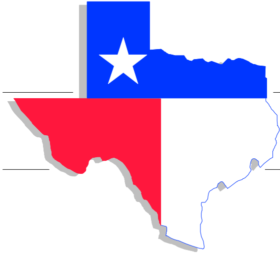

TTARA

Texas Taxpayers and Research Association

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Whither the Economy?

The latest report on the nation's economy suggests that the longest economic decline since the Great Depression is probably over. Third-quarter gross domestic product shot up 2.8 percent. On a technical basis, that likely brings the nation's longest recession in 76 years to an end. Still, many businesses will see a choppy recovery, and those millions looking for work may not find their job search any easier. While Texas has not suffered as severely as other parts of the nation, our economic traffic light may linger on yellow before eventually turning green.

…the longest economic decline since the Great Depression is probably over.

The US economy went into recession in December of 2007. Easy credit had led to a bubble of speculative over-borrowing and over-building that was far above what the economy could afford. It soon became clear that much of that borrowed money could not be paid back. A near collapse of the financial markets led to a sharp contraction across almost all economic sectors. Congress acted quickly in late 2008 to pass legislation to prop up our nation's credit markets and in 2009 passed a $787 billion fiscal stimulus package that was heavy on fiscal and light on stimulus. Official projections said the package would save or create from 3 to 4 million new jobs.

In fact, stimulus funds have been slower to enter the economy and the underlying downturn has been far greater than originally anticipated. Still, many economists are seeing signs of a bottom. But, as anyone who has fallen out of a tree can tell you, hitting bottom is often scant comfort. More important is how long it takes to recover from the experience. And that may take some time.

The nation has lost over 7 million jobs since the recession started.

National Economic Declines are Slowing

Recessions are not unusual. The current recession is the 11th experienced in the United States since the end of the Second World War. But this one has stood out for its depth, breadth and length. The "average" post-war recession lasts about ten months with an overall decline in economic output of roughly 2 percent to the bottom. It has been 23 months since the current recession began and overall economic output saw a 3.8 percent decline.

Worse is the news from the jobs front. The nation has lost over 7 million jobs since the recession started—a drop of more than five percent and the worst decline of any postwar contraction (Figure 1).

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Figure 1
Postwar Recessions and Jobs Losses

	Months of Recession	Months of Job Losses	Percent Job Losses	Number of Job Losses (000s)
Nov. 1948-Oct. 1949	11	14	-4.5%	(2,050)
July 1953-May 1954	10	13	-3.4%	(1,711)
Aug. 1957-April 1958	8	10	-4.2%	(2,216)
April 1960-Feb. 1961	10	12	-1.8%	(957)
Dec. 1969-Nov. 1970	11	8	-1.5%	(1,044)
Nov. 1973-March 1975	16	11	-2.7%	(2,115)
Jan. 1980-July 1980	6	4	-1.3%	(1,159)
July 1981-Nov. 1982	16	17	-3.1%	(2,838)
July 1990-March 1991	8	13	-1.4%	(1,581)
March 2001-Nov. 2001	8	28	-2.0%	(2,691)
Dec 2007 - current	?	21	-5.2%	(7,205)

Source: U.S. Bureau of Economic Analysis and U.S. Bureau of Labor Statistics.

Especially hard hit have been the housing and auto sectors—the two biggest purchases most consumers make and the engine that typically powers the economy. Housing starts peaked in January 2006 at a seasonally-adjusted annualized rate of 2.3 million units, but by April 2009 had dropped to an all-time low of 479,000. In the months since, they appear to have been bouncing along the bottom at half a million units each month. Since monthly data was first collected in 1959, housing starts have averaged over 1.5 million per month. In the recessions since, monthly starts averaged 1.2 million. That means current building rates are *less than half* the level typically seen during a recession. Owners of existing homes are under pressure as well. In October of 2009, over 332,00 homes were the subject of some type of foreclosure filing, or one of every 385 homes nationwide—about eight percent below July's record level.

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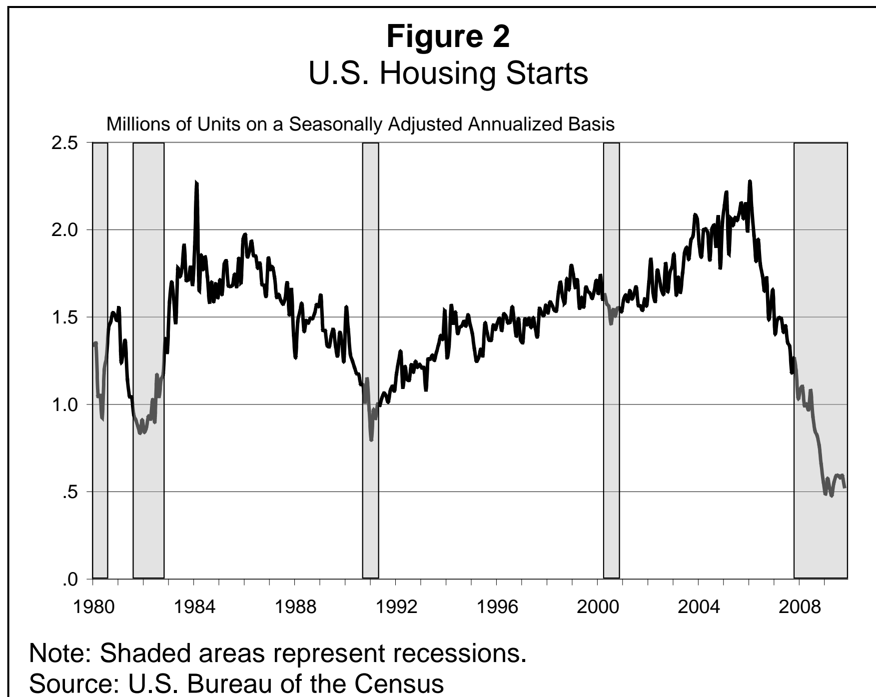
There are some indicators of prospects for growth. The inventory of available unsold new homes is declining. The October inventory of unsold homes stood at 7.5 months, down from the all time record of 12.4 months in January, but still well above the historical average of 6 months.

Unfortunately the housing bubble is being absorbed at a tremendous cost to the nation's wealth. To move the surplus housing stock, prices have dropped to levels not seen since 2003—meaning the average American homeowner has lost roughly six years' worth of equity in their home. One report estimates that one of every four homeowners owes more on their mortgage than their house is currently worth.

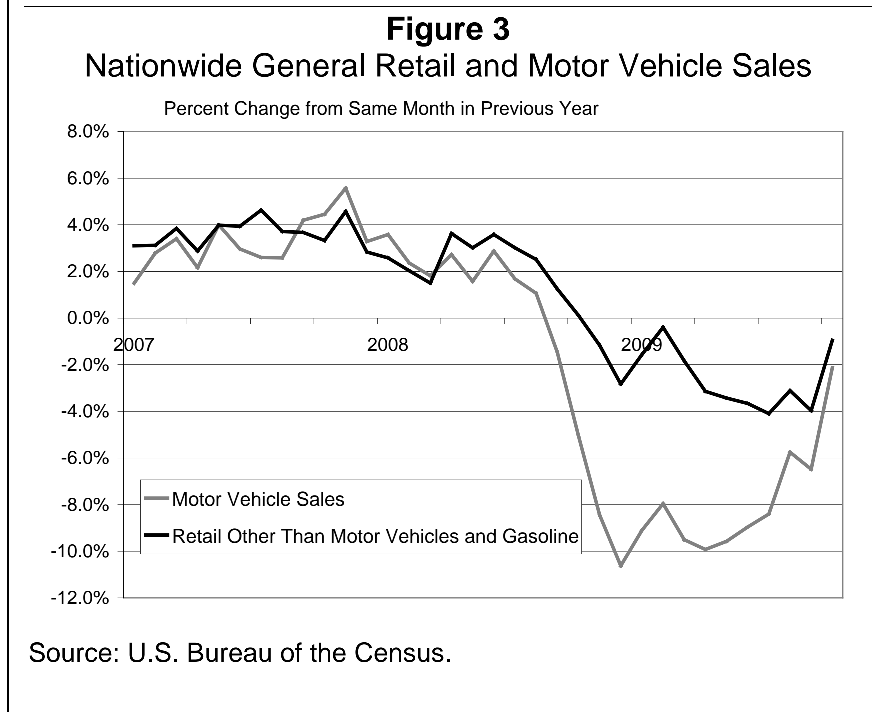
Auto sales have plunged to levels not seen in ten years, forcing two of America's three largest domestic auto manufacturers into bankruptcy. The federally-subsidized "cash for clunkers" program sparked a temporary bounce, but sales soon dropped back. The good news is that automakers may find that inventories have been sufficiently depleted to merit an increase in production.

Figure 2
U.S. Housing Starts



Note: Shaded areas represent recessions.
Source: U.S. Bureau of the Census

Figure 3
Nationwide General Retail and Motor Vehicle Sales



Source: U.S. Bureau of the Census.

...retail sales... declines are unprecedented.

The recession has been hard on traditional retail as well, as consumers have tightened their belts. Excluding autos and gasoline, retail sales have been declining on a year-over-year basis since November 2008—down by as much as 4 percent in July and September. These declines are unprecedented. Even in previous recessions sales increased at least modestly over the prior year. It is hard to suggest that sales have turned the corner when they are declining,

but it does appear the declines may be slowing. October's decline was just less than one percent.

The Lone Star Dims

Texas has fared better than the nation as a whole, but the ebbing U.S. tide has clearly lowered the Texas boat. Decades ago, Texas was more impacted by what happens in the oil and gas industry than what happens in the national economy. Today, oil and gas is still a Texas blessing, but it provides little insulation against the cold of a national economic freeze.

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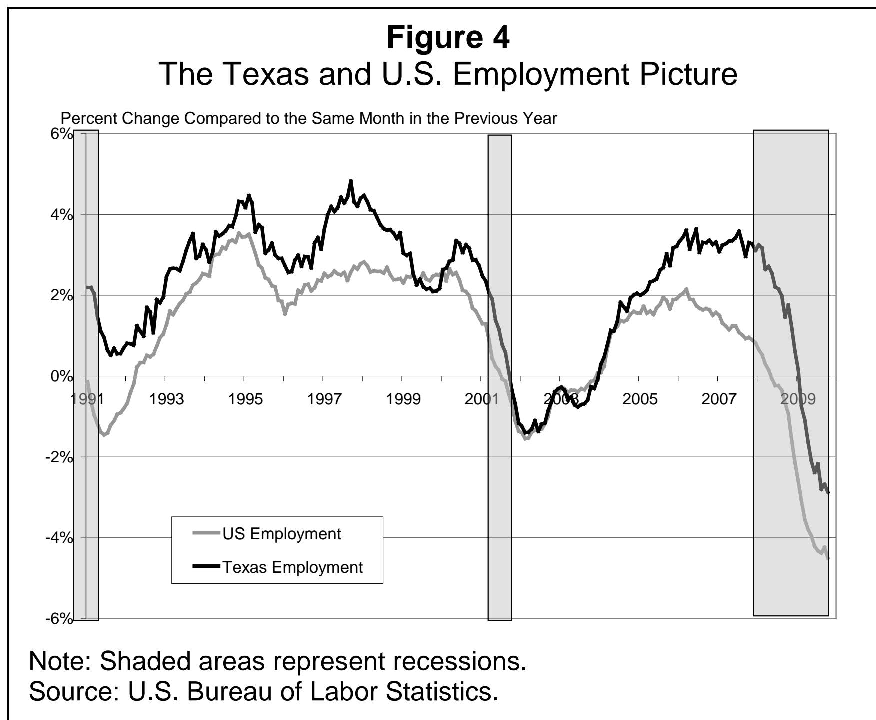
The massive housing bubble that burst in other states did not exist here, but Texas has still been spattered. Compared to the pre-recession peak, permits to build new single family homes are down in Texas by 66 percent—a staggering drop, but far better than the near 90 percent drop in Michigan, Florida, Georgia, California, and Illinois.

Texas is experiencing substantial job losses—down nearly 400,000 on a seasonally-adjusted basis from the pre-recession peak. Job losses have accelerated throughout 2009 (Figure 4). While Texas is faring better than the nation as a whole, the 2.9 percent drop in jobs in October (from the same month in the previous year) is among the worst the state has ever experienced. The state's unemployment rate stands at 8.3 percent, not quite two percentage points below the national average, but the worst rate the state has experienced since the energy/real estate bust of the mid 1980s.

Retail sales in Texas have matched the overall economic slide (Figure 5). Sales have seen dramatic declines throughout 2009—more so than those of prior recessions. Most recently, sales declines in September were not as bad

Figure 4
The Texas and U.S. Employment Picture



Note: Shaded areas represent recessions.
Source: U.S. Bureau of Labor Statistics.

as previous months, driven by somewhat "less bad" sales of cars and trucks as a result of the federal "cash for clunkers" program. With that program's expiration, data for subsequent months may show a continuing slide.

As the Texas consumer has retrenched, the business economy has suffered. Texas industrial production (of manufacturers, oil and gas operations, and utilities) dipped 4.8 percent from its pre-recession peak, but appears to have bottomed out (Figure 6). Texas' decline was not as precipitous as the 14.8 percent drop nationally; but, the U.S. economy has recovered some of its losses in recent months while Texas has not. Oil and gas suffered throughout much of 2009, but most recently prices have crept upward, offering a tiny spark to the industry. Throughout the summer, refinery shipments picked up somewhat, but chemicals and computers—the two largest segments of Texas manufacturing—remain flat.

The Recession is Over. When Does the Recovery Begin?

Unless they read the paper or watch the news, most people won't know that the recession is likely over. Employment will probably continue to slide for the foreseeable future. If the recession is truly over, this seems counterintuitive, but, it is a function of the fact that economists define a recession in terms of economic output—not by jobs. A "jobless" recovery occurs when increases in output are solely the result of improved productivity—businesses can produce more product with fewer employees. In fact, employment is what economists consider to be a "lagging" economic indicator—meaning it typically lags behind economic growth. Employers typically try to increase output through greater efficiency, relying on more

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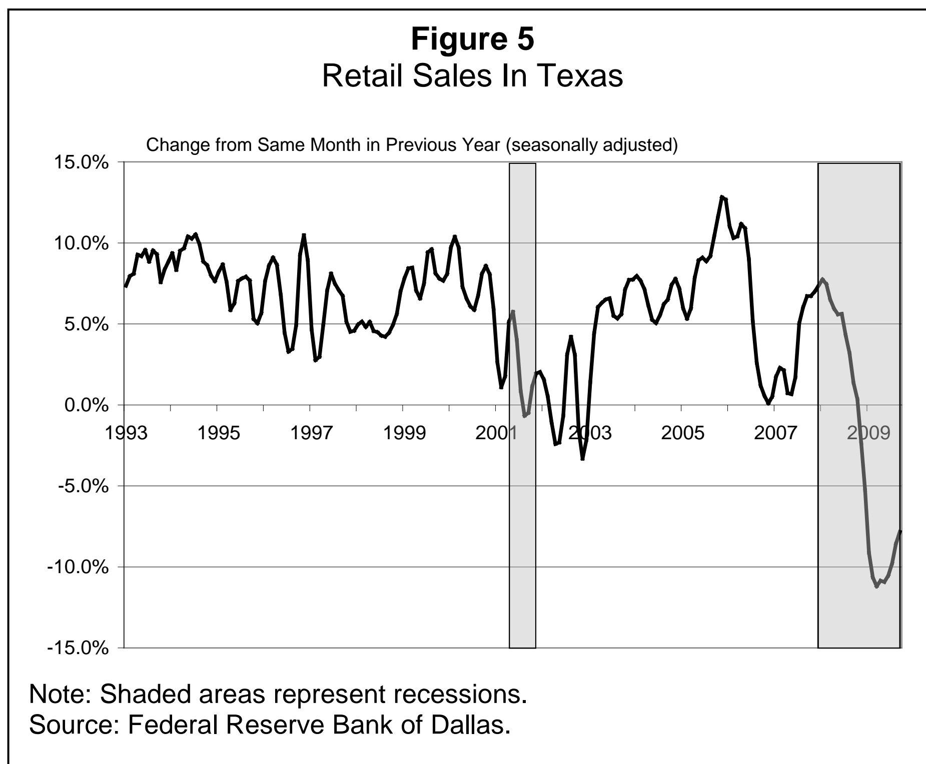
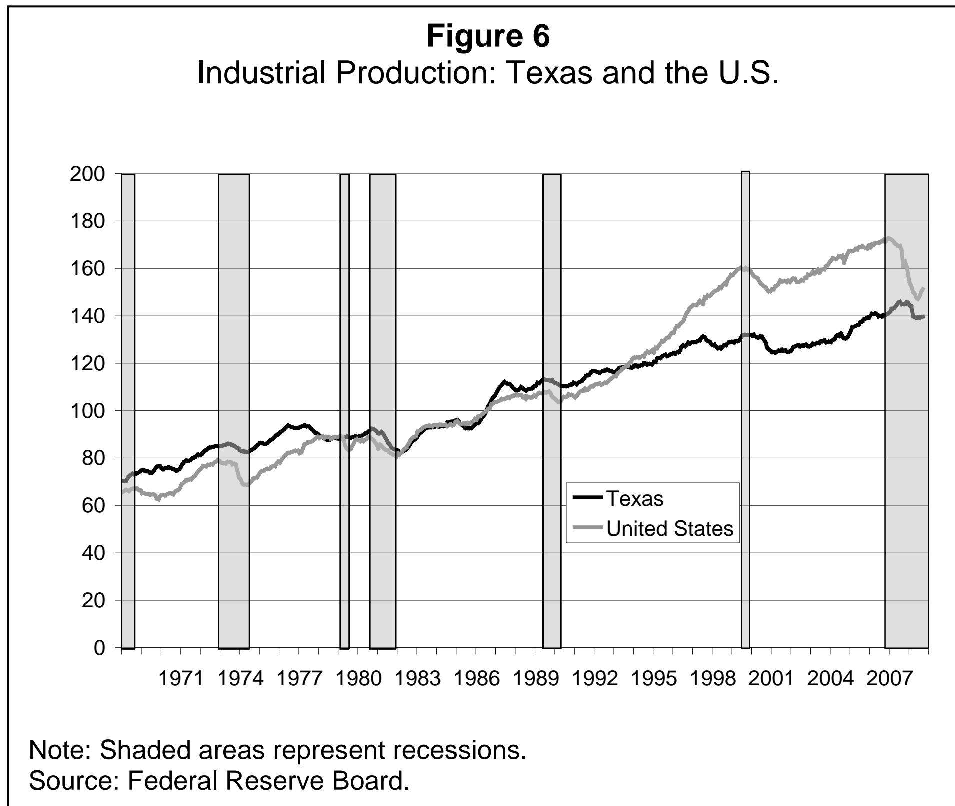


Figure 5
Retail Sales In Texas

Note: Shaded areas represent recessions.
Source: Federal Reserve Bank of Dallas.



Texas employment will continue to slide and unemployment will rise for the rest of the calendar year, and possibly into the early months of 2010.

hours from their current workforce, and adding to their payrolls as a last resort. Job losses typically continue for a period after a recession ends. The recession in 2001 lasted 8 months but was characterized by an unprecedented 28 months of job losses. Many economists predict that Texas employment will continue to slide and unemployment will rise for the rest of the calendar year, and possibly into the early months of 2010. A national jobs turnaround is not expected to occur until the middle of 2010 or later.

As unemployment drives more foreclosures, more foreclosures drive unemployment, creating a spiral drag on the recovery.

A slow jobs recovery will spill over into the housing market as unemployment sparks record foreclosures. The early stages of this recession were characterized by people with marginal credit losing homes that they may not have been capable of affording in the first case. The later stages of this recession have been characterized by people with previously stable finances losing homes to foreclosure because of the loss of their job and income. As unemployment drives more foreclosures, more foreclosures drive unemployment, creating a spiral drag on the recovery.

With consumers hurting, most retailers have low expectations for the holiday shopping season. The National Retail Federation predicts seasonal sales nationwide will be down one percent from a year ago—which is not much of a signal of an impending economic recovery.

Economists have also warned that another shoe may drop—rising bankruptcies in the commercial real estate sector (e.g., office buildings, apartments, retail space). Faced with economic challenges, businesses have downsized, cancelling or reducing leased space needs. As vacancy rates have

increased and as market rents have adjusted, commercial lessors have seen dramatic declines in their income. Some have found it difficult to make payments on their current loans; for others, the lack of available credit may make it difficult to negotiate a new loan as current ones expire. Loaning banks may take possession of the distressed properties, but they may be worth far less than the amount owed to them. The ripple effect is further bank failures, drawing down the resources of the Federal Deposit Insurance Corporation (FDIC)—the federal agency that ensures the stability of the nation's banking system. Over 100 banks have failed in 2009, more than four times the number in 2008. Typically, the banks reopen within a few hours under new management and depositors see no difference (though the bank's investors suffer a significant loss). The travails of the commercial market will most certainly be a drag on the recovery, but because the market is small relative to the residential housing market, most economists believe it is a lesser concern.

Nationally, the recovery is likely to be long and bumpy as employers are slow to rehire and as vacant real estate is absorbed. Over the next year, economic reports are likely to show good news some months and bad news other months—two steps forward, one step back—but most economists expect the worst is over.

…there appears to be general agreement among economists about the recovery—it is at hand, but it will be slow, taking years for the economy to return to previous robust levels.

Will Texas Lead or Follow?

Two prominent national economic forecasting firms—IHS Global Insight and Moodys.com—as well as the Brookings Institution, have stated that Texas will be one of the states to lead the nation out of recovery. But with many national economic indicators bouncing along a hoped-for bottom, and with the construction and oil and gas sectors weak, Texas still appears to be declining. Currently, the output of Texas' capital intensive industries—manufacturing, oil and gas, and utilities appear to be bottoming, but consumer-driven industries and construction are still declining.

Texas may be the leader of the recovery, however, largely because the usual suspects are still being detained. Those sunbelt states that typically lead the nation out of recession are the ones whose bursting real estate bubbles brought the nation into recession. Florida, California, Arizona, and Nevada have among the worst housing gluts at the moment and will likely be at the tail end of the recovery.

State Comptroller Susan Combs projects Texas employment declines will continue through the end of 2009. Keith Phillips of the Dallas Federal Reserve—one of the most accurate economic forecasters in the state—projects Texas employment will grow by one percent in 2010.

A favorite joke about economists is that if you ask two economists the same question you will get three different answers. What is unusual today is that there appears to be general agreement among economists about the recovery—it is at hand, but it will be slow, taking years for the economy to return to previous robust levels.

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