

# Economic Issues and Forecasts

**7<sup>th</sup> Annual CARE Conference  
29 April 2009**

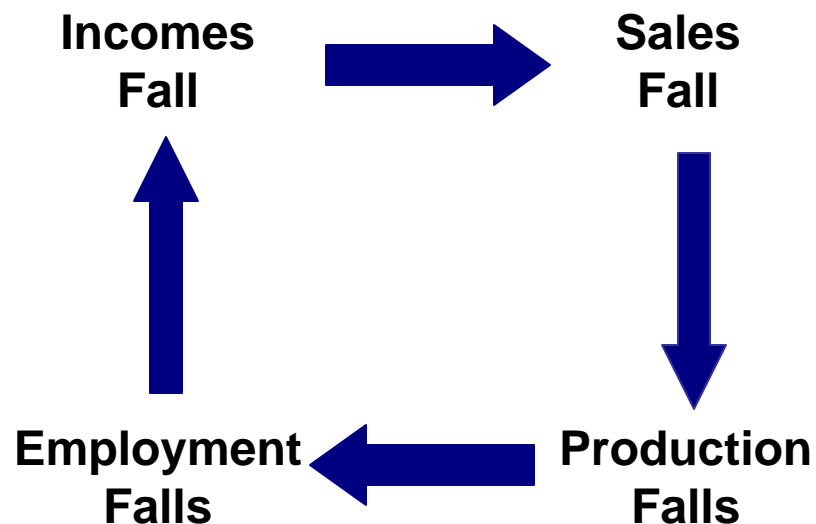
**Dr. TK Swift  
Chief Economist**



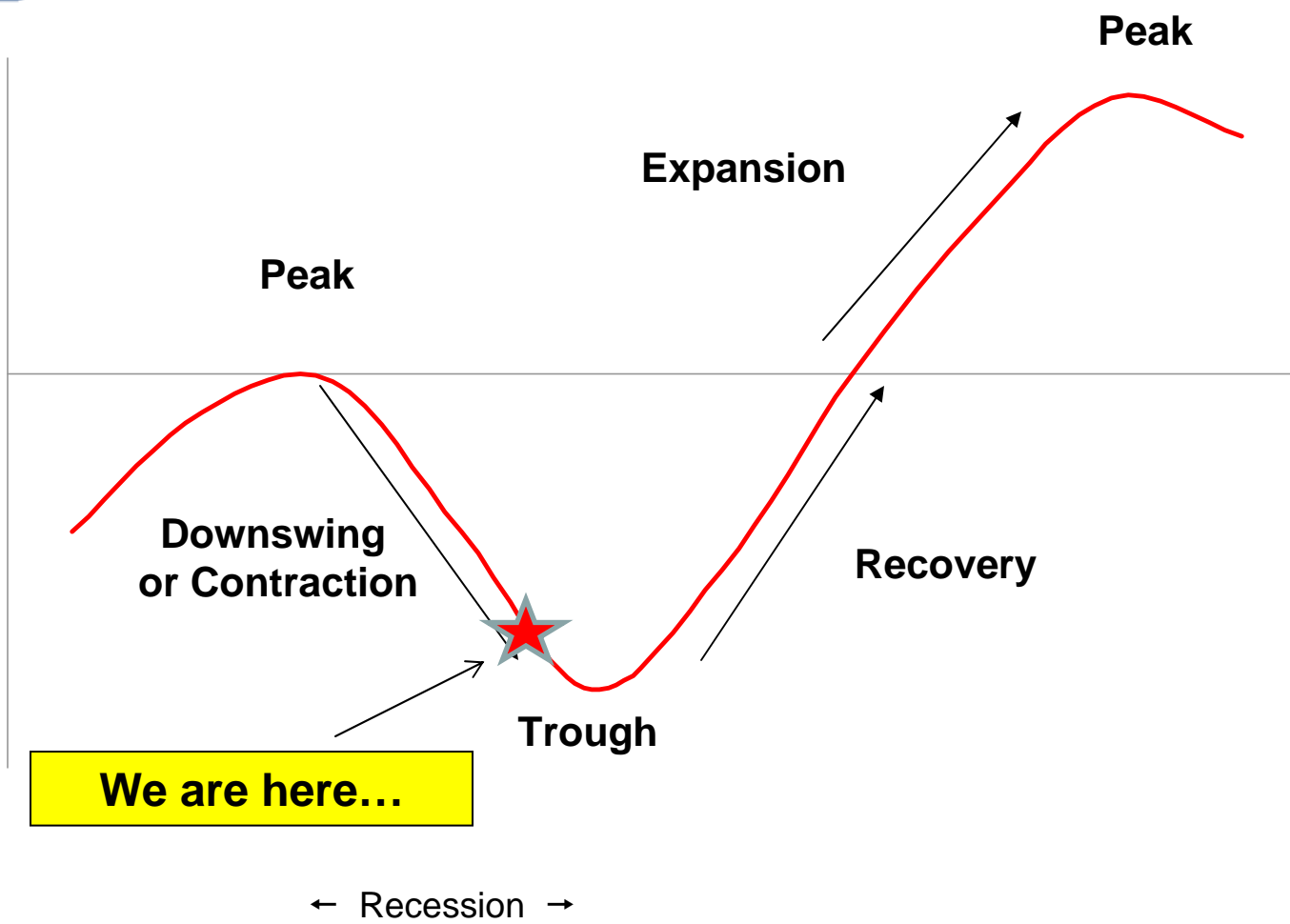


# The Vicious Cycle

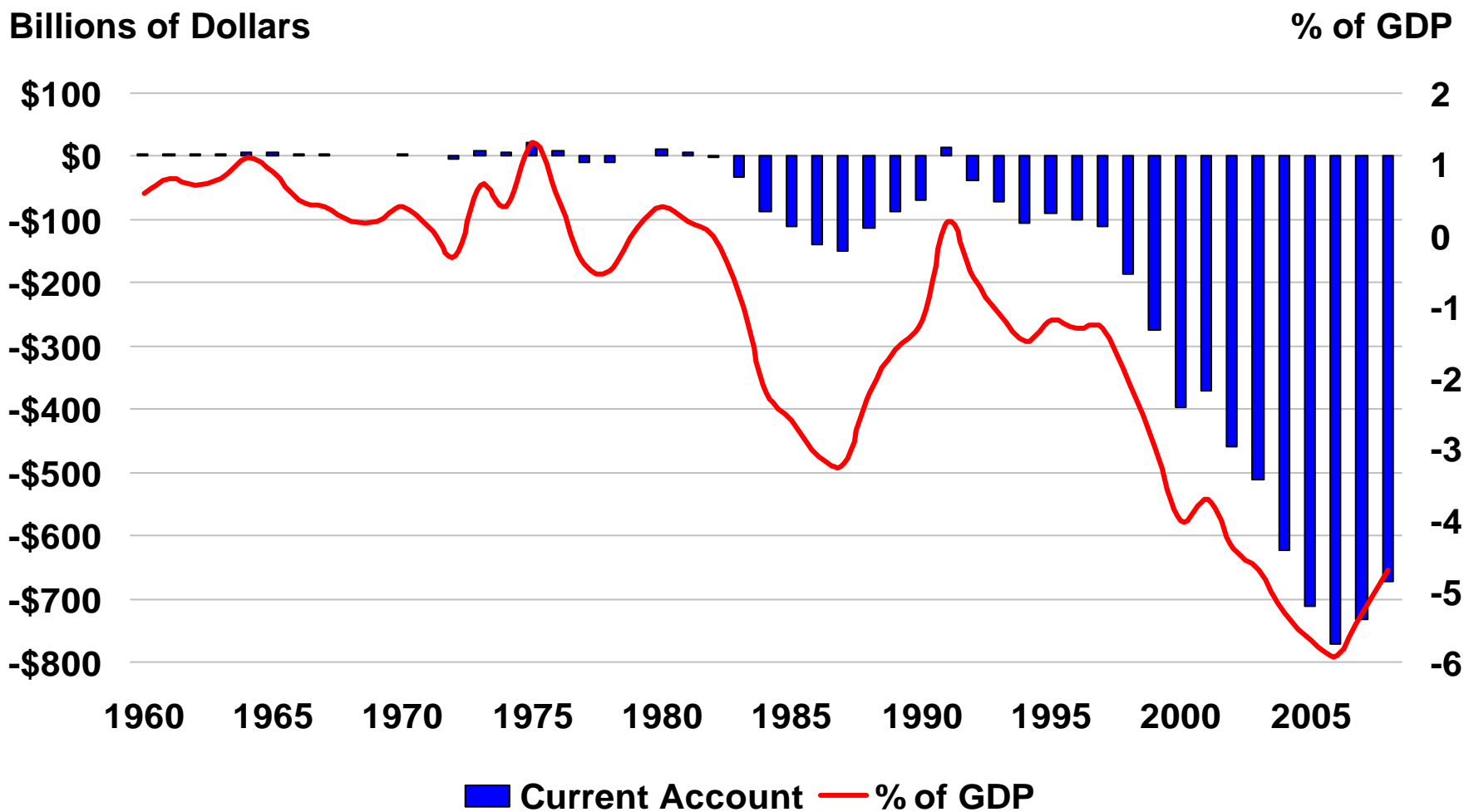
A recession occurs when a decline in a measure of aggregate economic activity initiates cascading declines in the other coincident measures of activity. For example, when a drop in business sales causes a drop in production, it triggers declines in employment and income, which in turn feed back into a further fall in business sales. A vicious cycle results and a recession ensues. This domino effect of the transmission of economic weakness from sales to output to employment to income, feeding back into further weakness in all of these measures in turn, is what marks a downturn, or recession.



# Business Cycles 101: Oscillation and Growth



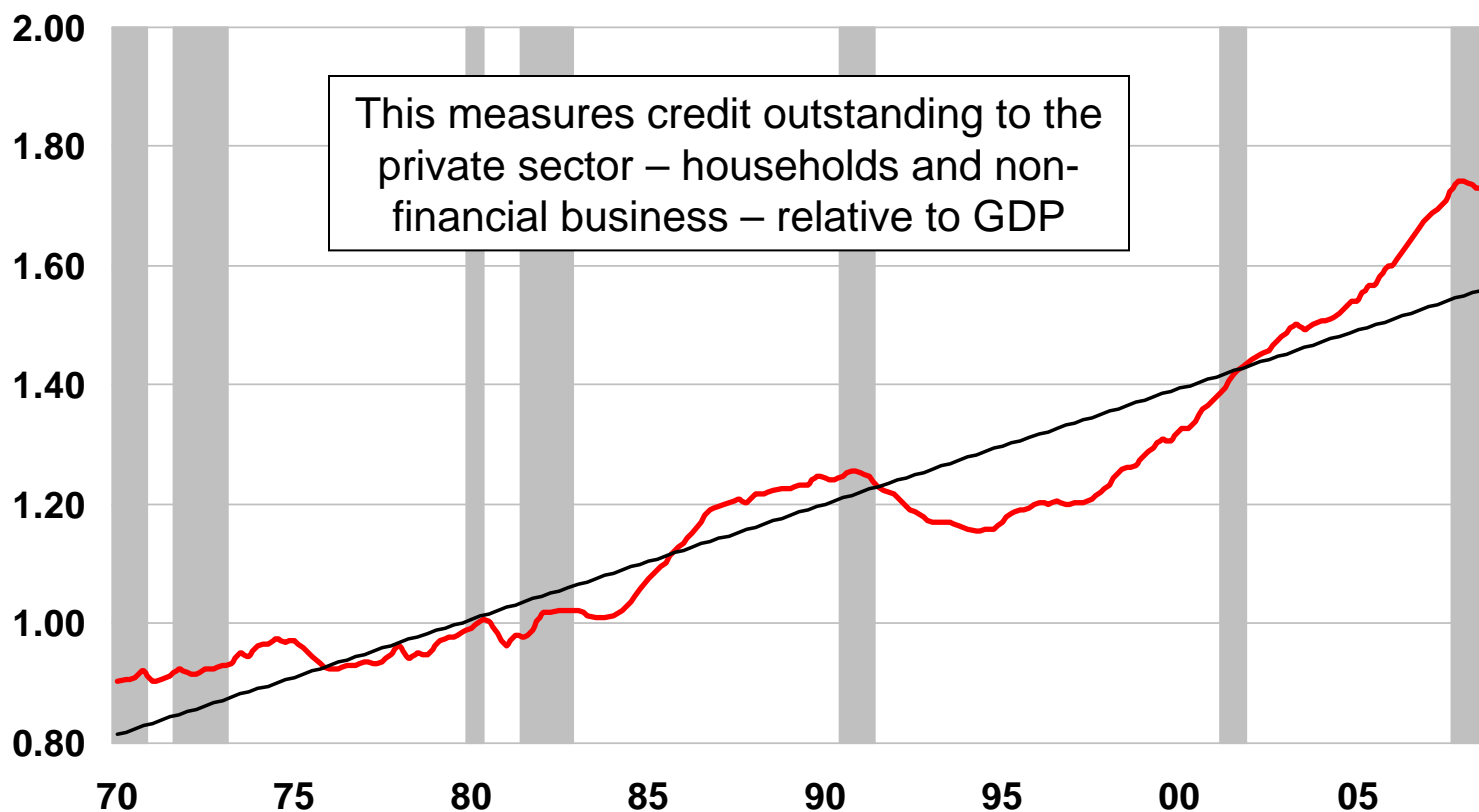
# Surge in Current Account Deficit Funded by Foreign Savings Inflow





# Credit Outstanding / GDP

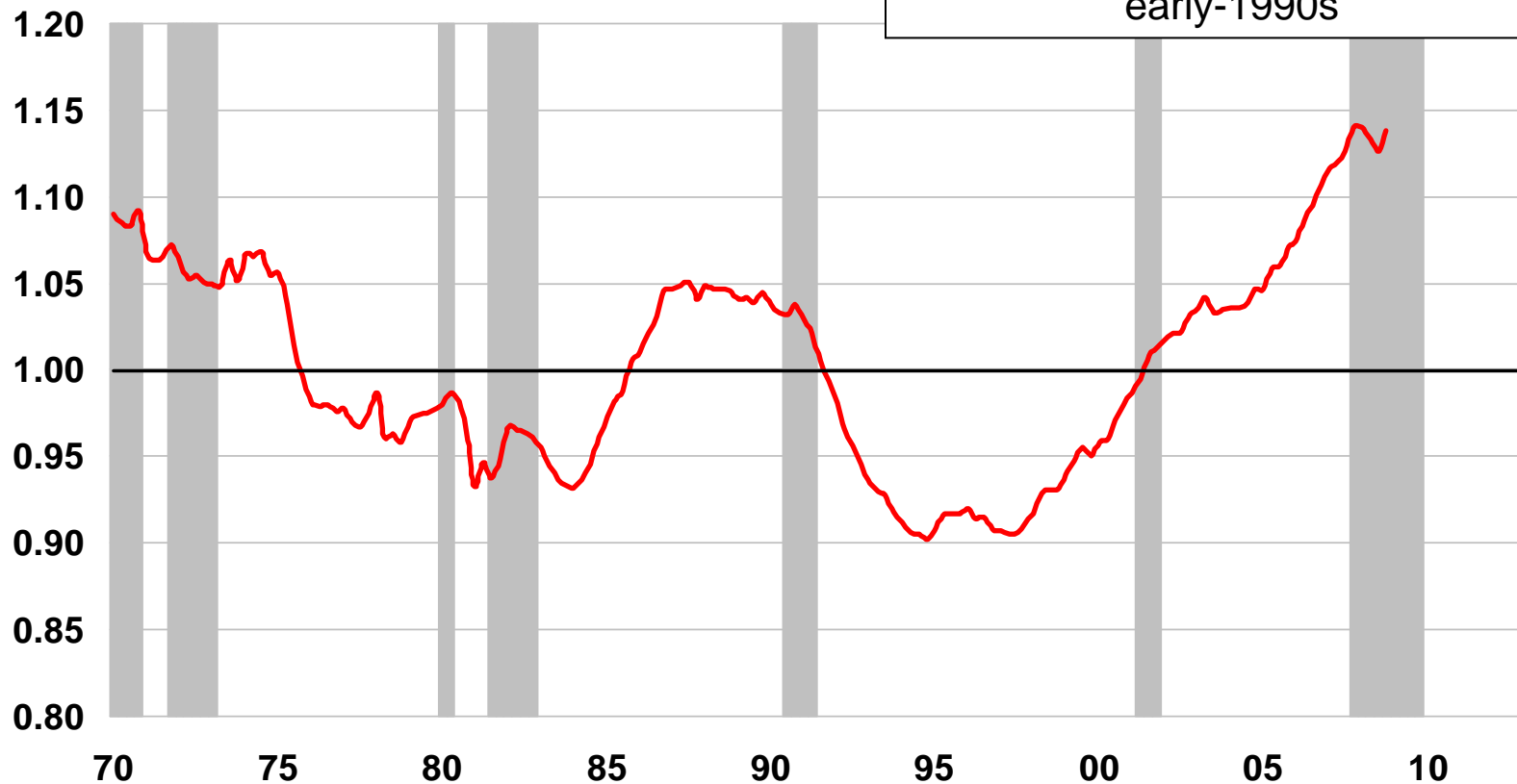
Ratio to Nominal GDP



Source: Federal Reserve Board and Bureau of Economic Analysis

# Unraveling of the Credit Boom

Index: Ratio to Trend



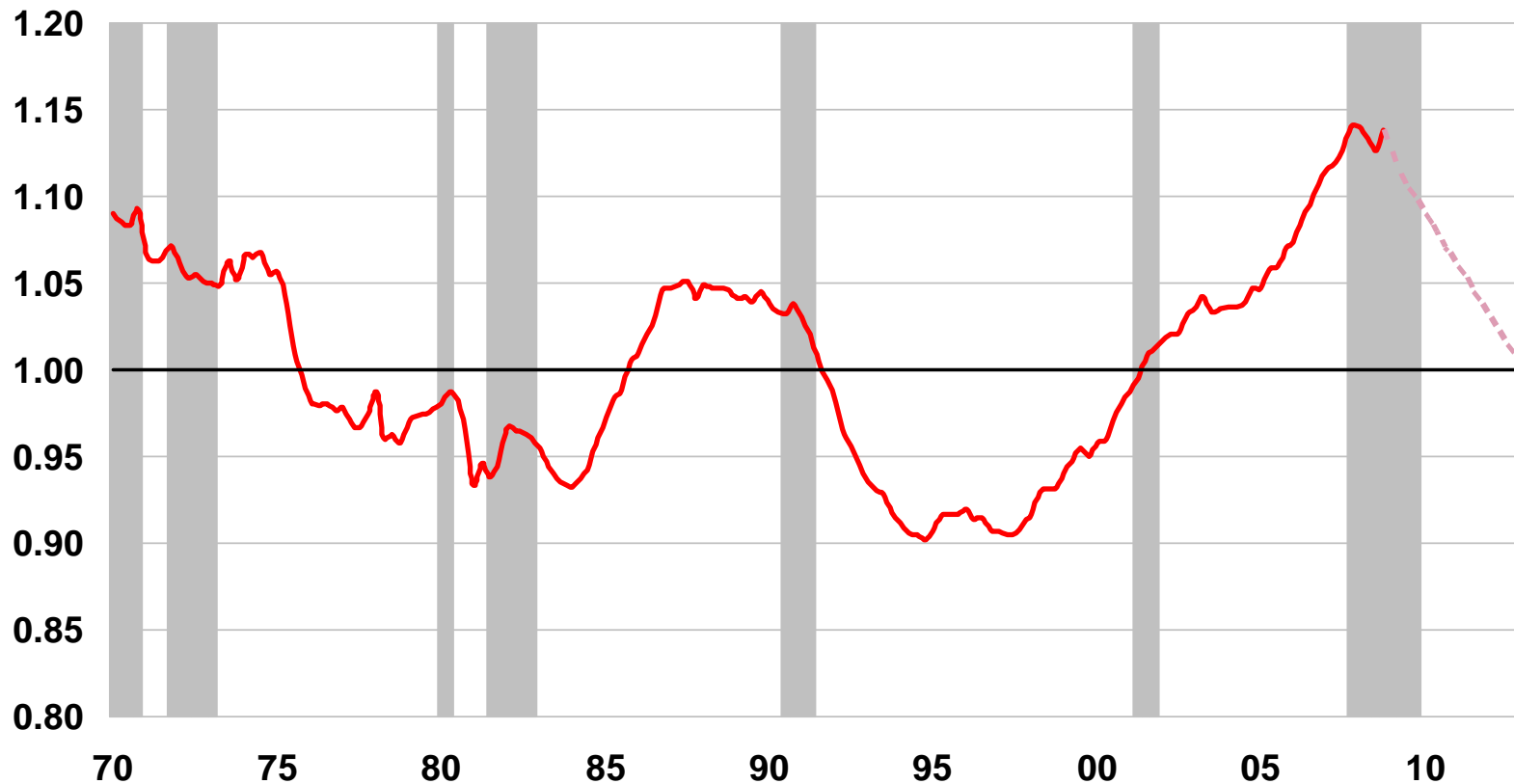
Source: Federal Reserve Board and Bureau of Economic Analysis



# Unraveling of the Credit Boom

Reversion to mean started in 2Q 2008, and it could take until 2012 to get back to trend

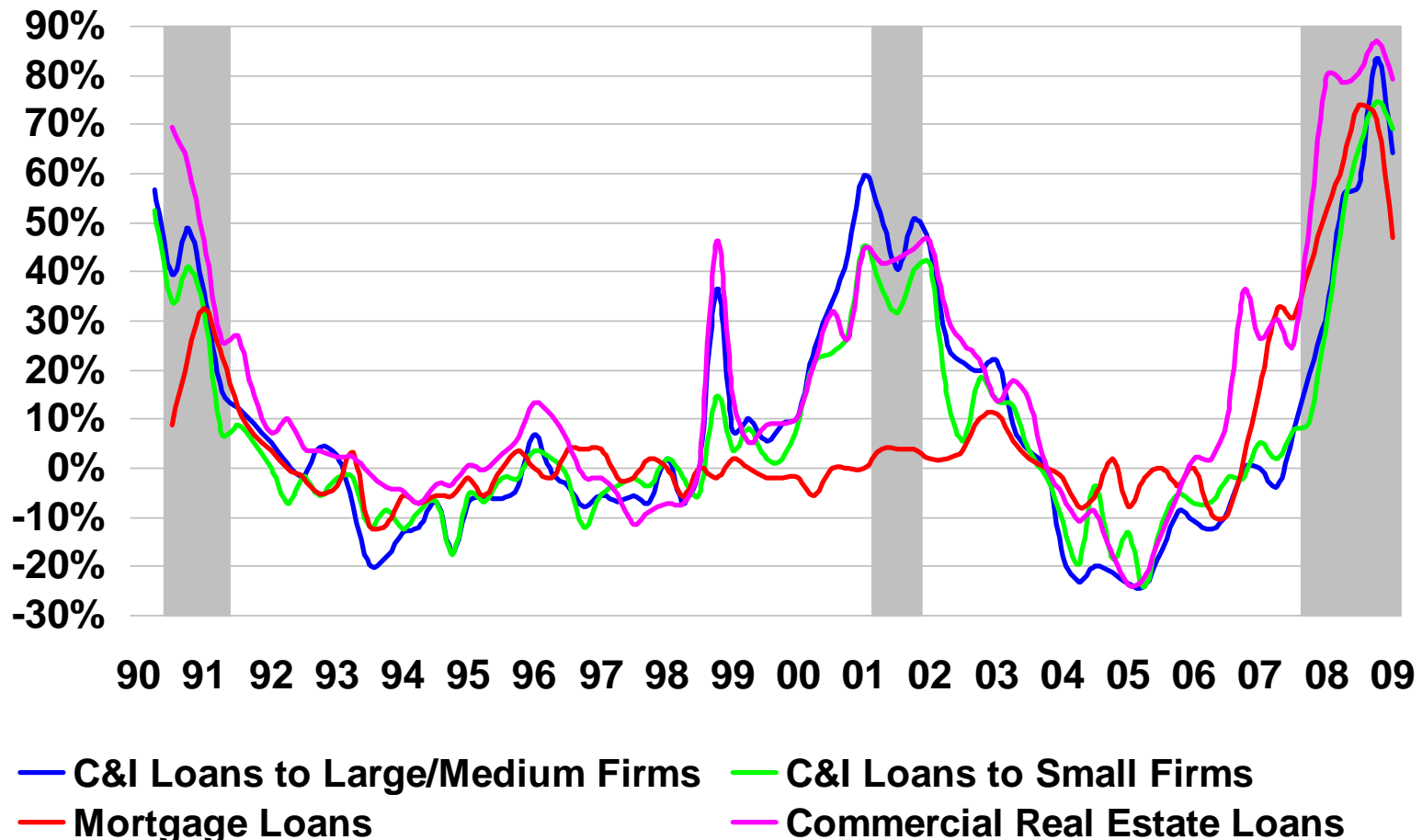
Index: Ratio to Trend



Source: Federal Reserve Board and Bureau of Economic Analysis

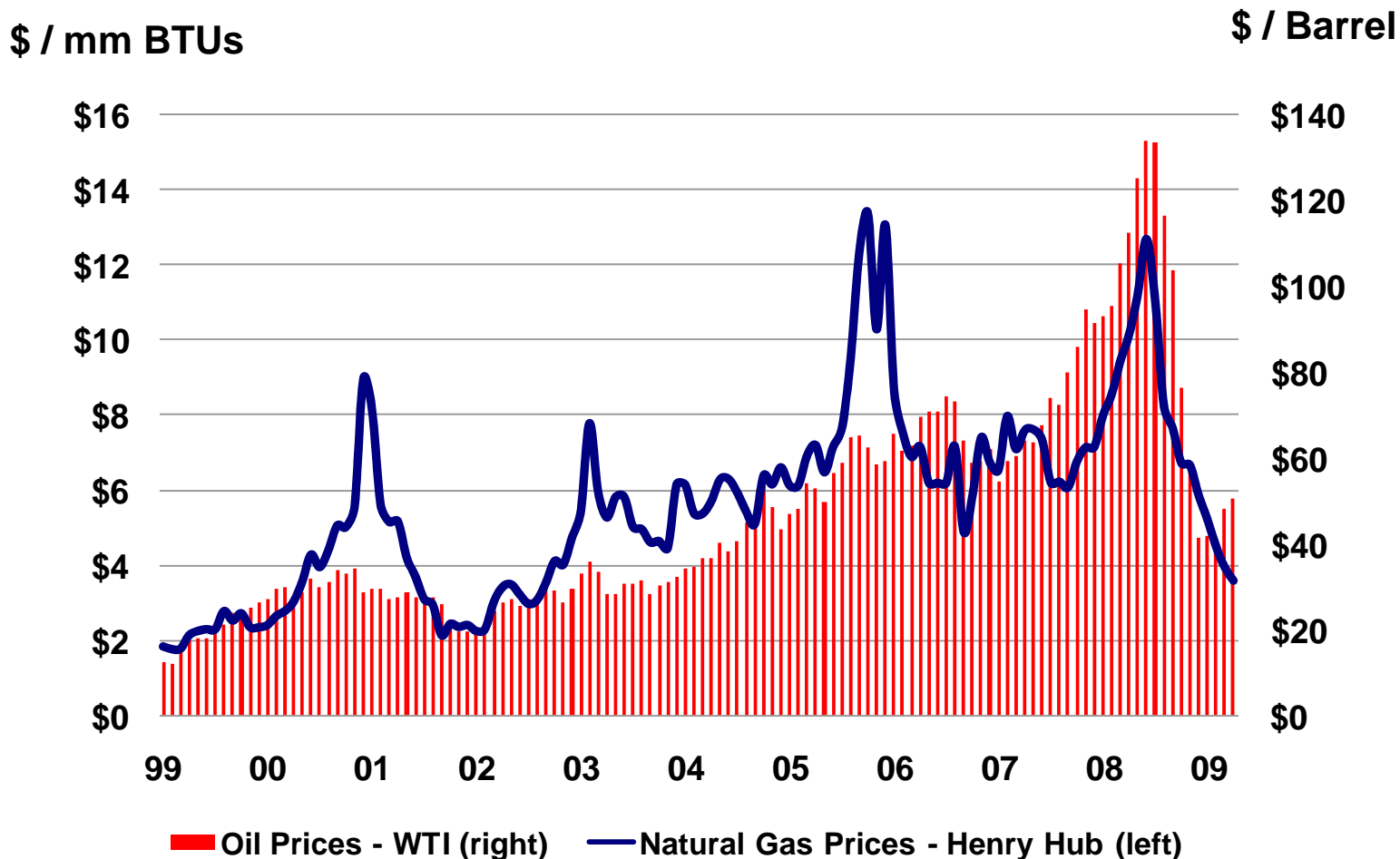
# Banks Clamped Down on Lending Standards – Now Easing?

% Reporting Tightening Standards



Source: Federal Reserve Board

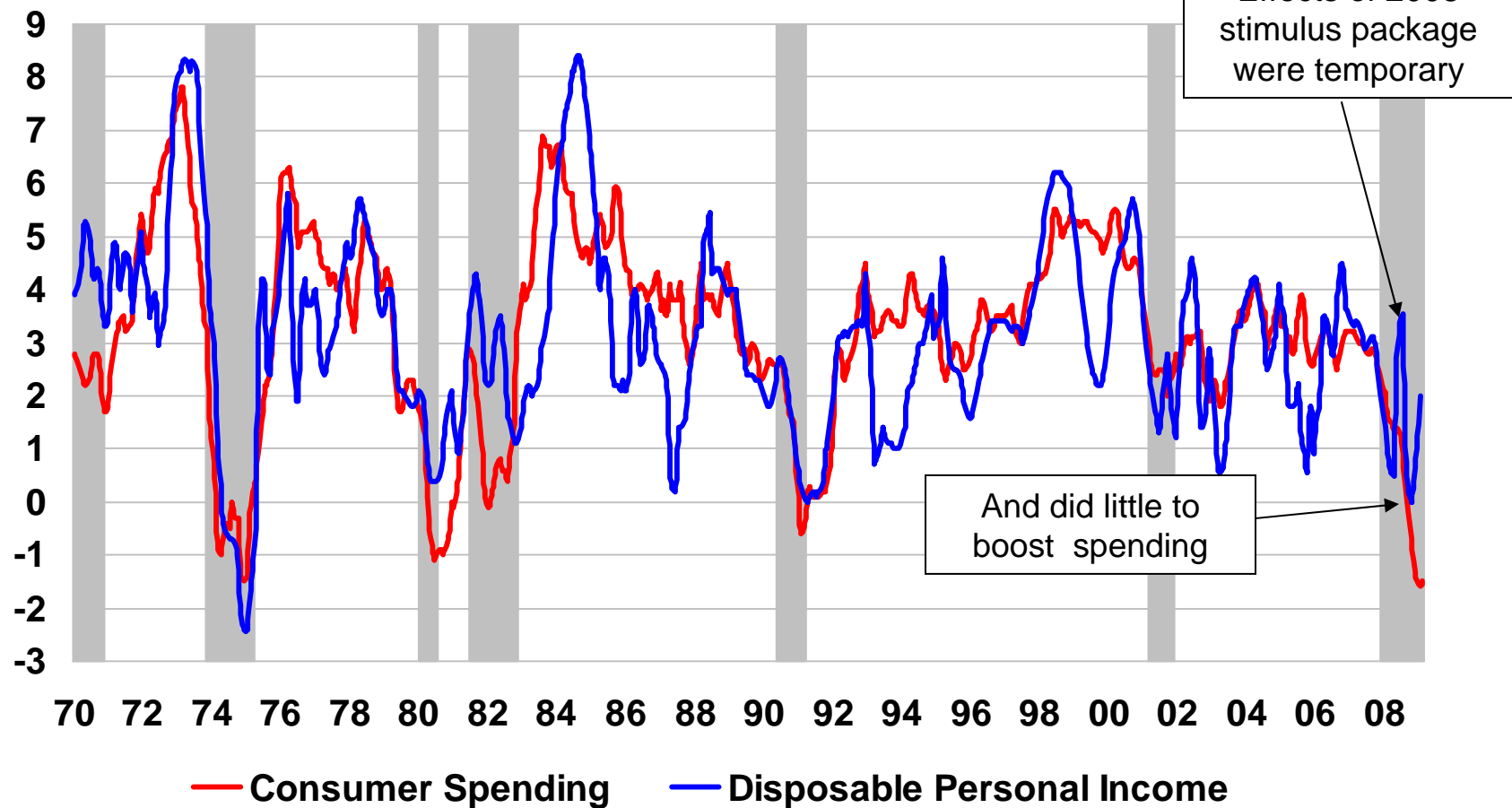
# Energy Prices Eroded Discretionary Income But Serving as a Tax Cut



Sources: EIA

# Eroding Incomes / Wealth Effects Softened Consumer Spending

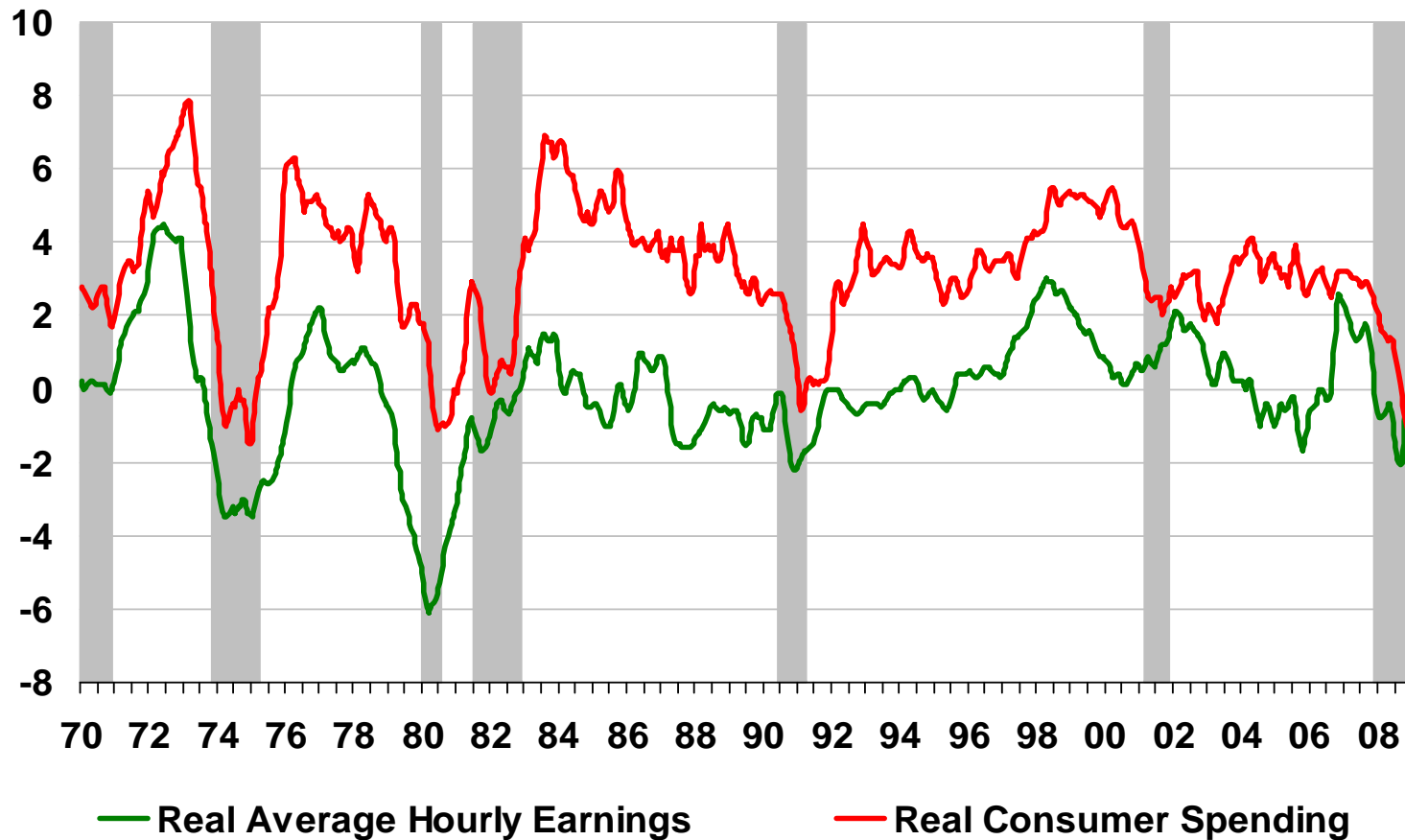
% Change Year/Year (3MMA)



Source: BEA

# Real Average Hourly Earnings Lead Consumer Spending and are Up!

% Change Year/Year (3MMA)

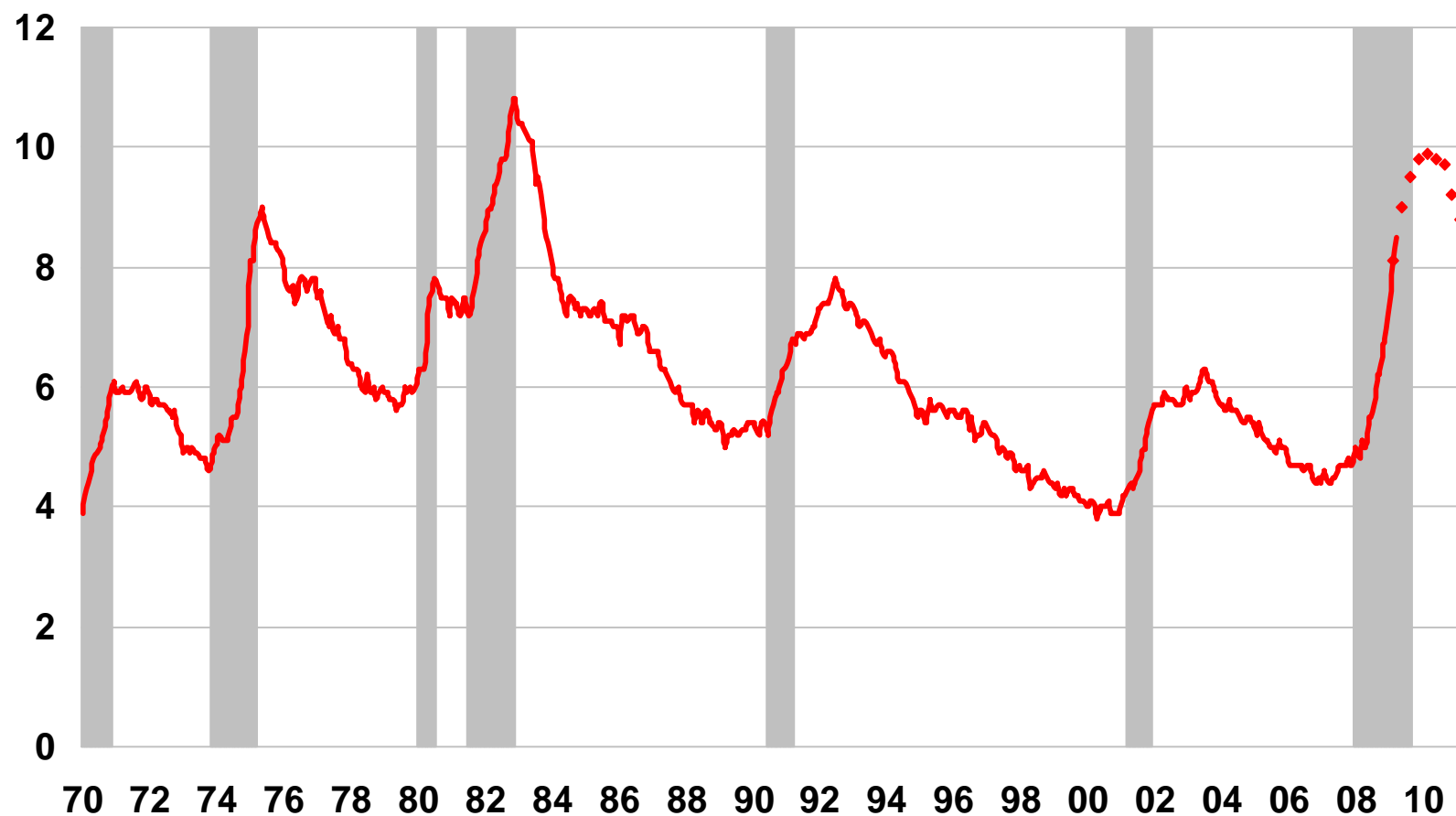


Sources: BEA and BLS



# Rising Unemployment

Unemployment as % of Labor Force



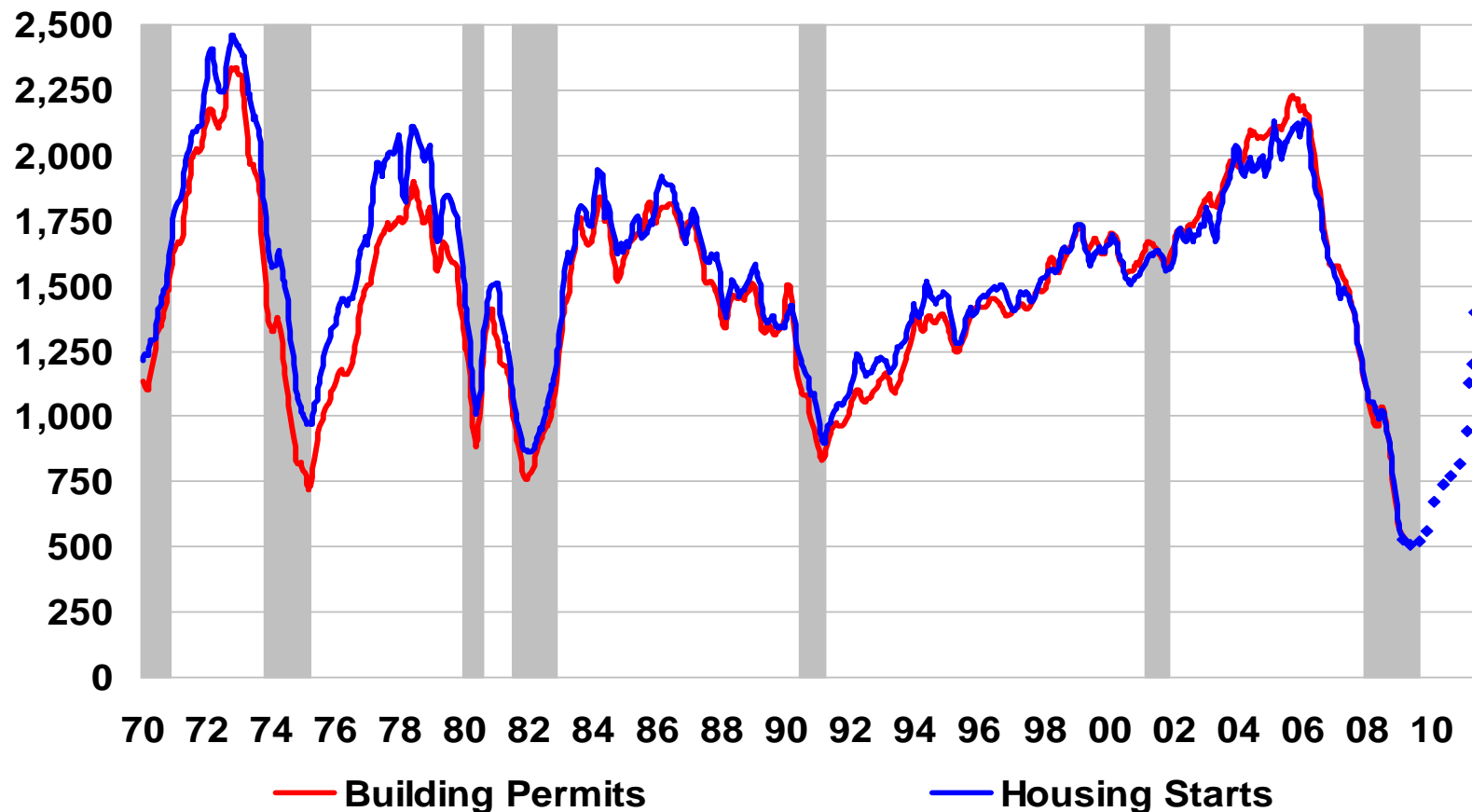
Sources: Bureau of Labor Statistics, Survey of Forecasters, ACC analysis

# Landslide in Housing Construction



Note: Commercial Construction lags residential

Thousands of Units (3MMA)

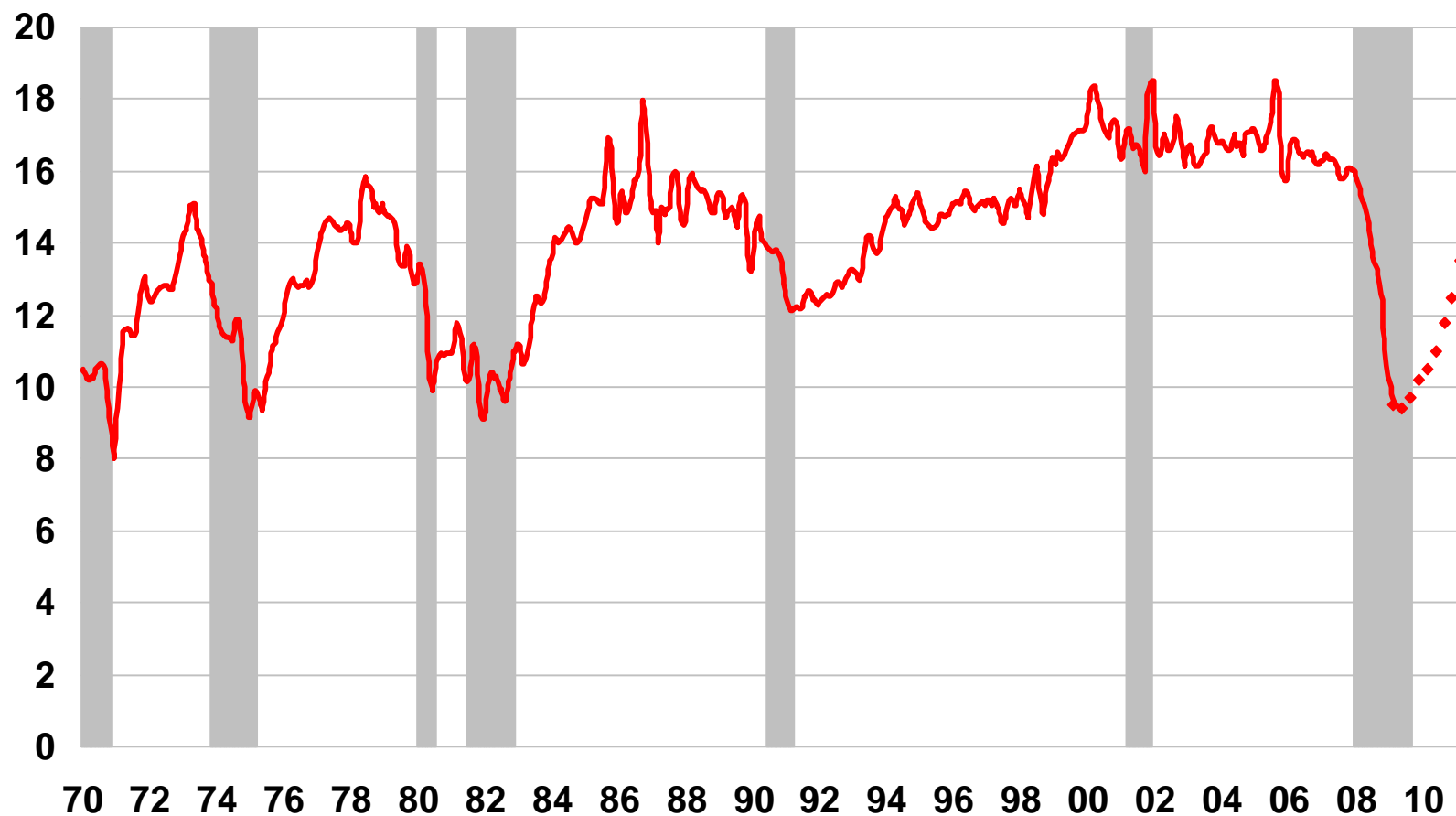


Sources: Bureau of the Census, Survey of Forecasters, ACC analysis



# Slumping Light Vehicle Sales

Million Units - SAAR (3MMA)

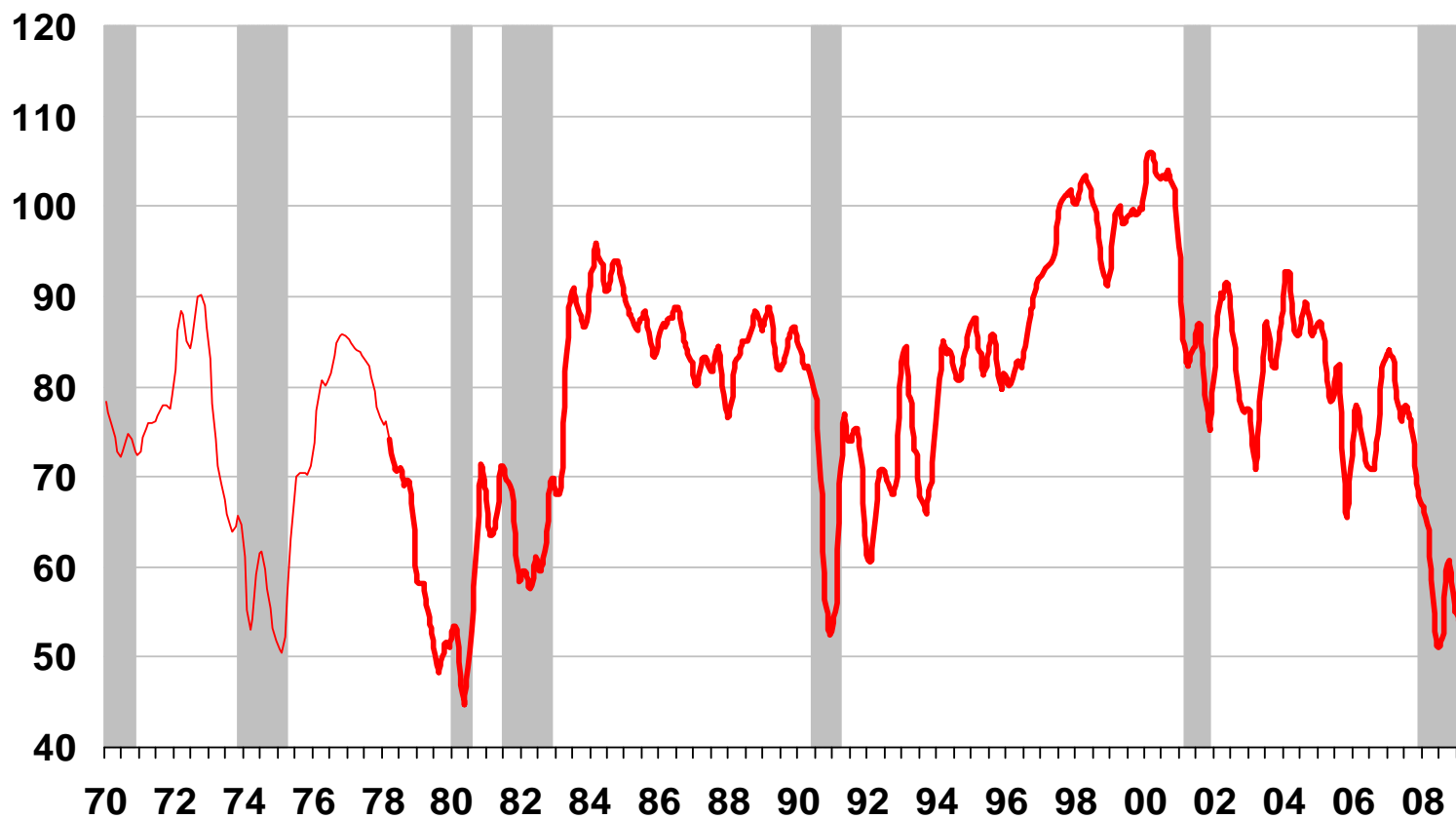


Sources: Federal Reserve Board, Survey of Forecasters, ACC analysis



# Faltering Consumer Expectations

1Q 1966=100 (3MMA)

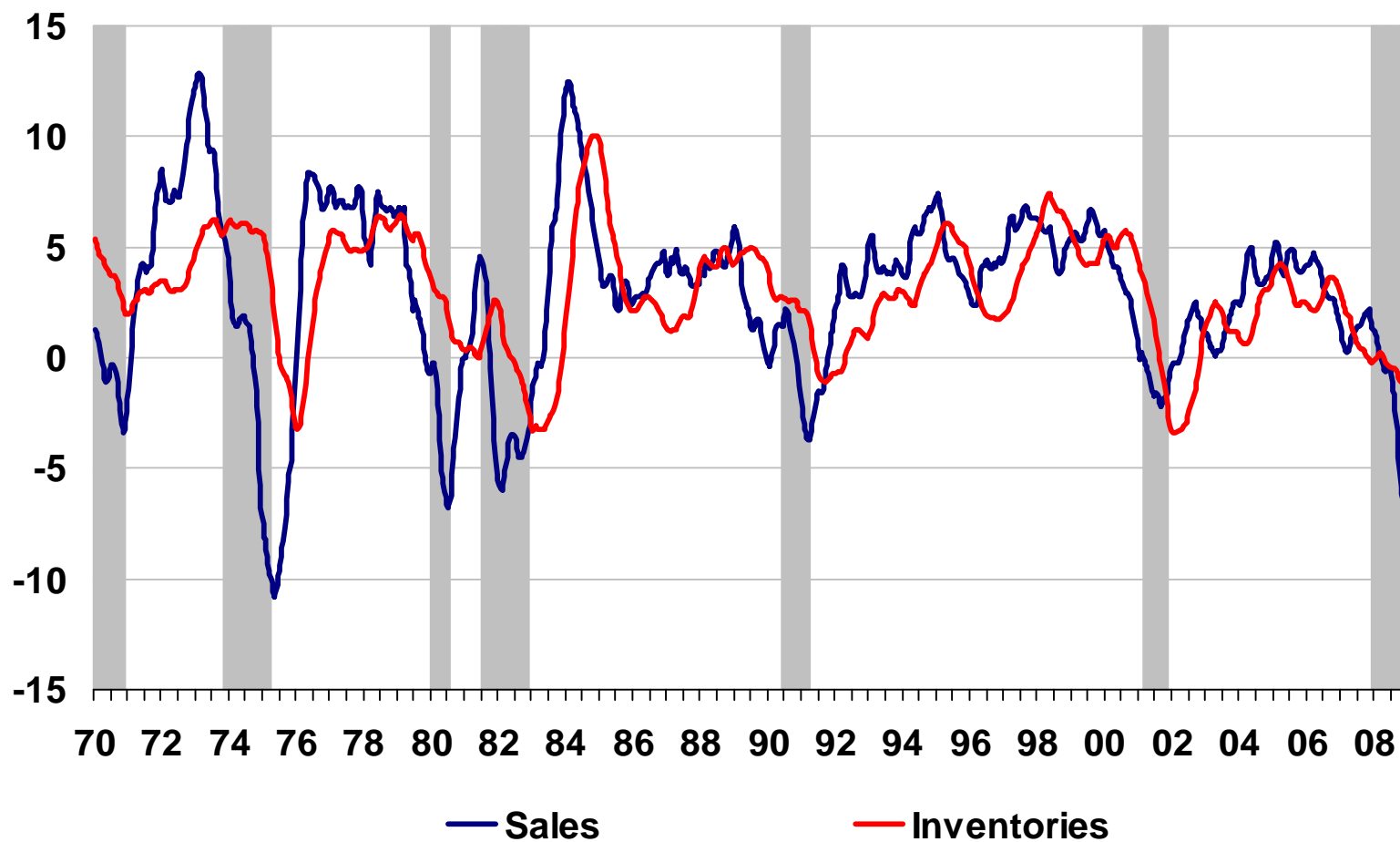


Source: University of Michigan



# Severe Inventory Destocking by Business

% Change Year/Year (3MMA)



Source: Bureau of the Census



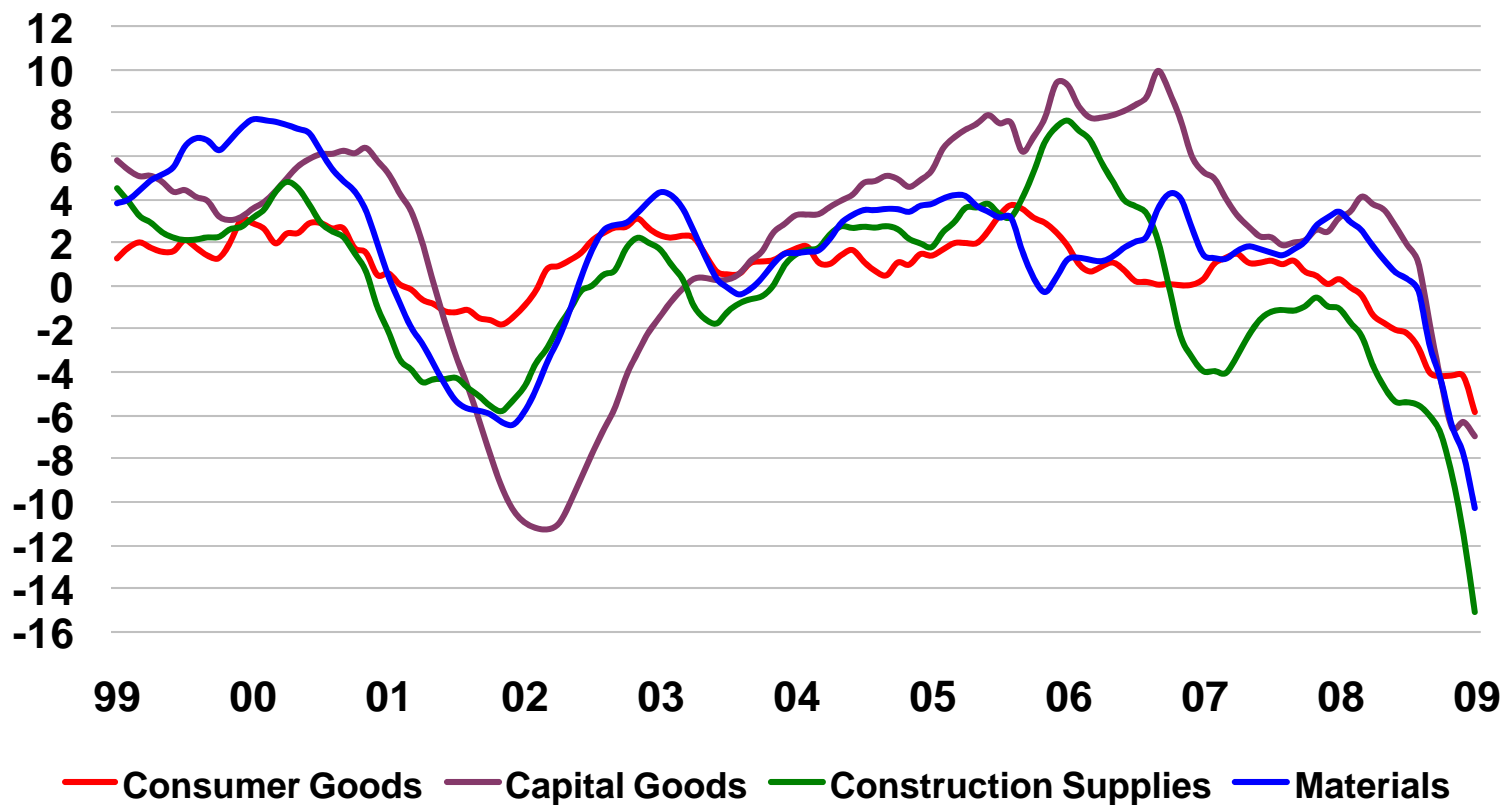
# Status of Industry

- **Longest recession since 1930s – “The Big One”**
- **Industrial sector in USA has been in decline since December 2007**
- **The decline was driven by:**
  - Collapse of final domestic demand
  - Disappearance of export markets
  - De-stocking (e.g., Customers consumed 5.36 billion pounds of thermoplastic per month, but bought only 4.44 billion pounds per month in 4Q: In 1Q consuming 4.89 billion pounds and buying 4.56 billion pounds per month)
- **The decline is broad-based and includes basic materials, consumer goods, capital goods, and other industries**
  - Basic materials being whipsawed
  - Uncertainty about economic and regulatory environment leading to a collapse in/slashing of capital spending (unwilling to commit) and capital goods output
- **Manufacturing downturn is global and synchronized with nations dependent upon manufactured goods exports (especially early in the supply chain) affected the worst**
- **Leading indicators do not suggest a near-term trough**
- **Signs of industrial recovery in 2010?**



# Industrial Production by Market

% Change Year/Year (3MMA)

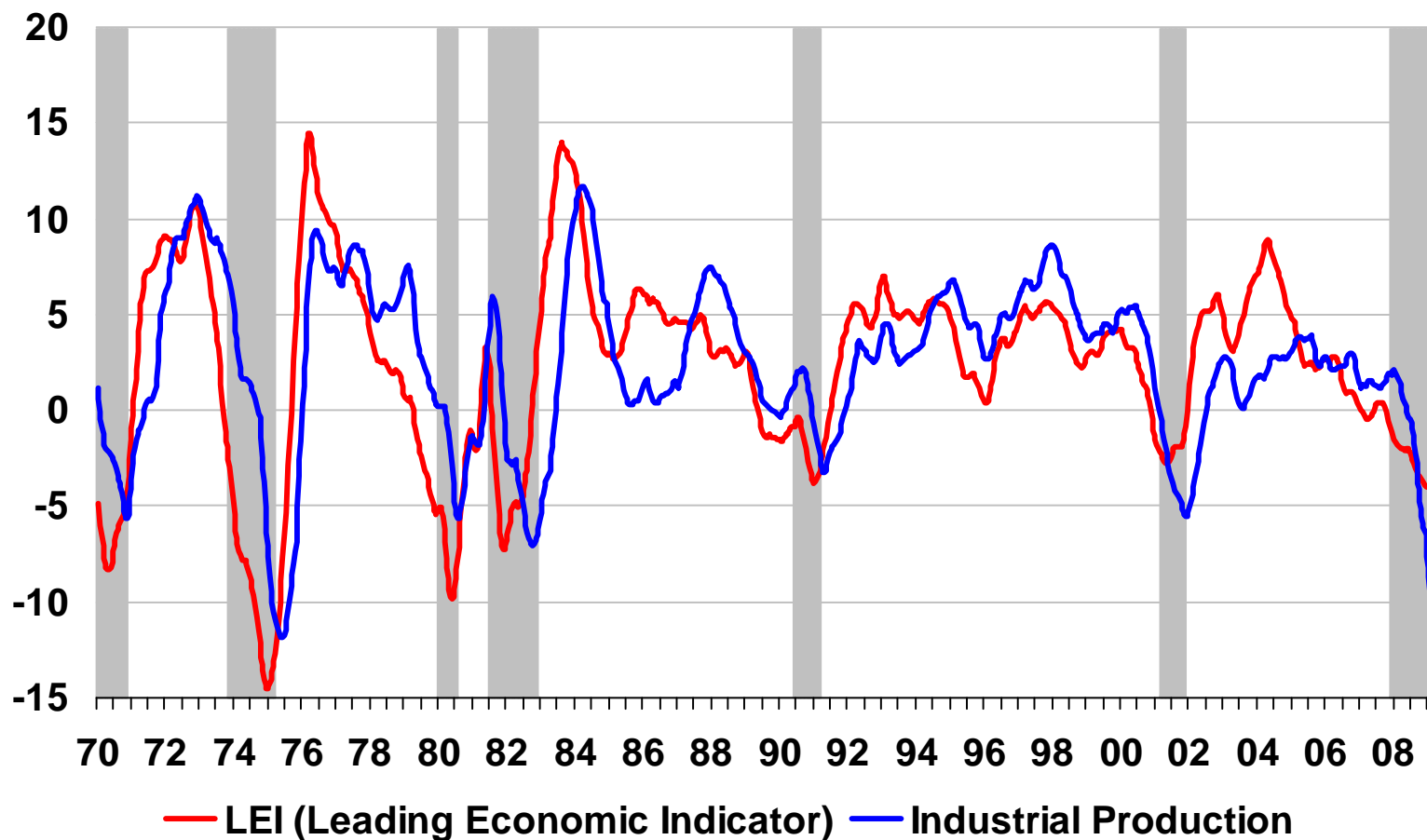


Sources: Federal Reserve Board



# LEI / Industrial Production

% Change Year/Year (3MMA)

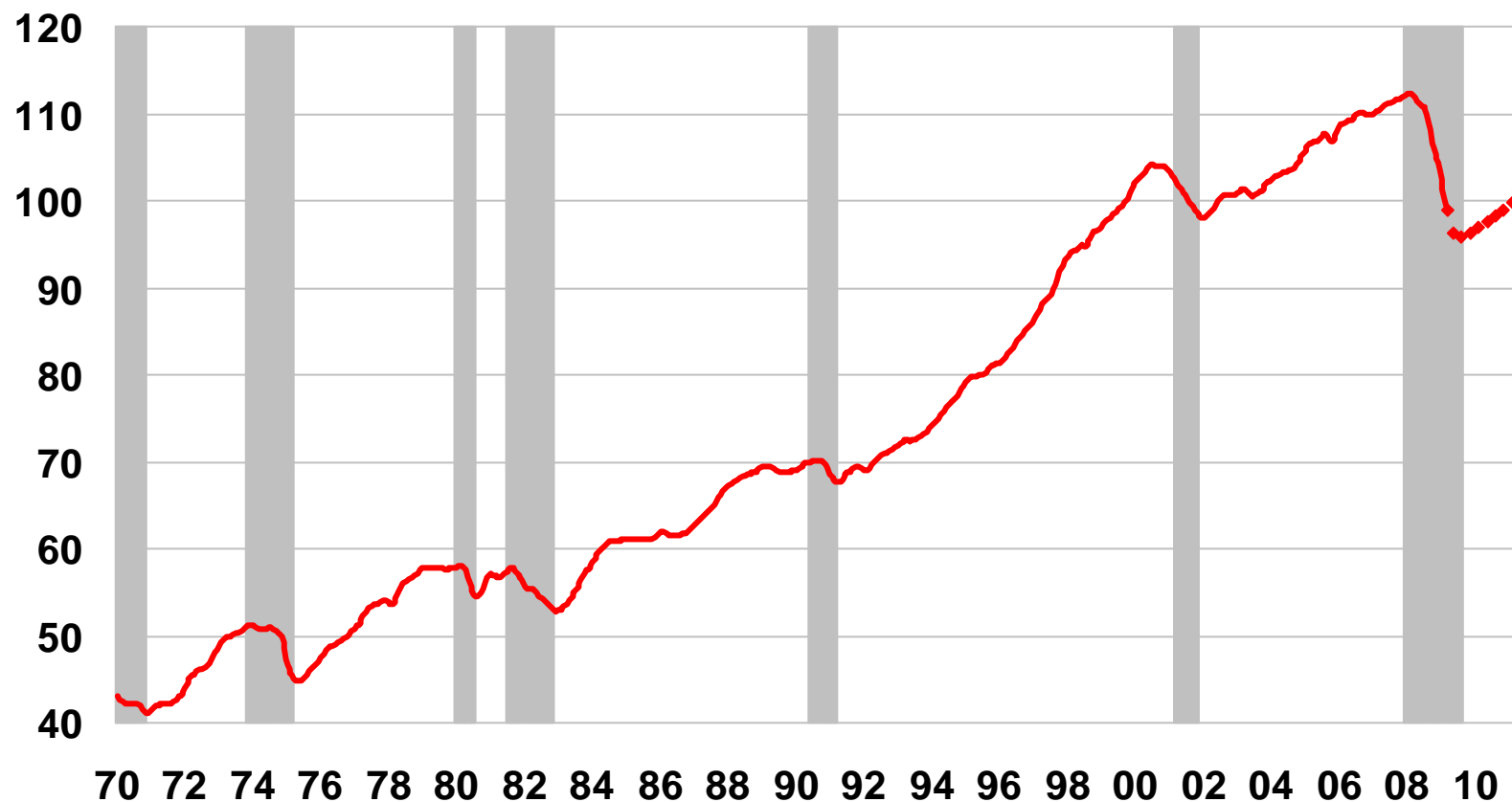


Sources: Conference Board and FRB



# Industrial Production

Index 2002 = 100 (3MMA)

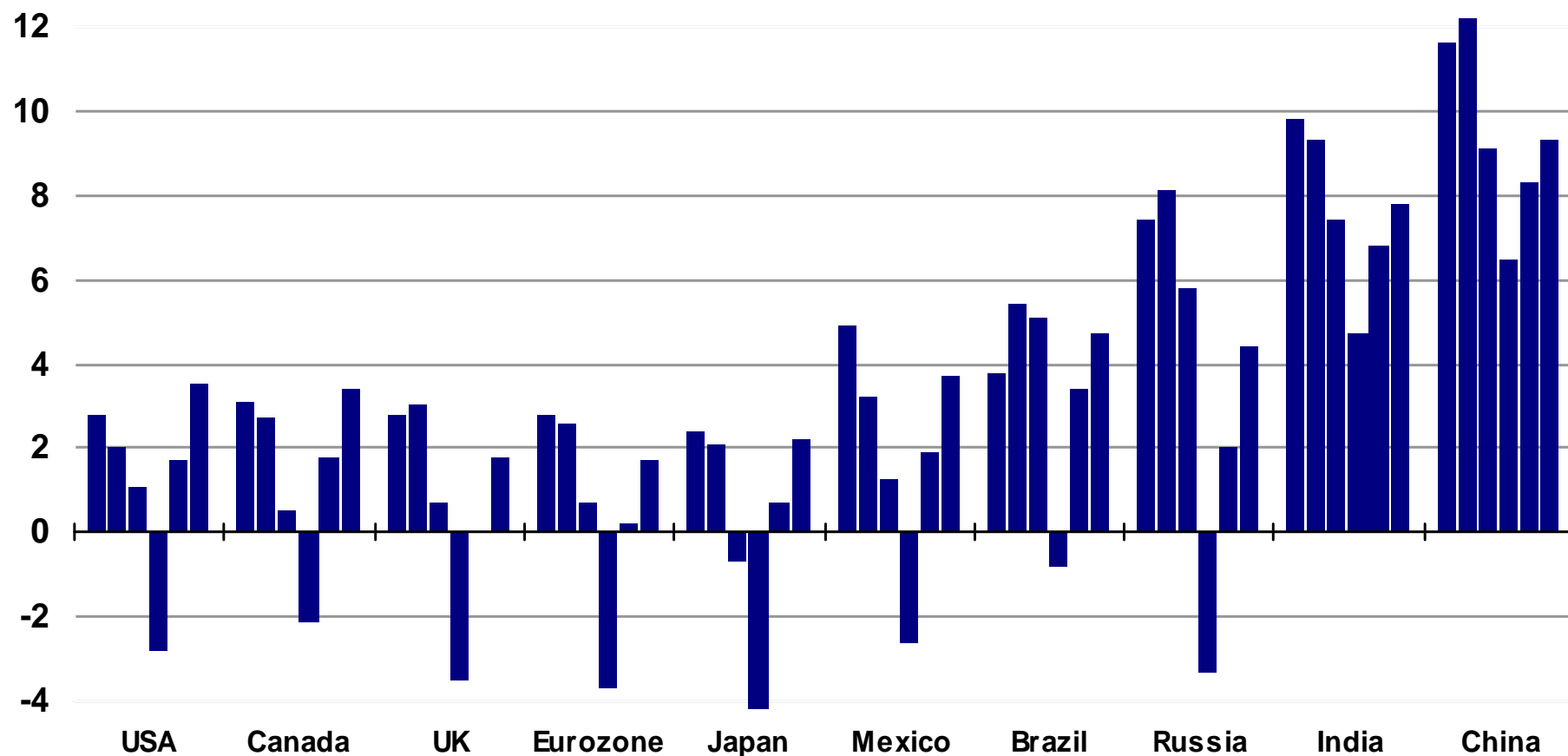


Source: Federal Reserve Board



# Synchronized Recession is Also Affecting Emerging Markets

Real GDP % Change (2006-11)





# Mustard Seeds of a Recovery

- Real incomes are improving (start of virtuous cycle?)
- Positive yield curve and monetary expansion
- Risk premiums are narrowing
- The “Mother of All” fiscal stimulus is in place
- ...and a global response
- Leading economic indicators suggest bottom
- Rate of decline slowing for most indicators (job losses, manufacturing activity, etc.)
- Balance returning to the indicator releases?



## Risks: Stuff that Causes Economist Insomnia

- Things are somewhat different than usual this time
- Emerging market crises (China, Baltics, etc.)
- Collapse of another major financial institution
- Other financial
  - Commercial real estate
  - Credit cards
- Deflation and severe liquidity trap
- Capital on Strike: Indecision and experimentation lead to uncertainty and further collapse of investment
- Protectionism
- Shocks (e.g., Swine flu)
- Eventual inflation and higher taxes



# Alternative Economic Environments

*% change on previous year  
(unless otherwise noted)*

**2007    2008**

## **World:**

**GDP (PPP basis)                    5.0      3.4**

**Trade Volume                        7.2      3.6**

## **USA:**

**GDP                                        2.0      1.1**

**Consumer Spending            2.8      0.2**

**Industrial Production            1.5     -2.2**

**Light Vehicle Sales (mm)        16.1    13.2**

**Housing Starts (mm)              1.36    0.90**

**Consumer Prices                    2.9      3.8**

**Unemployment Rate (%)         4.6      5.8**

**10-Year Treasury Notes (%)     4.63    3.67**

Sources: April Survey of Forecasters, ACC analysis



# Alternative Economic Environments

% change on previous year (unless otherwise noted)	2007	2008	Synchronized Global Recession (~65%)		
			2009	2010	2011
<b>World:</b>					
GDP (PPP basis)	5.0	3.4	-1.0	2.5	4.2
Trade Volume	7.2	3.6	-9.3	2.7	5.9
<b>USA:</b>					
GDP	2.0	1.1	-2.8	1.8	3.6
Consumer Spending	2.8	0.2	-1.2	1.7	3.2
Industrial Production	1.5	-2.2	-10.1	2.0	3.7
Light Vehicle Sales (mm)	16.1	13.2	10.0	11.7	14.7
Housing Starts (mm)	1.36	0.90	0.56	0.84	1.36
Consumer Prices	2.9	3.8	-0.7	1.6	2.5
Unemployment Rate (%)	4.6	5.8	9.1	9.7	7.9
10-Year Treasury Notes (%)	4.63	3.67	2.82	3.26	4.93

Sources: April Survey of Forecasters, ACC analysis



# Alternative Economic Environments

% change on previous year (unless otherwise noted)			Synchronized Global Recession (~65%)			The Great Recession (~30%)		
	2007	2008	2009	2010	2011	2009	2010	2011
<b>World:</b>								
GDP (PPP basis)	5.0	3.4	-1.0	2.5	4.2	-2.8	1.3	3.5
Trade Volume	7.2	3.6	-9.3	2.7	5.9	-13.5	1.5	4.3
<b>USA:</b>								
GDP	2.0	1.1	-2.8	1.8	3.6	-3.8	0.5	2.0
Consumer Spending	2.8	0.2	-1.2	1.7	3.2	-2.3	1.0	2.3
Industrial Production	1.5	-2.2	-10.1	2.0	3.7	-12.5	-0.8	2.5
Light Vehicle Sales (mm)	16.1	13.2	10.0	11.7	14.7	9.3	10.8	13.2
Housing Starts (mm)	1.36	0.90	0.56	0.84	1.36	0.45	0.55	1.03
Consumer Prices	2.9	3.8	-0.7	1.6	2.5	-1.8	0.4	1.8
Unemployment Rate (%)	4.6	5.8	9.1	9.7	7.9	9.3	10.3	8.8
10-Year Treasury Notes (%)	4.63	3.67	2.82	3.26	4.93	2.18	2.39	3.55

A Disorganized  
Unwinding

Sources: April Survey of Forecasters, ACC analysis





Yes – these don't add to 100%. There is an alternative optimistic scenario with growth returning in the 2<sup>nd</sup> half of 2009

# Alternative Economic Environments

% change on previous year (unless otherwise noted)			Synchronized Global Recession (~65%)			The Great Recession (~30%)		
	2007	2008	2009	2010	2011	2009	2010	2011
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A Disorganized Unwinding

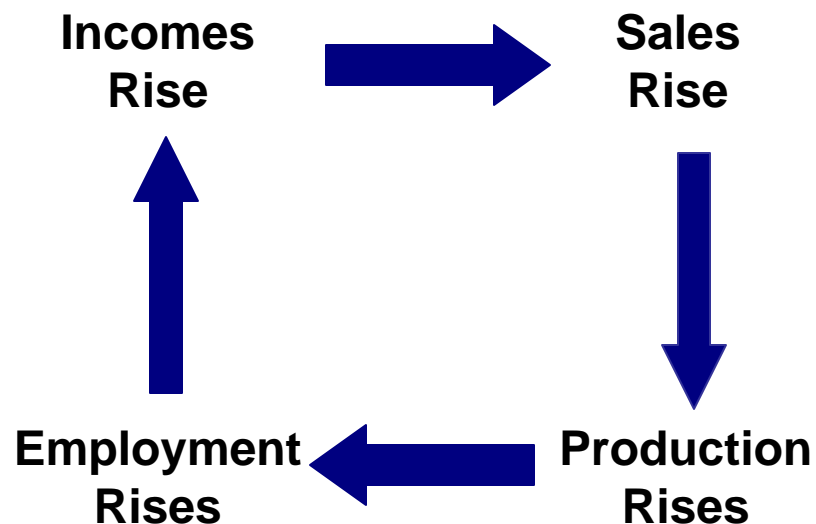
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# The Virtuous Cycle

As a recession moderates, job losses slow and new businesses start to emerge. Prices hit a floor and consumers that have been waiting (and saving) on the sidelines, step in to pick up bargains. This sales boost works off inventories and stimulates demand along the supply chain. Eventually, inventories are depleted and new orders turn into production. Production rises and workers are hired. This boosts aggregate income which generates additional sales. And thus, a recovery is born.





# US Recessions: 1929-2009

----- % Change Peak to Trough -----

Peak / Trough	Duration (months)	GDP	Per Capita Incomes	Industrial Production	Non-Farm Payrolls	Peak Unemployment Rate	Average Inflation Rate
Aug '29-Mar '33	43	-32.6	-26.2	-50.5	-33.9	25.6	-6.6
May '37-June '38	13	-13.2	-6.4	-31.8	-11.6	20.0	-0.1
Nov '48-Oct '49	11	-1.7	-2.7	-8.6	-5.2	7.9	0.0
July '53-May '54	10	-2.7	-1.9	-9.0	-3.4	6.1	0.9
Aug '57-Apr '58	8	-3.7	-2.3	-12.7	-4.4	7.5	3.4
Apr '60-Feb '61	10	-1.6	-0.9	-6.2	-2.3	7.1	1.5
Dec '69-Nov '70	11	-0.6	-0.7	-5.8	-1.5	6.1	5.9
Nov '73-Mar '75	16	-3.1	-3.9	-12.9	-2.8	9.0	10.7
Jan '80-July '80	6	-2.2	-1.4	-6.5	-1.3	7.8	14.2
July '81-Nov '82	16	-2.9	-0.7	-8.7	-3.1	10.8	7.8
July '90-Feb '91	8	-1.3	-1.5	-3.7	-1.5	7.8	5.7
Mar '01-Nov '01	8	-0.2	-1.7	-3.9	-2.1	6.3	2.8
Dec '07- Aug '09??							
Sources: NBER, BEA, BLS							



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Mar '01-Nov '01	8	-0.2	-1.7	-3.9	-2.1	6.3	2.8
Dec '07- Aug '09??	20?	-3.9?	-5.0?	-14.3?	-4.3?	10.0?	1.7?

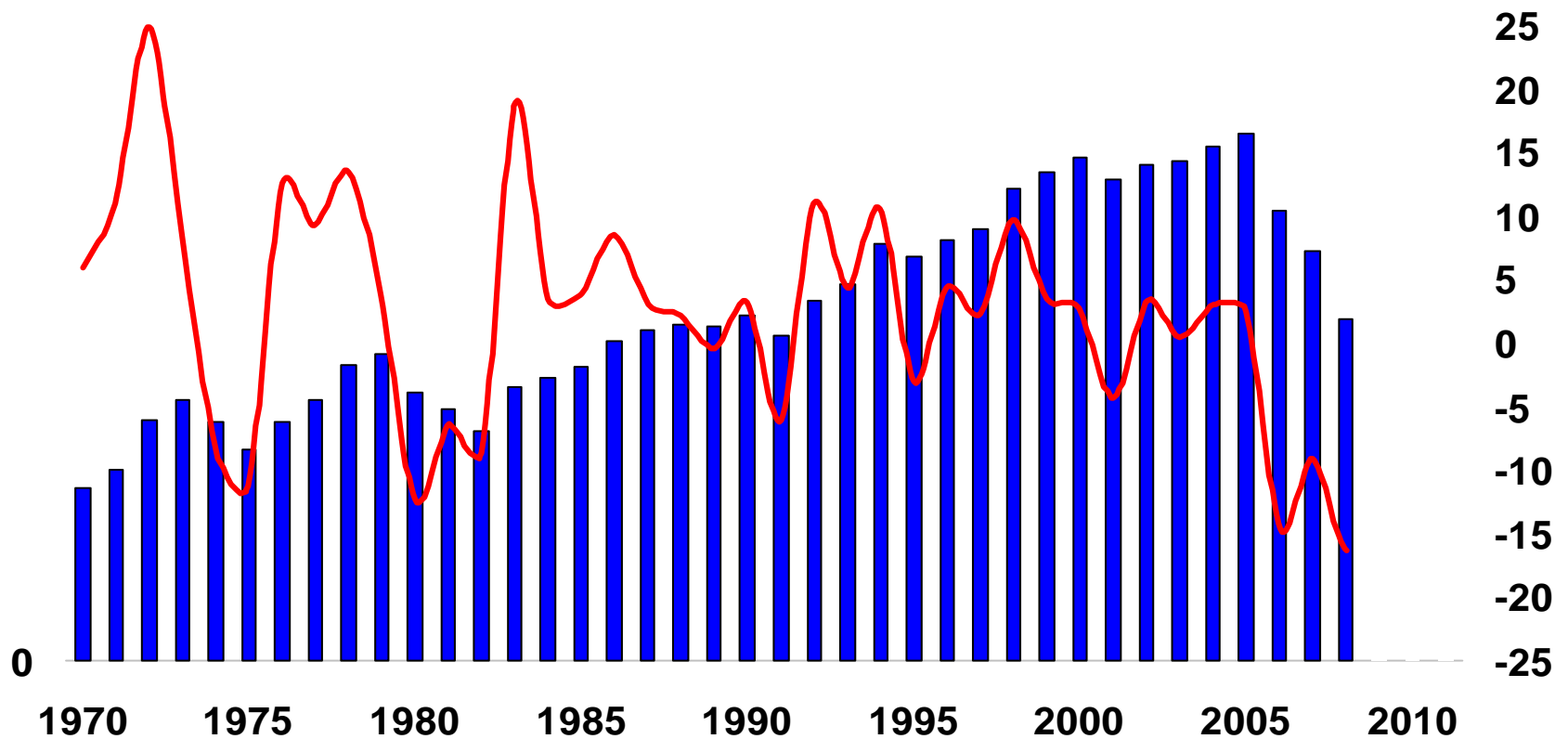
Sources: NBER, BEA, BLS



# Implications for US Carpet Shipments

Millions of Square Yards

% Change Y/Y



■ Shipment Volume — % Change

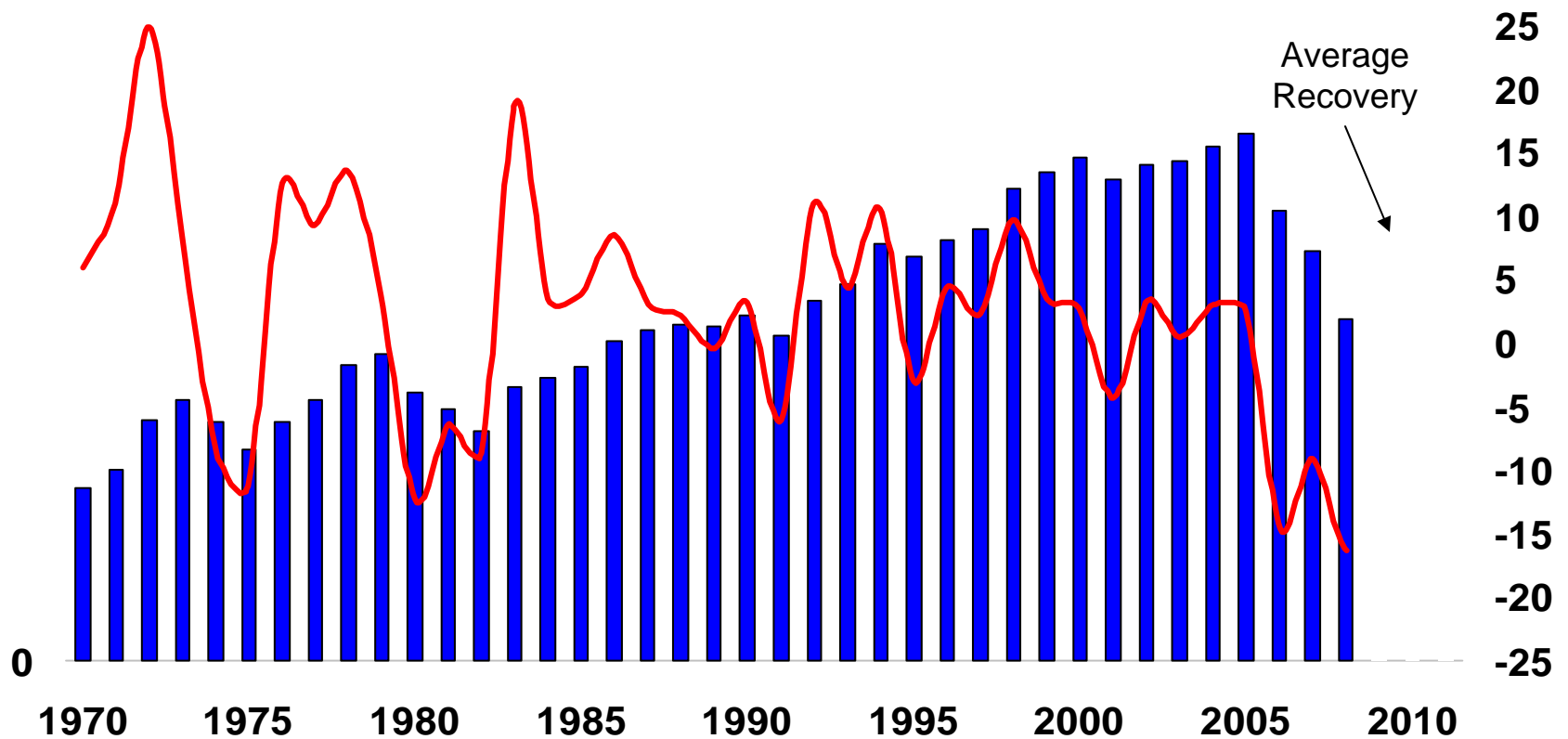
Sources: Carpet and rug Institute, Bureau of the Census, ACC analysis



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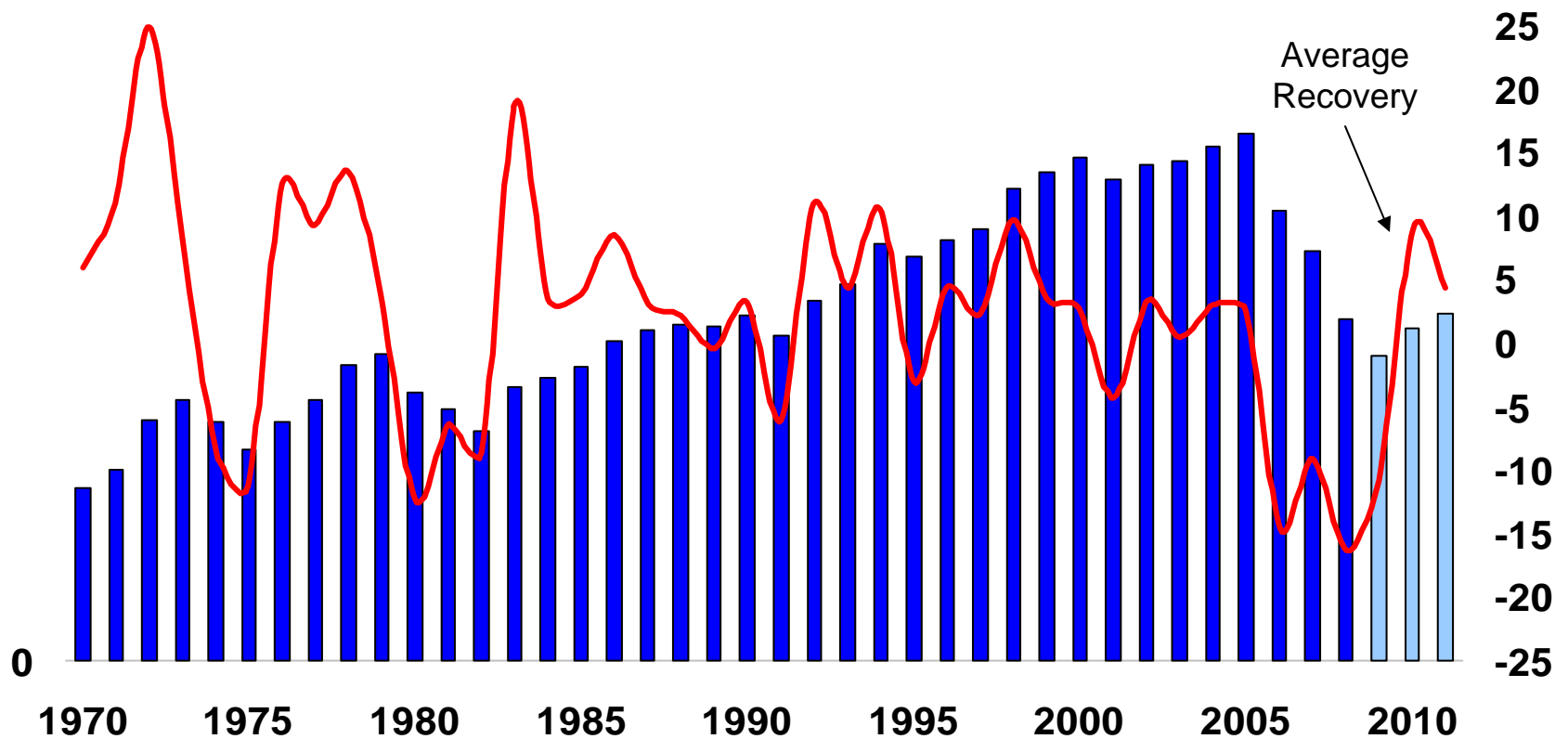
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# Conclusions

- US economy is in the worst financial crisis since the Great Depression
- The *real* economy is facing its worst downturn since the 1970's
- Global GDP will decline for the first time since World War II
- But, a virtuous cycle will emerge and the economy will return to its historic growth trajectory
- Indicators to watch:
  - Leading Economic Indicators (LEI)
  - Weekly initial claims
  - Consumer confidence