

The 2009 Columbus Blue Chip Economic Forecast
Columbus Metropolitan Club
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- Happy New Year! On behalf of the Columbus Chamber and my other panelists, thanks to my friends at CMC for having us back for an eighth year. And many thanks to the Otterbein MBA Program for their generous sponsorship again this year. I also appreciate the partnership of the Columbus Council on World Affairs and the Columbus Bar Association. Above all, thanks to all of you for being here.

- When CMC's program director, Andy Campbell, suggested the subtitle for this year's forum, the Good, the Bad, and the Ugly, my immediate reaction was that there is precious little good this year...and just who are you calling ugly???

 - Maybe he is hoping that I will reveal what cemetery the buried treasure is in so that we will all be rich.

 - I can tell you that although you have to look really hard, there actually is some good, even this year. But I'll get to that in a little bit.

- An equally apt subtitle, though, might be, "What the blank?" I'll let you fill in that blank.

 - When we met here last year, we had a housing market in deep trouble. But the U.S. had 1.9 million more jobs than we do now, the FDIC's list of failed banks was 25 entries shorter, Lehman Brothers

was in business, Merrill Lynch was independent, and the CEOs of the Big Three still had their private jets.

- Little did we know then that we had already been in recession for a month and had seen the high water mark for U.S. employment.
- I am going to spend a good chunk of my time today looking at why we are in the mess we're in.
 - ◇ I'll talk in general terms about the Chamber's 10th annual forecast for the Columbus region. Please be sure to pick up a copy.
 - ◇ Also, I invite you to go to our web site, www.columbus.org. There you will find materials for a completely different speech I gave on this forecast last month, which included a sector-by-sector review of employment trends and prospects.
- But back to the question: What happened?
- The short answer is that the problems in the real estate market metastasized into the financial system and the economy as a whole.
 - This is something that few people foresaw a year ago. The housing market was in retreat and people holding mortgages – especially the more exotic ones – were getting burned.
 - ◇ These mortgages were made with no money down, others were made to people with poor credit histories or income that they

- couldn't document. Some loans had initial teaser rates far below market – which were scheduled to rise to market in a few years. In some loans, the mortgage balance actually rose over time.
- * The idea was that house prices would continue to rise. This would create equity for borrowers who had put nothing down, and would allow those with below-market rates to refinance before the mortgage repriced.
 - * Those who couldn't refinance could just sell the house and use the proceeds to pay off the loan.
- ◇ Of course, what really happened was that house prices dropped, which brought down that house of cards.
 - ◇ But the conventional wisdom was that the subprime market wasn't big enough to take down the overall economy. We would burn through these junk mortgages – and the firms that were holding them – and everything would get better.
- But we know now that there was a big hole in this argument. The junk mortgages were the tip of a huge iceberg of derivative securities – securities whose value is based on the value of something else.
 - ◇ There were derivatives based on the mortgages and derivatives based on the derivatives that were based on the mortgages. The total value of all derivatives markets globally last June 30 was \$530 trillion – 21 times the value of the New York Stock Exchange

- on that date. Of that \$530 trillion, the industry estimated last fall that \$2.7 trillion was at risk.
- ◇ Some people call the derivatives markets “dark markets” because these securities aren’t traded on exchanges and aren’t regulated or regularly observable.
- Derivatives exploded both in volume and in complexity as the housing market boomed. This was because they promised to reduce or eliminate the risk of writing a 100 percent mortgage for somebody without verifiable income – and maybe generate some profit as well.
- ◇ If the borrower couldn’t or wouldn’t pay, the derivative would. And anyhow, the increase in the house value – which of course would happen – would help insulate the mortgage holder too.
 - ◇ This idea led the financial markets to take stupid, crazy risks – like writing a 100 percent mortgage for somebody without verifiable income. And writing a derivative based on that mortgage.
- Derivatives were what hit Lehman Brothers, AIG, Merrill Lynch, and the others. And here is something really scary. Some of the derivatives still out there on financial institutions’ books are too complex for financial theory to value.
- ◇ That means that the value of those institutions’ assets is uncertain. For an institution with just a few cents of capital for every dollar of

assets, that is a big deal. In an extreme case, you wouldn't know whether you are solvent or not.

- So where do we go from here?
 - The problems in the mortgage market are not over yet.
 - ◇ Some mortgages with teaser rates are due to reprice this year. That and the mounting number of layoffs is likely to lead to another wave of foreclosures this year.
 - ◇ Corporate downsizing is also causing commercial vacancy to increase. That could lead some commercial mortgages to default.
 - ◇ Both these problems will be magnified by the derivatives that are still out there.
 - What about the economy as a whole?
 - ◇ The recession is now in its 13th month. That fact makes it already longer than average. The 10 recessions since the end of World War II have lasted an average of 10 months. And we are likely to stay in this one well into next year, making it twice as long as that 10-month average.
 - ◇ The Wall Street Journal's monthly poll of economists expects an annualized decline of 4.3 percent for the fourth quarter of 2008, which would be the steepest quarterly GDP decline in 26 years.

There will be a 2.5 percent annualized loss this quarter and 0.5 percent in the second. The economy goes into recovery in the second half.

- ◇ This is not a happy forecast, but it is not nearly as dire as some of the headlines predicting Great Depression II. The GDP decline peak to trough is worse than the recessions of 2001 and 1990-91, but not as bad as the three recessions between 1974 and 1982.
 - ◇ It is longer than average, but if the economists are right, it will be shallower than average – except for the bad fourth-quarter drop.
 - ◇ The feeling that the downturn will continue into 2010 is definitely a minority view. Only 10 of the 54 economists expect the recession to end any later than the third quarter of next year. Nearly half expect it to end in the second quarter.
 - ◇ Employment is another question. Employment started growing in all the recessions prior to 2001 soon after the recession ended. In contrast, the last recession ended in November 2001, but it took another 21 months – August 2003 – for employment to bottom out.
- * I am guessing that the wait will not be nearly as long this time for two reasons.
- Productivity in several crucial sectors – especially manufacturing – is so much higher now than it was in 2001.

It will be harder now than it was then to coax out further output growth without adding employment.

- Employment declined steadily through 2008, but output really started falling only in the third quarter. So rather than paying later, as we did last time, we have paid up front this time.
- * Still, I think we need to expect declines in employment throughout the year – possibly at a diminishing rate in the second half.
- * The Wall Street Journal survey consensus is for an average employment decline of 162,000 jobs per month in 2009. That is mercifully much less than we have seen in the last few months, but it still implies a year-over-year U.S. employment decline of 1.7 percent.
 - The unemployment rate will rise from 6.7 percent now to 8.1 percent by next December.
- How has Columbus fared in all this, and what lies ahead for us?
 - 2008 was actually a reasonably good year for our region, especially when you compare our employment situation to that elsewhere.
 - ◇ It looks like the initial estimate of Columbus employment for 2008 will be up about 6,700 jobs (0.7 percent) from 2007. That is

- absolutely stellar when you compare it to the results for the state and the nation.
- ◇ U.S. employment should be down more than 300,000 – 0.2 percent.
 - ◇ And Ohio employment should be down about 17,000 – 0.3 percent.
 - ◇ The Columbus area's stronger-than-average performance was broad-based: we did much better than average in most sectors.
- There are two things that make developing the local forecast especially difficult this year.
- ◇ The first is the fact that the Wall Street Journal forecast is a moving target. It has been way too optimistic the past few months – so it may be too optimistic still. We don't know.
 - * The financial crisis is addressed, but it is certainly not solved, and we are layering on the uncertainty surrounding the Detroit automakers. On top of that, there is the possibility of another round of foreclosures, and problems with credit card and student loan debt – and their associated derivatives.
 - ◇ The second is the fact that the local employment trend I shared earlier is also a moving target. It always is.

- * The employment estimates that the Bureau of Labor Statistics brings out for our region every month are preliminary. They issue a comprehensive revision for each year the following March.
 - * These revisions can be dramatic. Last year's revision transformed 2007's employment gain from 0.5 percent – a little better than a third of the national average – to a better-than-average 1.4 percent.
 - * This year, the fact that our employment trend is so much better than average makes me think that our employment might get revised downward. If so, the trends that we are forecasting from are too strong.
- All this aside, we have plunged bravely – or foolishly – into the breach and come up with a local employment forecast for a 10th consecutive year.
- ◇ As always, it is a collaborative effort, including Joe Mandeville of Red Capital; George Mokrzan of Huntington Bancshares; Jim Newton of Commerce National Bank; and me. They will be joining me on the stage later for your questions.
 - ◇ Each of us does an independent forecast; the Chamber's forecast is the average of our individual forecasts. Essentially, I am trusting the wisdom of the crowd to yield a forecast better than what any of us could have developed on our own.

- We are predicting a total employment decline of 0.3 percent – about 3,100 jobs. But there is some disagreement among us, as there often is.
 - ◇ Joe Mandeville is this year's optimist. He is expecting a gain of 2,500 jobs – 0.3 percent.
 - ◇ Jim Newton expects a decline of 2,600 jobs – 0.3 percent.
 - ◇ George Mokrzan expects a decline of 3,100 jobs – also 0.3 percent.
 - ◇ For once, I am the cranky one this year. I am expecting a decline of 9,000 jobs – 0.9 percent.
- Still, as we usually do, we pretty much agree on which sectors will be stronger than average and which will be weaker than average.
 - ◇ The biggest difference between my forecast and everybody else's is that I am worried that we will pay for the growth we have been seeing in business services and distribution. Everybody else is less worried about this.
 - ◇ But even if I am right, we will still probably do better than the national average. Remember, that is forecast to be off 1.7 percent.

- There are a few high points and low points in this forecast and a couple things to be worried about.
 - Private education and healthcare is one high point. This is the one sector whose growth we expect to be better in 2009 than in 2008. We are expecting a gain of 2,700 jobs (2.4 percent). Last year was 2.2 percent.
 - ◇ We've been tracking the national average fairly well, and this is the one sector that doesn't seem to be much affected by recessions.
 - * You need care if you get sick whether there is a recession or not, and people who get laid off can access federal workforce dollars and get education and training to upgrade their skills.
 - ◇ In fact, healthcare employment has not declined in any year since estimates first became available in 1983.
 - A second high point of the consensus forecast is transportation and utilities. This sector should add about 800 jobs (1.6 percent).
 - ◇ Transportation and warehousing (more than 90 percent of this sector) has been trouncing the national average for years. Thanks to the consolidation of distribution operations in Columbus, we have gained 38 percent since 2001. The U.S. has been flat.

- ◇ Everybody but me is expecting a gain of 900 to 1,400 jobs this year – which would certainly be better than the U.S. I am expecting a net loss of 500 jobs.
- Professional and business services is another sector that has been doing especially well, and the consensus is for continued growth of 500 jobs (0.7 percent).
 - ◇ We have been doing splendidly over the past three years, with a growth rate twice the national average. Everybody but me expects a nice gain in 2009 – anywhere from 1,000 to 2,700 jobs.
 - ◇ The rub is that a couple of the subsectors have been weakening for several months. Only the professional and technical services subsector has been doing really well.
 - * Without too much basis for my argument, I am expecting this last prop to get knocked out in 2009 and a loss of 2,800 jobs to result. But I wouldn't be all that surprised to see us do better than that.
- The first thing to be worried about is manufacturing.
 - ◇ This is another sector that has outperformed the national average, although here we have had job losses less than average – five percent here, seven percent elsewhere since the beginning of 2005.

- ◇ The potential problem is our reliance on auto manufacturing. This represents one-fifth of our total regional manufacturing employment – a much higher percentage than average.
- ◇ Even though our automotive anchor is Honda and not the Big Three, we still have to be worried about their problems.
 - * For one thing, some of our local parts manufacturers supply the Big Three as well as Honda.
 - * Conversely, Honda gets parts from manufacturers that primarily supply the Big Three. If some of these go under, Honda may face some shortages.
- ◇ And of course, the tightness of credit and the ongoing recession means weak demand for all auto manufacturers, as Honda's 35 percent sales decline in December reminded us.
- The other thing to worry about is government.
 - ◇ We have been doing miserably lately. Federal employment has grown, thanks to the expansion of DSCC, but local government has been flat and state government has been down.
 - * Nationally, growth in state and local government employment both strengthened last year.

- The state is our region's largest single employer by far with 63,000 jobs. The state's budget problems make it likely that we will lose some of those – including some of the 24,000 in our five state-supported institutions. This is another reason why we in Columbus need to be worried about the plight of the Detroit automakers – which have a huge presence in Ohio, and a huge impact on the budget.
- Local budgets are also fragile. Cities are funded mostly by income taxes, counties by sales taxes, school districts by property taxes. Each of these is vulnerable.
- So where does this leave us?
 - We will have a very challenging year in 2009. To some extent, we don't know how bad things will get, but it is likely that we will be seeing daylight by this time next year.
 - We will also face challenges locally, but probably not to the same extent as other regions.
 - We as a community need to recognize that we have a clear idea of the sectors that make our economy grow and thrive and that we have strong strategies that reinforce the long-term success of those sectors and the region as a whole. We need to keep that focus.
- Thanks for listening! At this point, I will invite up my co-conspirators Joe Mandeville, George Mokrzan, and Jim Newton to take your questions. Please see your program for their bios.