Economic Forecast for 2008

by

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2008 Economic Forecast

National Economic Conditions and Forecast

It appears that the expansion that began after the relatively brief and mild recession in 2001 may finally be beginning to run out of steam. Since the end of the recession, the economy has grown in inflation adjusted 2000 dollars from $9.875 trillion (10.021 trillion nominal dollars) in the first quarter of 2001 to $11.659 trillion (13.970 trillion nominal dollars) in the third quarter of 2007. This represents an increase in output of slightly over 18% in real dollars or 39% in nominal terms. Furthermore, the US economy has added 10.129 million jobs since the trough of the last recession. Although this sounds impressive, an examination of Table 1 shows that the current expansion has been the weakest expansion in over 60 years. Employment has increased every quarter at an average rate of just 0.3% while the average annualized growth rate of real GDP has only been 2.8%.

Furthermore, it appears that other problems, such as the housing market and energy prices, might begin to affect other aspects of the economy via consumer confidence. There has been a lot of discussion about the ‘sub-prime’ mortgage meltdown and the impact that it is having on the economy; however, the sub-prime market is a relatively small percentage of all mortgages (approximately 14%). The bigger problem is the asset pricing bubbles created by many years of extremely lax monetary policy by the Federal Reserve. Figure 1, for example, shows how the extremely low interest rates produced from an easy monetary policy helped to alter housing prices in the United States. As one can see from the graph, the median housing price hit a peak of 5.2 times the median household income in 2005. This is in comparison to the 25 year average of 4.06. (The ratio value falls to 3.8 times median income if we exclude the past few years of abnormally high outliers.) This means that national housing prices would have to fall 15.3% to return to the 25 year historical average if we wanted an immediate return to an ‘equilibrium’ housing price. Alternatively, we can restore the relationship between housing prices and income by keeping housing prices constant and letting incomes rise. It is likely that a combination of the two will occur—housing prices will continue to soften nationally and median household incomes rise. Figures 2 and 3 further hint at the housing price bubble and how much it has deflated. As one can see from these graphs, the seasonally adjusted annual rate of the value of residential construction began to increase dramatically in 2002 before peaking in February 2006. Since that time it has fallen 31% while the value of all construction has only fallen 9.6% during a similar time frame. Housing permits have fallen to a level not seen since July 1993 and are off 48% from their high that was reached in September of 2005. Compared to the national average, housing prices in Missouri, and in particular the Springfield and Joplin Metropolitan Statistical Areas (MSA), continue to be ‘reasonably’ priced.

The rise in energy prices is another ‘double-whammy’ that many households are currently having to deal with. The rate of inflation is definitely on the rise with prices being an average of 4.3% higher in November 2007 than they were in November 2006 as shown in figure 5. Food and energy prices changes are even larger with food prices up 4.8% and energy prices up 21.3% over the same time period. Figure 6 better illustrates the dramatic increase in gasoline and natural gas prices that has occurred since late 2001 and early 2002. Even though gasoline prices have moderated slightly in 2007, they are up 60% since January 2000. As of yet, this has had a relatively modest, if any, impact on the economy since consumers today are spending a smaller percentage of their income on energy than in the past. However, the increase in energy prices, in conjunction with the troubles in the housing market, may have finally begun to slow the U.S. economy down.

Even though real GDP continues to grow at an acceptable level, the employment picture has turned troubling. Figure 7 shows the growth of real GDP by quarter at seasonally adjusted annual rates. Over the last 4 quarters, real GDP has grown a respectable 2.8%. However, whether the U.S. economy can maintain this growth with the current employment picture is another matter. Figures 8 through 10 demonstrate the slow down in employment. Employment in the 4th quarter of 2007 is only 0.49% higher than in the 4th quarter of 2006. The only time employment growth has slowed to this level without the economy on the verge of, or in, recession was 1996. In short, the US has only added 746,000 jobs since the beginning of the 4th quarter of 2006 and has only added 312,000 jobs so far in 2007. This is reflected in consumer sentiment which is down 15% from a year ago.

It is with this in mind the we are predicting an increase of real GDP in 2008 of only 1.9% (range is a low of 1.6% to a high of 2.2%). Employment is expected to increase only 0.65% (range of 0.49% to a high of 0.8%) which means that the US should create only about 950,000 jobs (range of 717,000 to 1,170,000 jobs). We are expecting inflation to be between 2.9% and 3.8% with an actual estimate of 3.5%. Unemployment should be slightly higher in 2008 than in 2007 with an estimate of 5.1% (range of 4.8% to 5.3%). Finally, we are increasing the probability of recession in 2008 to 48%. In contrast, the 2007 recession probability was only 29%.

State and Regional Economic Conditions and Forecast

The Missouri economy continues to under perform in relation to the US economy. Figure 12 examines the growth rate of real US GDP compared to real Missouri GSP. As the reader can verify, the US economy has experienced growth rates that are far better than those experienced here in Missouri. Over the past 10 years, the US economy's real GDP has grown 33.9% while the Missouri economy has grown less than 17%. Unfortunately, as shown in figure 13, the Missouri economy is becoming increasingly irrelevant to the national economy. In 1963, the Missouri economy produced 2.24% of the nation's output. Today that figure stands at 1.7%--a decline of over 24%.

The slower than average growth of the Missouri economy is further evidenced by figure 14 which shows how employment has changed since the 1st quarter of 2001 where the employment level was set at 100. The US experienced a slight decrease in employment of 1.2% before returning to the pre recession index value of 100 in the 4th quarter of 2003. In comparison, Missouri experienced a decline of 2.2% in employment, nearly double the US percentage decline. Furthermore, the Missouri economy did not return to pre recession employment levels until the summer of 2006. In short, the Missouri economy has only increased employment 0.7% in the past 7 years. In contrast, Southwest Missouri, and the Springfield MSA in particular, appears to be doing quite well. Referring back to figure 14, the Springfield MSA experienced an employment decline of only 0.52% and rebounded to pre recession employment levels in the 2nd

quarter of 2002. Although Southwest Missouri experienced a steeper decline in employment of 2.3% than Missouri as a whole, the regional economy was able to return to pre recession employment levels by the 1st quarter of 2005. Since the 1st quarter of 2001, employment is up 6.26% in the US, 0.7% in Missouri, 4.8% in Southwest Missouri, and 9.2% in the Springfield MSA. Further evidence of the relative strength of the Springfield MSA economy can be seen in that between 2001 and 2005 (the only years that data is available for all of the series), real output in the Springfield MSA grew 13.2% while Missouri's real output grew 7.1% and the US's real output grew 11.1%.

However, it appears that the good news may be slow in coming in the future. Figures 15 through 17 offer comparisons of the percentage change in employment for the US, Missouri, Southwest Missouri, and the Springfield MSA. Even though employment growth in the US has slowed to 0.49%, it Missouri is has fallen to 0.01% in the 4th quarter of 2007 and to nearly zero percent for Southwest Missouri. In November of 2007, the last point that reliable monthly data was available, Missouri experienced a decline in employment of 0.34% meaning that the Missouri economy lost jobs in November 2007 relative to November 2006. Springfield MSA is doing slightly better with employment growth of 0.38%, but it too has seen employment growth slow almost to a standstill. In other words, in seasonally adjusted employment, Springfield has created 807 new jobs over the past year while Missouri has created 562 and Southwest Missouri has only seen an employment increase of 25 jobs. Figures 18 and 19 offer further evidence of the slow down in the economy by exhibiting the virtual halt to employment growth while figure 20 shows that unemployment rates have begun to move upwards in all of the previously discussed regions. Currently, the unemployment rate in the Springfield MSA is the lowest at a rate of 4.4% while the US as a whole stands at 4.7%. Southwest Missouri and Missouri itself both have an unemployment rate of 5.2%.

We expect the employment growth in Missouri and in Southwest Missouri to turn negative this year, but for the decline to be a relatively modest 0.3%. In short, employment should come in at 2,890,650 for a job loss of 8,700 for the state of Missouri while Southwest Missouri should lose 1,300 jobs so that employment falls to 466,550. Expectations are for Springfield employment to remain relatively flat. Unemployment rates should increase in all of the mentioned regions with Missouri's and Southwest Missouri's rates increasing to 5.5% while Springfield's unemployment rate increases to 4.8%.

Table 1. Selected Characteristics of US Economic Expansions (1949-Present)

Expansion	Number of Quarters	Employment Gain in Thousands	Percentage Increase in Employment	Average Growth Rate of Employment	Average Growth Rate of Real GDP
2001:4 – Present	25	10,129	7.43	0.3	2.83
1991:2 – 2000:4	39	19,612	16.65	0.4	3.56
1983:1 – 1990:3	31	19,569	19.74	0.6	4.21
1980:4 – 1981:3	4	983	0.9	0.4	4.45
1975:2 – 1980:1	20	14,530	17.02	0.8	4.34
1971:1 – 1973:4	12	7,518	9.55	0.8	5.25
1961:1 – 1969:3	35	12,415	18.89	0.5	5.00
1958:2 – 1960:1	8	2,468	3.93	0.4	6.30
1954:3 – 1957:3	13	4,208	7.14	0.5	3.99
1950:1 – 1953:2	14	3,601	6.24	0.4	7.61

Figure 1. Ratio of Median Sales Price of New Home to Median Household Income

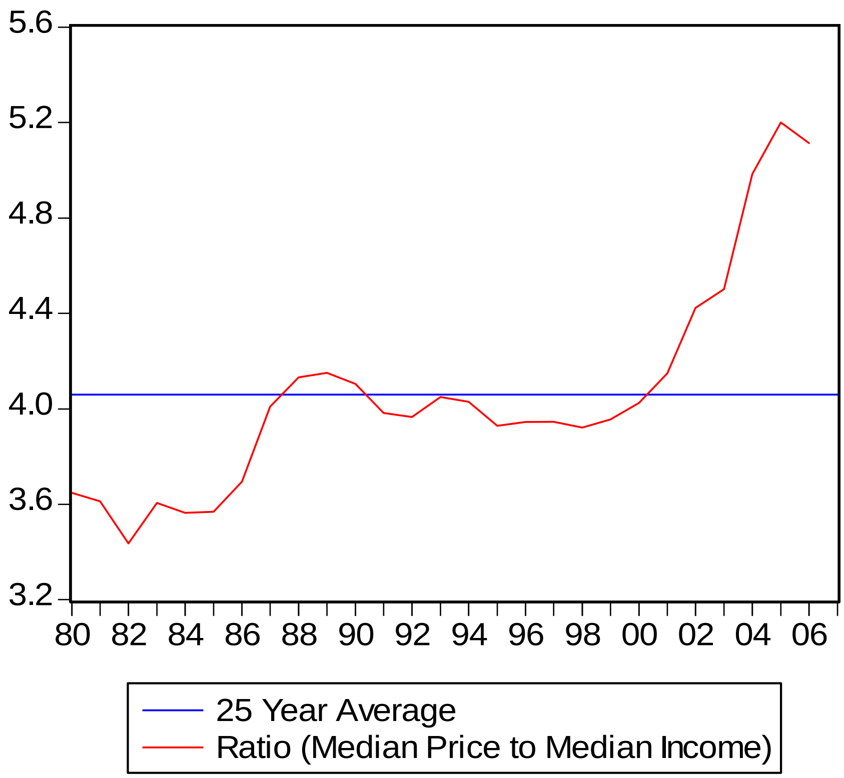

Figure 2. Index of the Value of Construction (SAAR January 1993=100)

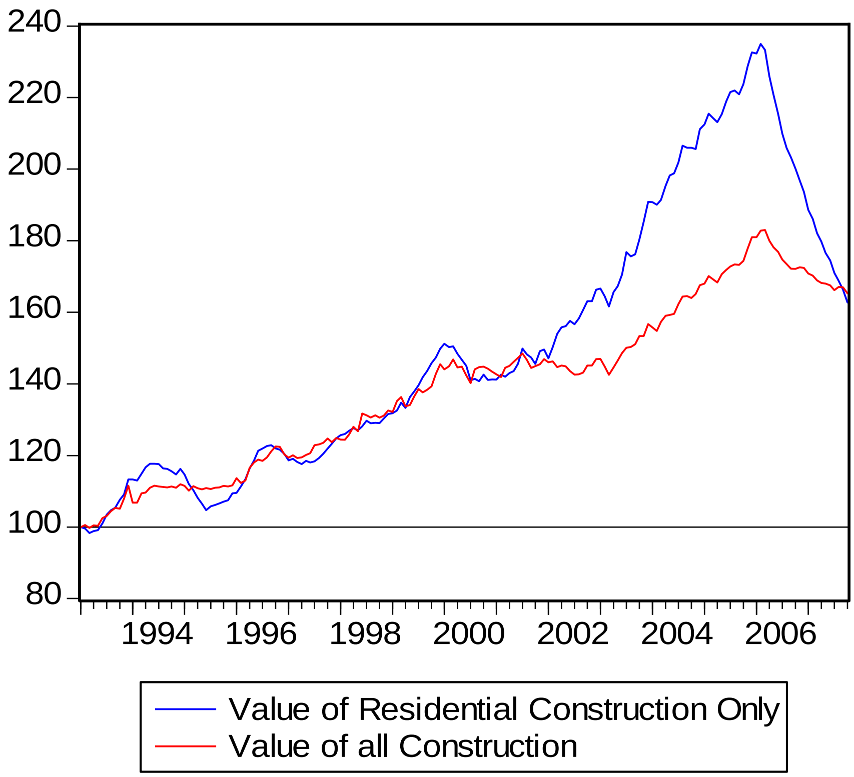

Figure 3. Index of Total Construction Value, Residential Construction Value, and Housing Permits (Jan 1993=100)

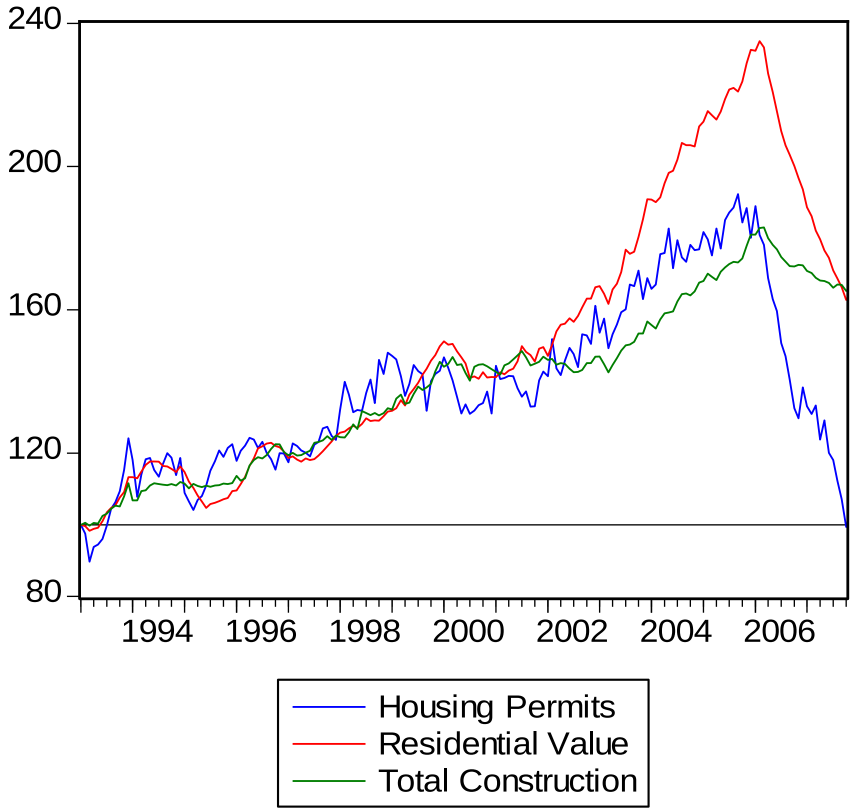

Figure 4. Housing Price Index (1995 Q1 = 100)

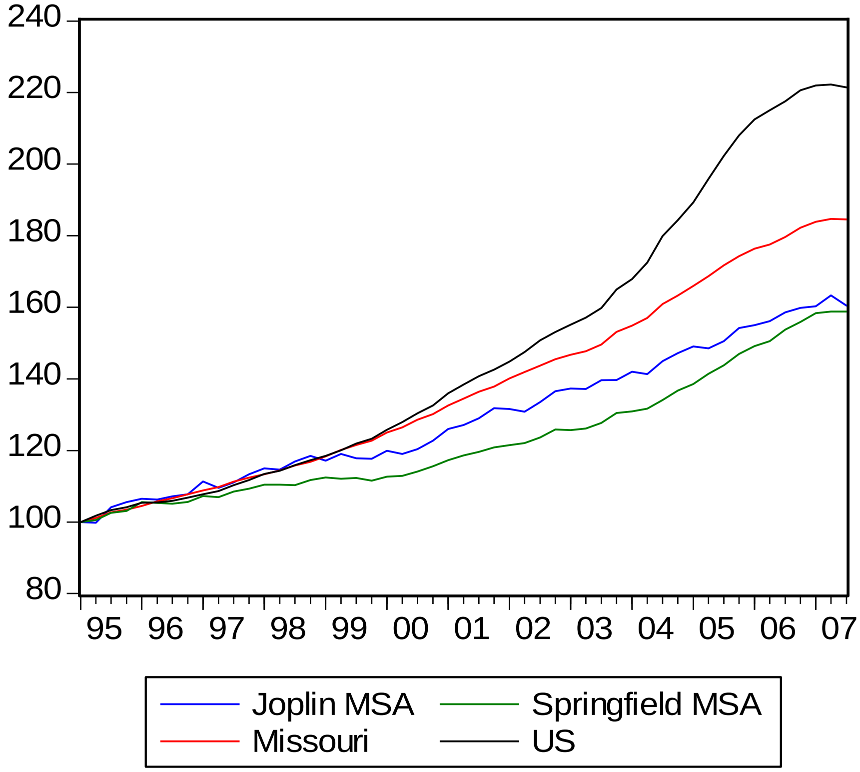

Figure 5. Inflation Rate

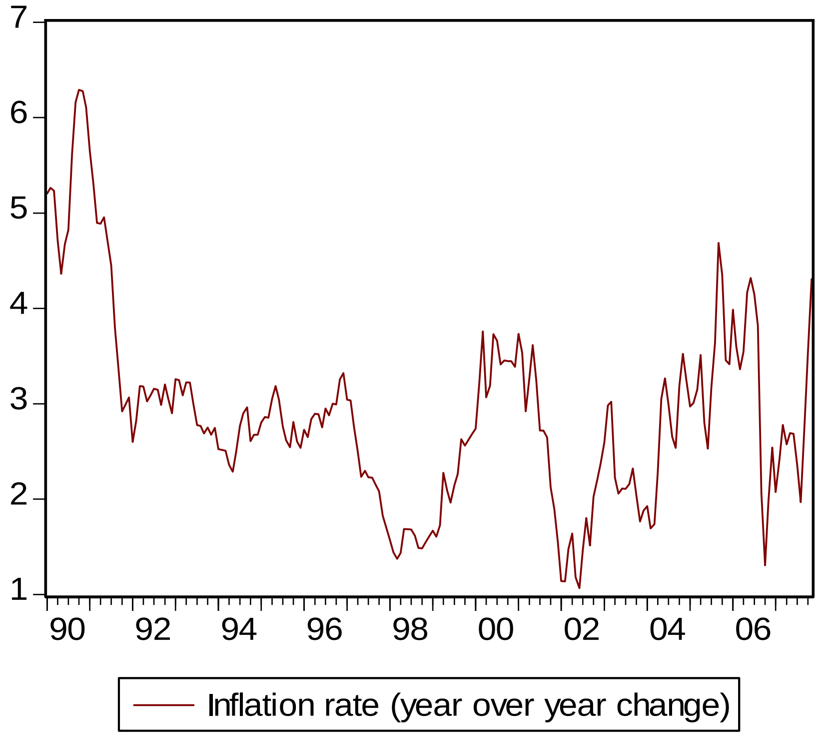

Figure 6. Real Gasoline and Natural Gas Price Index
(September 2007 Prices with January 2000 Real Seasonally Adjusted Prices =100)

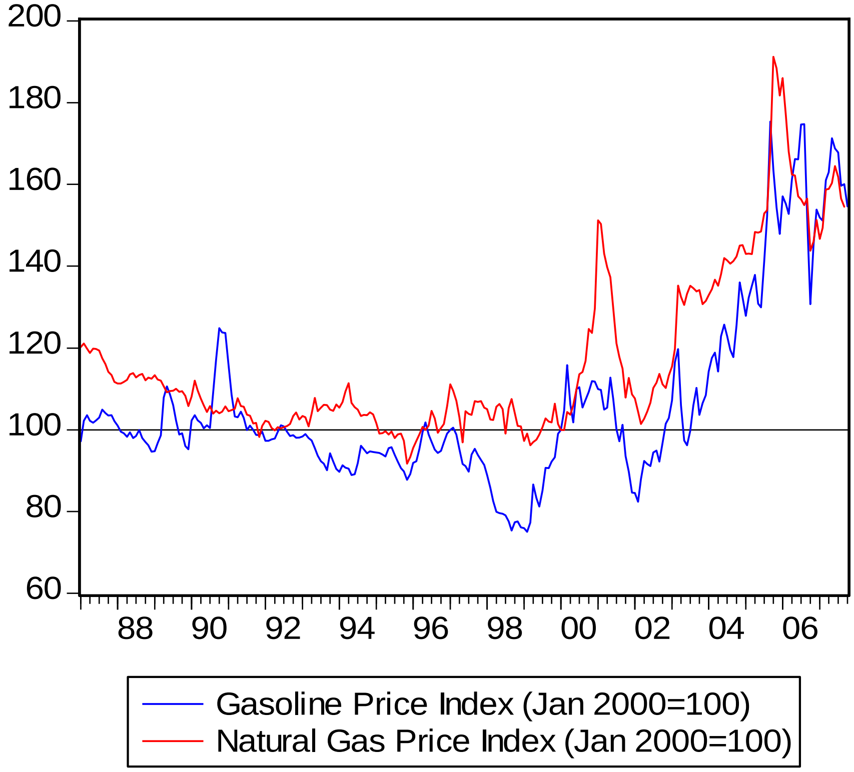

Figure 7. GDP Growth by quarter (SAAR)

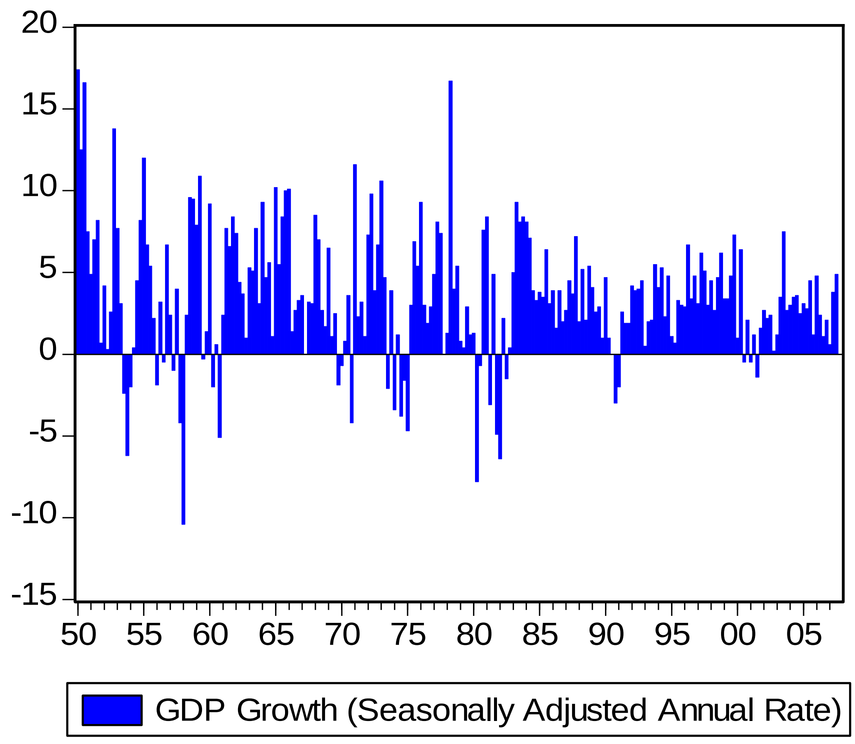

Figure 8. Total Seasonally Adjusted US Employment (Thds.)

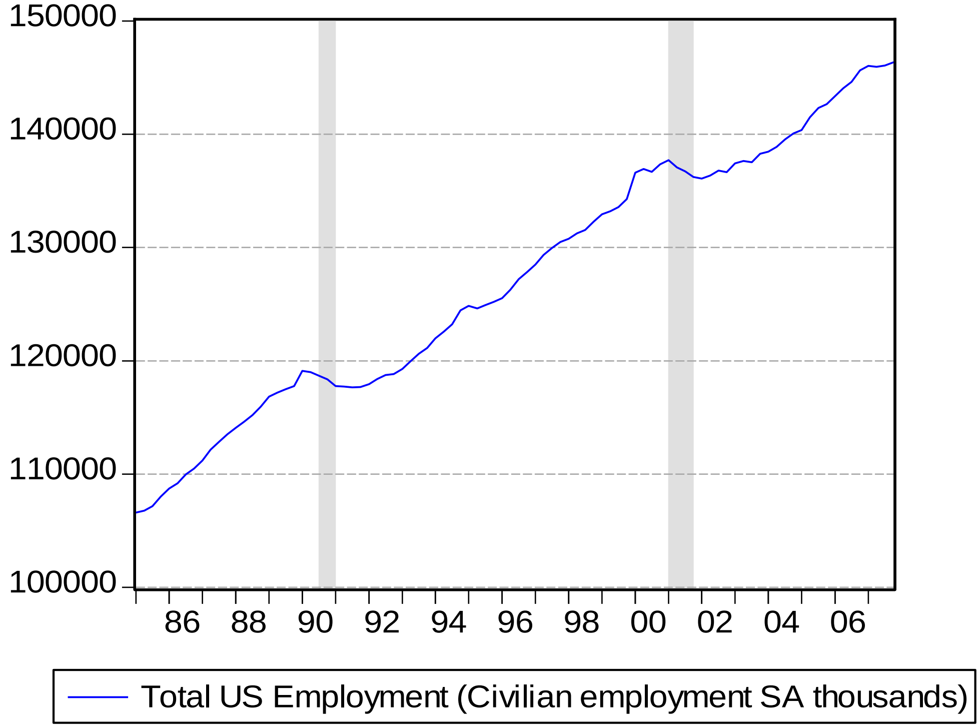

Figure 9. Year over Year Percentage Change in US Employment (recessions are shaded)

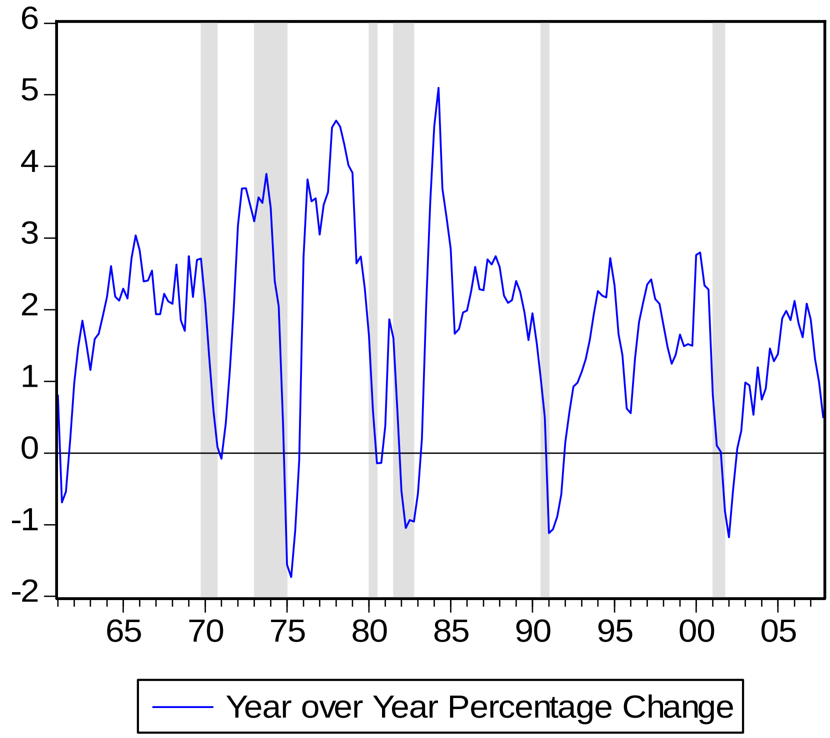

Figure 10. US Unemployment Rate

Figure 11. Percentage Change in Consumer Sentiment (year over year)

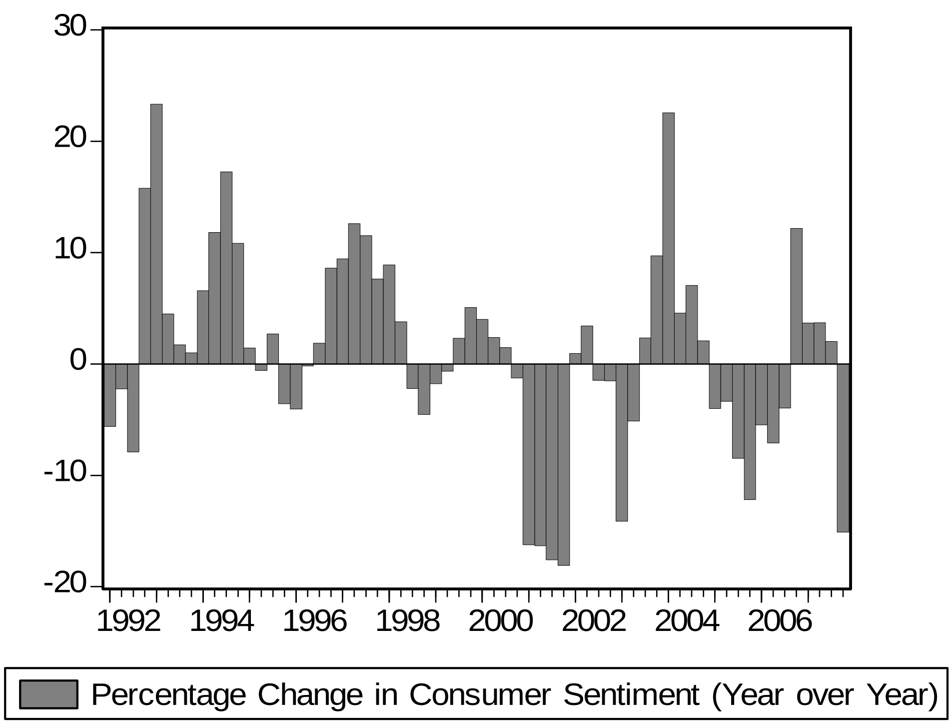

Figure 12. Growth Rate in US GDP and Missouri GSP

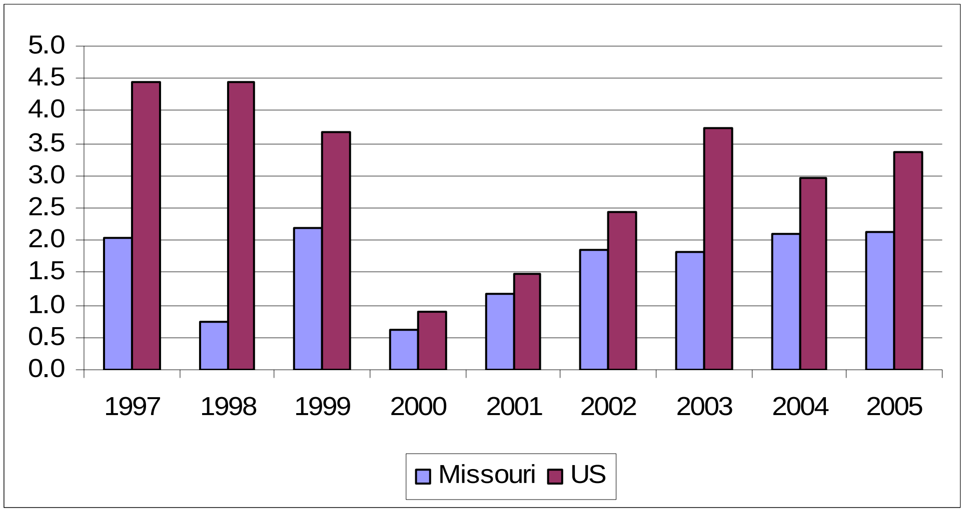

Figure 13. Missouri GSP as a Percentage of National GDP

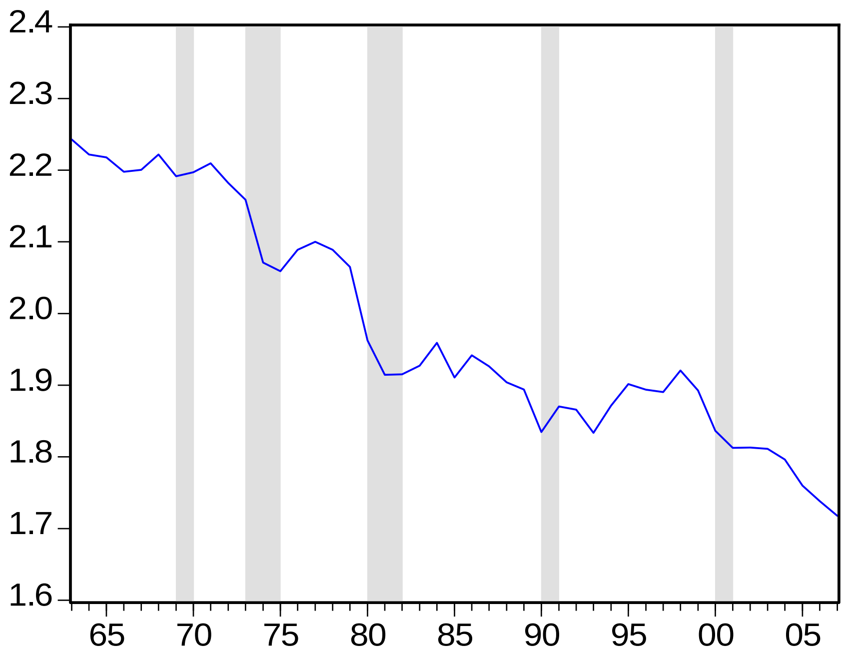

Figure 14. Employment Index
(Seasonally Adjusted Employment in 1st quarter of 2001 = 100)

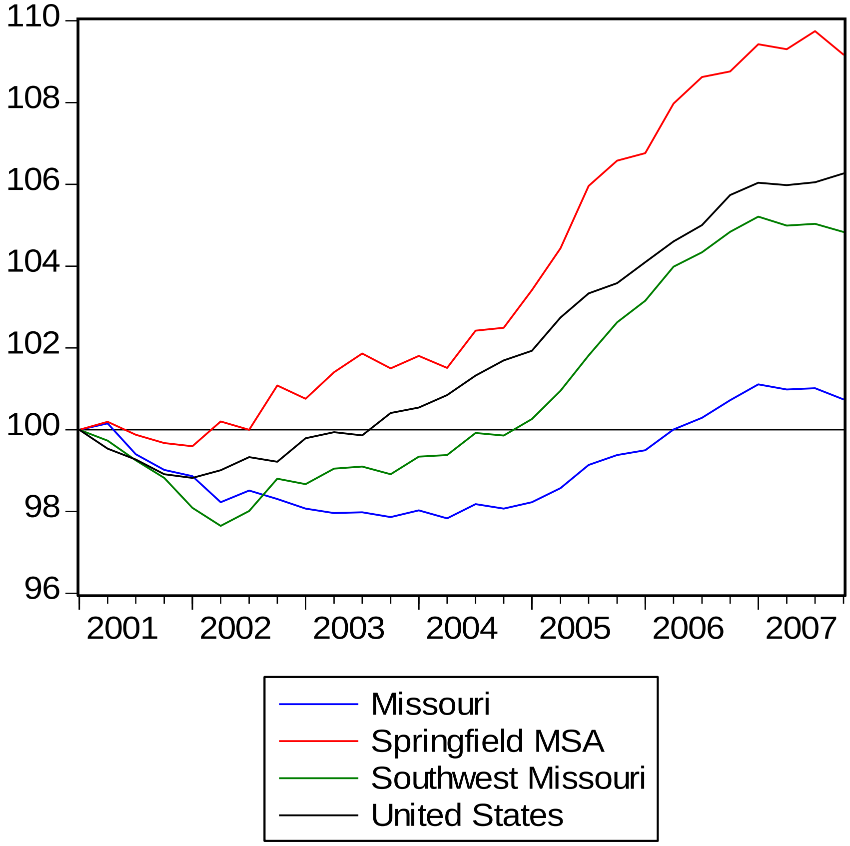

Figure 15. Percentage Change in Employment (year over year)

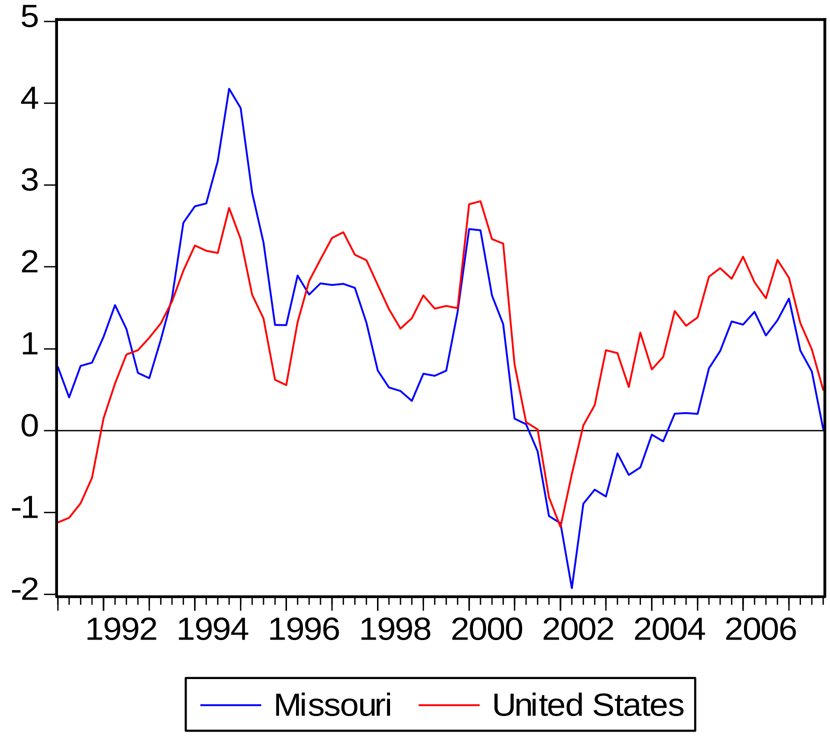

Figure 16. Percentage Change in Employment (year over year)

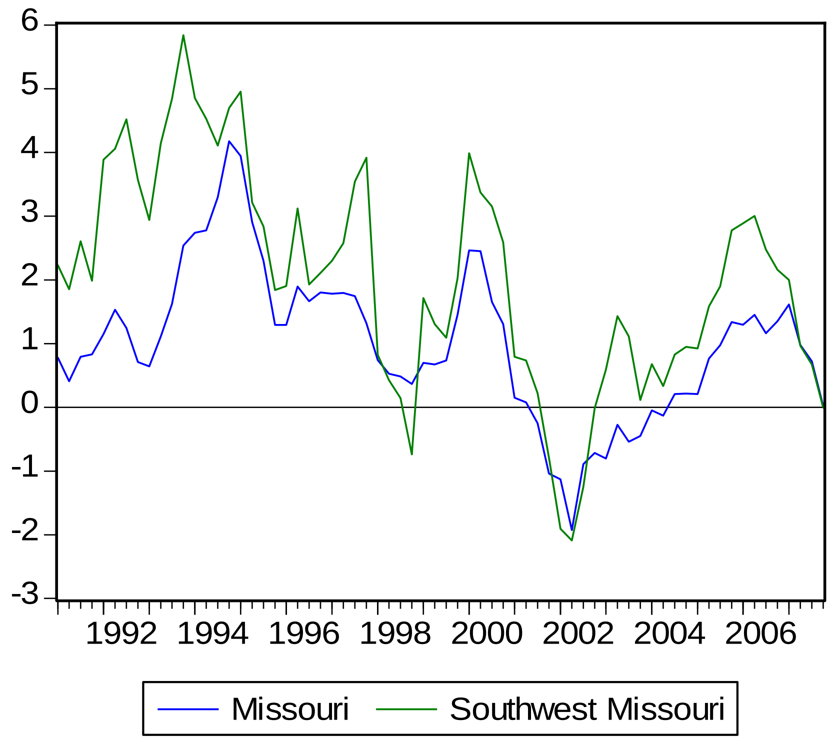

Figure 17. Percentage Change in Employment (year over year)

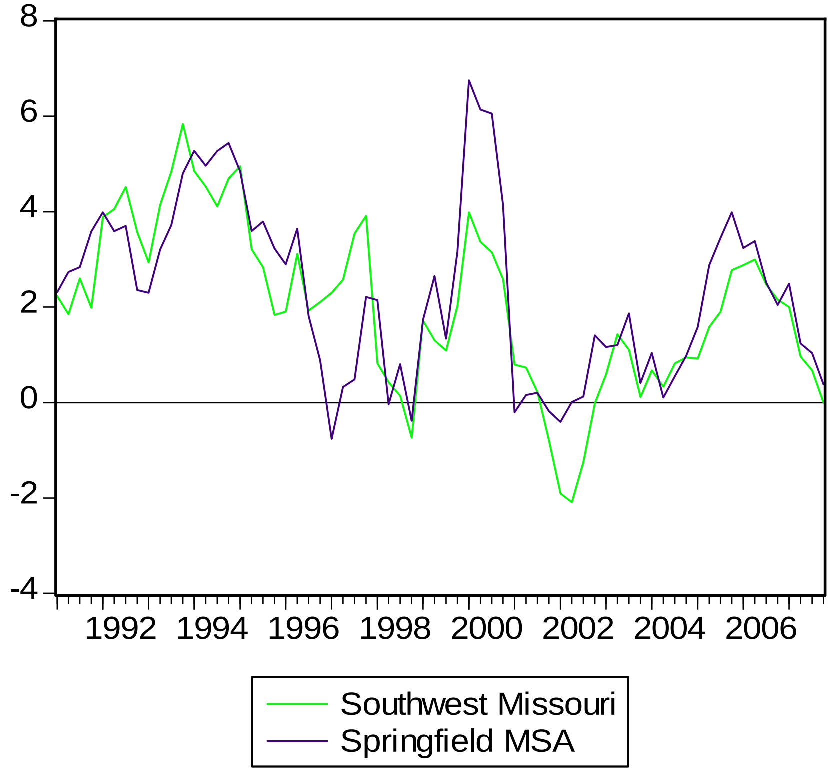

Figure 18. Missouri Employment Seasonally adjusted

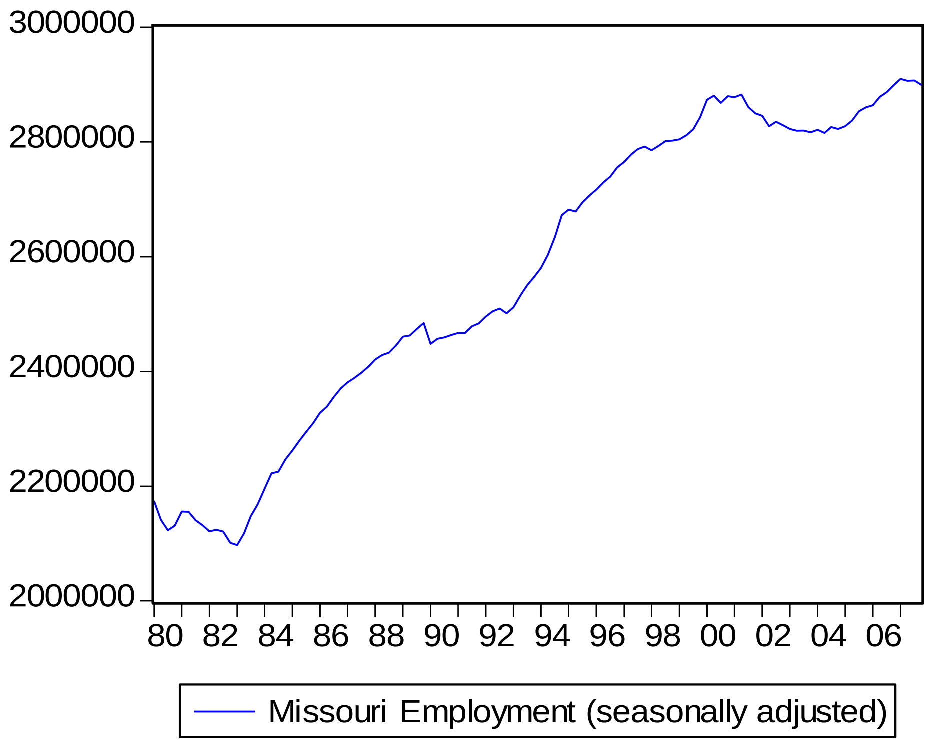

Figure 19. Employment in Southwest Missouri and Springfield MSA (Seasonally adjusted)

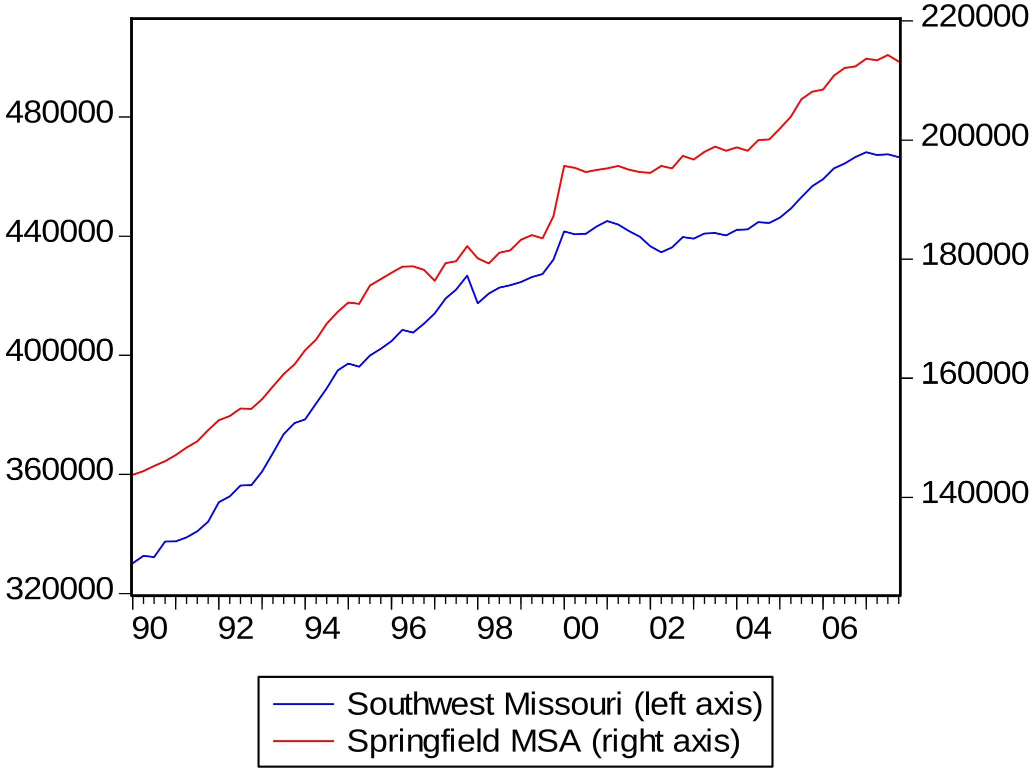

Figure 20. Unemployment Rates of Selected Areas
(Seasonally Adjusted)