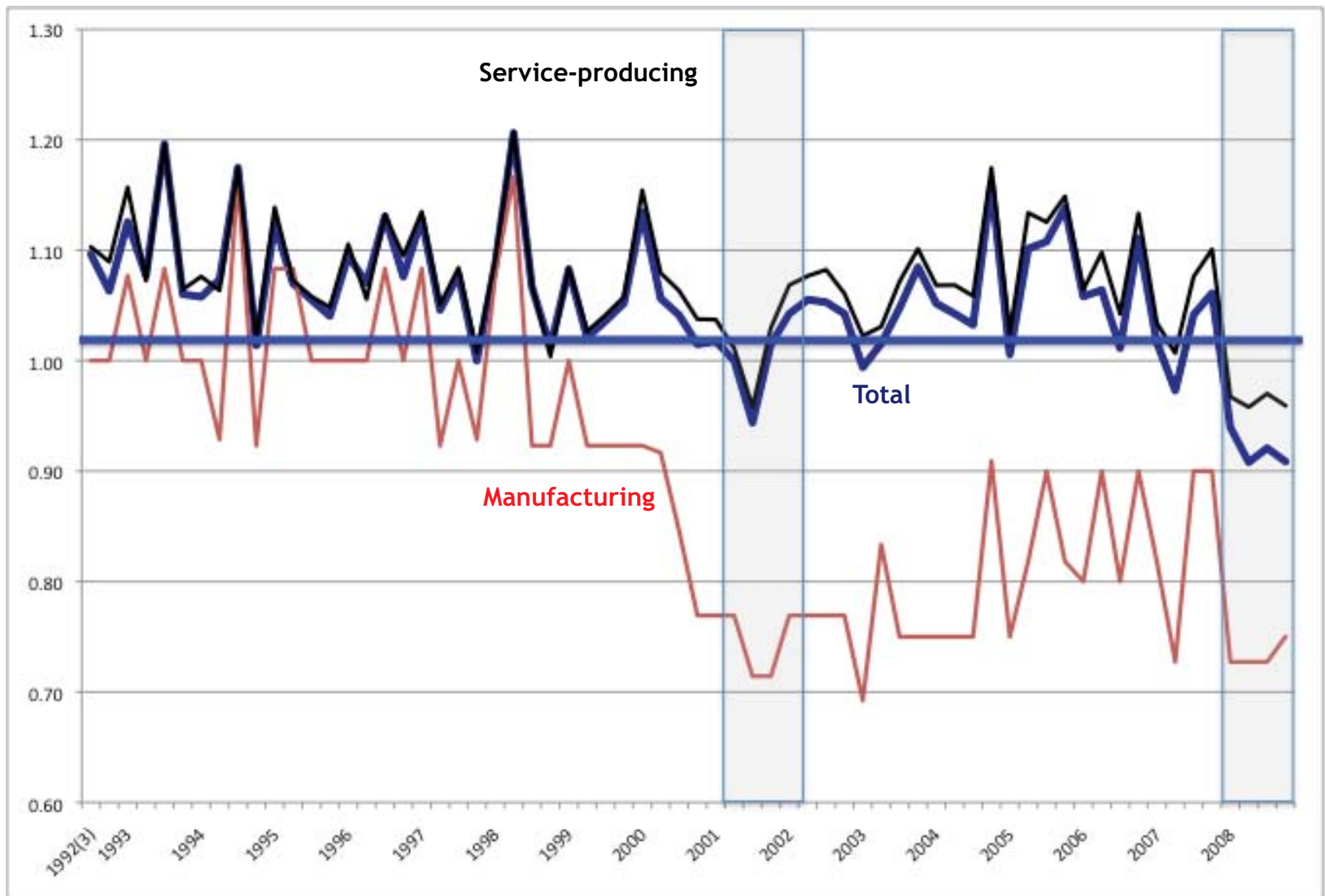
Annualized growth rates:

2009(3)	-2.5%
2009(4)	-1.6%
2010(1)	0.7%
2010(2)	2.6%
2010(3)	4.4%
2010(4)	6.4%

In the US businesses are closing faster than opening

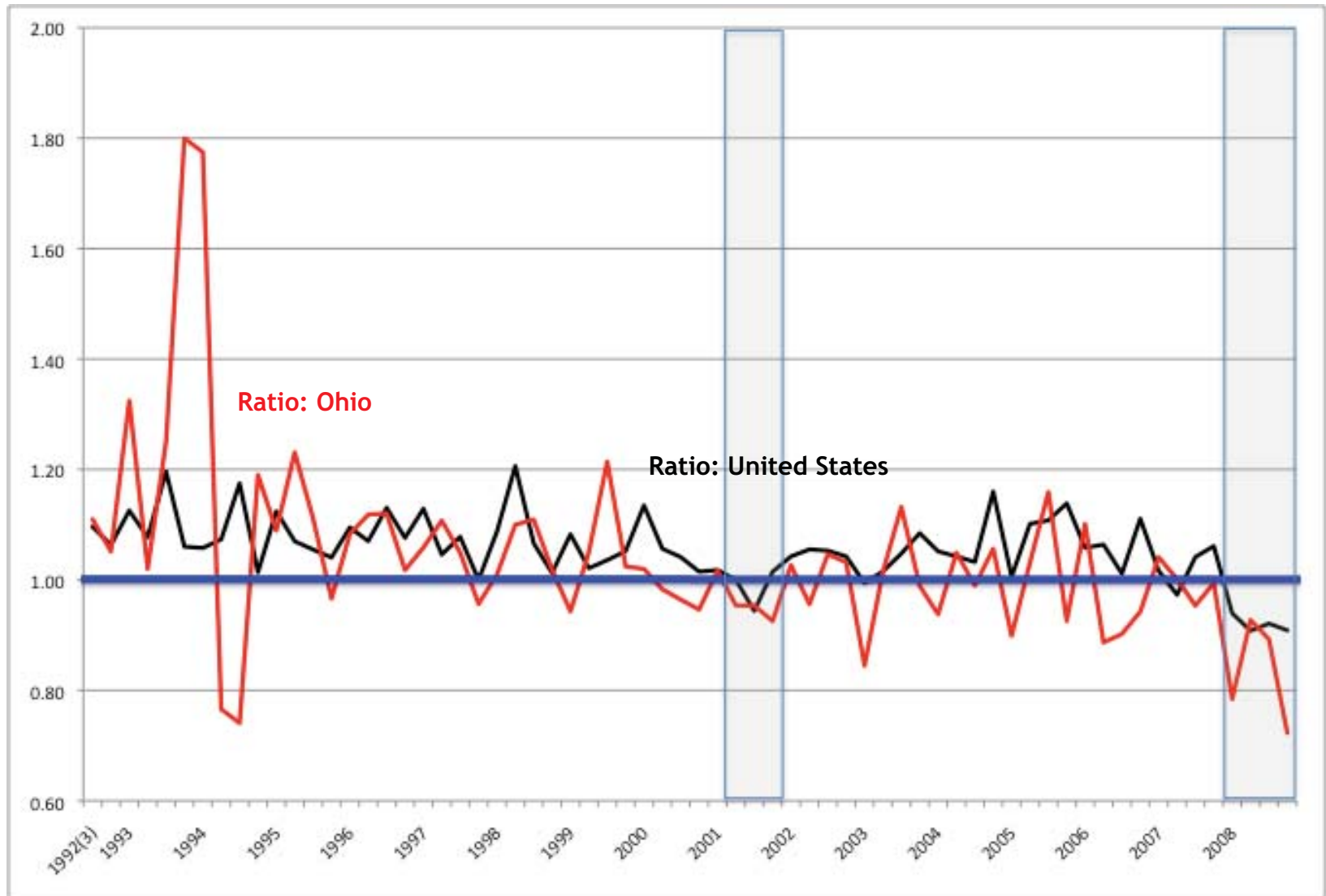
Ratio of openings to closings

Consequences: Business Dynamics



Business dynamics: Ratio of business openings to closings for Ohio and the nation; Ohio underperforms

Consequences: Business Dynamics



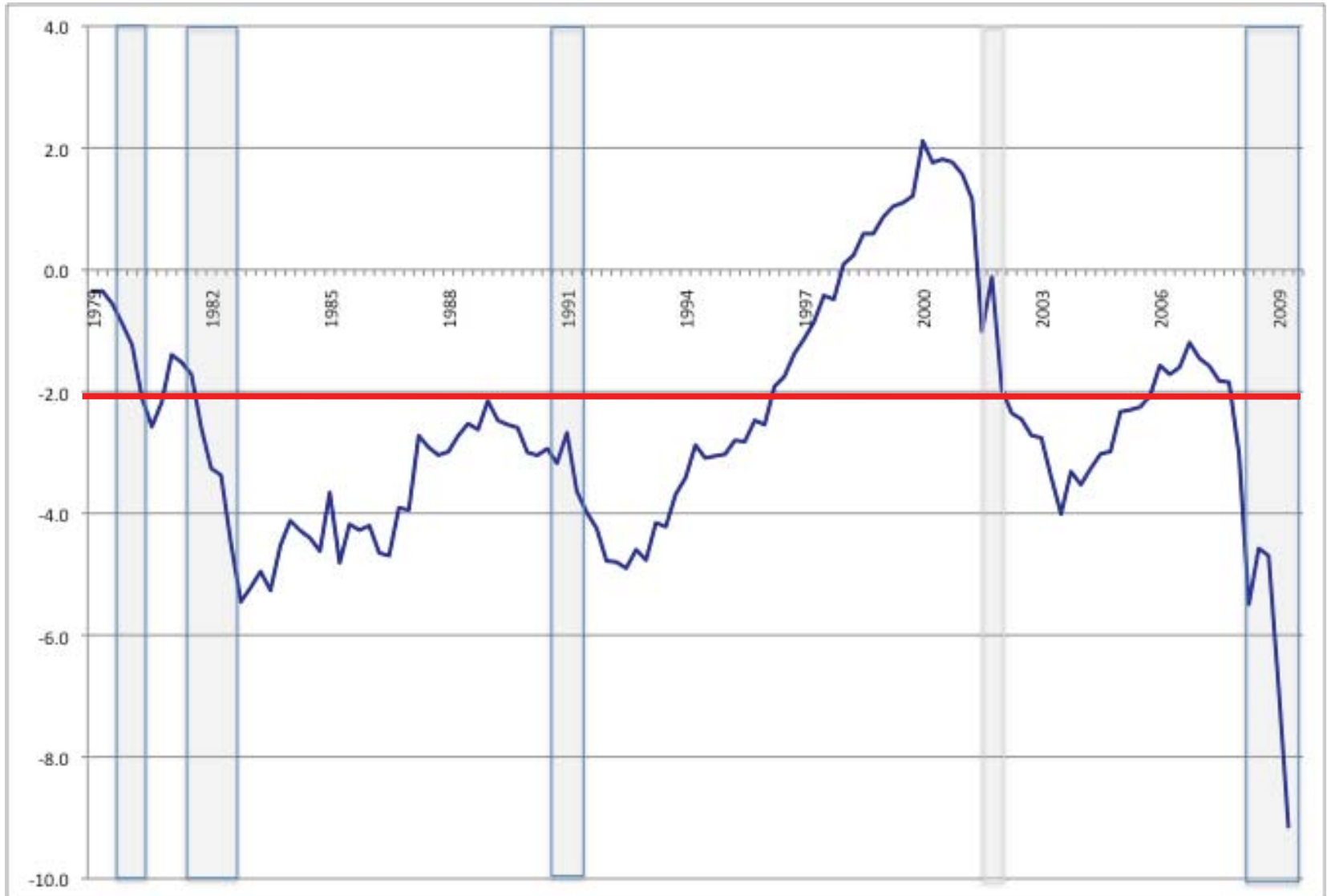
Source: US Bureau of Labor Statistics, Business Employment Dynamics, from Quarterly Census of Employment and Wages, August 19, 2009 retrieved November 14, 2009

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Ratio of business starts to closings for the US and Ohio. All sectors. Data point above 1.0 more openings than closings; below 1.0 than fewer.

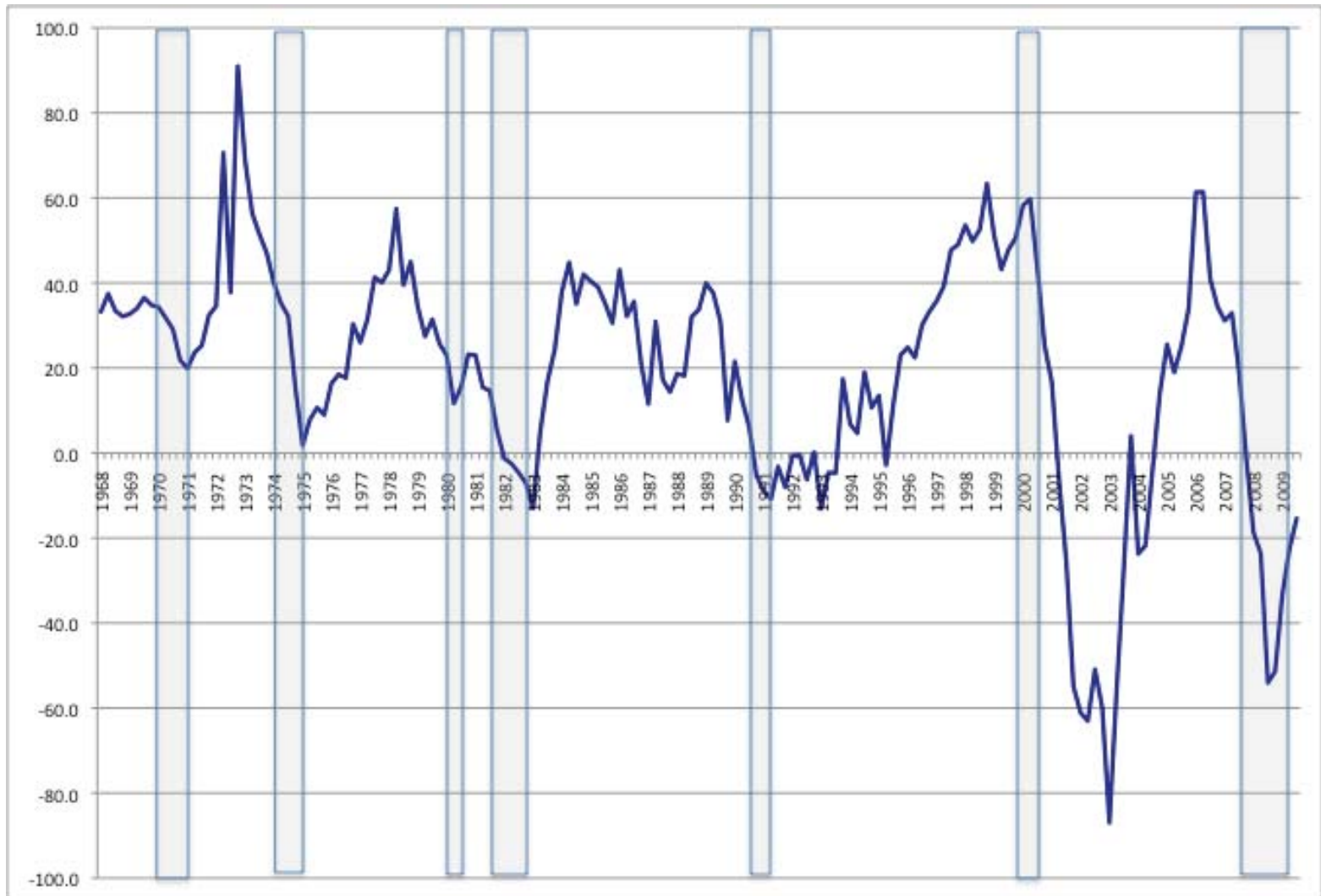
Federal Government Savings (deficit) as a percent of Gross Domestic Product; Current near term deficits are defensible; Long term prospects are troubling, Quarterly data 1947 to 2009(1)

Trouble ahead: Federal Deficit



Despite balance budget laws and stimulus funds state & local governments are running deficits

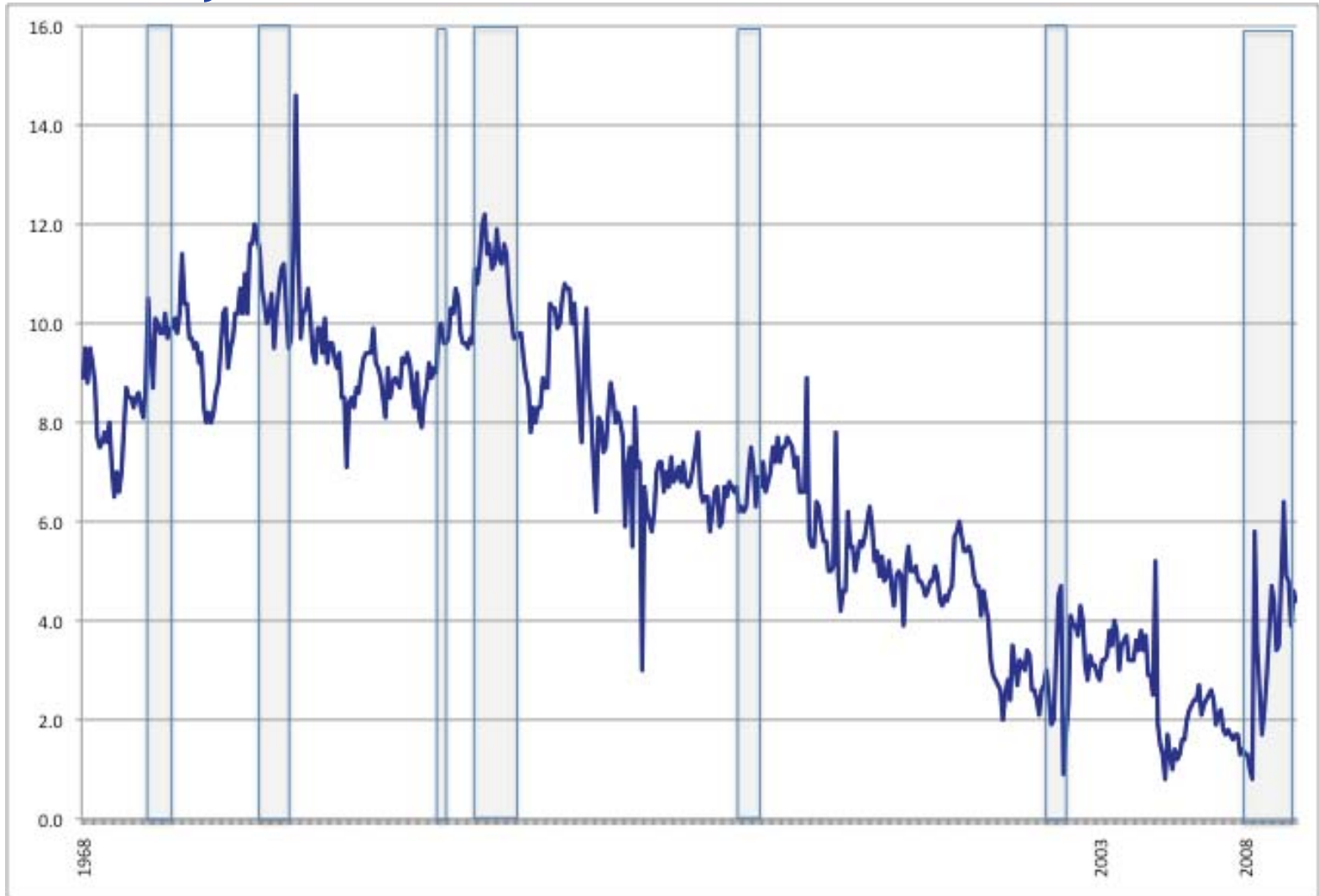
State and local government savings (deficits) 1968(1) to 2009(3)



Trouble ahead: Personal savings low & can't offset Federal government savings

Personal Savings are on a long-term downswing

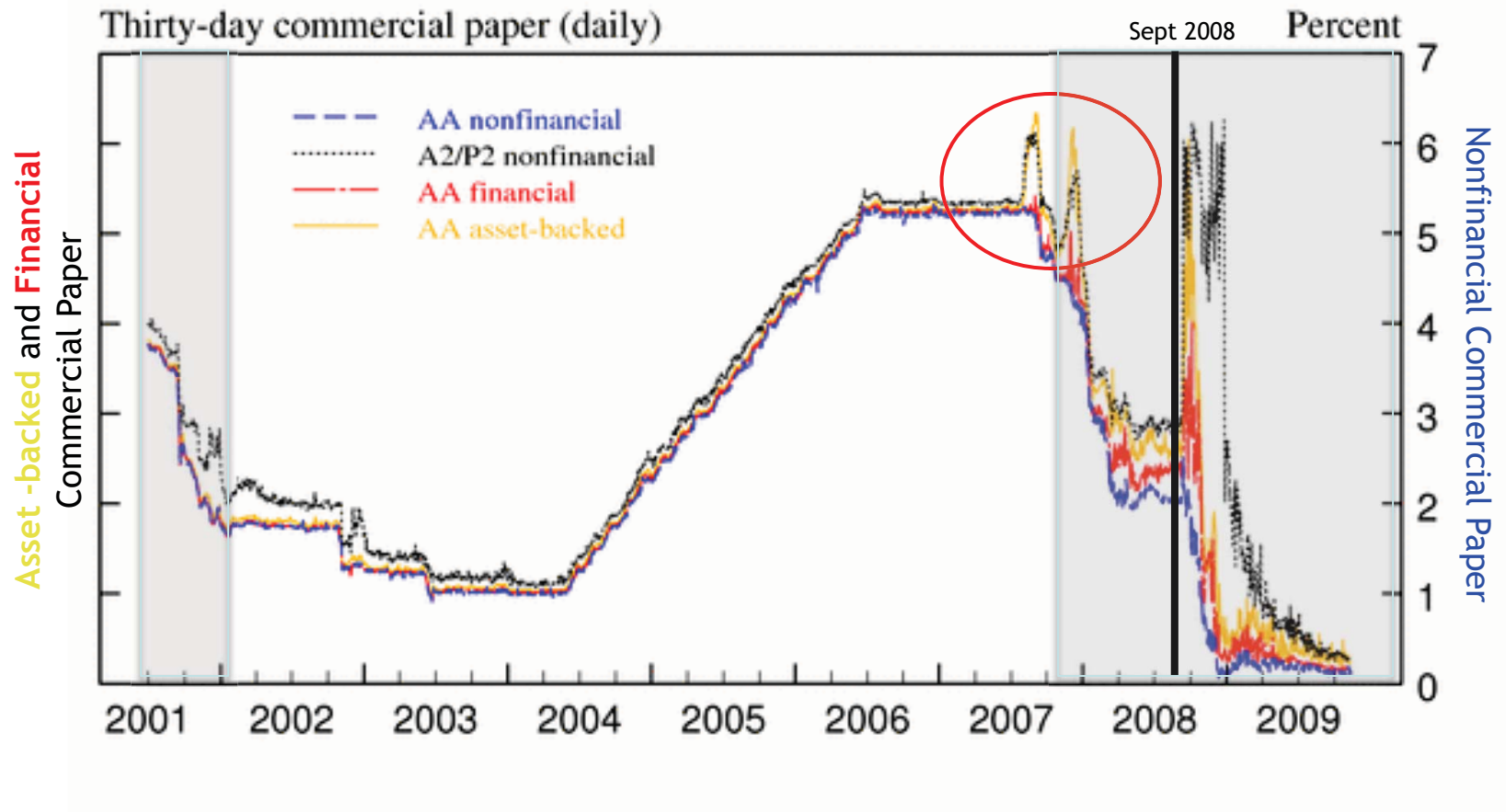
They increase during recessions and for a bit afterward
Currently at 4.5% of after-tax income



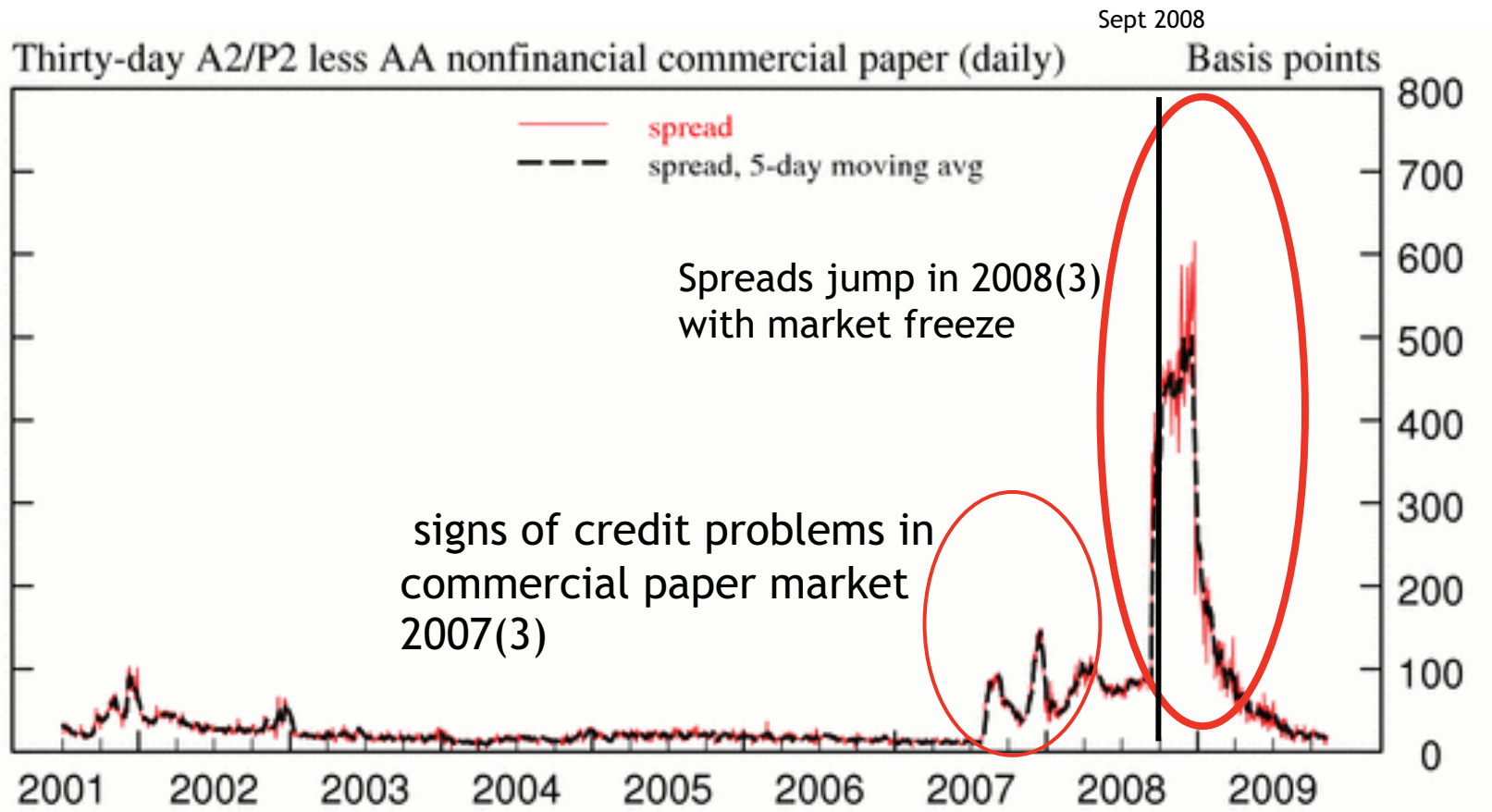
Commercial Paper (CDO) market falls in mid-2007 Markets are settling

Nonfinancial scaled on right side; Financial and Asset-backed on left

Markets: Commercial paper



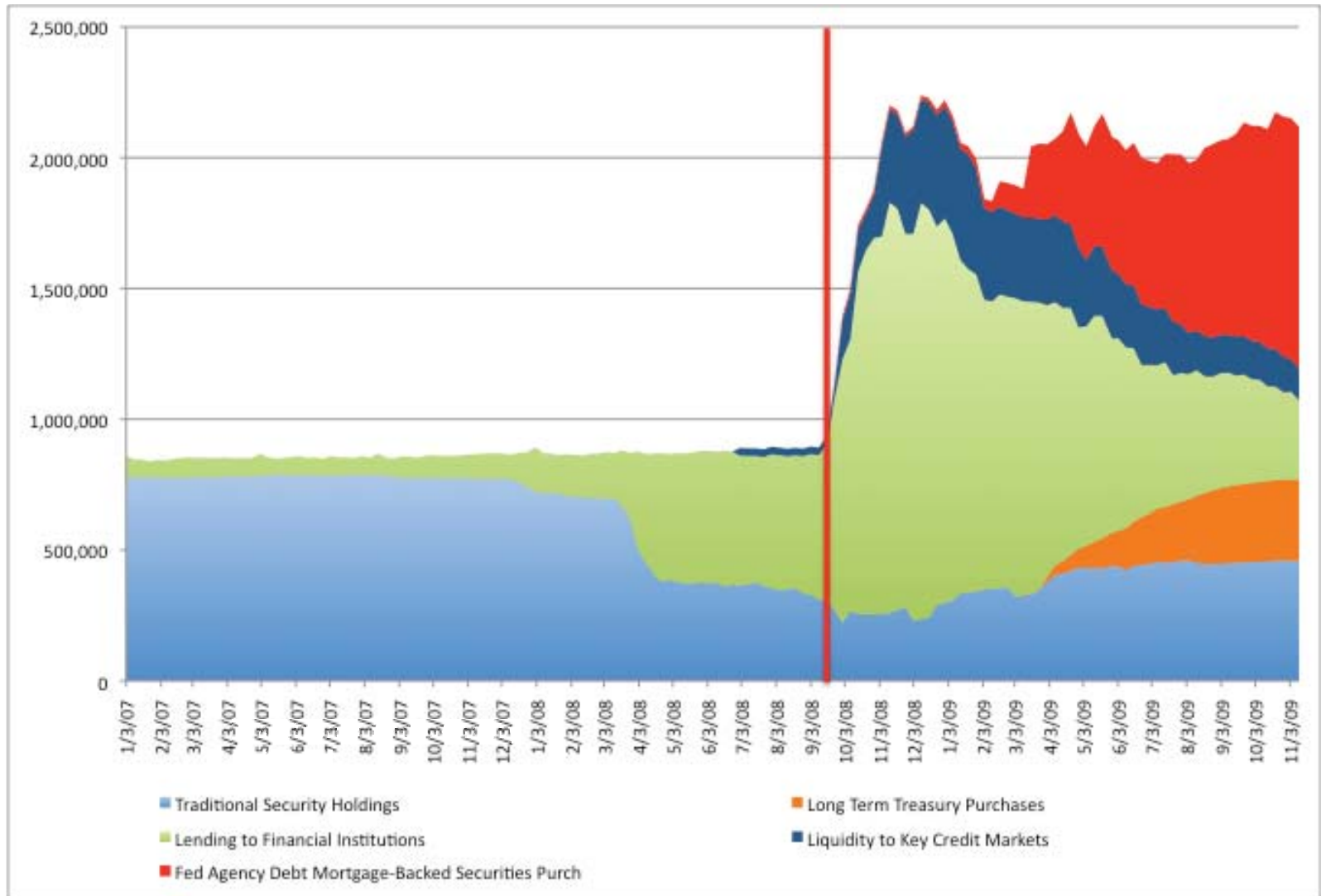
Discount rate spread in the short term commercial paper market—starting to settle down. Precursor to recovery



The Fed fights systematic risk & becomes the commercial paper market. Signs of recovery in the credit markets

Composition of the Fed's assets, weekly, from January 2007 to November 3, 2009 in millions of dollars

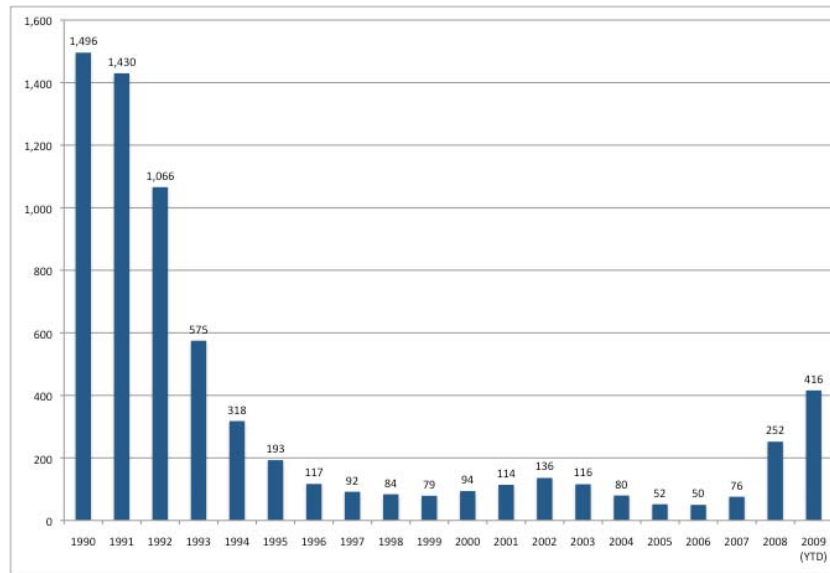
Assets of the Federal Reserve System



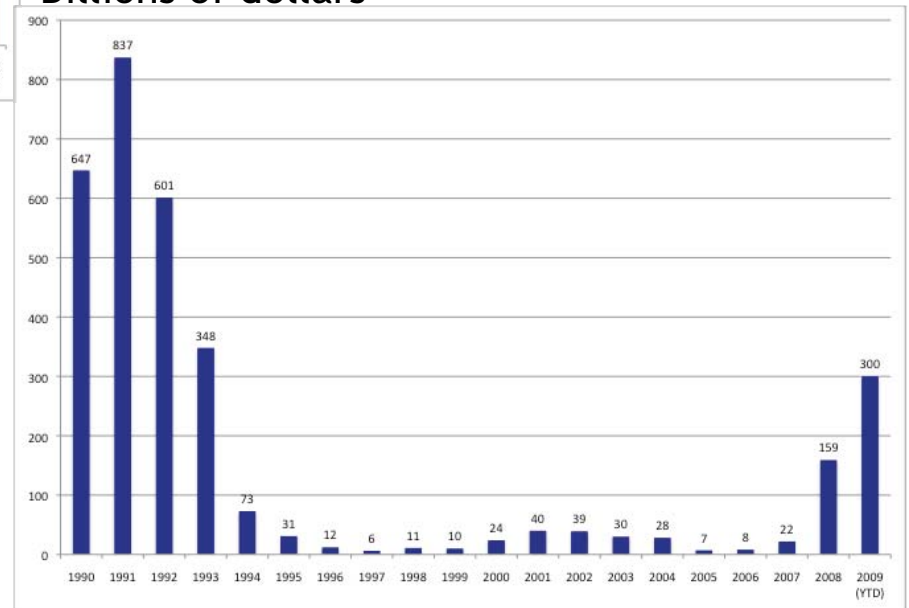
Banks: The number of troubled institutions accelerates in September 2008

Troubled banks & bank assets

Number



Billions of dollars

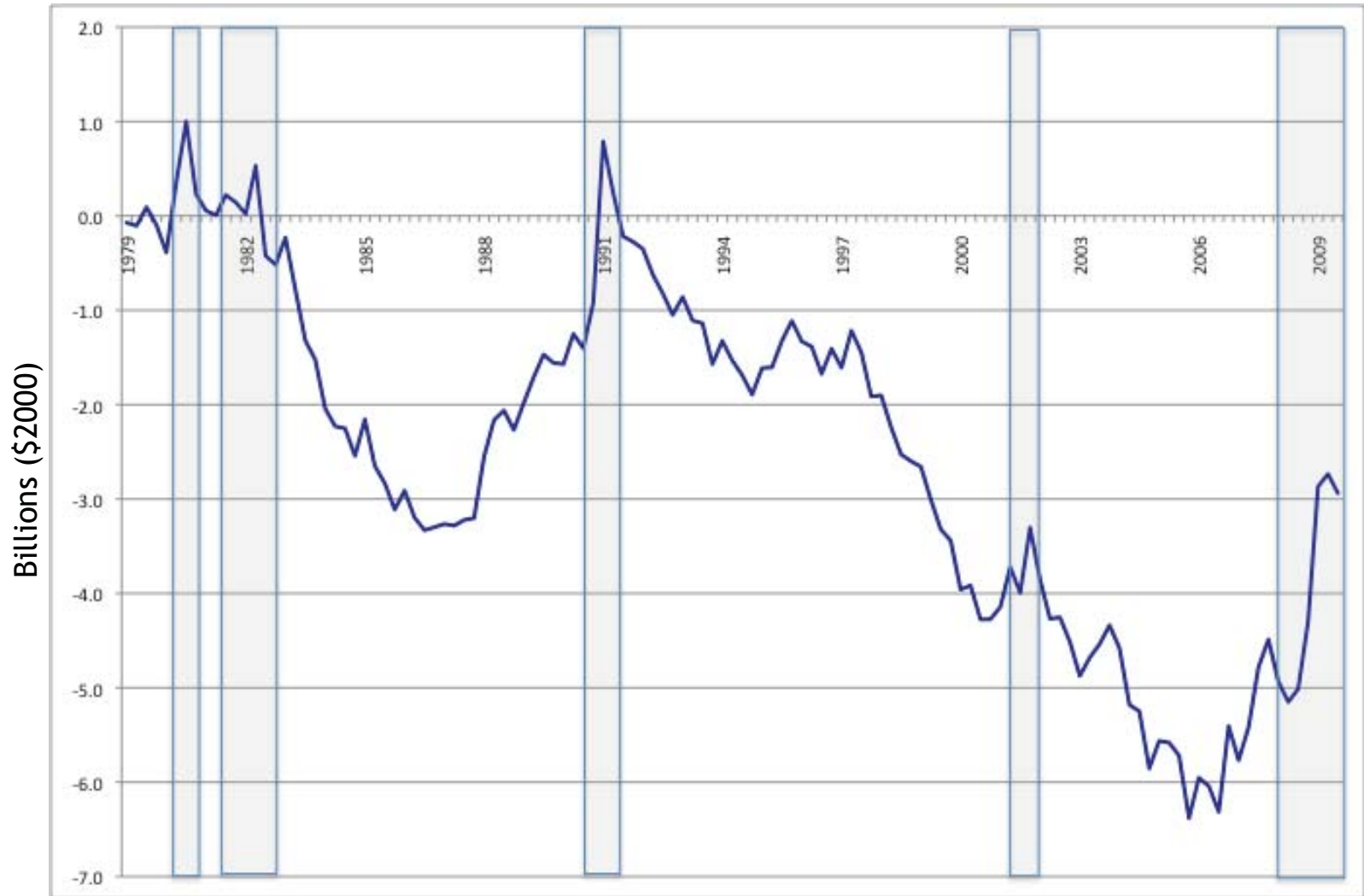


- Number of problem banks increase
 - 76 to 416 from 2007 to June 2009
- Troubled assets explode
 - \$22B in 2007 to \$300B June 2009

Net exports of goods and services as percent of GNP

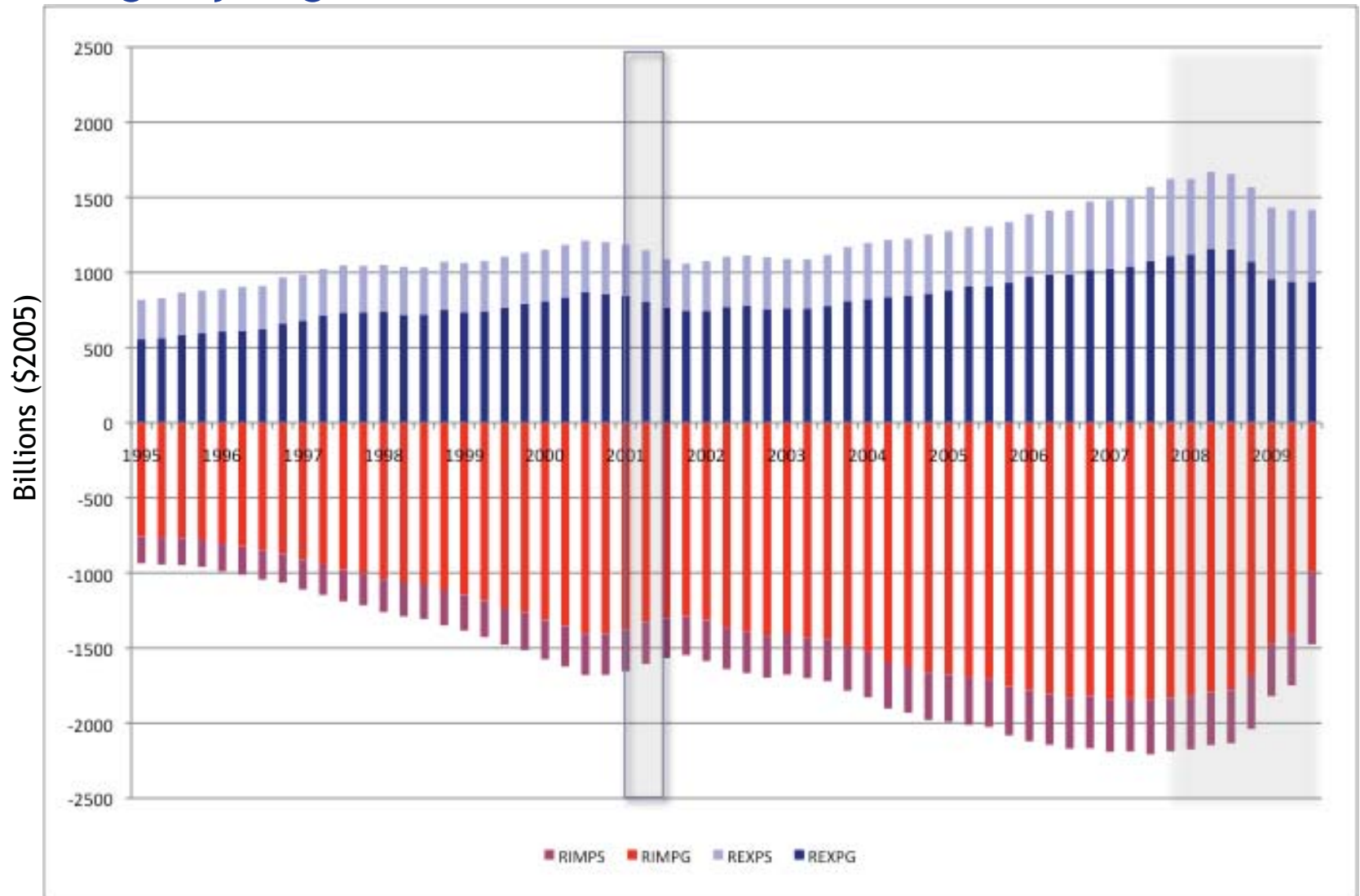
Trade balance on current account

Balance of payments improving but not enough:
dollar will stay weak



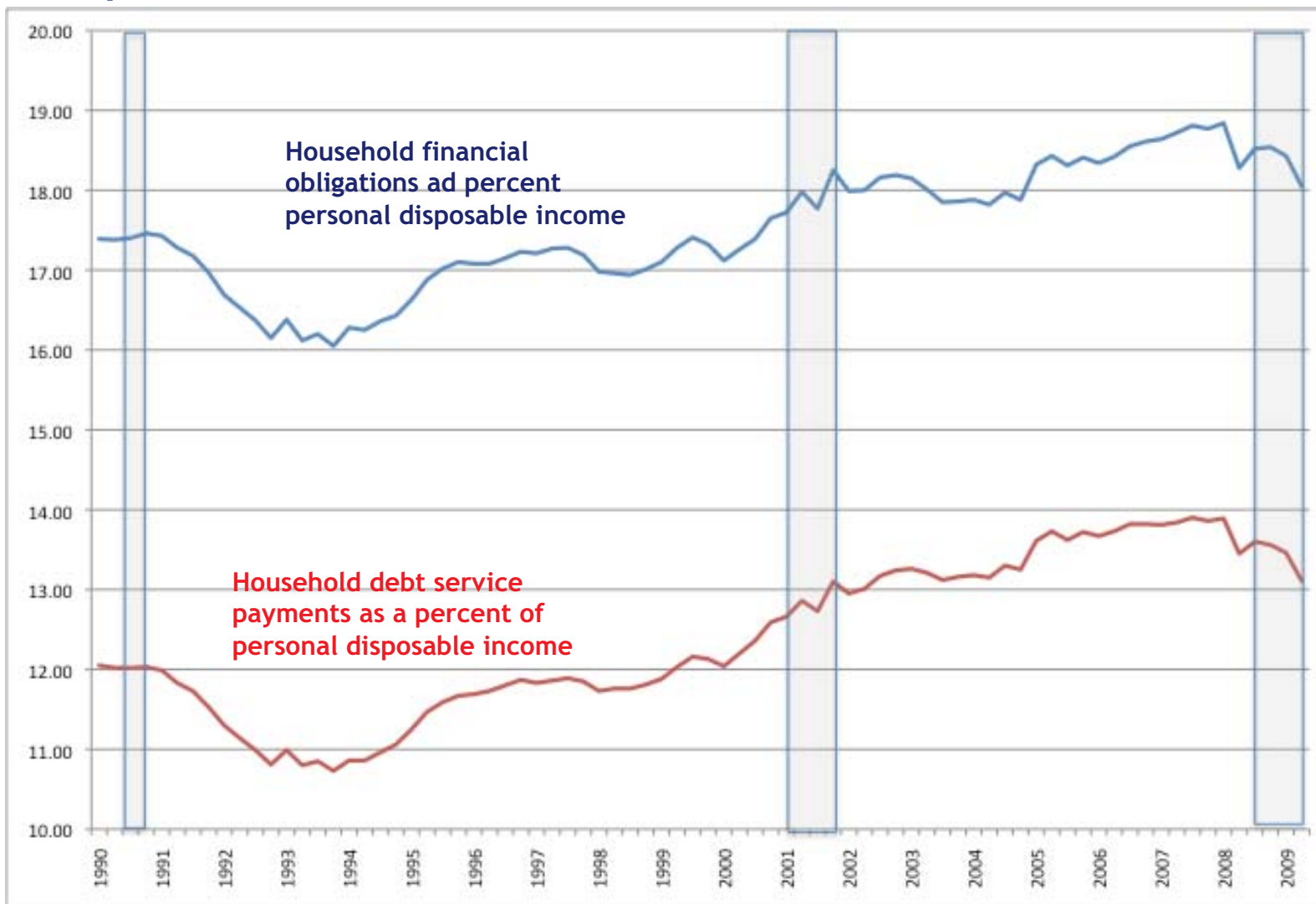
Trade balance is starting to close thanks to a weakening dollar and the recession; but there is a long way to go

Trade in goods and services



Financial burdens of households recovering, but still high Household financial obligations and debt as a percent of disposable income

Households will not lead the recovery

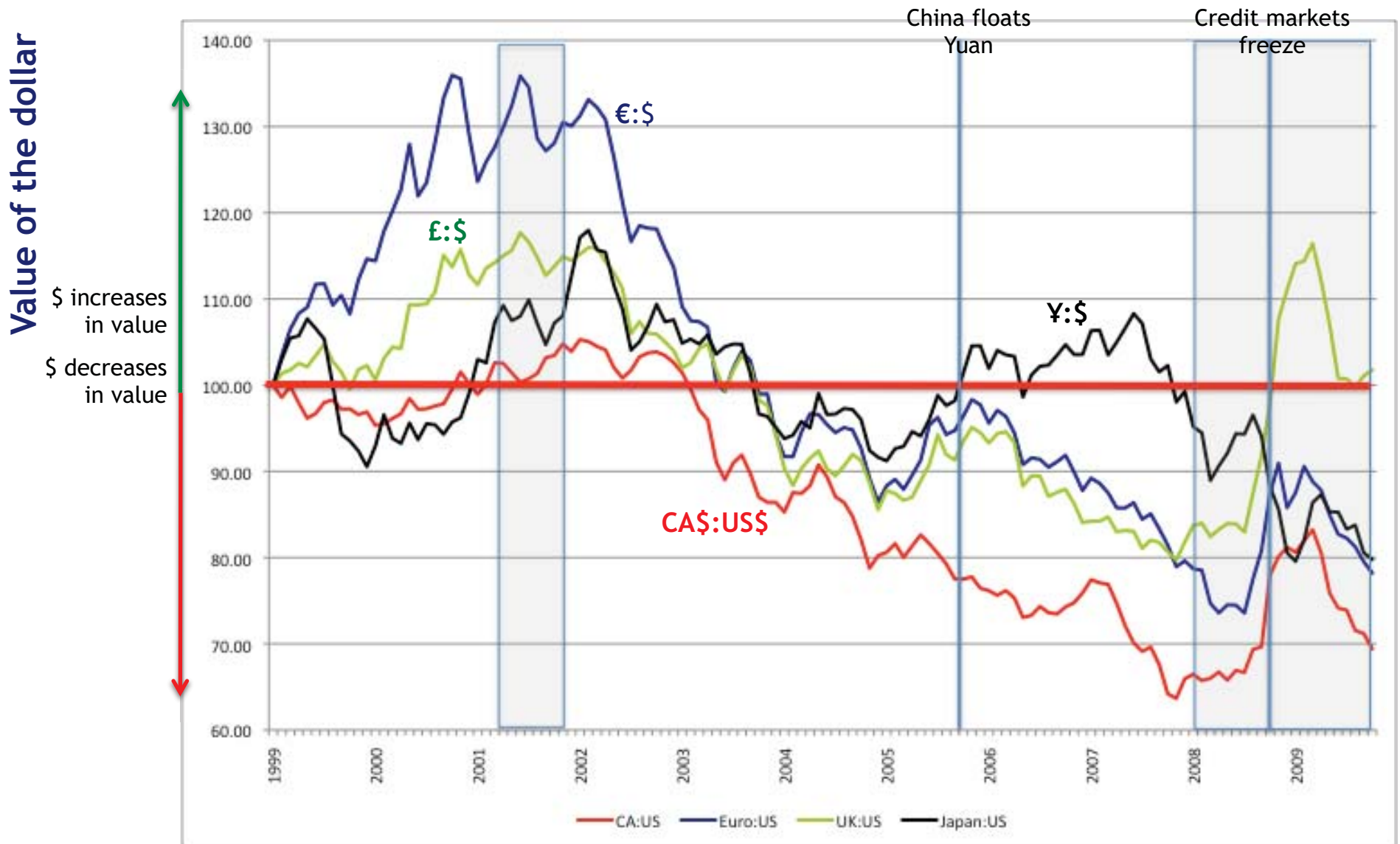


Trade weighed value of the dollar reflects its role as a reserve currency—but gravity is reasserting itself due to trade

Gravity reasserting itself: Value of the dollar



Dollar gains begin to moderate in 2009

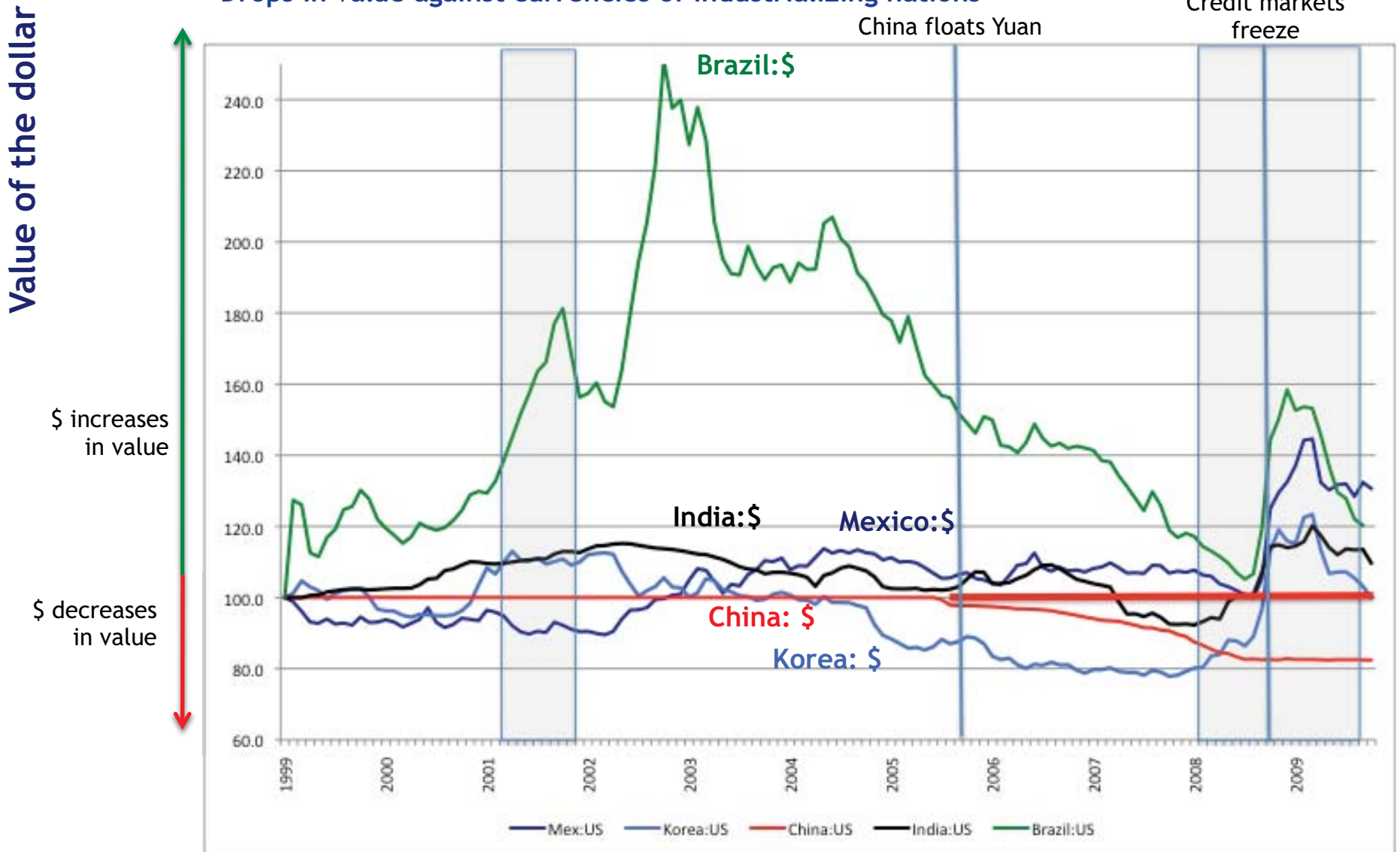


Dollar in managed decline against Yuan; Second peg began mid-2008; Makes Yuan cheaper against other currencies as well

Drops in value against currencies of industrializing nations

China floats Yuan

Credit markets freeze



Oil prices peak in June-July 2008 and crash

What is the long run equilibrium price?

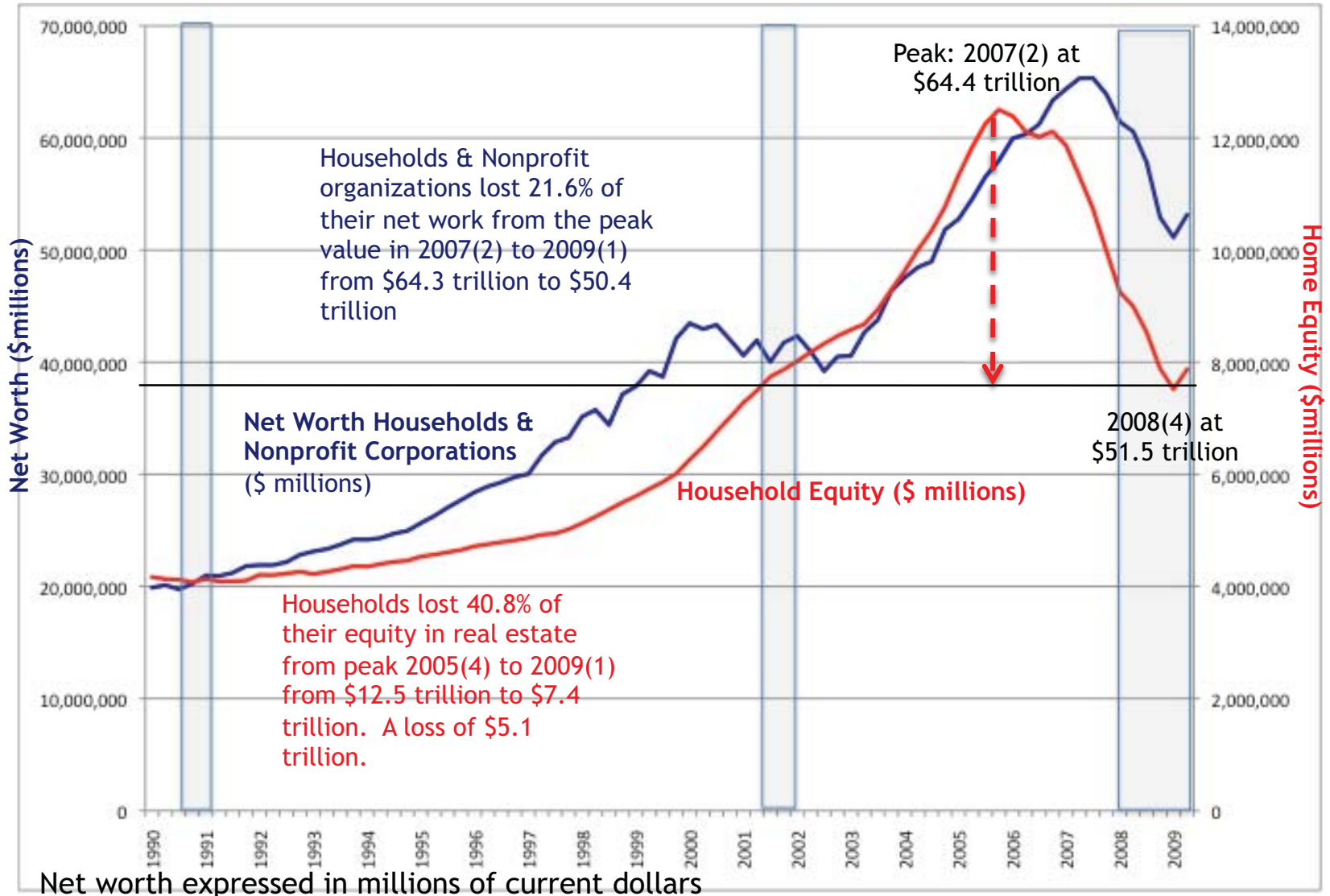
Price of West Texas Intermediate, Closing price on 1st of the month

Oil: searching for a market equilibrium



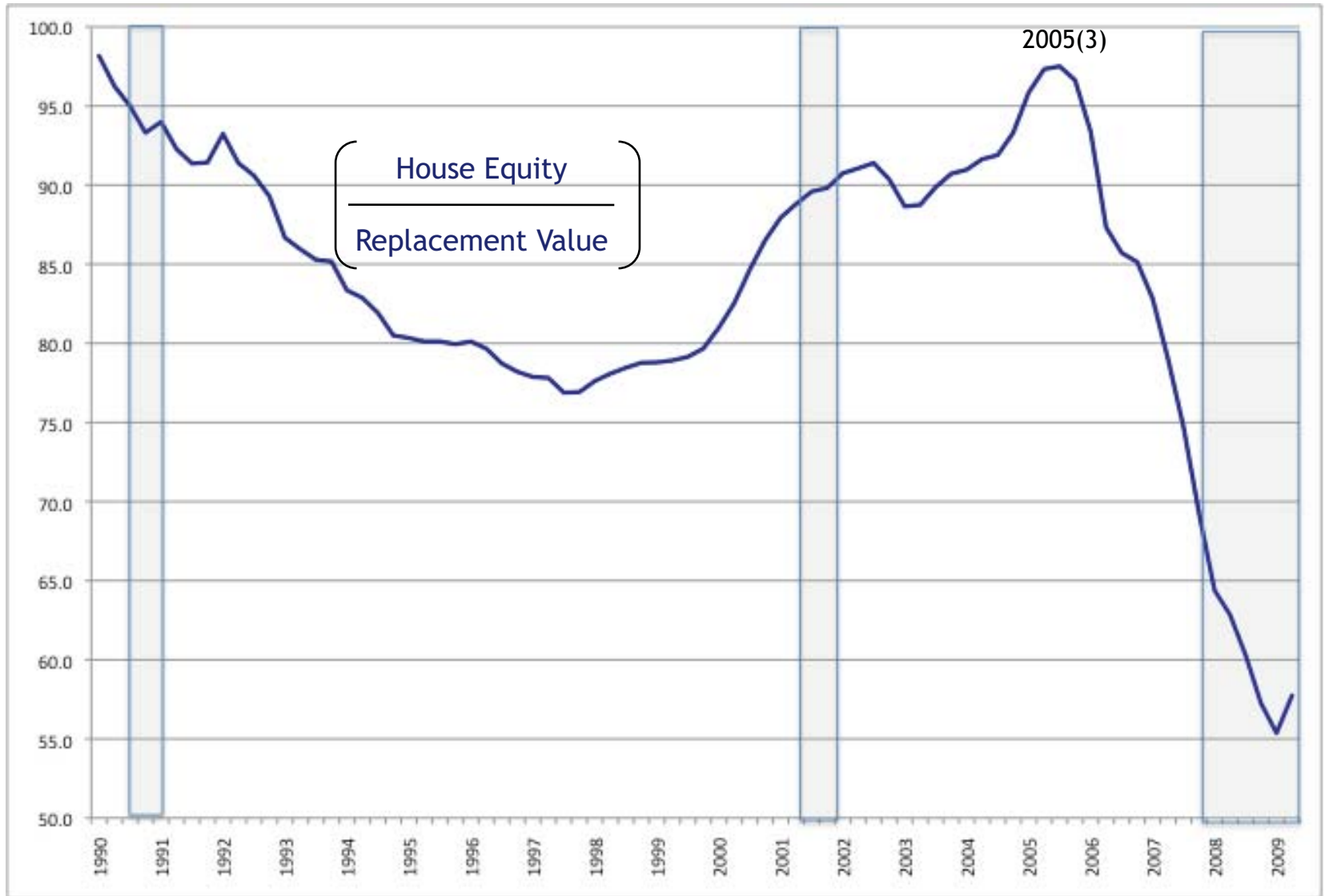
Net worth of households and nonprofit corporations lost 20% of value, or \$13.9 trillion, in 2 years from 2007(2) to 2009(2). Home equity dropped dramatically. Sign of modest recovery beginning in 2009(2)

Personal Wealth: After effects of asset bubbles imploding



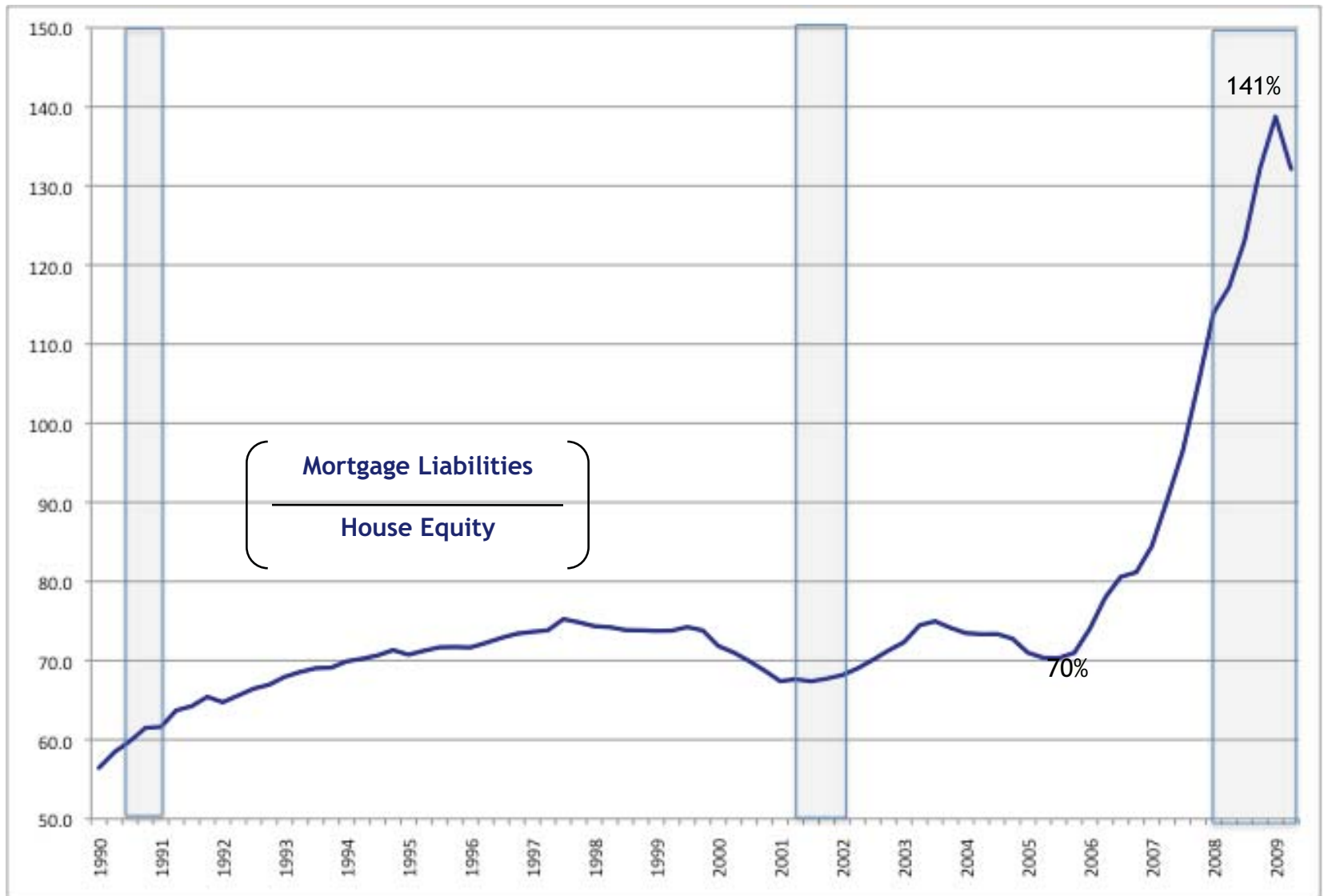
Housing is becoming more leveraged as equity is withdrawn from houses & houses fall in value. The slide began in 2005(3); signs of recovery 2009(2) The ratio of home equity to replacement value

Housing: After effects of a burst bubble



As home values decline, mortgage liabilities as a percent of house equity climbs. Involuntary leveraging. Quarterly 2002(4) 2009(2)

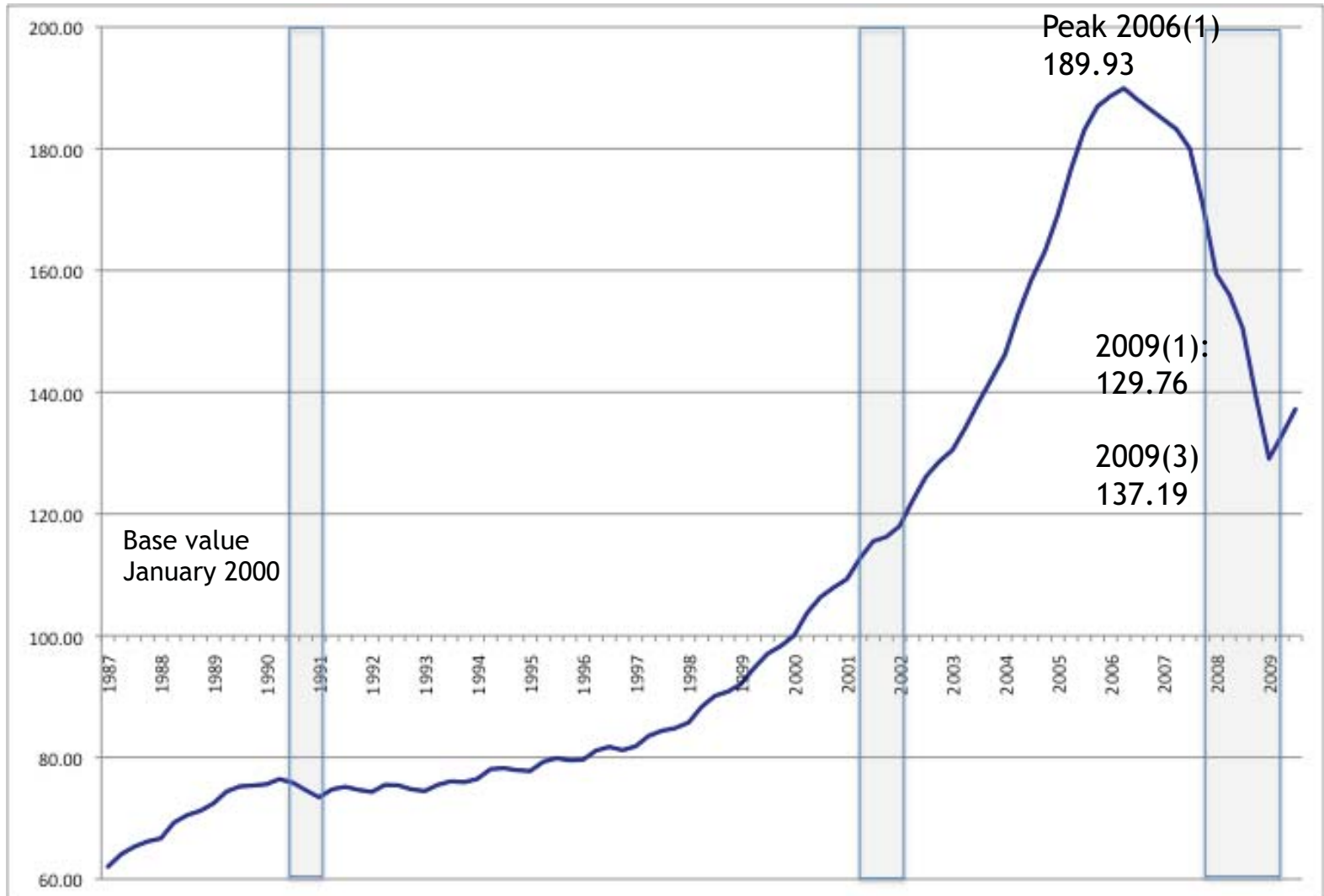
Housing: After effects of a burst bubble



Some recovery

From 2006(2) to 2009(1) Case Schiller Index lost 32.1% value

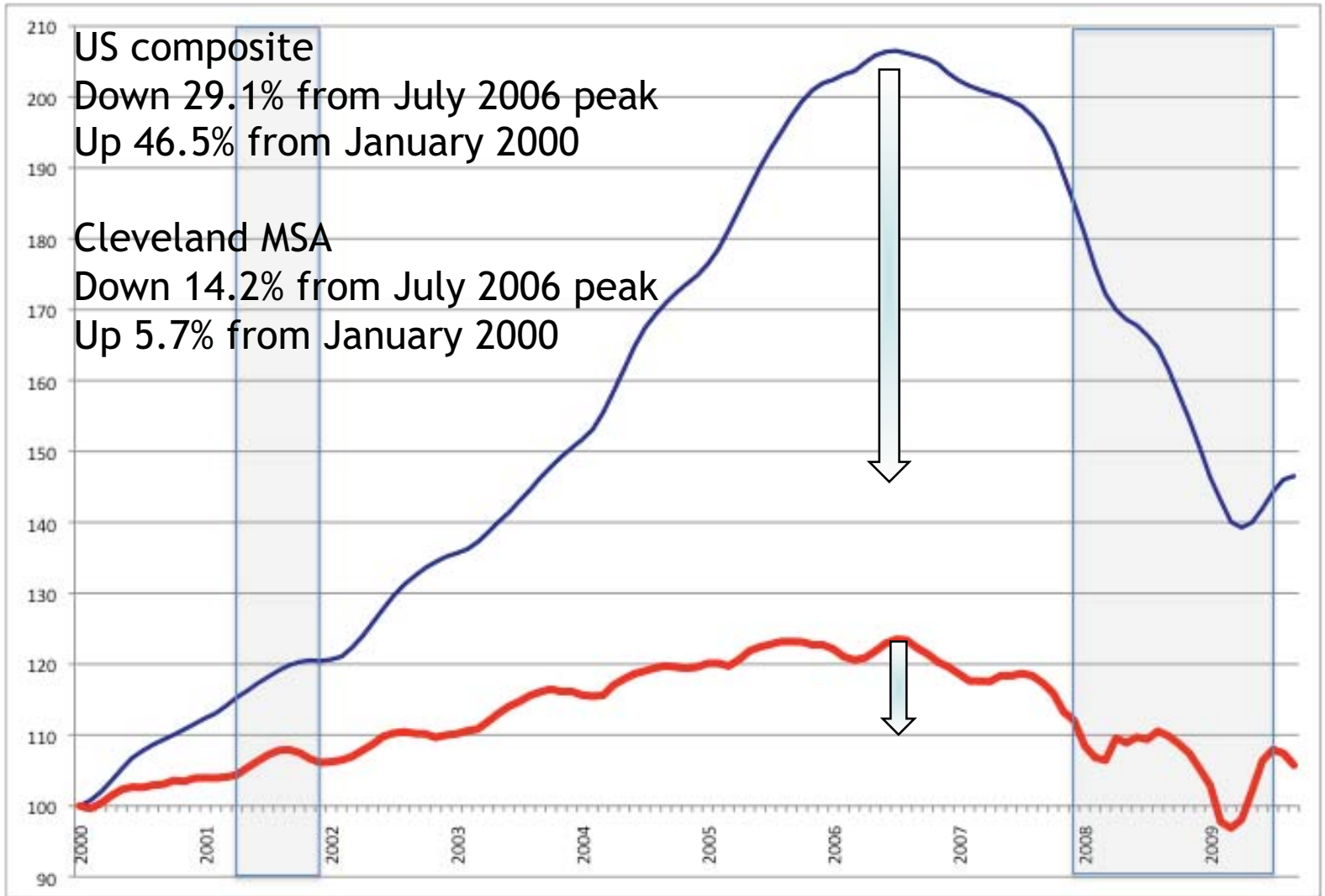
From 2006(2) to 2009(3) Case Schiller Index lost 27.1% value



How bad is the loss? It depends on when you bought

Comparison of housing values in the Cleveland Metropolitan area compared to the Case-Schiller 20 metro area composite

Housing: After effects of a burst bubble



Housing prices recovering thanks to first time homebuyers & bottom feeders

Sunbelt hit hardest; Low demand in Frostbelt

Housing: After effects of a burst bubble

	Percent change from June 2006 to	
	March 2009	September 2009
Phoenix	-54.0	-51.9
Los Angeles	-41.4	-38.3
San Diego	-41.7	-37.5
San Francisco	-45.3	-38.0
Denver	-11.8	-6.5
Washington DC	-32.9	-27.6
Miami	-47.7	-46.3
Tampa	-41.0	-40.1
Atlanta	-20.9	-16.5
Chicago	-26.8	-20.9
Boston	-17.0	-11.9
Detroit	-43.4	-41.0
Minneapolis	-36.5	-27.0
Charlotte	-5.3	-4.3
Las Vegas	-51.8	-55.0
New York	-21.0	-19.3
Cleveland	-19.7	-13.4
Portland, OR	-16.9	-15.2
Dallas	-7.4	-2.3

New housing starts plummet; slide starts in January 2006

Housing: After effects of a burst bubble



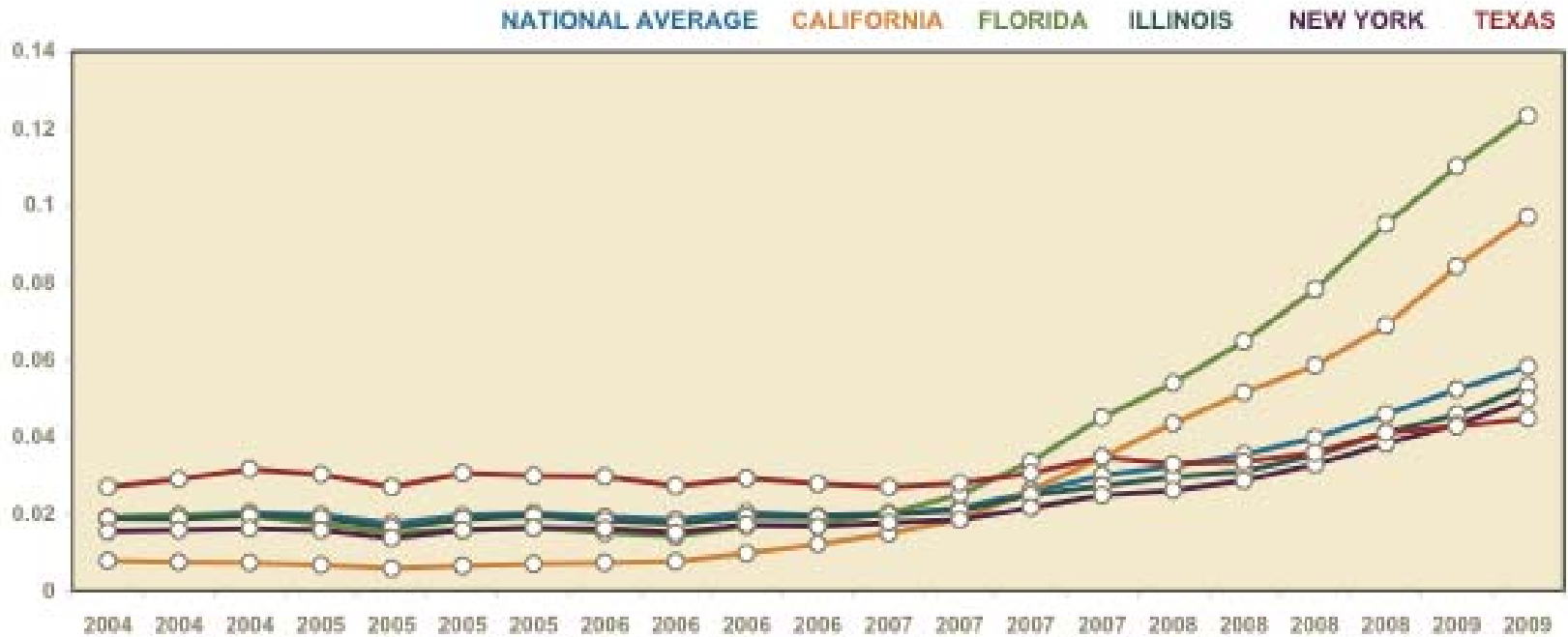
Housing market to stay flat through 2010

Conference Board's November forecast of new housing starts

2009 Q3	590,000
2009 Q4	680,000
2010 Q1	730,000
2010 Q2	770,000
2010 Q3	830,000
2010 Q4	910,000

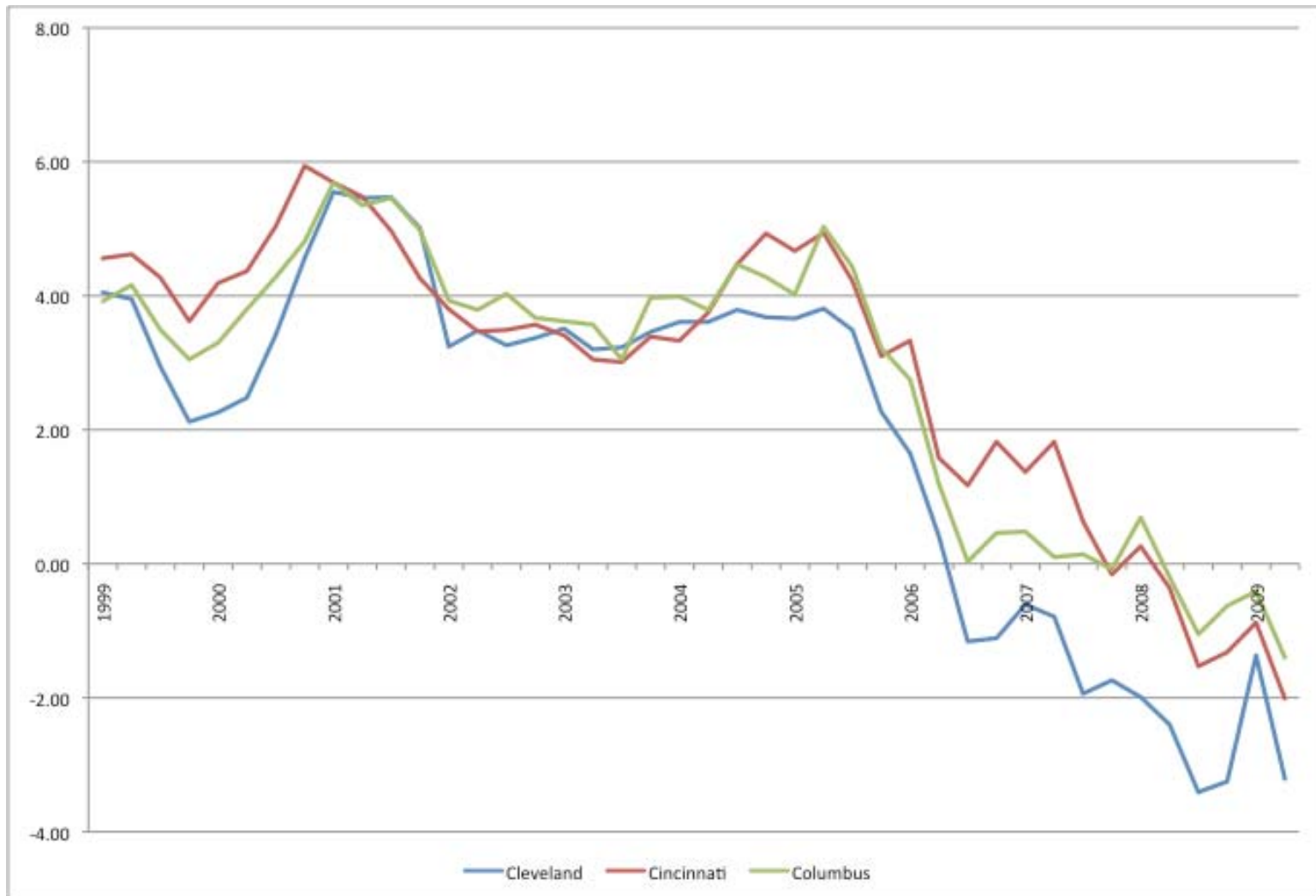
Mortgage default rates are climbing
 Gone from predatory defaults to cyclical defaults
 Two more rounds of resets due—this will be ugly
 National Average above 4.0%; Florida above 12%; Nevada above 14%

Ratio Of Mortgage Borrowers
 Currently 60 Days Or More Past Due

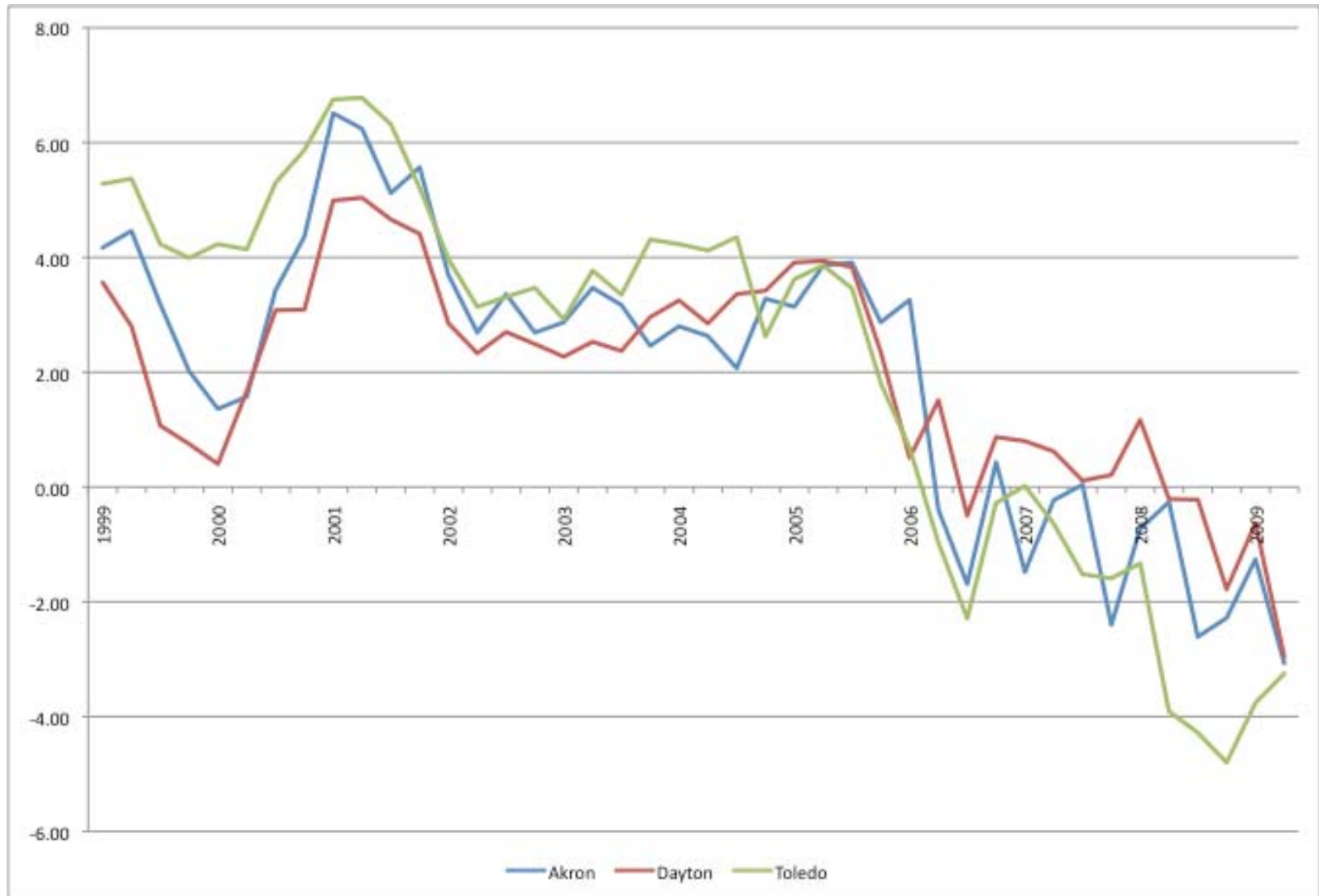


Second quarter 2009

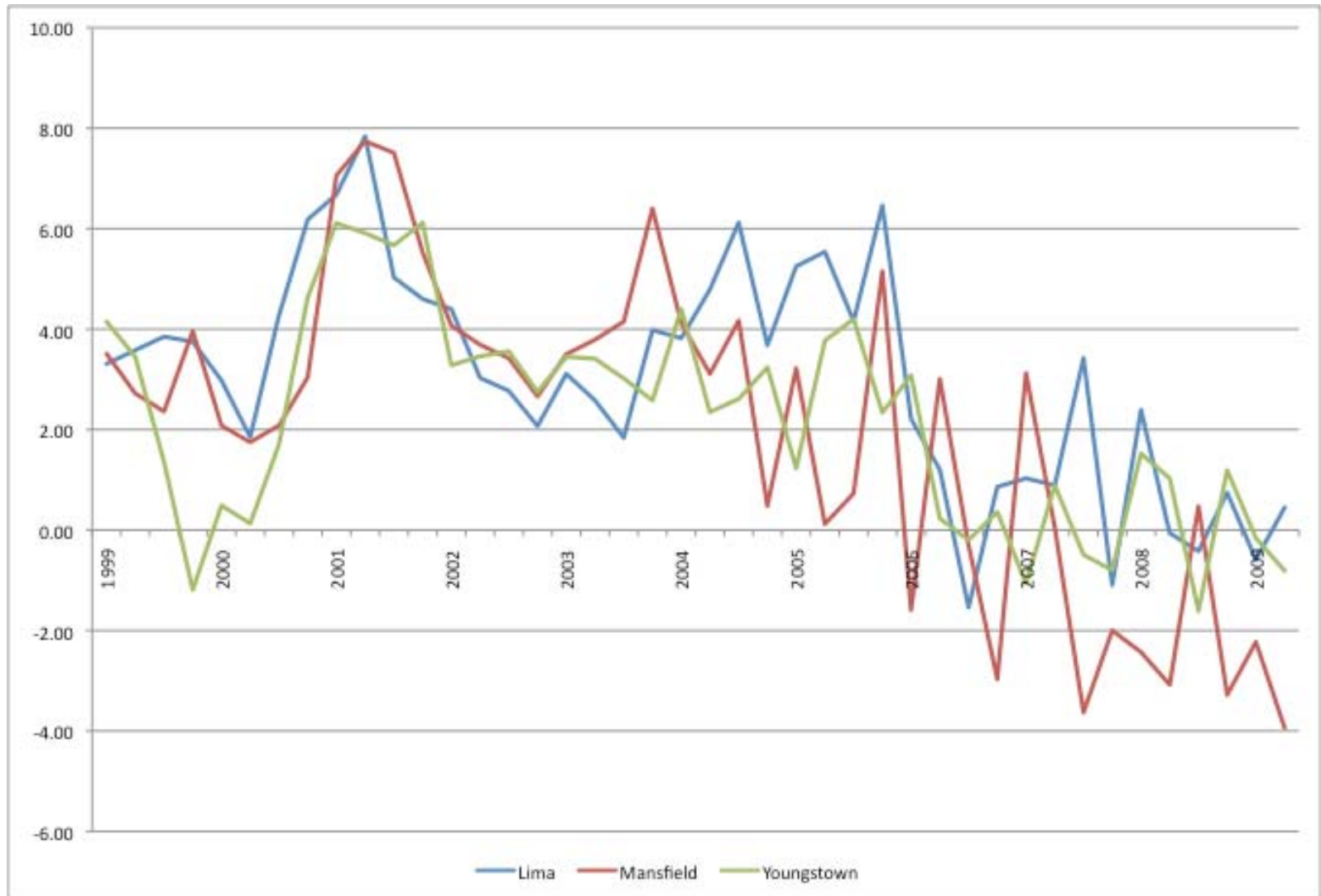
4-quarter percentage change in metropolitan housing price index: Cleveland, Cincinnati, Columbus MSA: 1999(1) to 2009(2)



4-quarter percentage change in metropolitan housing price index: Akron, Dayton, Toledo MSAs 1999(1) to 2009(2)



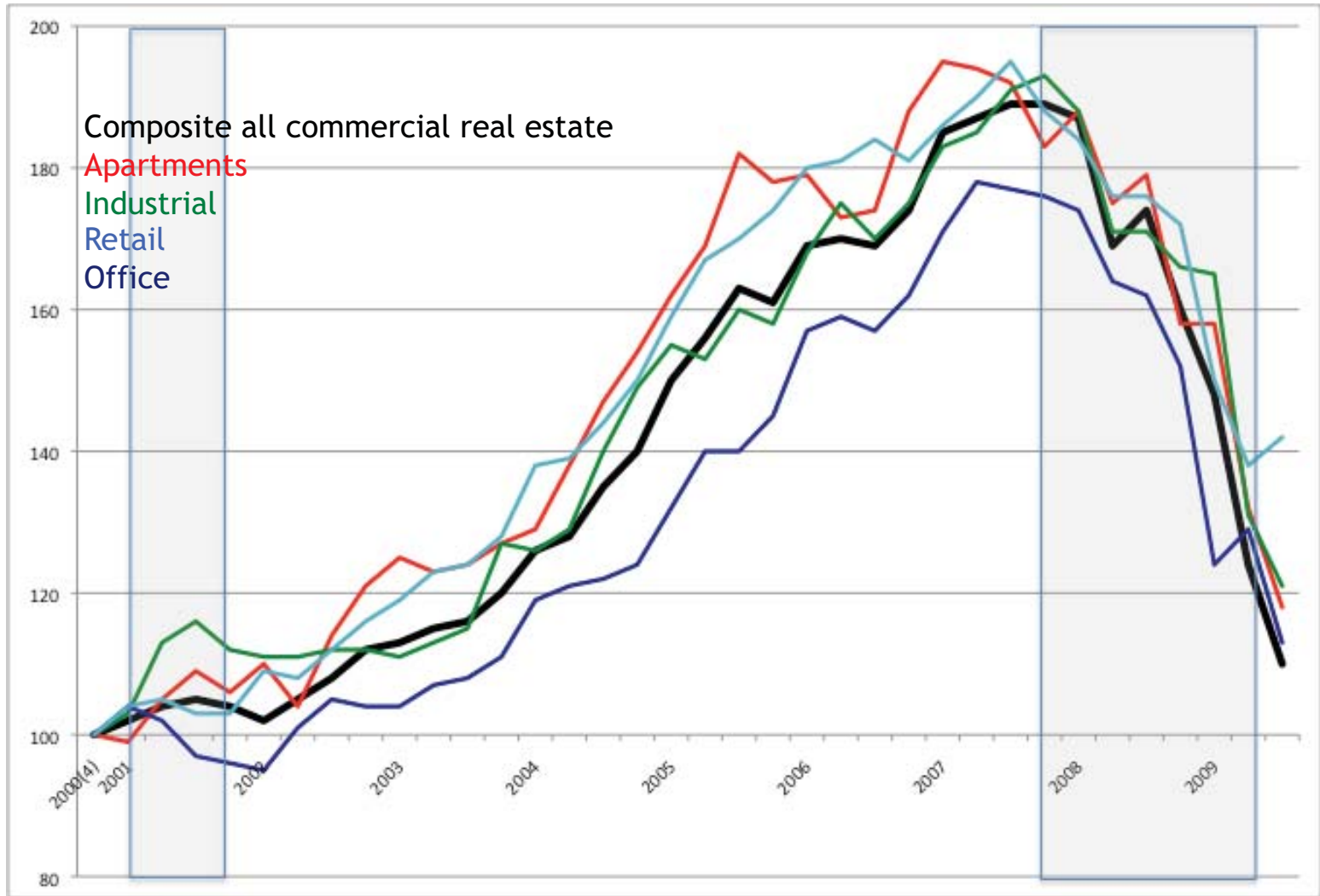
4-quarter percentage change in metropolitan housing price index: Lima, Mansfield, Youngstown MSAs 1999(1) to 2009(2)



Commercial Real Estate—all gains from boom nearly gone; index down 90 basis points; values of late 2002

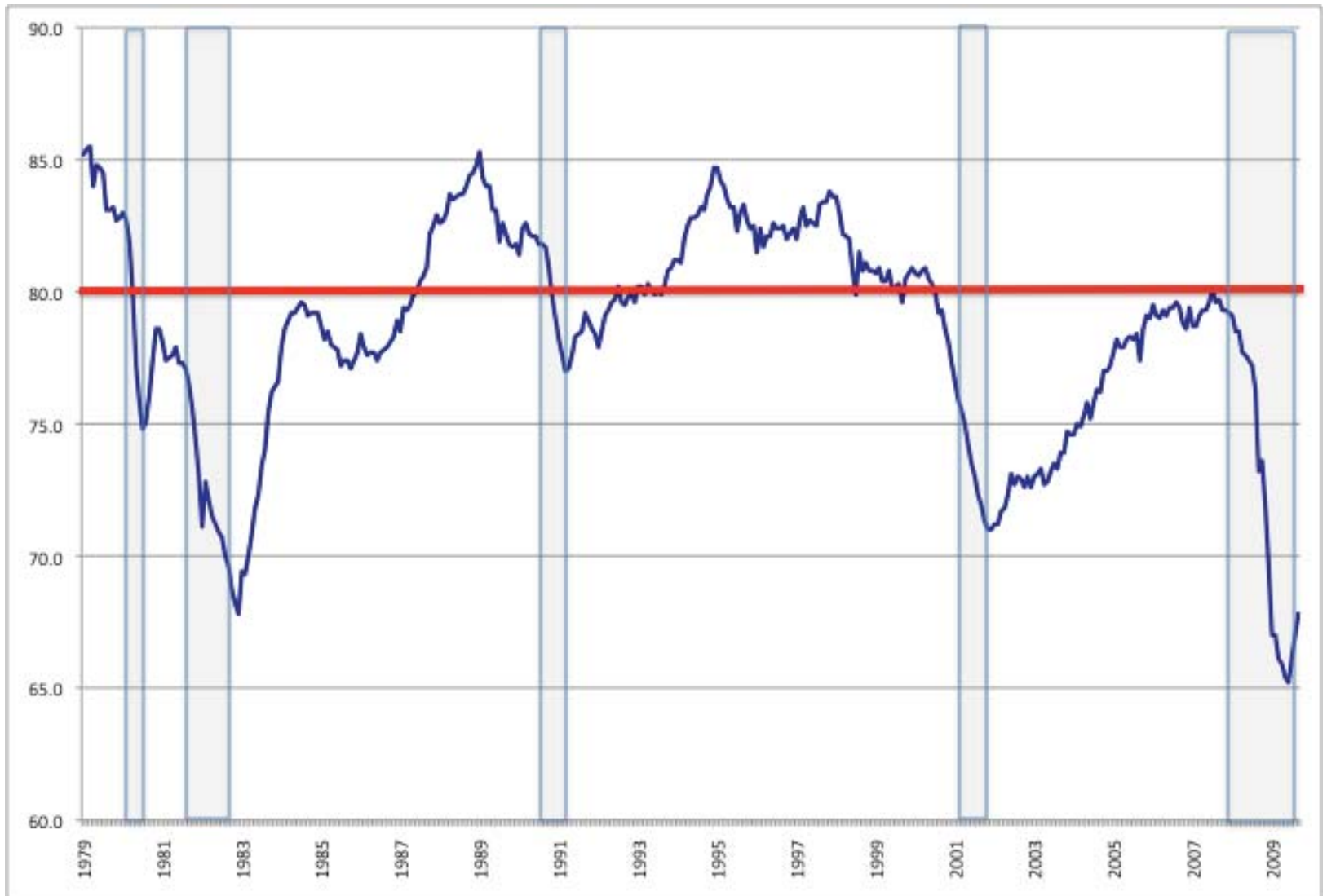
Losses flows into the portfolios of long term institutional investors--pension funds and investment trusts

Commercial real estate—the next shoe to fall



Manufacturing capacity utilization struggles to reach 80% Collapses in August 2007 when the liquidity trap began

Manufacturing



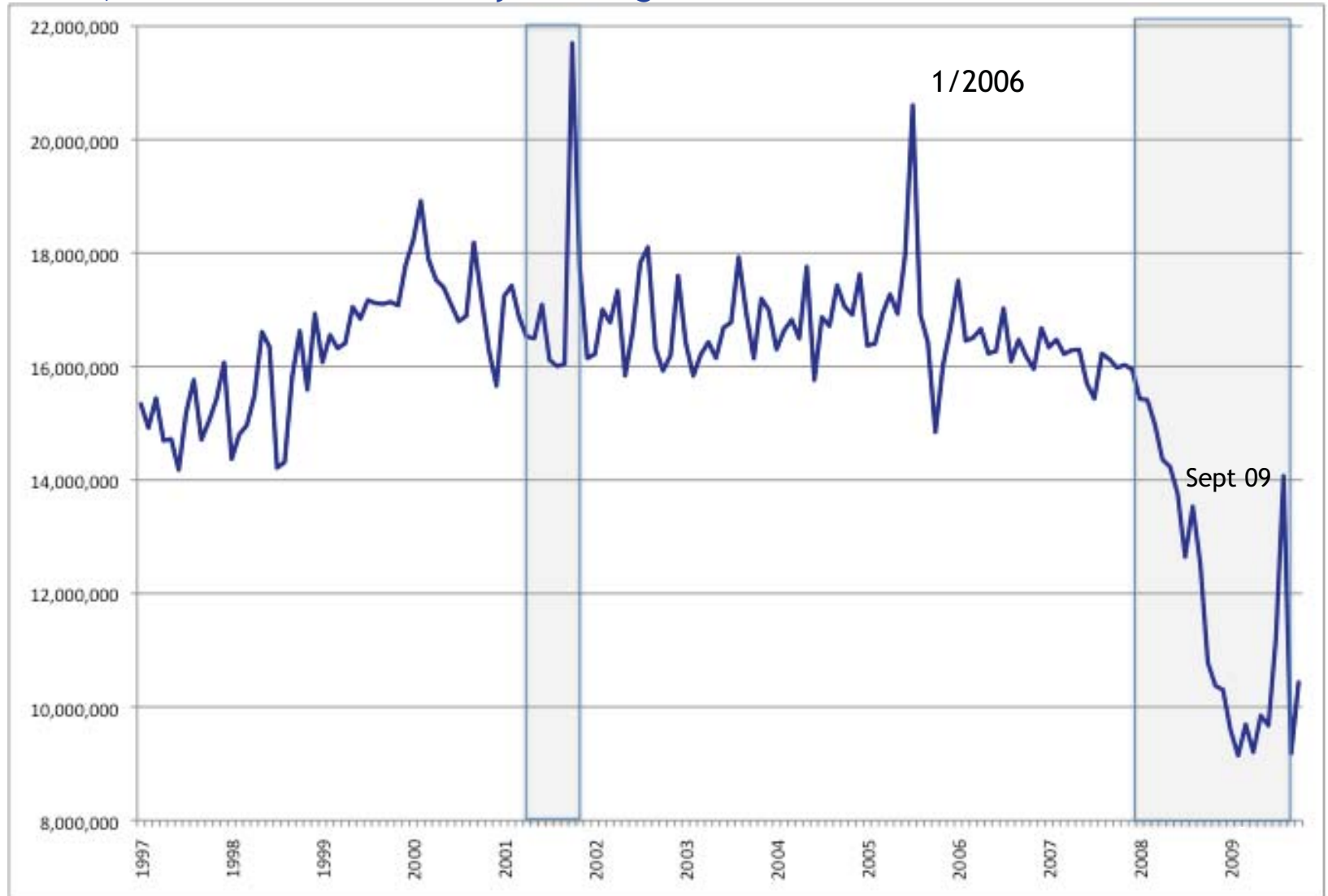
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Auto & light truck sales walk off a cliff;

Decline starts in January 2006; accelerates September 2007; falls apart September 15, 2008 Annualized monthly car & light truck sale

Autos & light trucks



Source: St. Louis Federal Reserve Bank, FRED, from US Bureau of Economic Analysis , retrieved Nov 18, 2009

Edward (Ned) Hill

Monthly 01/97 to 10/09

Cars and trucks will be made in the United States

North America remains a big market

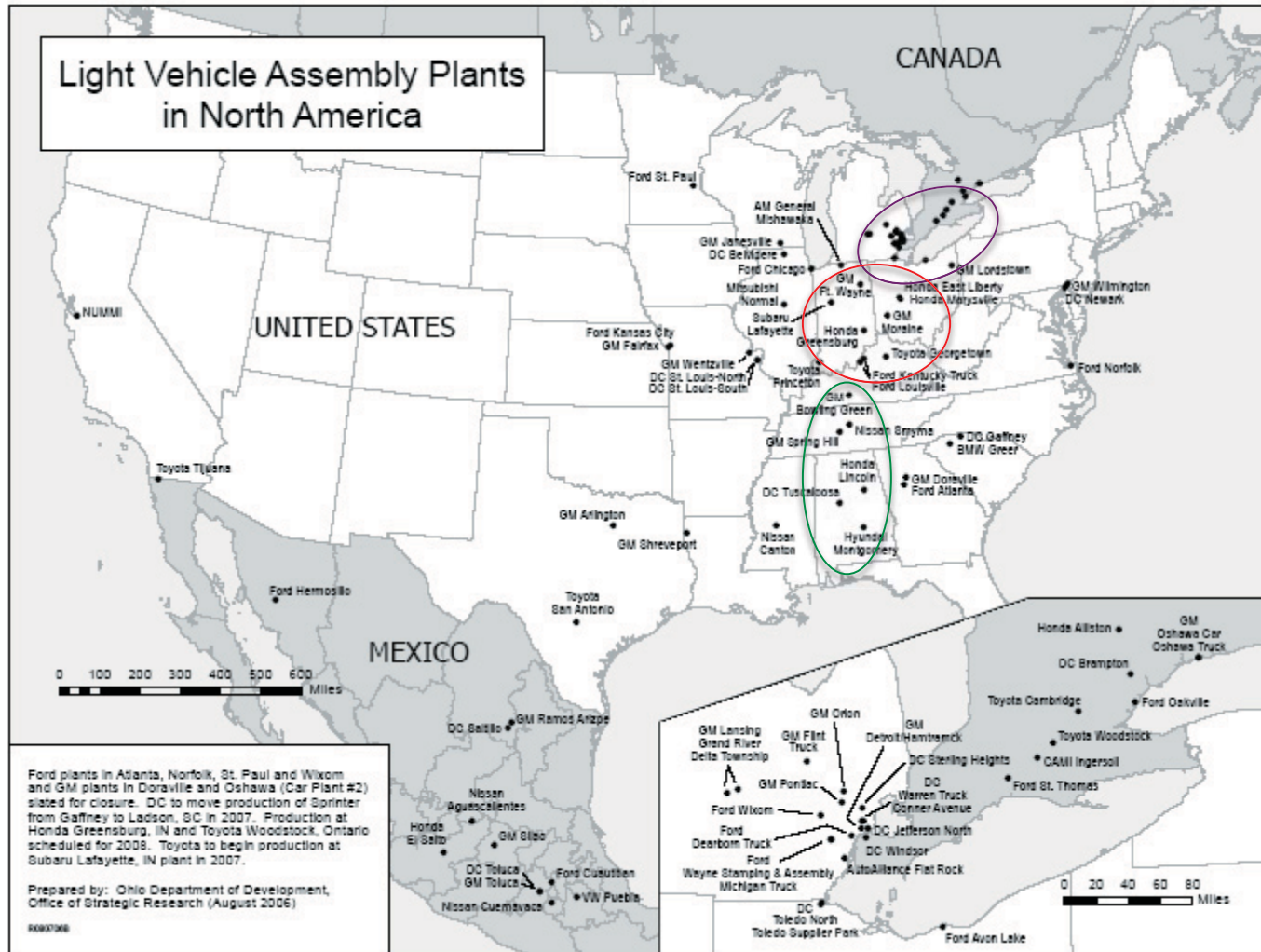
US production numbers drop; Mexico climbs

Numbers of cars, light trucks, and commercial vehicles produced				
Year	North America	Canada	Mexico	US
1999	17,633,716	3,058,813	1,549,925	13,024,978
2000	17,697,020	2,961,636	1,935,527	12,799,857
2001	16,713,689	2,629,437	1,804,670	12,279,582
2002	16,243,280	2,552,862	1,575,447	12,114,971
2003	16,243,280	2,552,862	1,575,447	12,114,971
2004	16,278,082	2,711,536	1,577,159	11,989,387
2005	16,318,783	2,687,892	1,684,238	11,946,653
2006	15,881,796	2,572,292	2,045,518	11,263,986
2007	15,454,212	2,578,238	2,095,245	10,780,729
2008	12,974,058	2,077,589	2,191,230	8,705,239

Annual percent change in car, light truck & commercial vehicle production

Year	North America	Canada	Mexico	US
2000	0.4	-3.2	24.9	-1.7
2001	-5.6	-11.2	-6.8	-4.1
2002	-2.8	-2.9	-12.7	-1.3
2003	0.0	0.0	0.0	0.0
2004	0.2	6.2	0.1	-1.0
2005	0.3	-0.9	6.8	-0.4
2006	-2.7	-4.3	21.5	-5.7
2007	-2.7	0.2	2.4	-4.3
2008	-16.0	-19.4	4.6	-19.3

A tale of 4 clusters: Auto assembly in North America Old domestic heartland; New Domestic center I-70 - I-75 crosshair; Southeast Corridor



What's next: Realities

- Automotive work will continue to exist—for those that survive this auto depression
- There will be a different set of impacts for communities anchored by an assembly plant and those with parts manufactures
- Just-in-time, fuel costs, and congestion will continue to re-concentrate the industry
- Keys to survival for companies and plants
 - Flexible workforce and flexible work rules
 - Company & supply chain culture will continue to be important
 - No debt—leverage is now the company killer
 - Long term value of the dollar will influence the health of assembly clusters

The performance of the labor market

Changing economic advantage

Three observations

Failed corporate strategies and old products

Place-based legacy costs and work rules

Returning to Fundamentals

- Balancing economic policy
 - Short run—fight the recession
 - Long run—fight huge structural deficits
- Return to credit culture—both for individuals & banks
- Financial regulation for transparency and monitoring of behaviors; not micromanaging accounting
- Erosion of too big to fail and a move to workout banks
- Dollar will fall again—economic physics will reassert itself

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