

The Storm Has Passed, but It Is Still Cloudy— *A Mid-Year Economic Review*

George A. Erickcek

W.E. Upjohn Institute for Employment Research

July 22, 2009

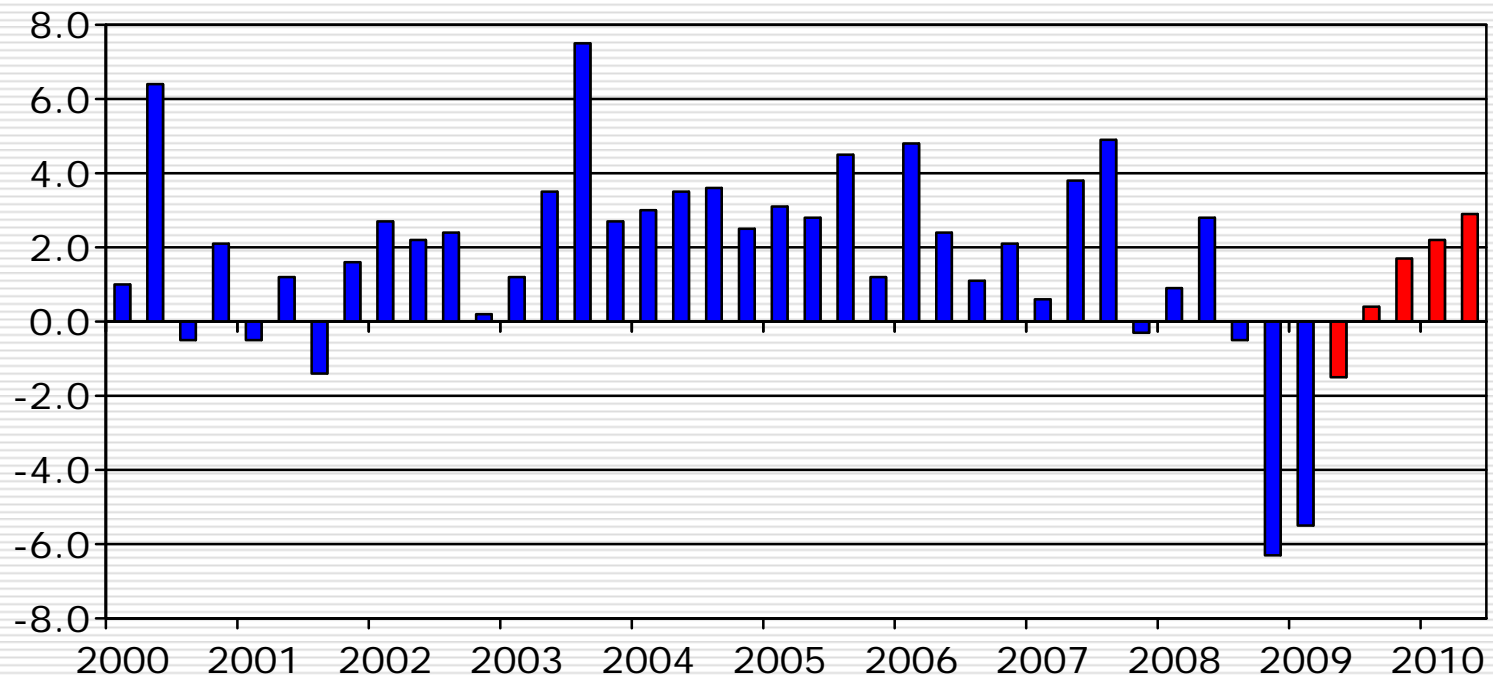
*So there are a physicist, chemist
and economist on a deserted
island.....*

Agenda

- National Outlook—*Still stuck but stable*
- State Outlook—*Are we looking into a tunnel or a mine?*
- Kalamazoo-Portage MSA—*Stuck in the middle.*
- So what?
 - *Nationally—A Minsky's moment.*
 - *The good and not-so-good news about the local economy.*

Percent change in the nation's GDP—*Fell 5.5 percent during the first quarter.*

Annualized Percent Change in GDP



Source: BEA, Philadelphia Federal Reserve Survey of Professional Forecasters.

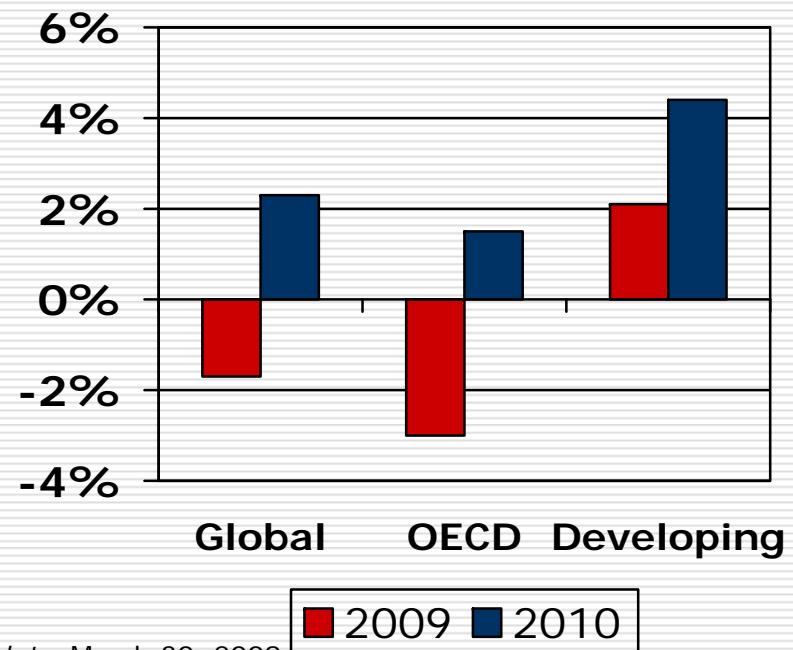
National outlook: Most of the nation's economic indicators are pointing south.

<input type="checkbox"/> Employment	RED
<input type="checkbox"/> Residential construction	RED
<input type="checkbox"/> Consumer confidence	RED
<input type="checkbox"/> Consumer financial conditions	RED
<input type="checkbox"/> Credit markets	RED
<input type="checkbox"/> ISM Purchasing Mgrs. Index	RED
<input type="checkbox"/> Stock market	YELLOW
<input type="checkbox"/> Inflation	GREEN

It's global!

- The 1.7 percent forecast decline in worldwide GDP would be the first on record!
- Developed OECD countries are all expected to fall this year.
- Economic growth in developing nations is slowing significantly.
- Expected 2009 global trade change: -6.1%.

Forecast 2009 GDP Growth Rates

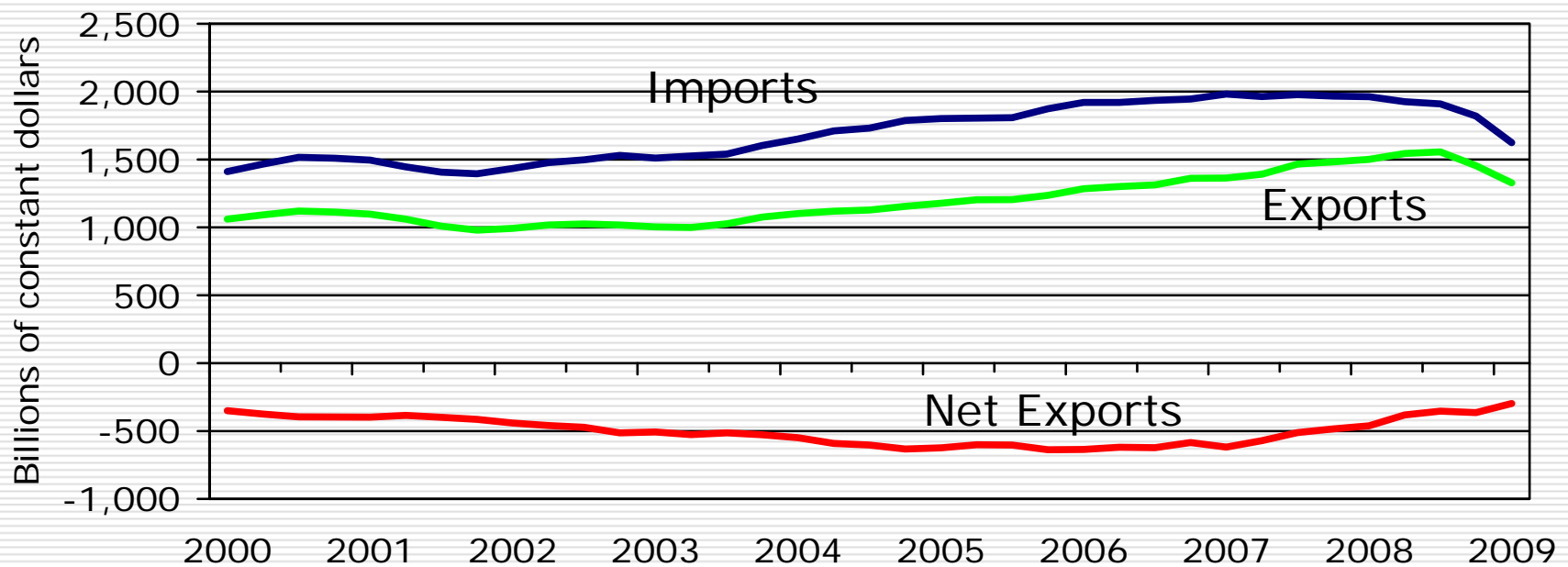


Source: World Bank, *Global Economic Prospects 2009: Forecast Update*, March 30, 2009.

The trade gap is improving, but only because the world economy is slowing. Still, our foreign trading partners are holding a lot of dollars.

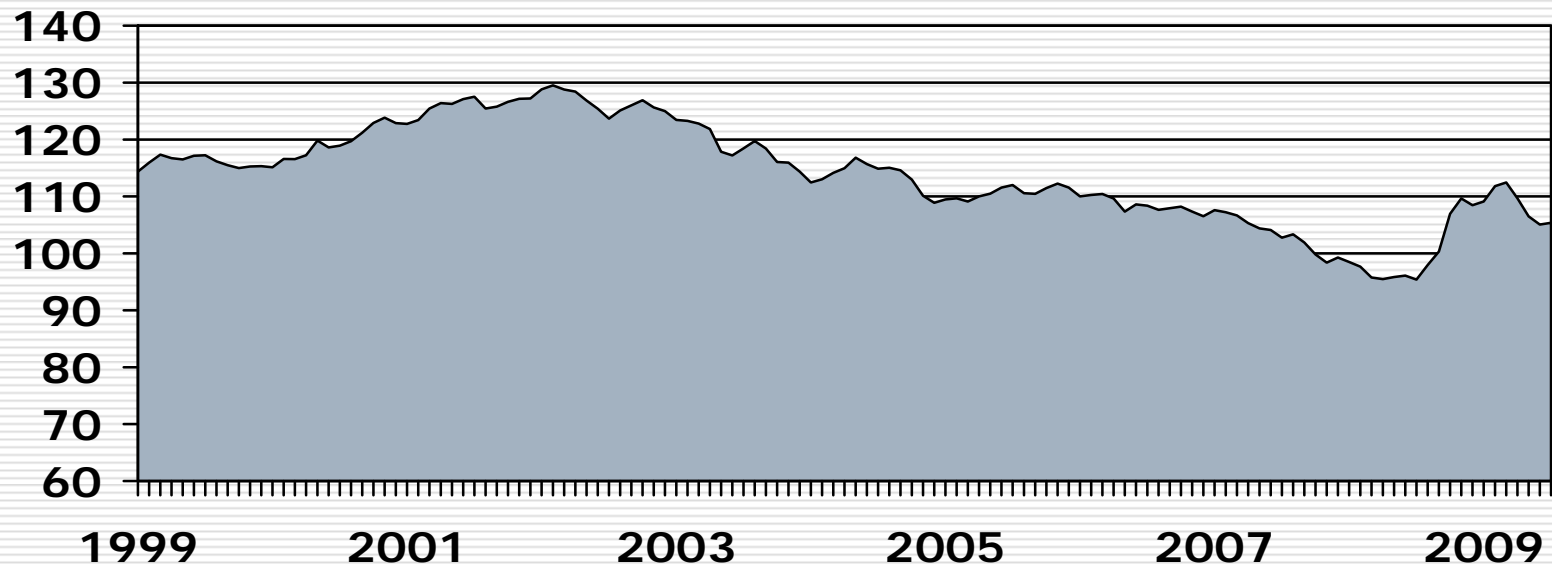
International Trade

Seasonally-Adjusted Annualized rates



The strength of the U.S. dollar has improved in 2009; however, exchange rates are still far below levels seen earlier in the decade.

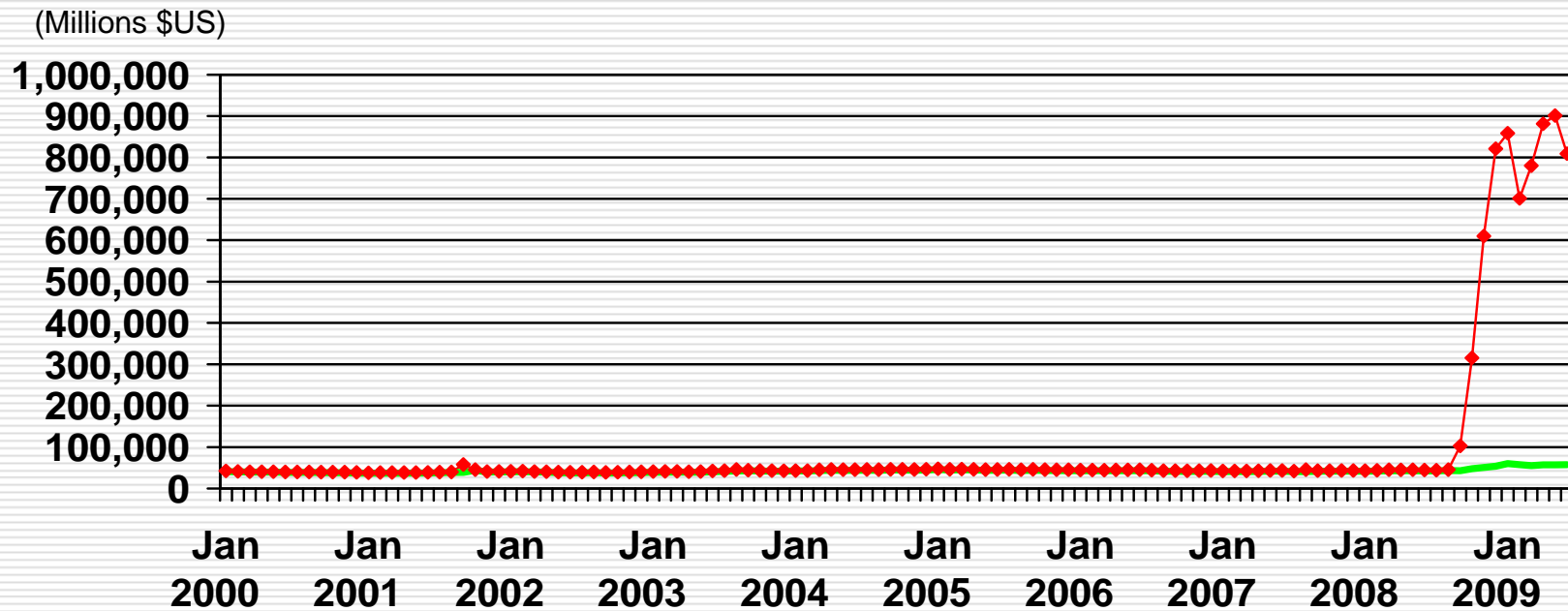
Broad Index
(U.S. Dollar Exchange Rate with Major Trading Partners)



Source: Federal Reserve Board, Statistical Release H.10.

Banks continue to hold on to their reserves.

Aggregate U.S. Depository Institution Reserves
(Adjusted for seasonality and changes in reserve requirements)

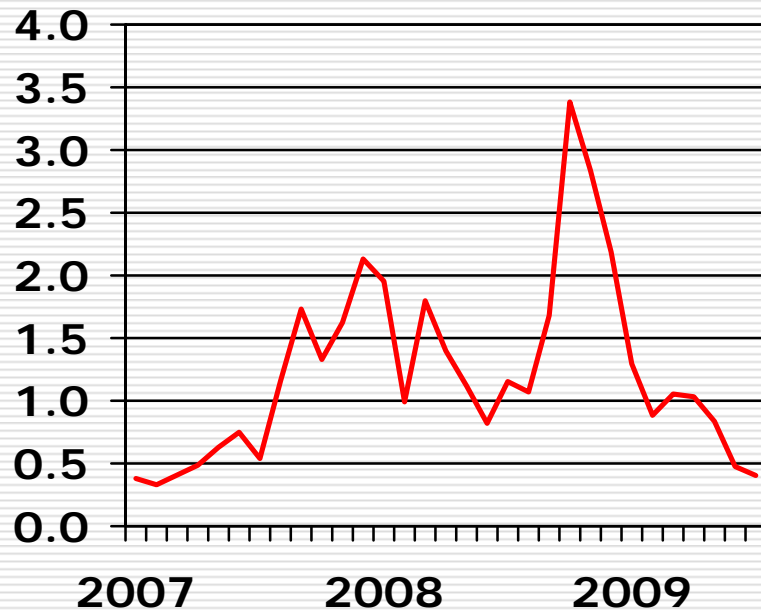


Source: Federal Reserve, Statistical Release H3.

◆ Total reserves — Required

Risk premium has returned to pre-crisis levels.

LIBOR Rate Minus 3-Mo. Treasury Rate

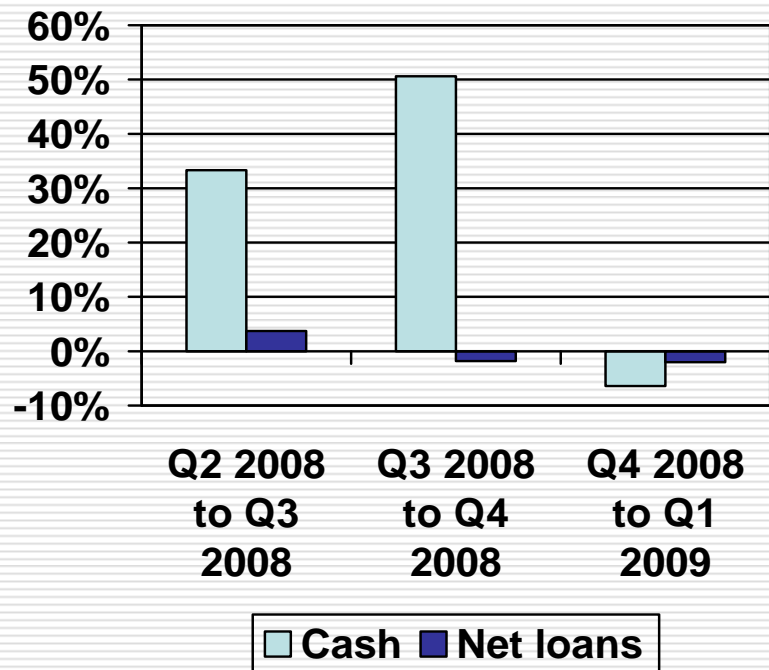


Source: Calculated using data from Federal Reserve and MoneyCafe. All data are for 3-month market rates.

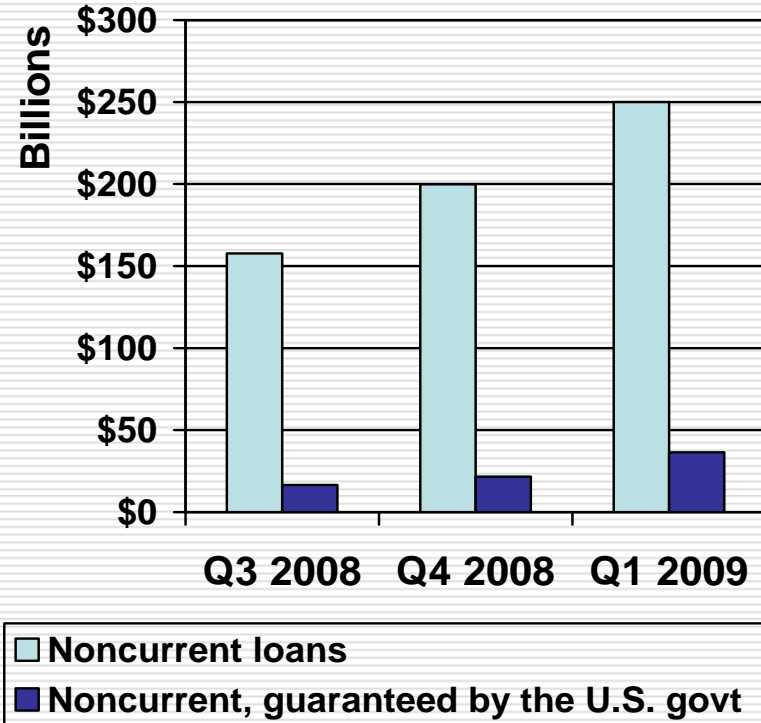
- Difference between LIBOR and risk-free treasury shows risk premium.
- The average rate difference from 2000-2005 was only 0.35 percentage points.

The financial world turned conservative in response to growing losses.

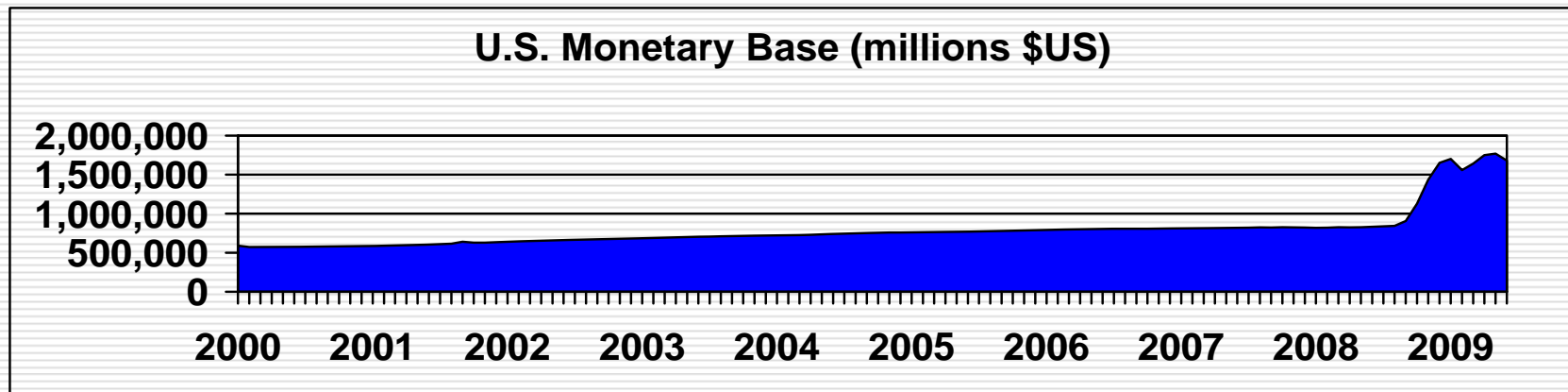
Change in Select Bank Assets



Loans 90+ Days Past Due



The nation's money supply has doubled over the past year!



- ❑ Federal stimulus efforts and bank bailouts have led to a substantial increase in the amount of money in the system.
- ❑ However, inflation remains low. Consumers are paying down debts and saving, while banks are hoarding cash reserves.
- ❑ Our international trading partners are also holding a lot of dollars.
- ❑ However, when there is too much money chasing too few goods, inflation is often the result.

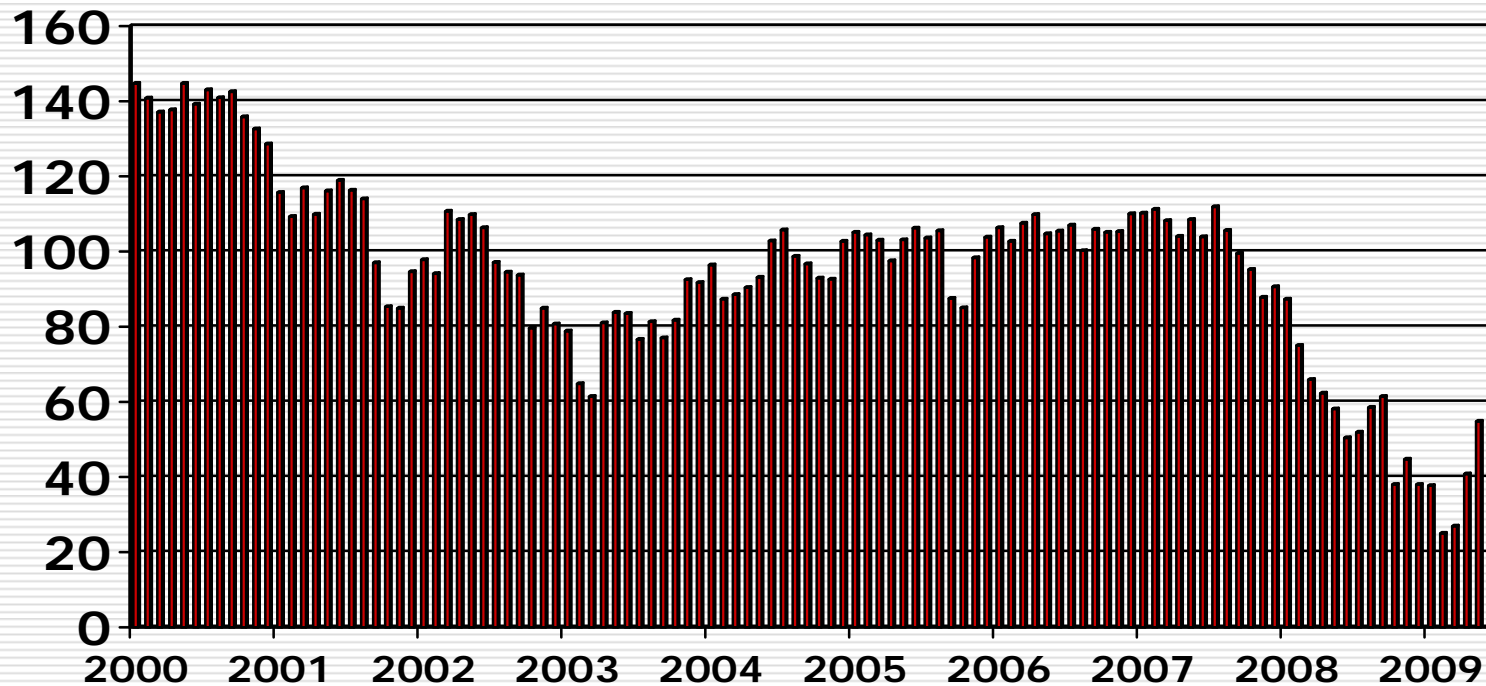
Source: Federal Reserve, Statistical Release H3.

Consumers

- ❑ Confidence is slowly returning.
- ❑ The housing market has stabilized.
- ❑ Retirement savings remain troubled, but the savings rate has increased dramatically.
- ❑ Job outlook is not good.

Consumers' confidence is still low but has improved in two of the past three months.

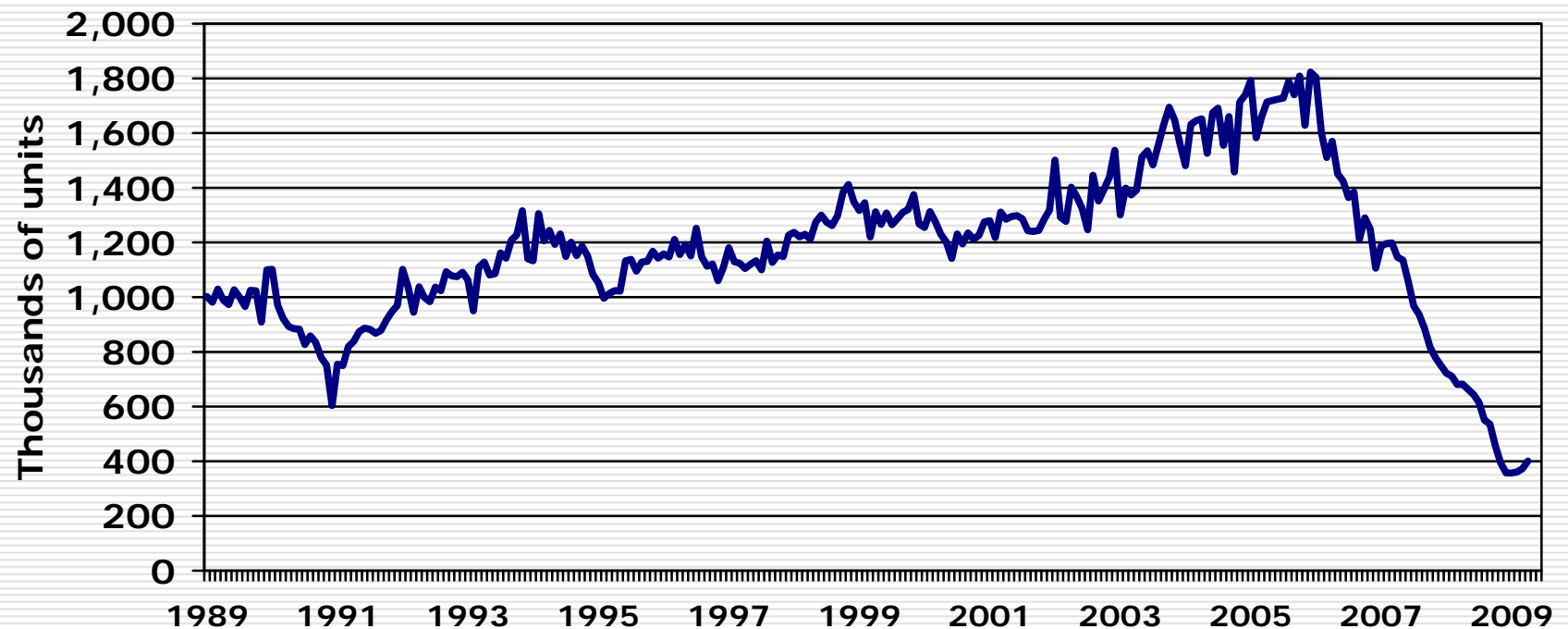
Consumer Confidence (1995=100)



Source: Conference Board

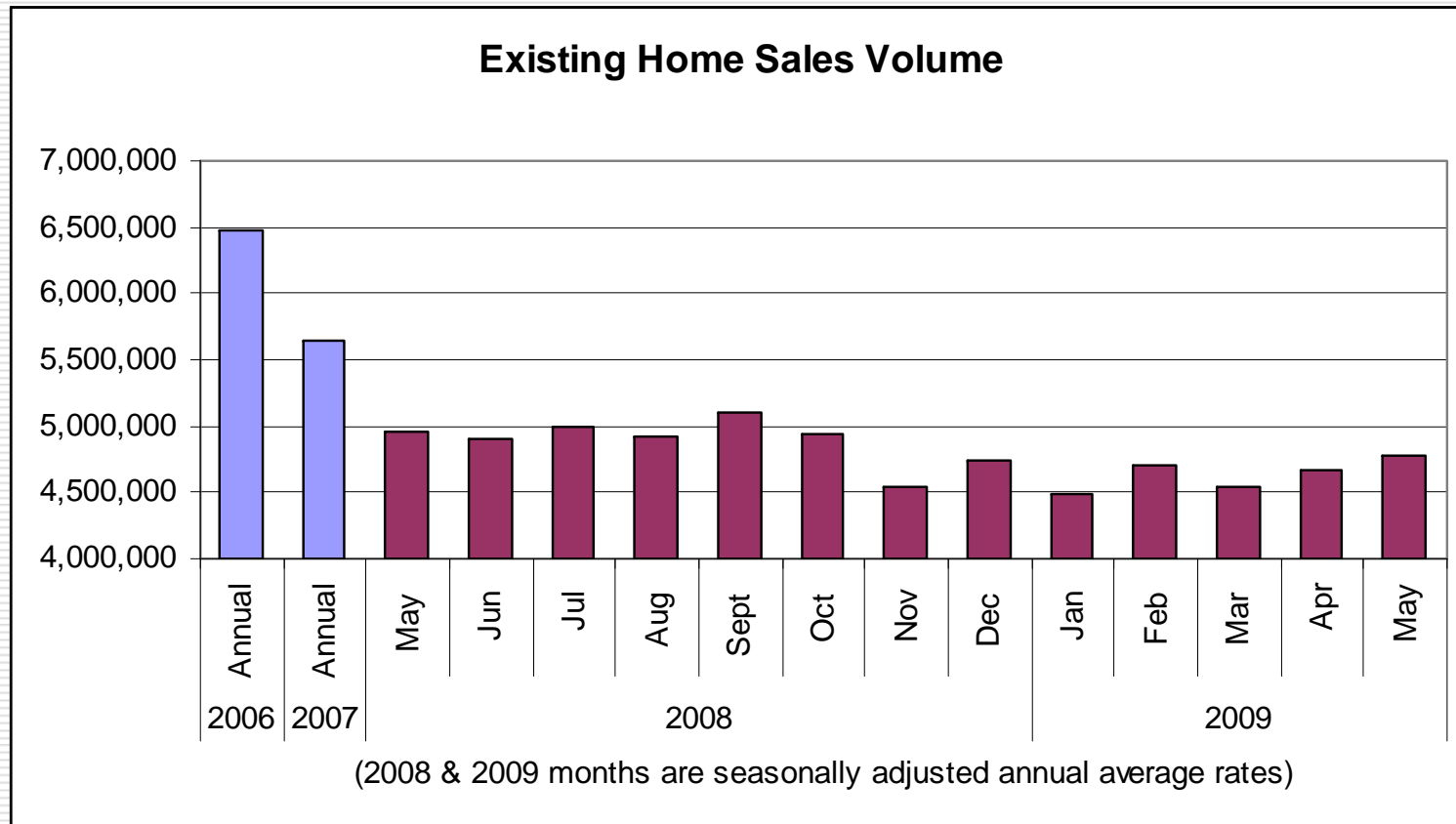
Single-Family Housing Starts—*Have we found bottom?*

Seasonally Adjusted Annual Rates



U.S. Census

Sales volumes have perked up the last few months; however, the market for existing homes is still far below earlier years.



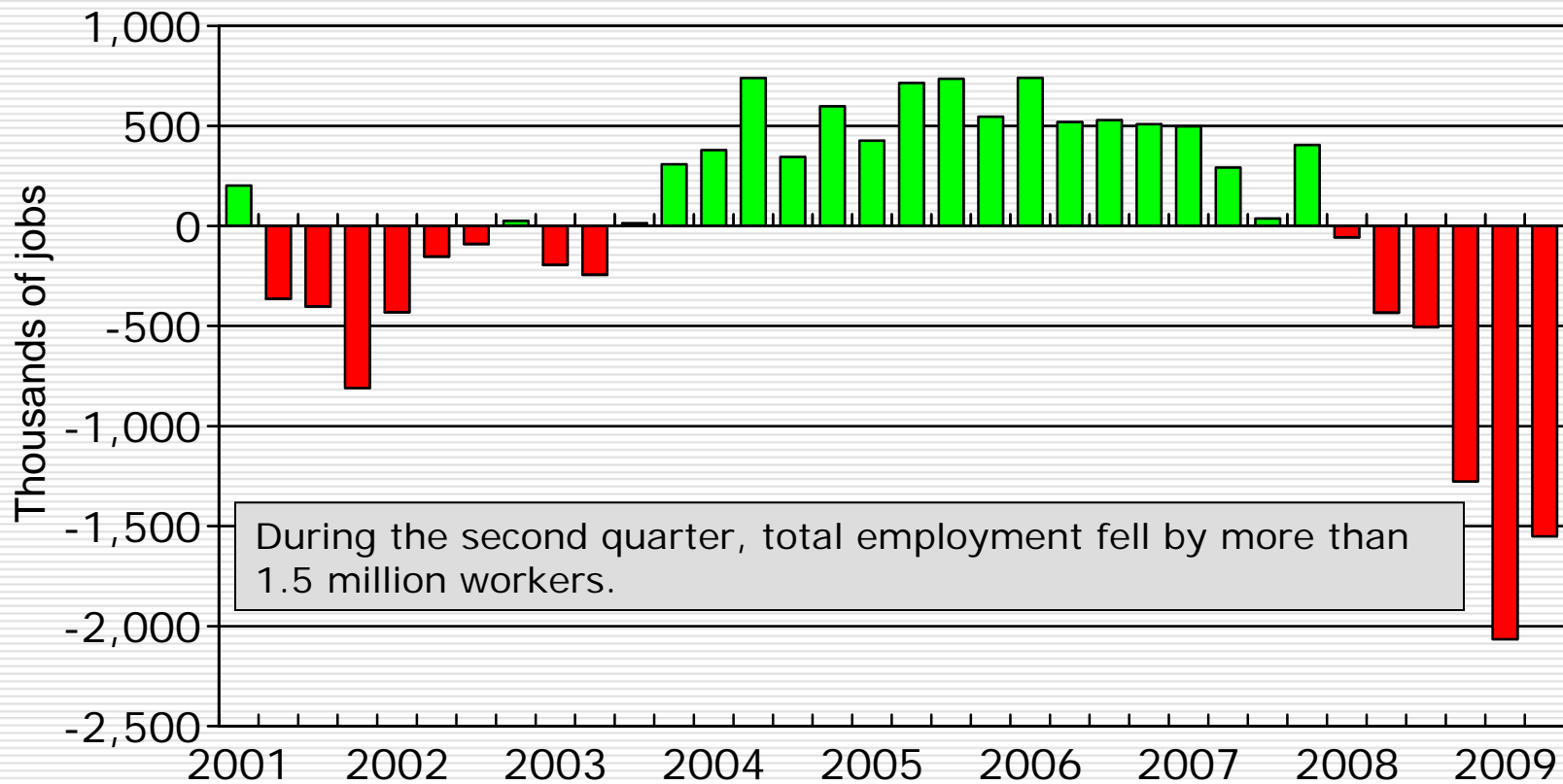
Source: National Association of Realtors.

The home foreclosure problem is still impacting markets.

- ❑ Over 1.5 million properties received a foreclosure notice during the first six months of 2009—up 17% from one year ago.
- ❑ Foreclosure filings increased 4.6 percent in June '09.
- ❑ However, default notices—the first step in the foreclosure process—decreased 6% in June.
- ❑ In May, Michigan reported the 6th highest foreclosure rate in the nation, with 1 in 326 homes in foreclosure.

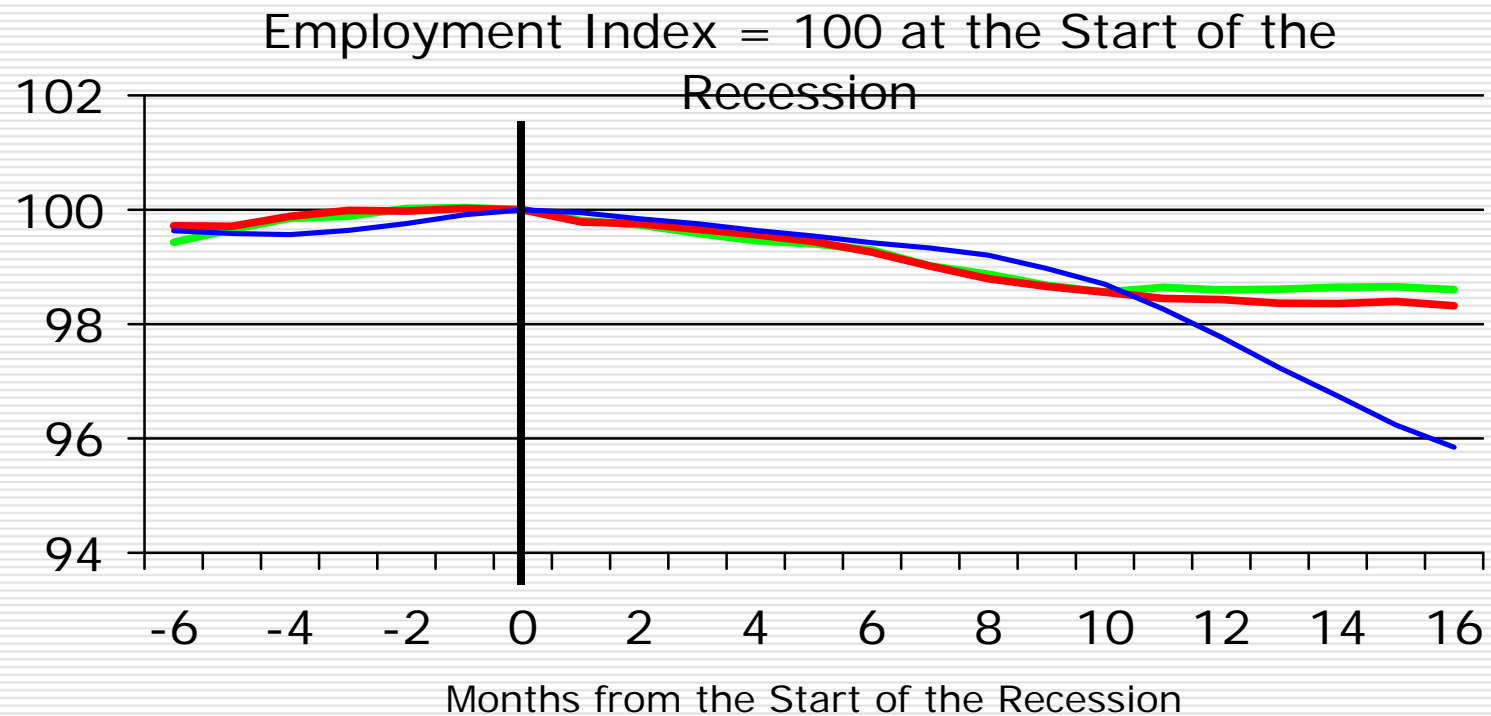
Source: RealtyTrak: ForeclosurePulse and Realty Trends.

Nationwide, employers are cutting way back.

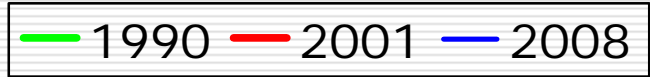


Source: BLS.

Nationwide, the current period has suffered a greater decline in employment than previous periods.



Source: CES, seasonally adjusted.



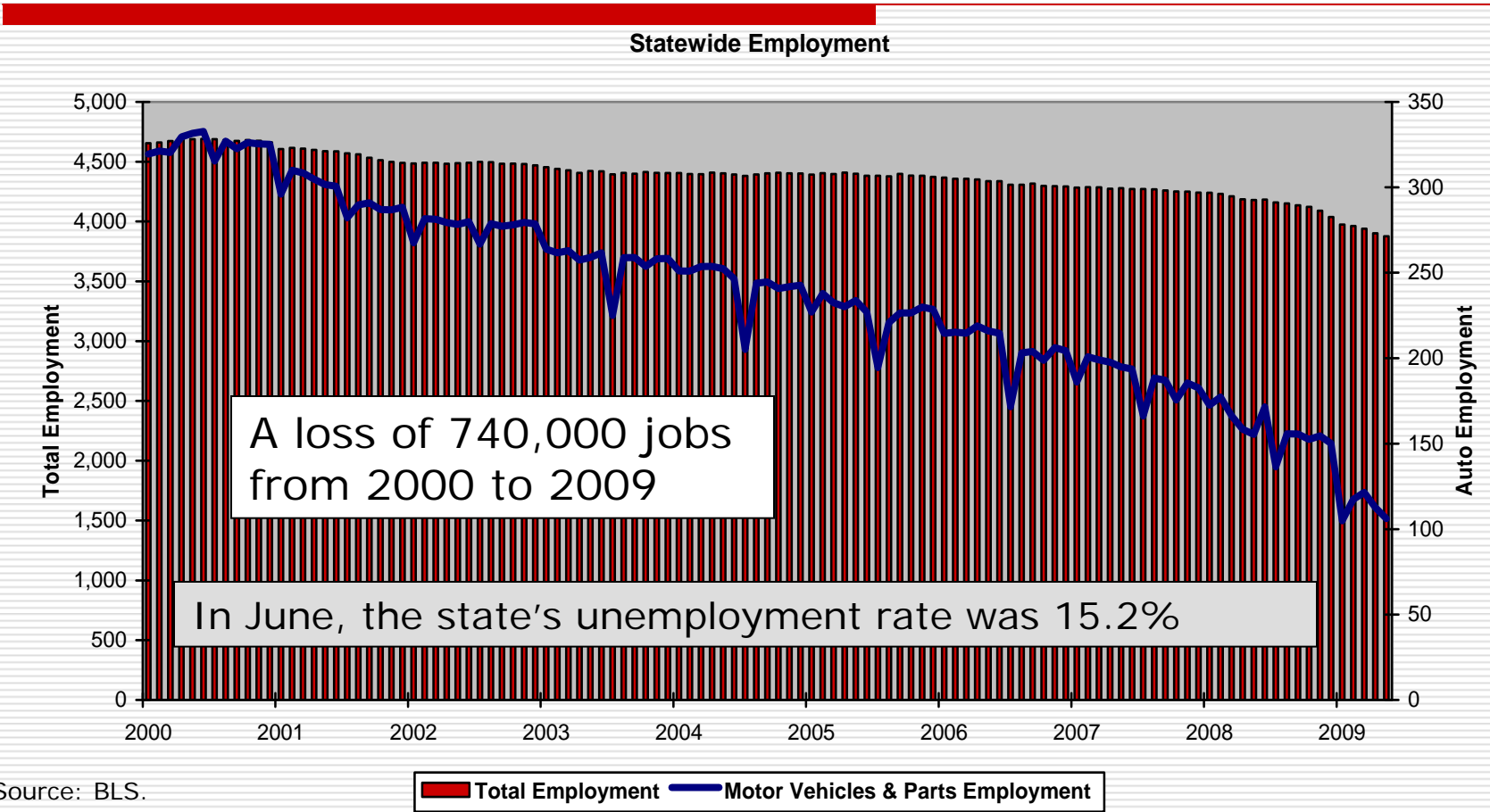
We must remember that the current recession was rooted in the nation's financial markets.

- This suggests that the recession could be more cyclical than structural. In other words, the economy could bounce back looking roughly the same. However,
 - As in any recession, the weaker companies may fail.
 - There are a lot of dollars out there which may cause future inflationary pressures.
 - Employment is a lagging indicator. It may not be until 2012 that employment levels will return to pre-recession levels.

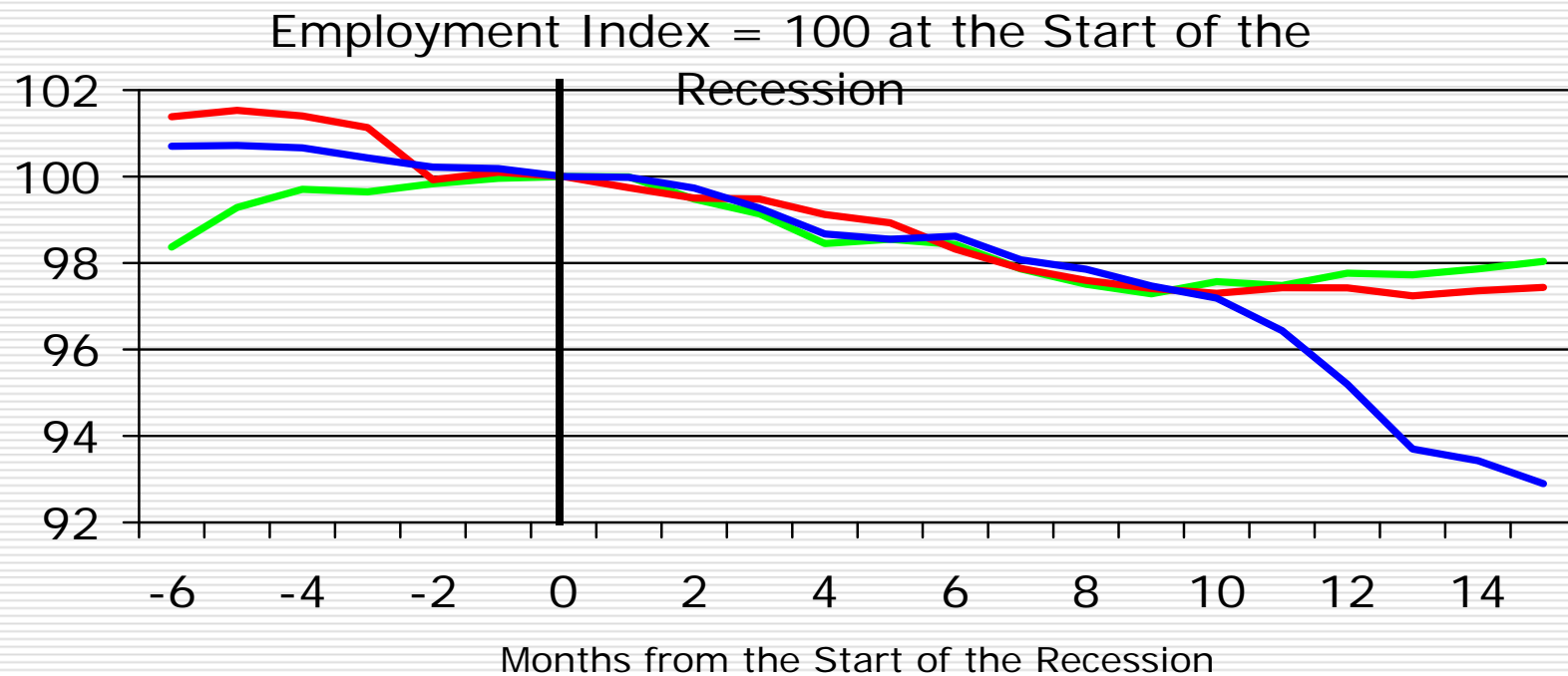
Michigan remains in crisis.

- ❑ A one-horse town with one sick horse.
- ❑ State government is facing a structural deficit that will not go away without a substantial change in its tax structure.
- ❑ Perceptions are important and hard to change.

With the national slowdown, the state's turnaround is further postponed.



This is a tough recession for the state.

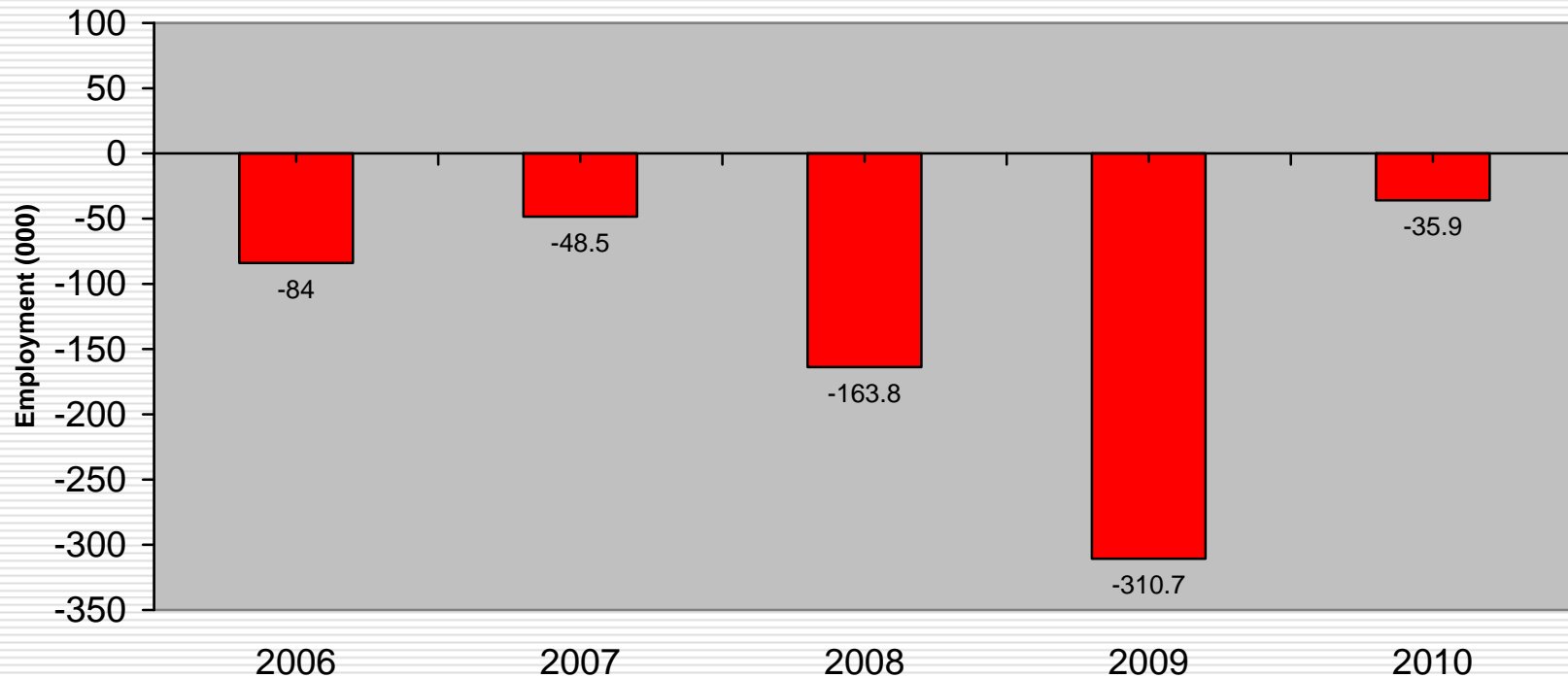


Source: CES, seasonally adjusted.



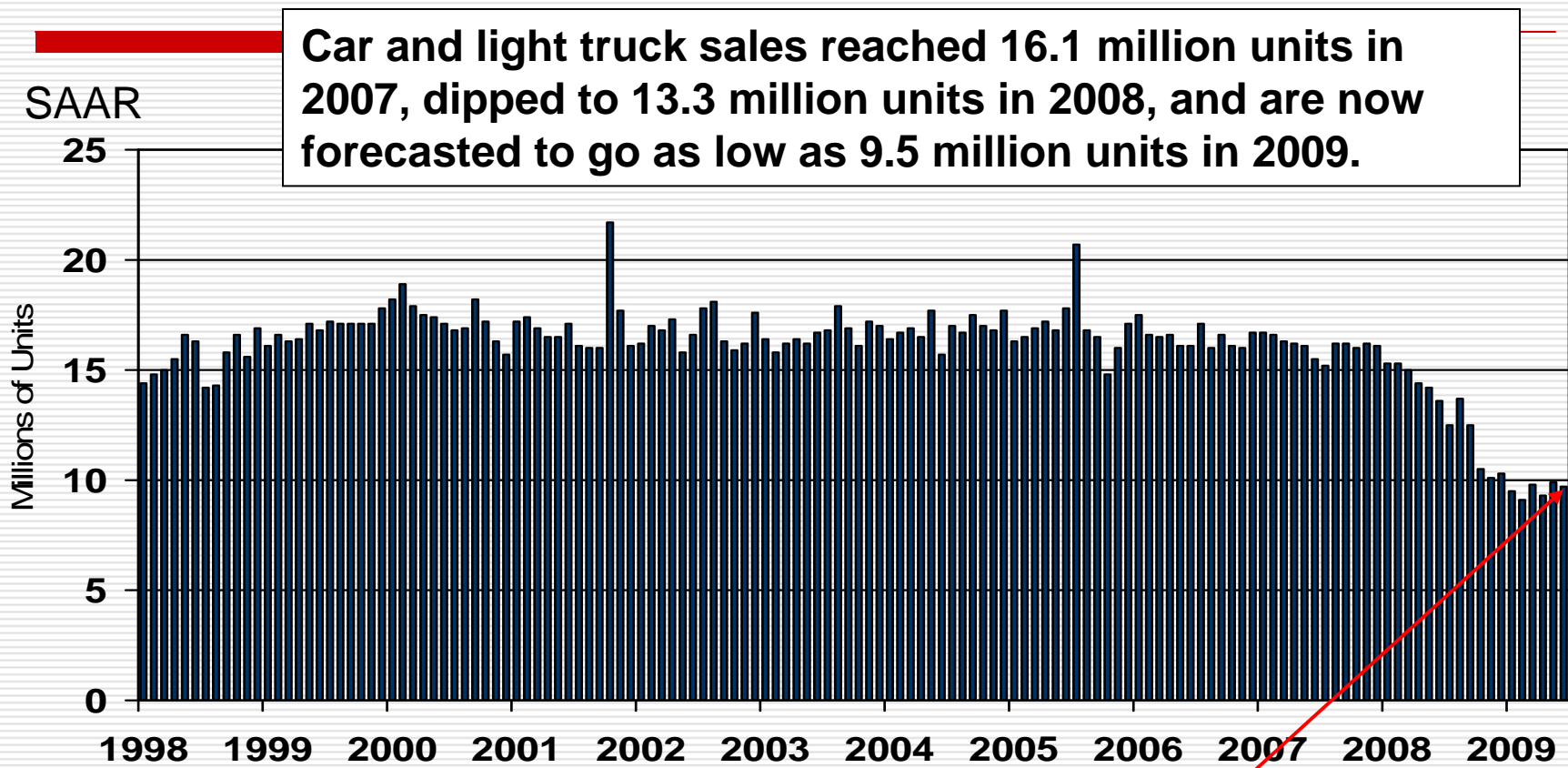
Employment declined for 10 straight years.

Employment Change, 4th Quarter to 4th Quarter



Source: University of Michigan, July 2009.

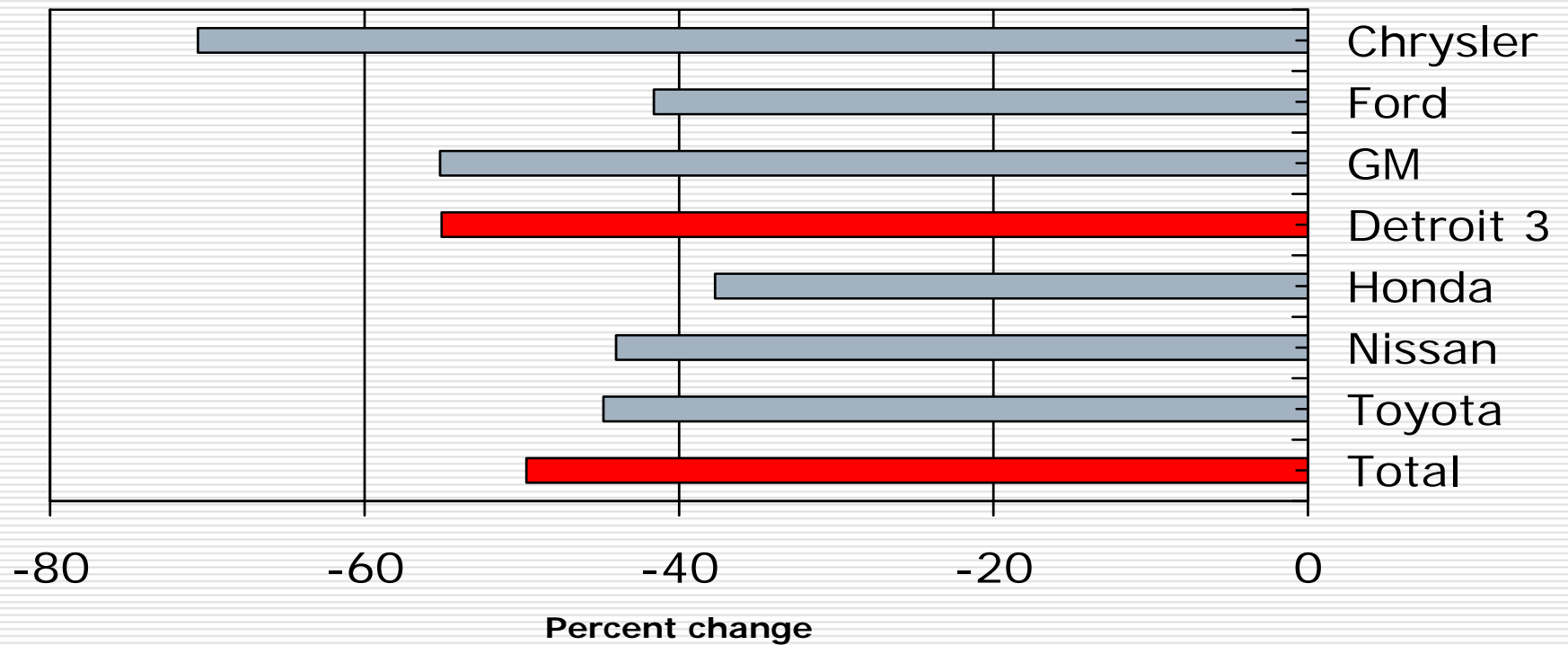
Consumers are simply staying away from auto dealers.



Source: BEA.

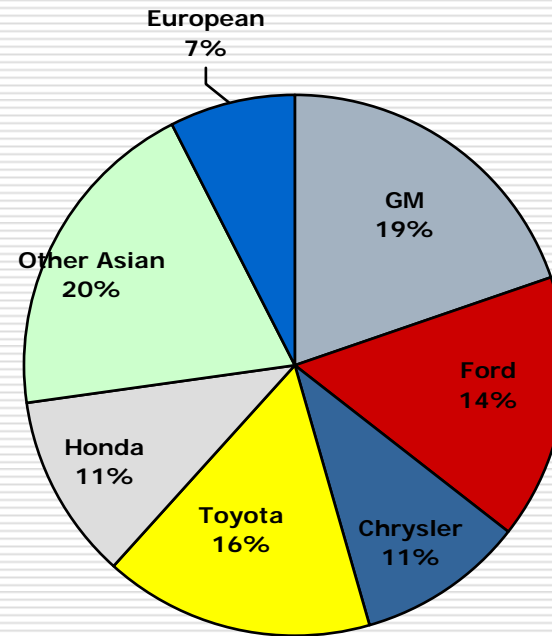
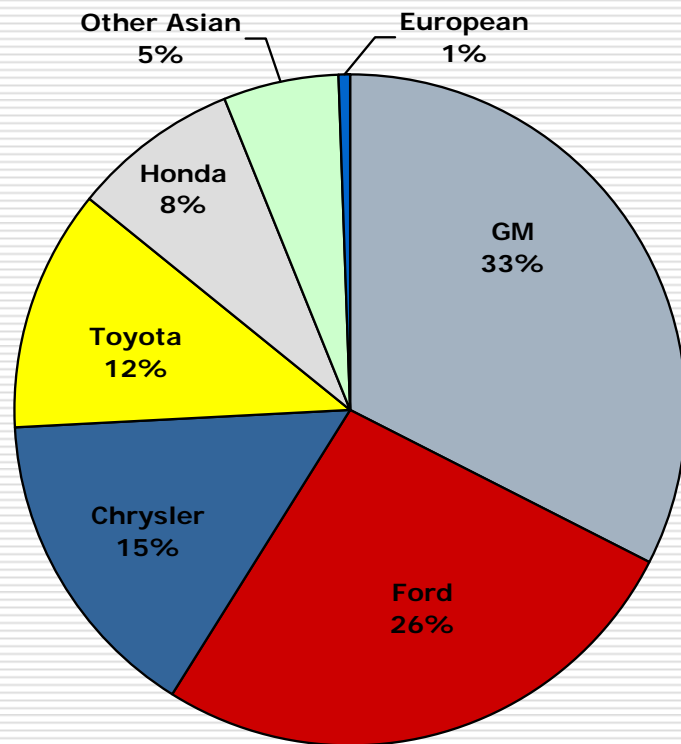
Production levels have plunged. Jan-June 2008 to Jan-June 2009

North American Car Production



Source: Ward's AutoInfoBank <http://wardsauto.com/keydata/NAProductionSummary0902/>

Loss of market share: In 2001, the Detroit Three controlled 74%; in 2009 it fell to 44%



Source: *Wards AutoWorld*.

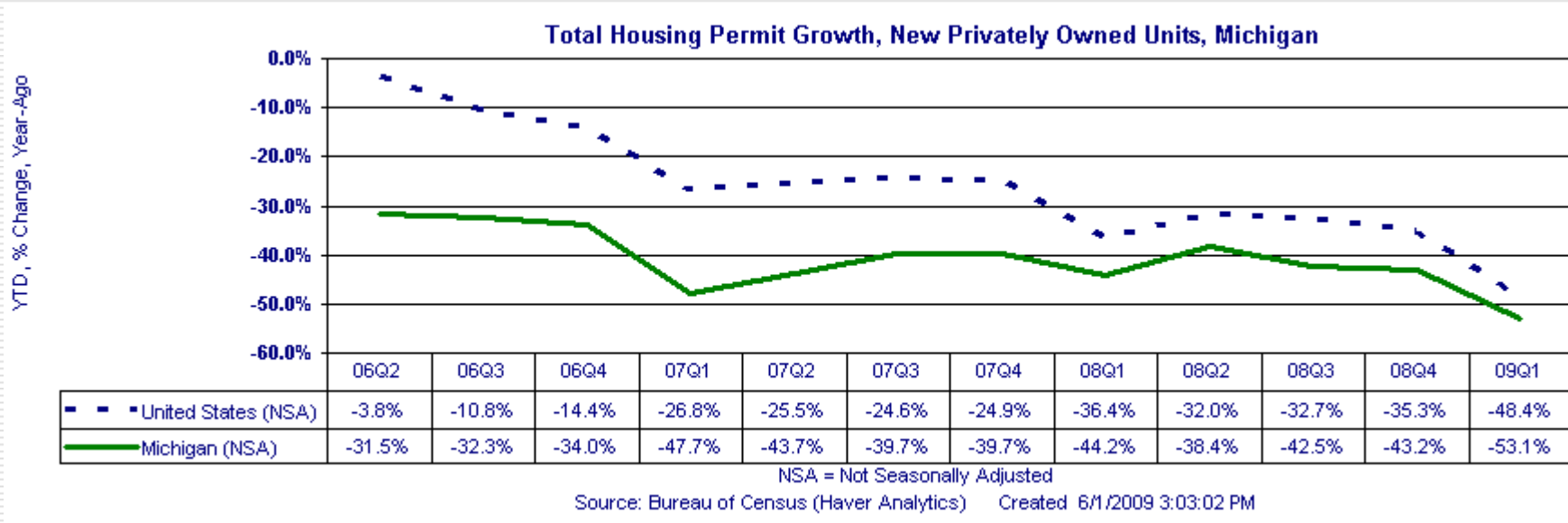
2001

2nd Q 2009

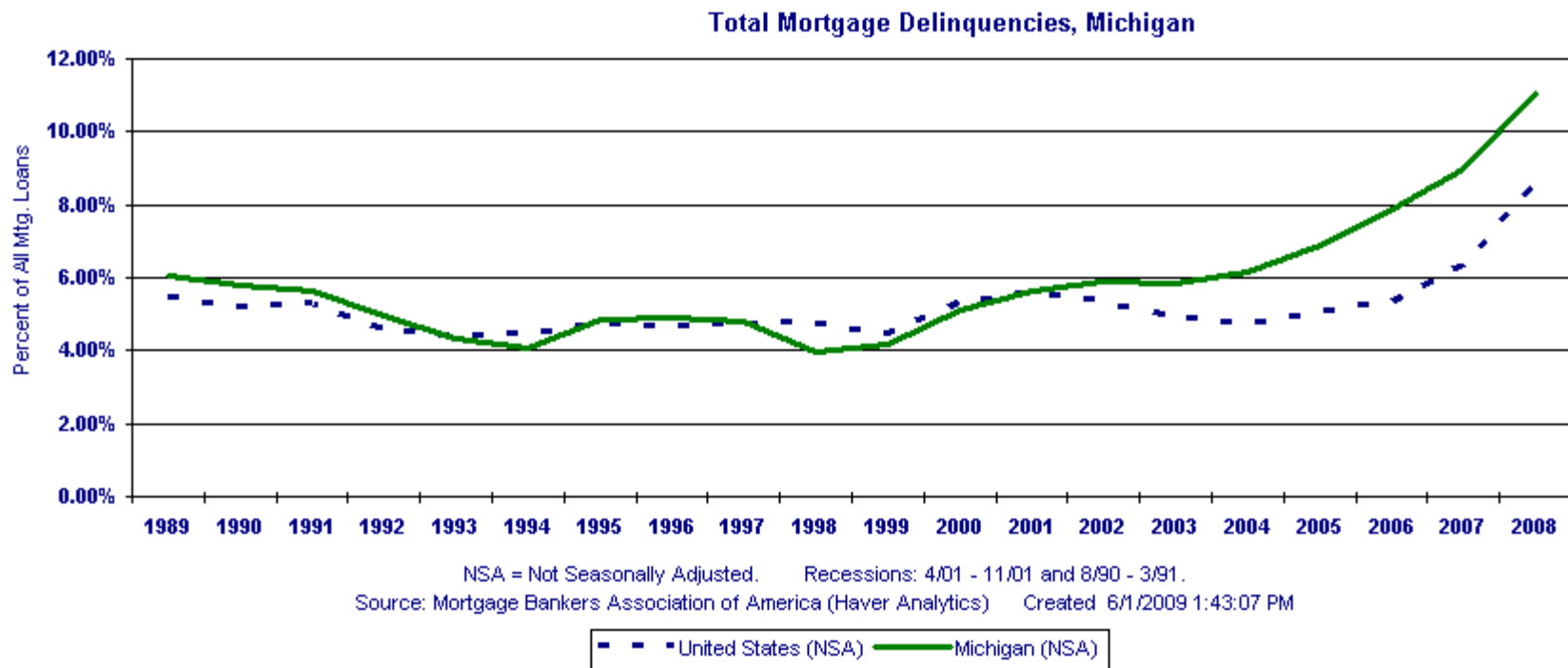
So, will GM make it?

- The company will reportedly go from 47 factories to 34 by the end of 2010. U.S. employment will go from 91,000 at the end of last year to just 64,000 at the end of this year.
 - Their cars are not known for quality.
 - Their cars are not known for design.
 - Their management structure is a mess.
 - The car market is lousy.
 - The competition is not standing still.
 - Building trucks is different than building fuel-efficient cars.

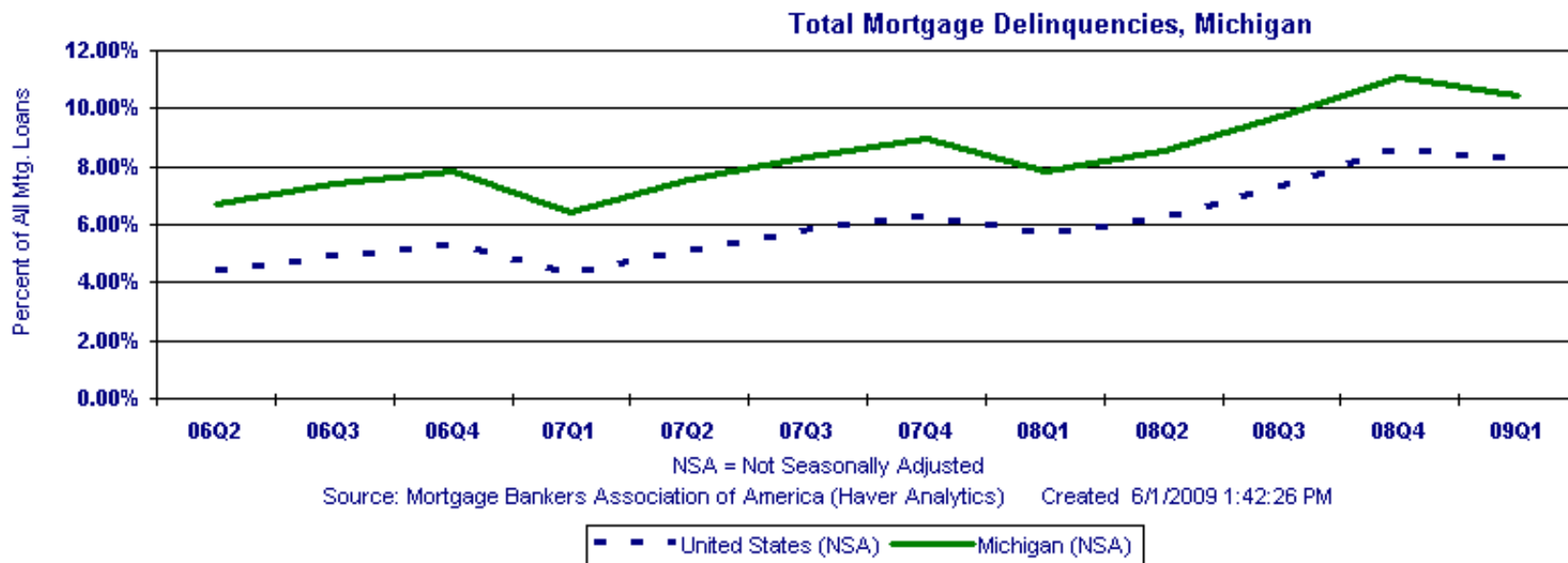
The market for new home construction has fallen even faster in Michigan than in the rest of the nation.



Mortgage delinquencies have risen to a very high level—especially in Michigan.



The small delinquency rate decline in Q1 2009 was probably just a seasonal dip.

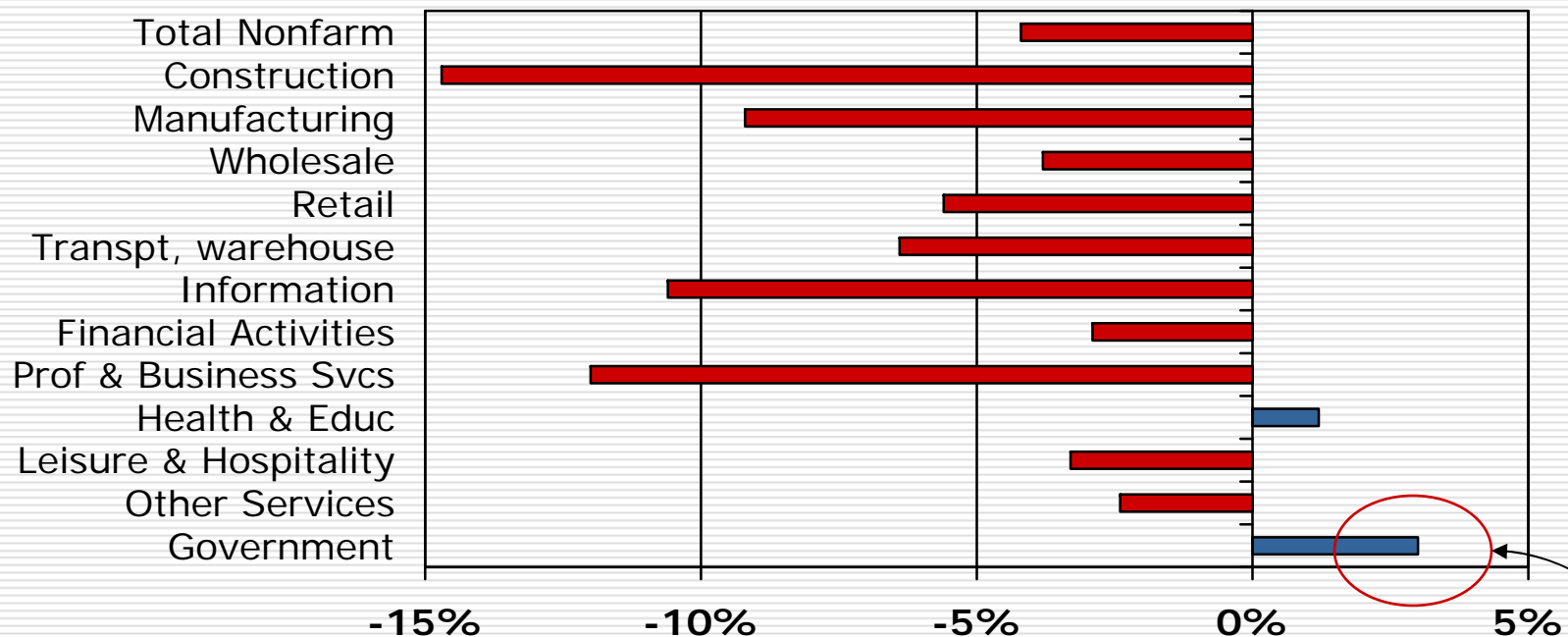


Kalamazoo Portage MSA

- ❑ The Battle Creek and Kalamazoo-Portage MSAs have lost jobs during the past four quarters.
- ❑ Its performance is stuck in the middle between the U.S. and the state.
- ❑ Housing market appears to be stable.

Over the past year, Kalamazoo-area employment declined by 4.2 percent, a loss of 6,100 jobs.

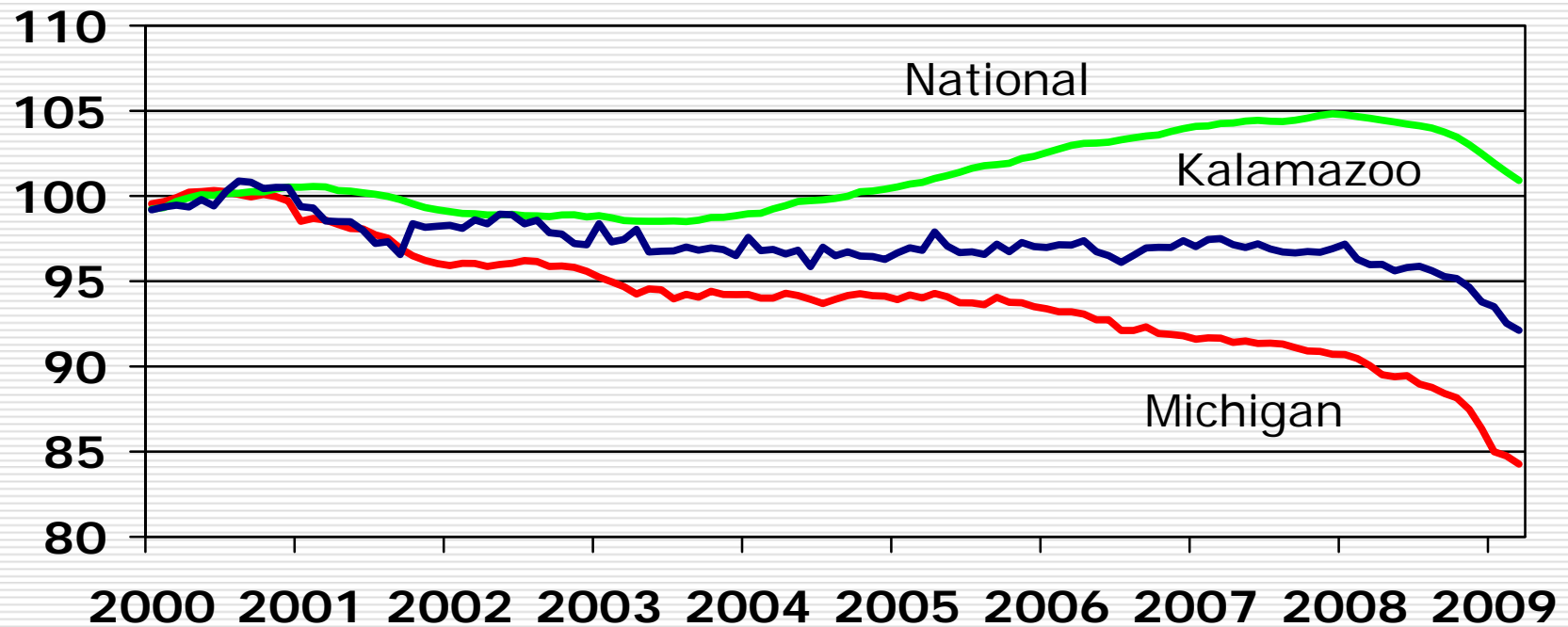
Kalamazoo MSA Employment Change
January-June 2008 - January-June 2009



Government employment growth was a result of increased state and local sector increases, most likely tied to education (K-12, KVCC, and WMU).

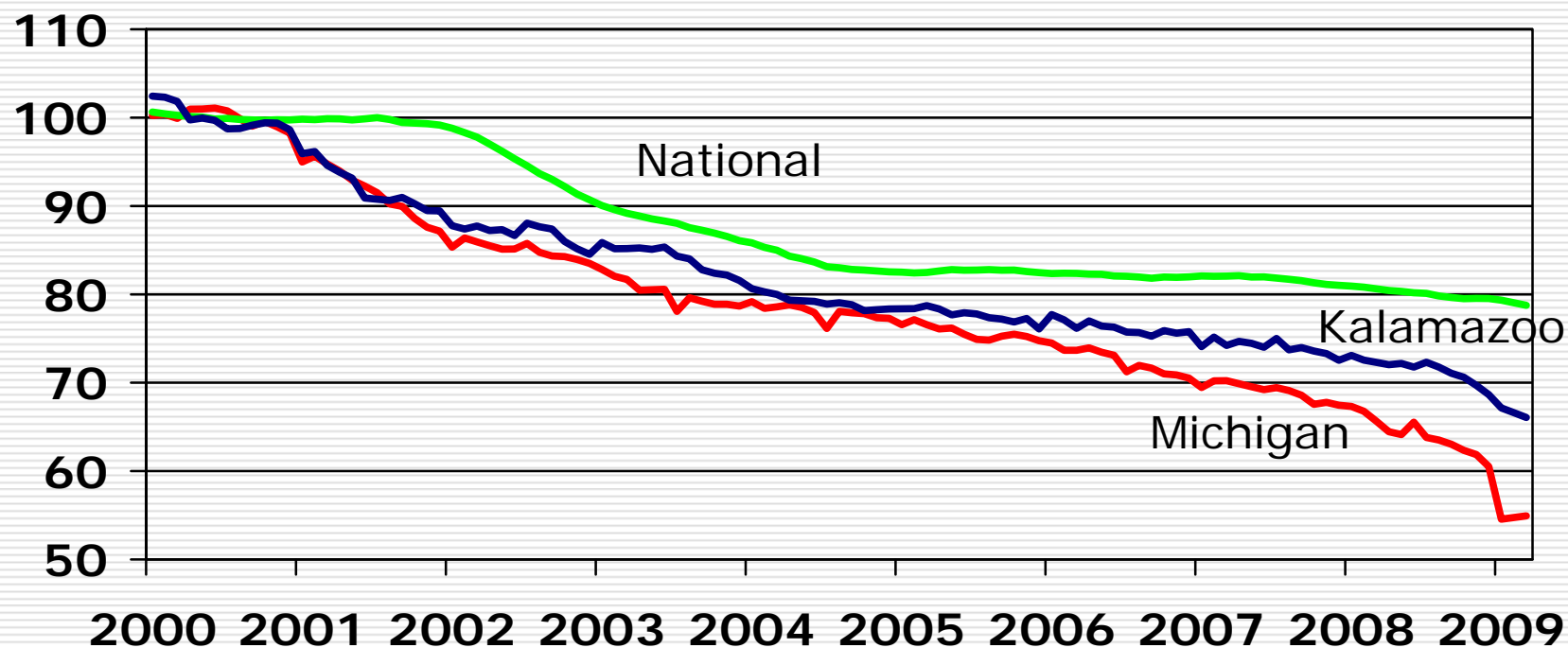
The Kalamazoo-Portage MSA is stuck in the middle.

Total Employment Index 2000 = 100



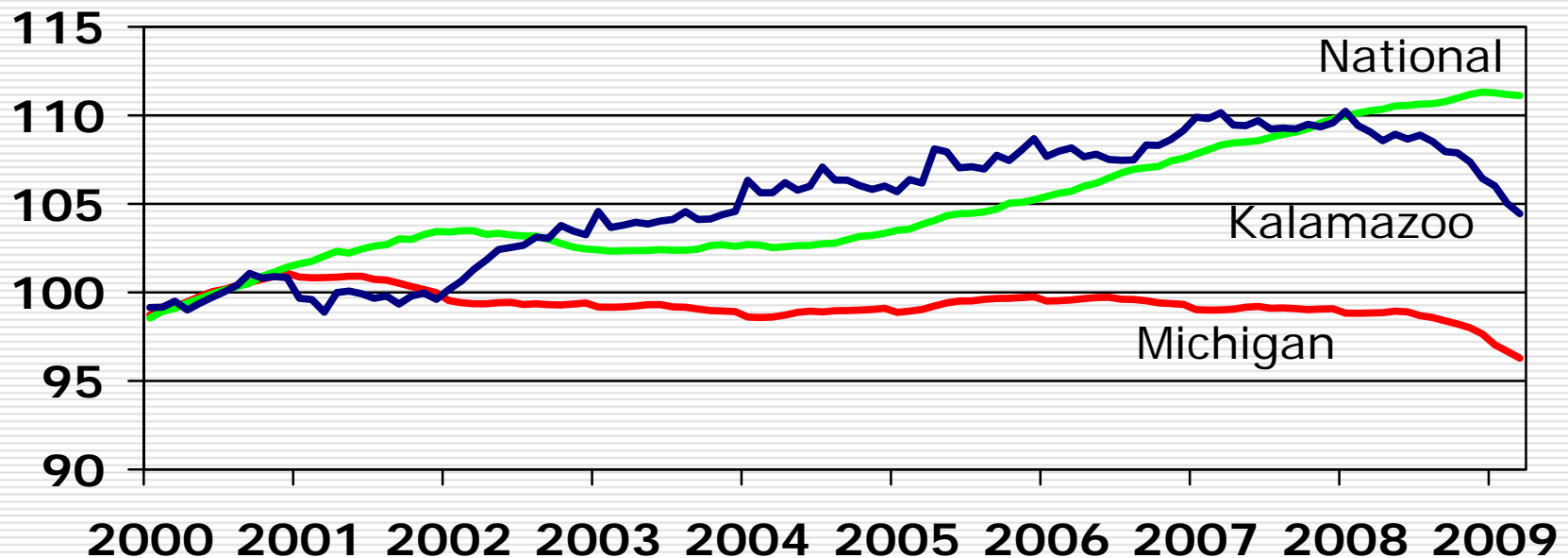
Kalamazoo MSA has lost 35 percent of its manufacturing jobs since 2000. *The state has lost 45 percent.*

Manufacturing Employment Index 2000 = 100

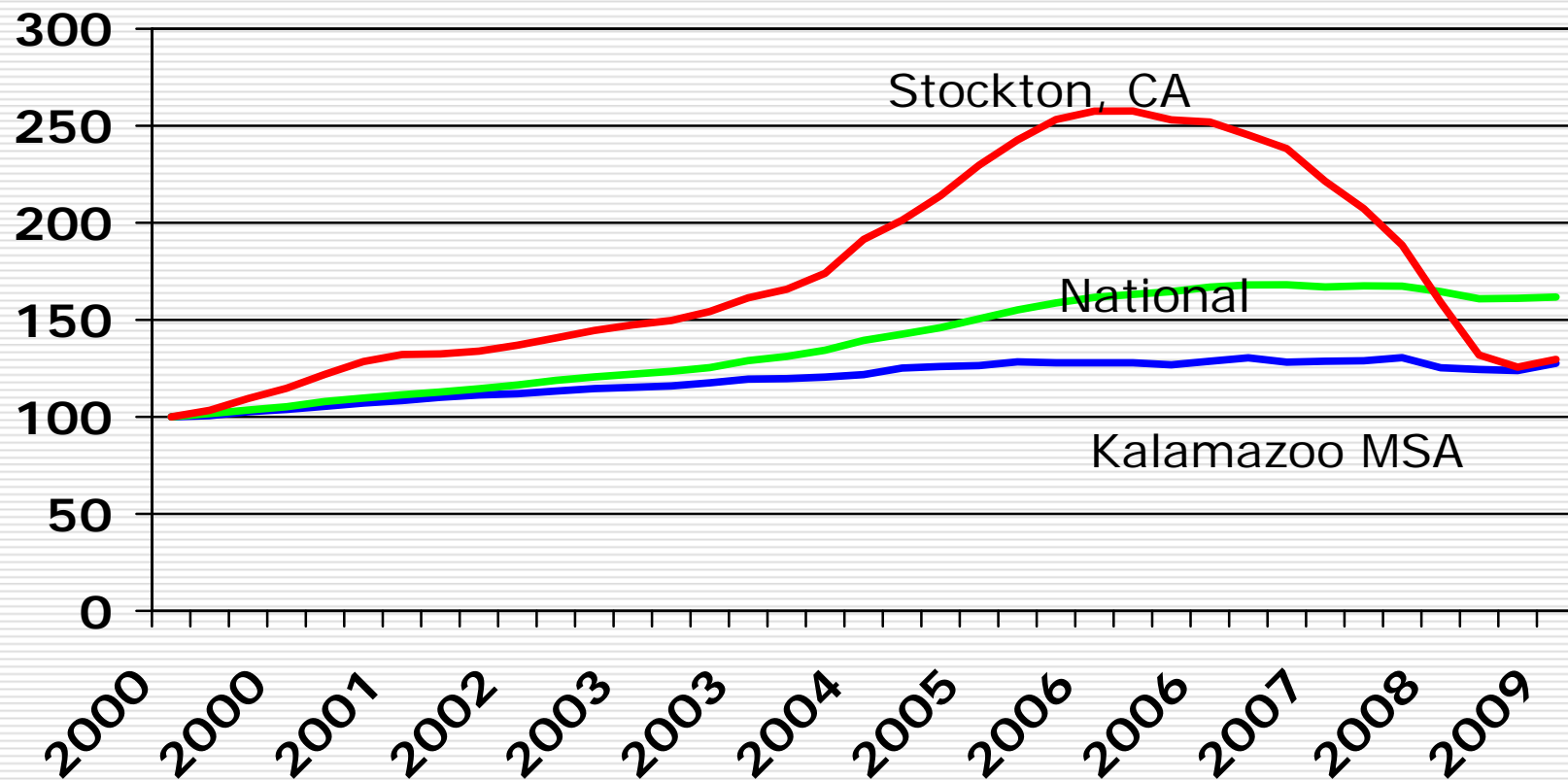


The Kalamazoo-Portage MSA was running with nation until 2008.

**Private Services Employment Index
2000 = 100**



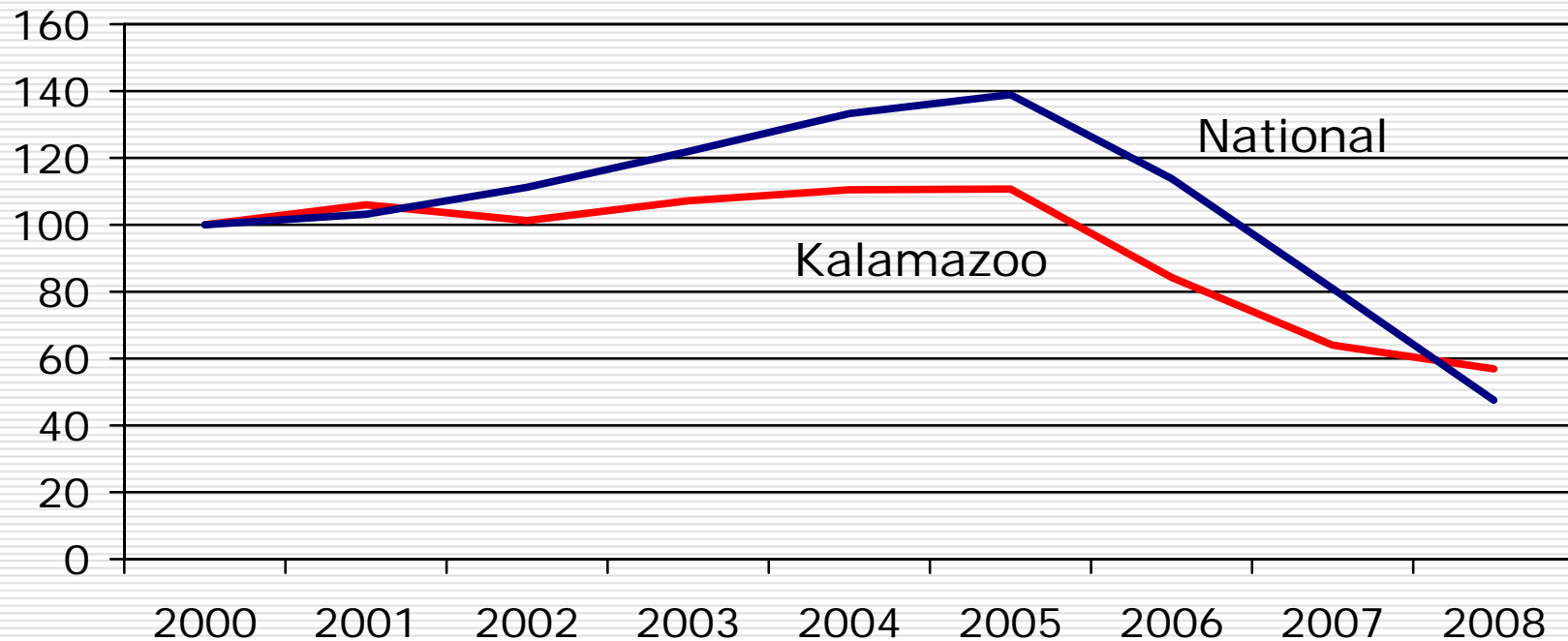
Sales (including refinancing) on the same property has remained stable in the Kalamazoo-Portage MSA.



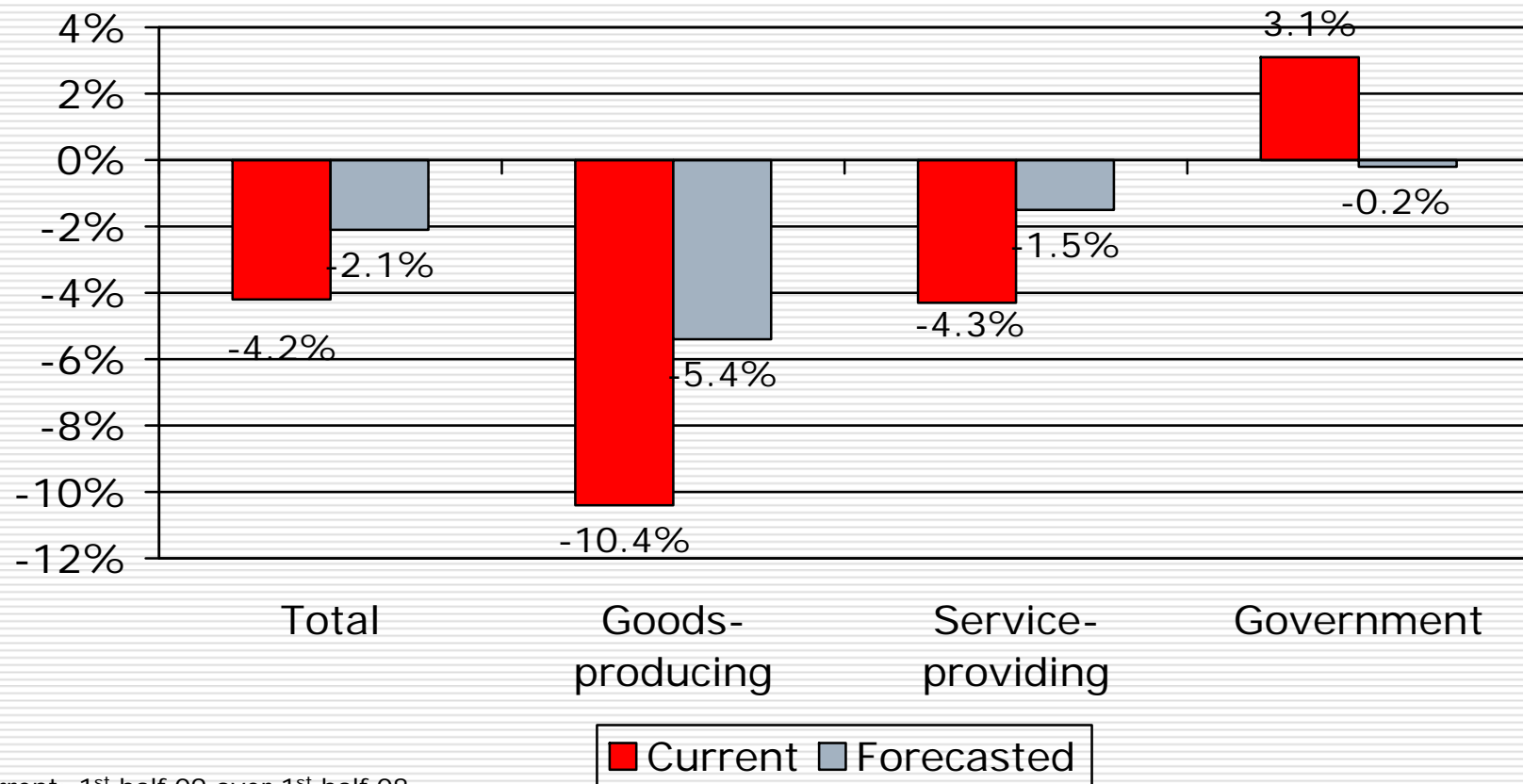
Federal Housing Finance Agency (FHFA).

Decline in building permit activity in the County is similar to the nation.

Index of Building Permits for Single-Family Dwellings
100 = 2000



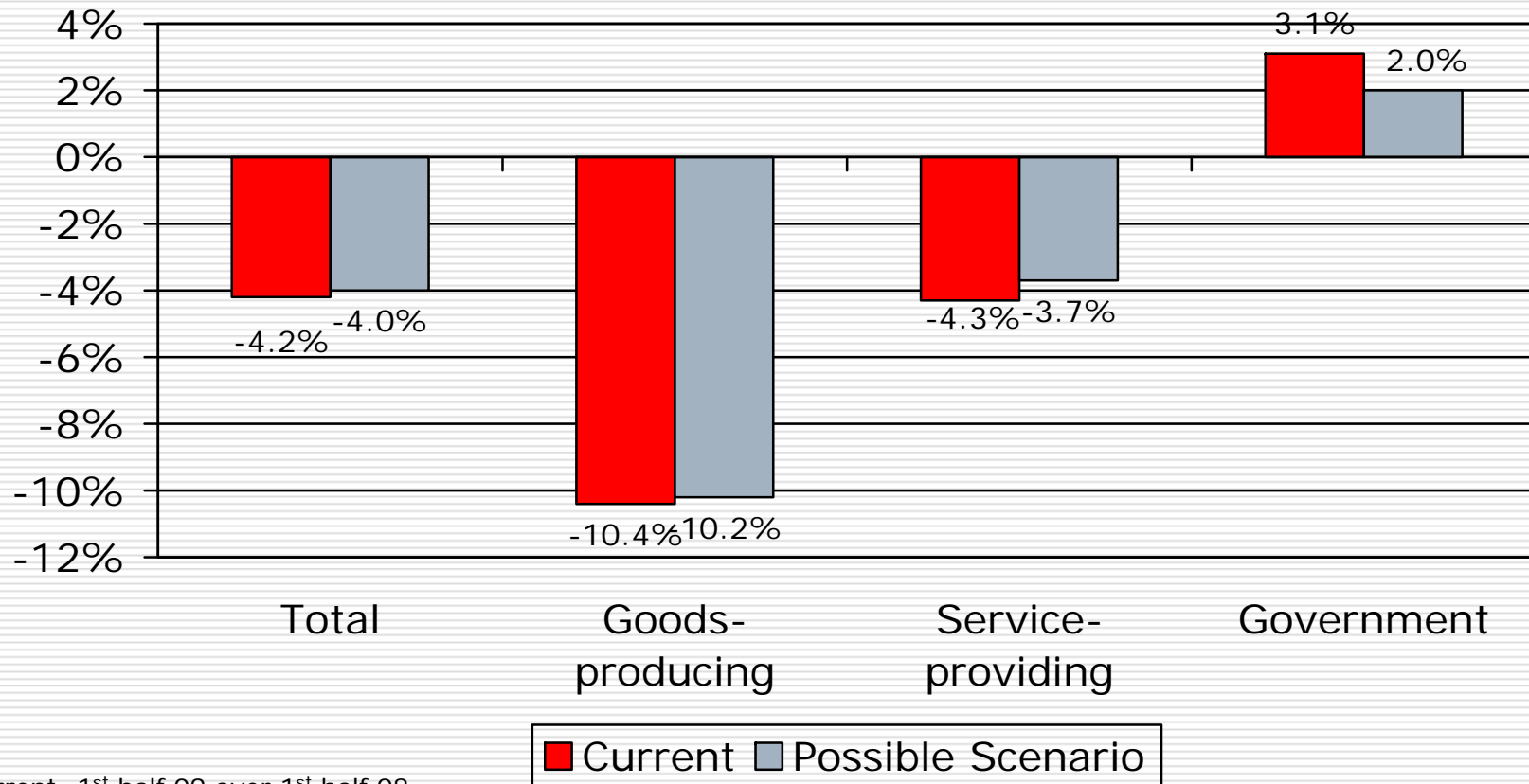
The current performance is much worse than forecasted.



Note: Current: 1st half 09 over 1st half 08.

If for the next 6 months:

1. manufacturing employment declines by a modest 2% annualized rate,
2. private services employment stabilizes, and
3. government employment returns to last year's levels.



Note: Current: 1st half 09 over 1st half 08.

So what?

- Nationally—A Minsky's moment.
- Locally, the good and not-so-good news about the local economy.
 - We remain dependent upon manufacturing however our job creation rate is below the state average.
 - The good news is that Kalamazoo County has a solid job creation rate for professionals.

A Minsky moment – *Can we learn from our past mistakes?*

Warning Signs

1. Change in traditional practices
2. New willingness to take on debt.
3. New innovations in the market.
4. The promise of higher prices tomorrow.

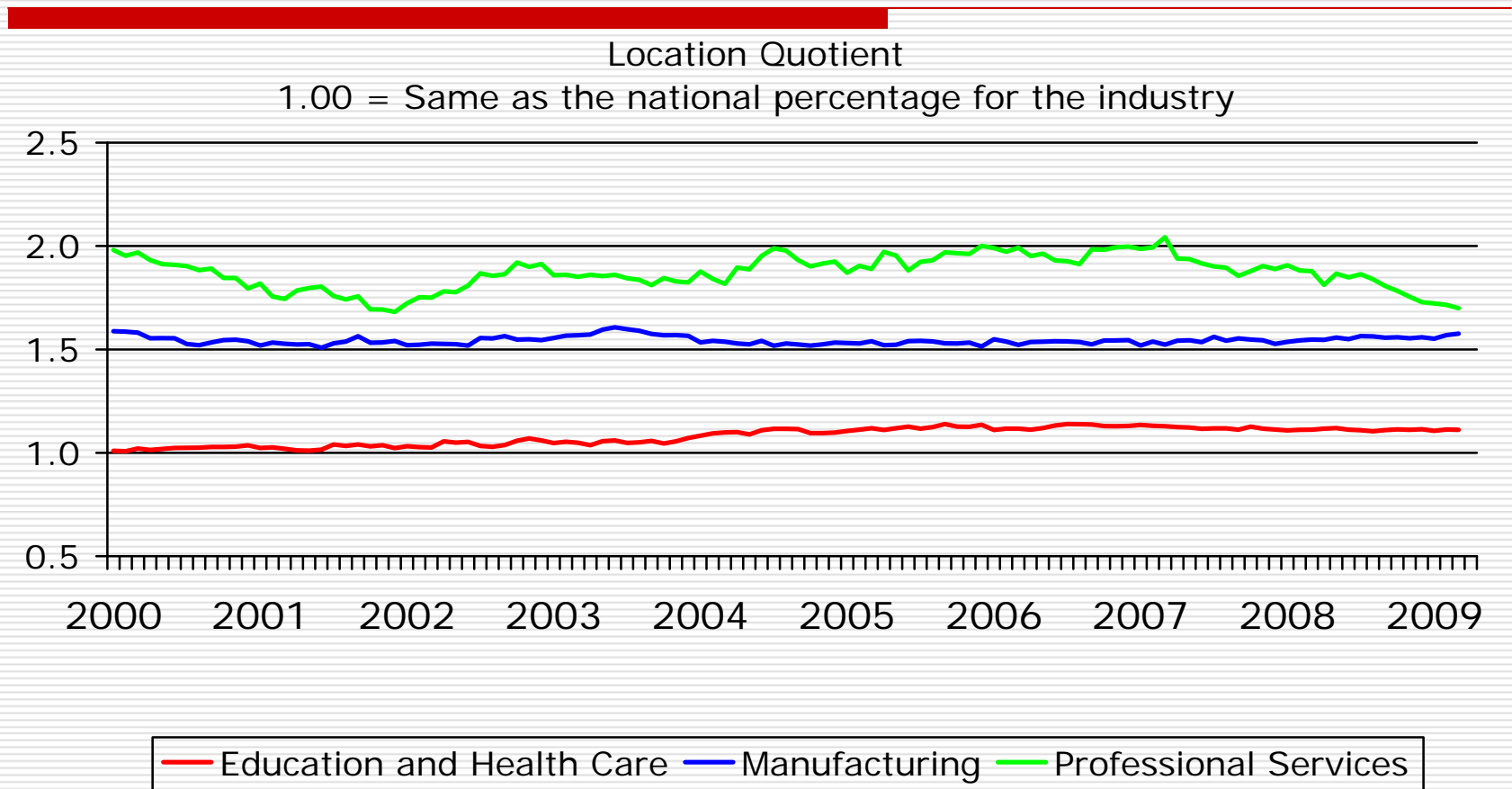
□ Financial Examples

1. New mortgage instruments that allowed little money down with low teaser rates
2. Securitization and the inability to properly account for risk.
3. An environment that encouraged extremely leveraged deals.

Takeaways:

1. In the middle of a bubble, cautious is disregarded.
2. According to Minsky, new regulations and a more conservative culture will keep the banking industry from another bubble for years.
3. But, it is likely that this pattern will repeat itself in another sector

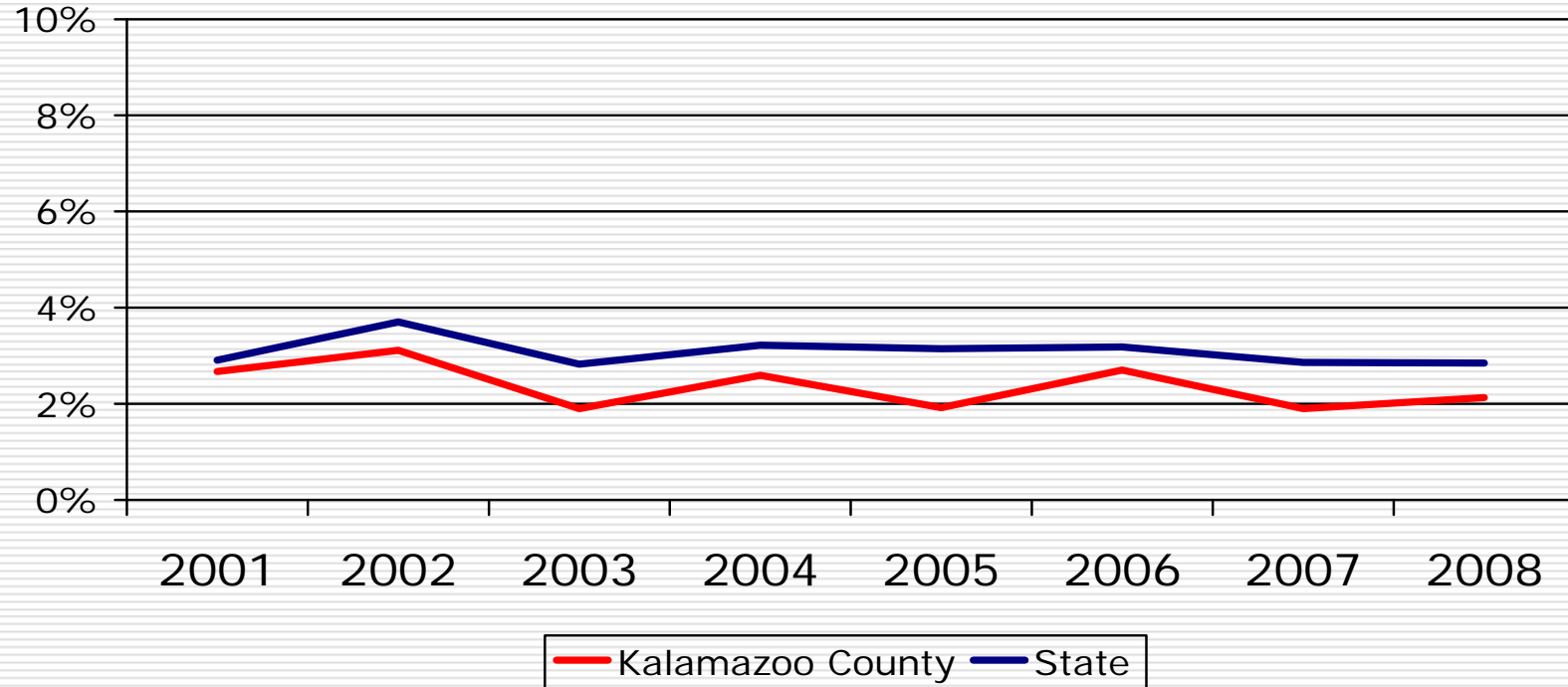
Kalamazoo County remains dependent on manufacturing and professional services.



Source: W.E. Upjohn Institute

Job creation in manufacturing— *surprisingly below the state.*

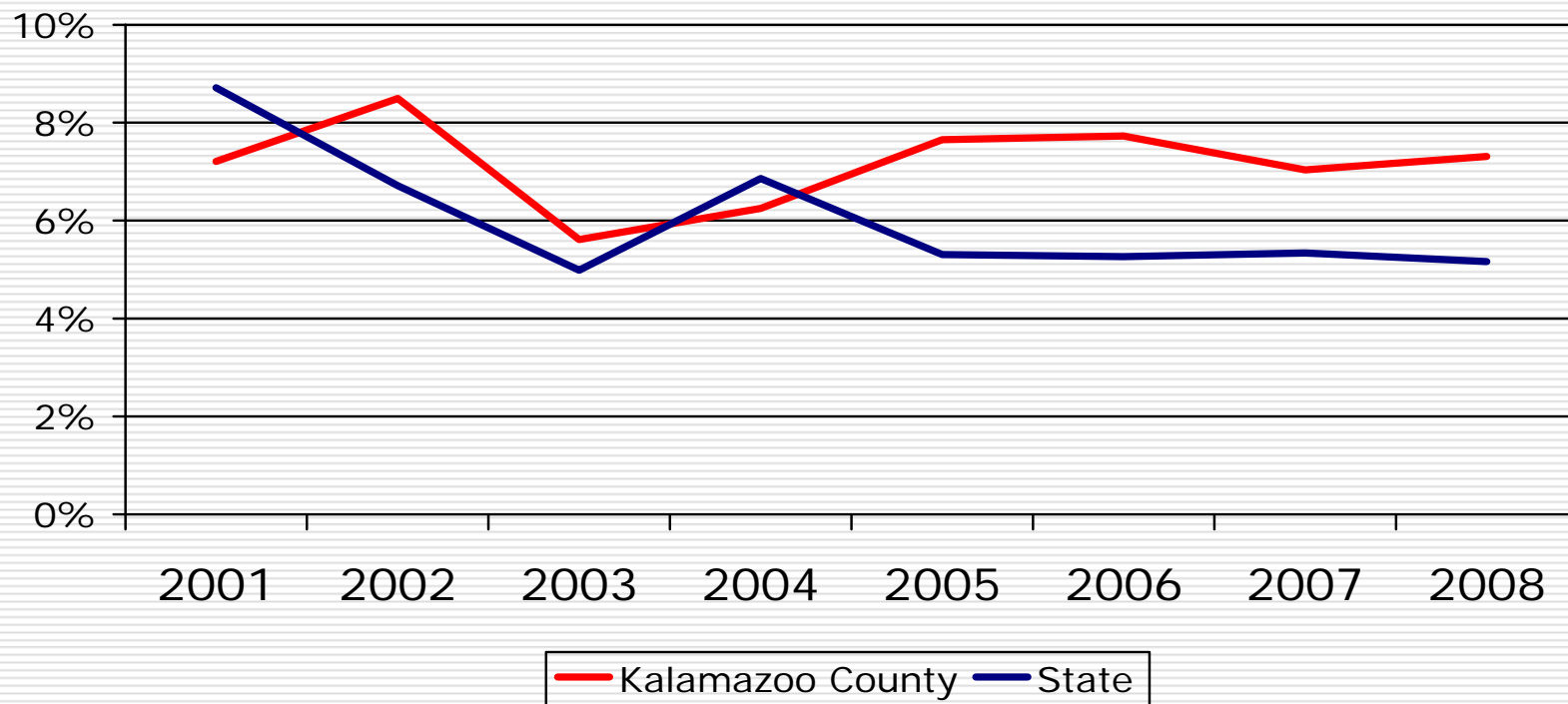
Job Creation as a Percentage of Total Manufacturing Employment



Source: Michigan LMI, Quarterly Workforce Indicators

Job Creation in Professional, Scientific, & Technology—*better than the state.*

Job Creation as a Percentage of Prof., Sci. & Tech. Employment



Source: Michigan LMI, Quarterly Workforce Indicators.

Wrap up

- Signs suggest that the national economy is stabilizing but a slow turnaround is expected
 - Financial markets are still very cautious.
 - It's global.
 - Employment will lag and not rebound until possibly 2012.

Wrap up (continue)

- Michigan is not expected to recover until 2012 at best.
 - The future of the Detroit 3 is very unclear.
 - Perception is very difficult to change.
- Kalamazoo-Portage
 - More stable conditions are expected with promising signs in its professional services sectors.

The Storm has Passed, but it is still Cloudy—*A Mid-Year Economic Review*

A Special Thanks to Keystone Community Bank

George A. Erickcek

W.E. Upjohn Institute for Employment Research

July 22, 2009