

Redwood Credit Union Board Retreat: Our Economy and Lending Markets

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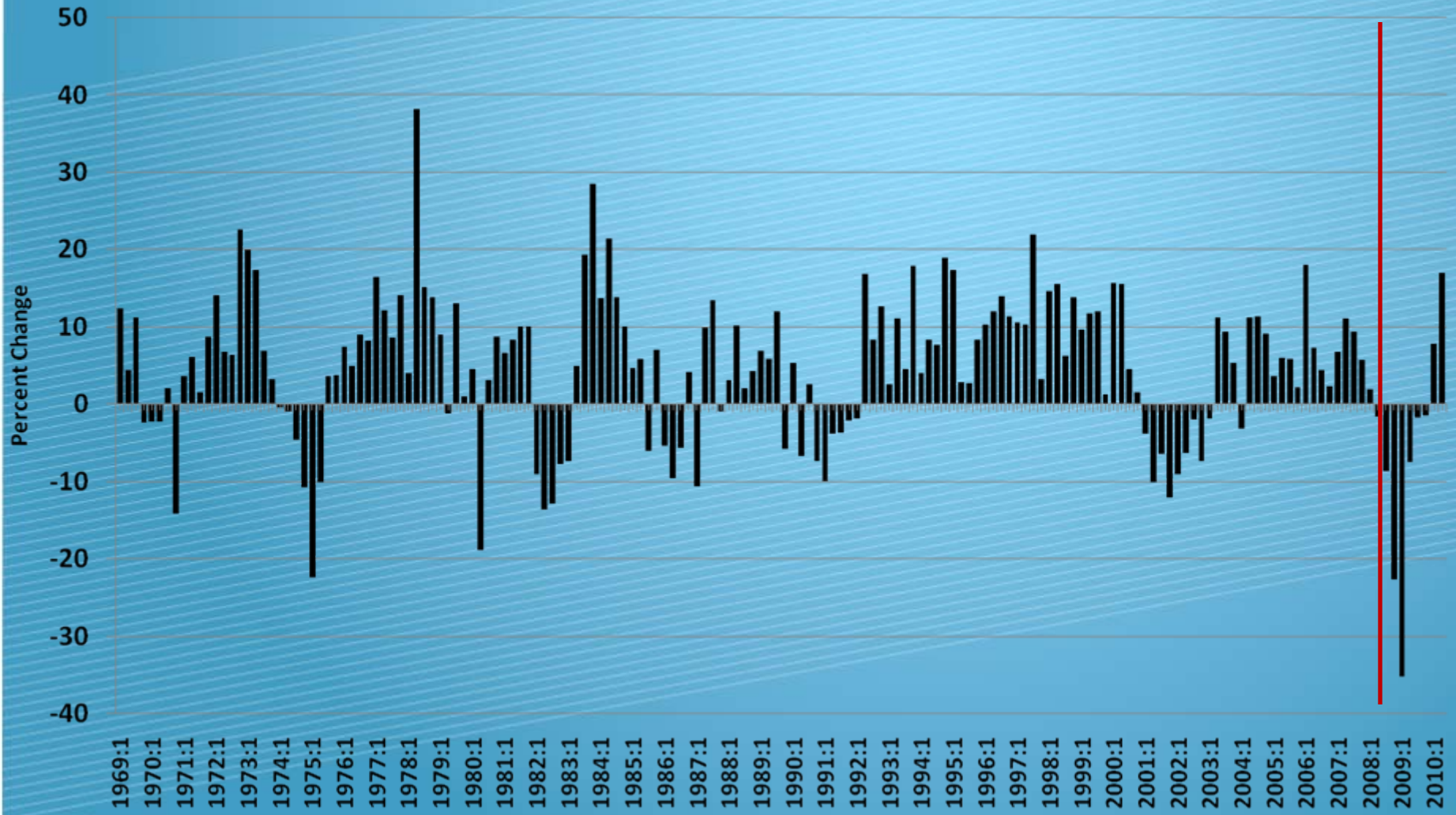


School of Business
and Economics

Conclusions (9/13/08)

- Bad news abounds, depths media-driven
 - We are in a downturn, depth still unknown
 - Likely trough spring 2009
 - Combination of rate cuts and end of election year should begin working
 - If Obama is elected, wait two weeks and buy stocks like crazy
 - National economic picture driven by exports for next 12 months
 - Need a tech focus to truly break out
 - Watch non-residential business investment

Non-Residential Investment, US (% change 2005\$, SA)



Introduction

- We are in recovery: for how long?
- Quick macro ideas
 - Labor, goods, money
 - Global issues, national issues
- Lending markets seen as the major problem
 - Innovation and entrepreneurship need the fuel
 - Why is there continued, stagnant credit?
- State issues
- Local issues

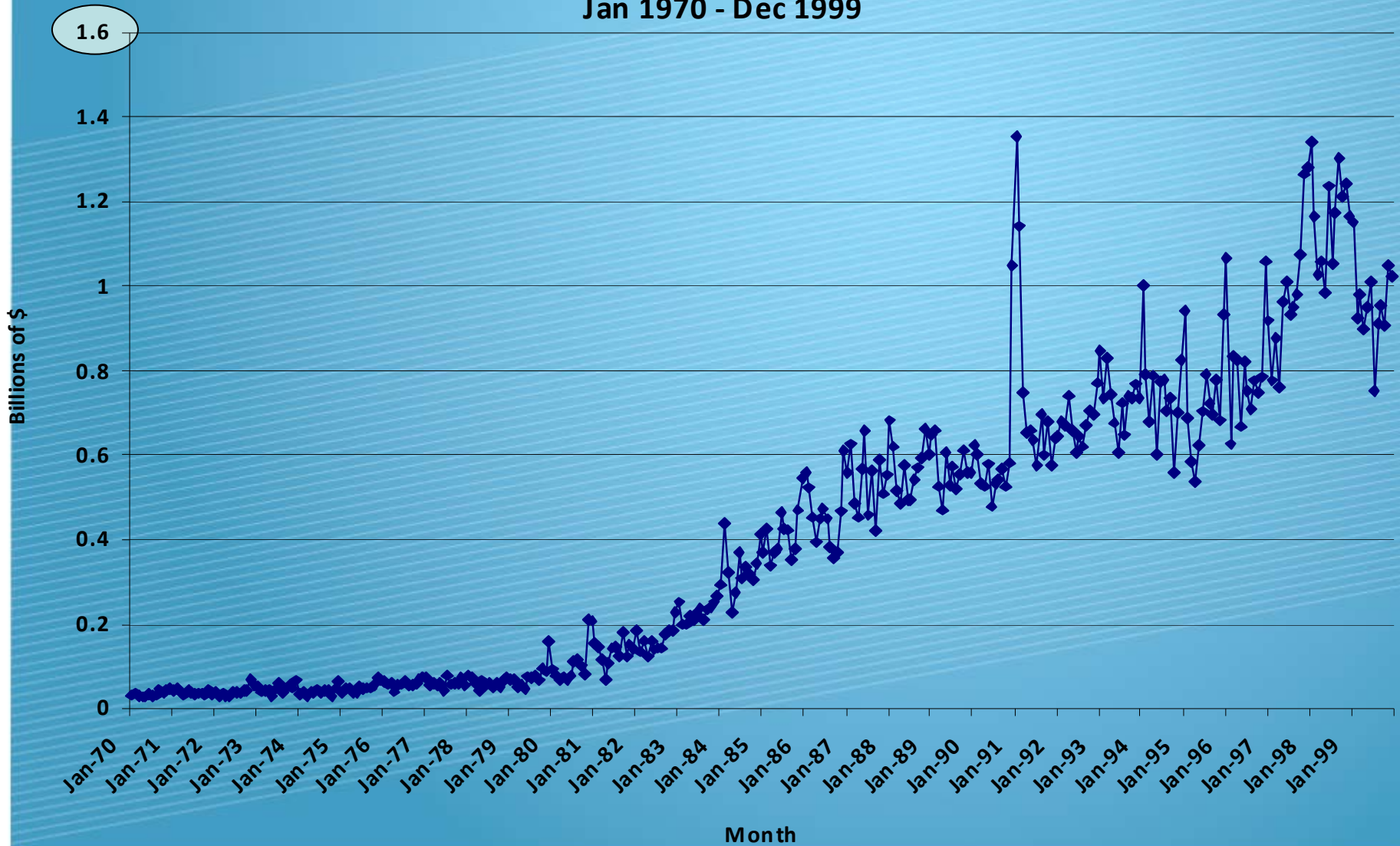
Deleveraging

- “Deleveraging” recession: risk reversal
- Slow recovery a function of
 - Labor market tentativeness
 - Financial market uneasiness
 - Uncertainty that policies have worked: usually measured by business and consumer spending
- Local and state governments deleverage through shedding services

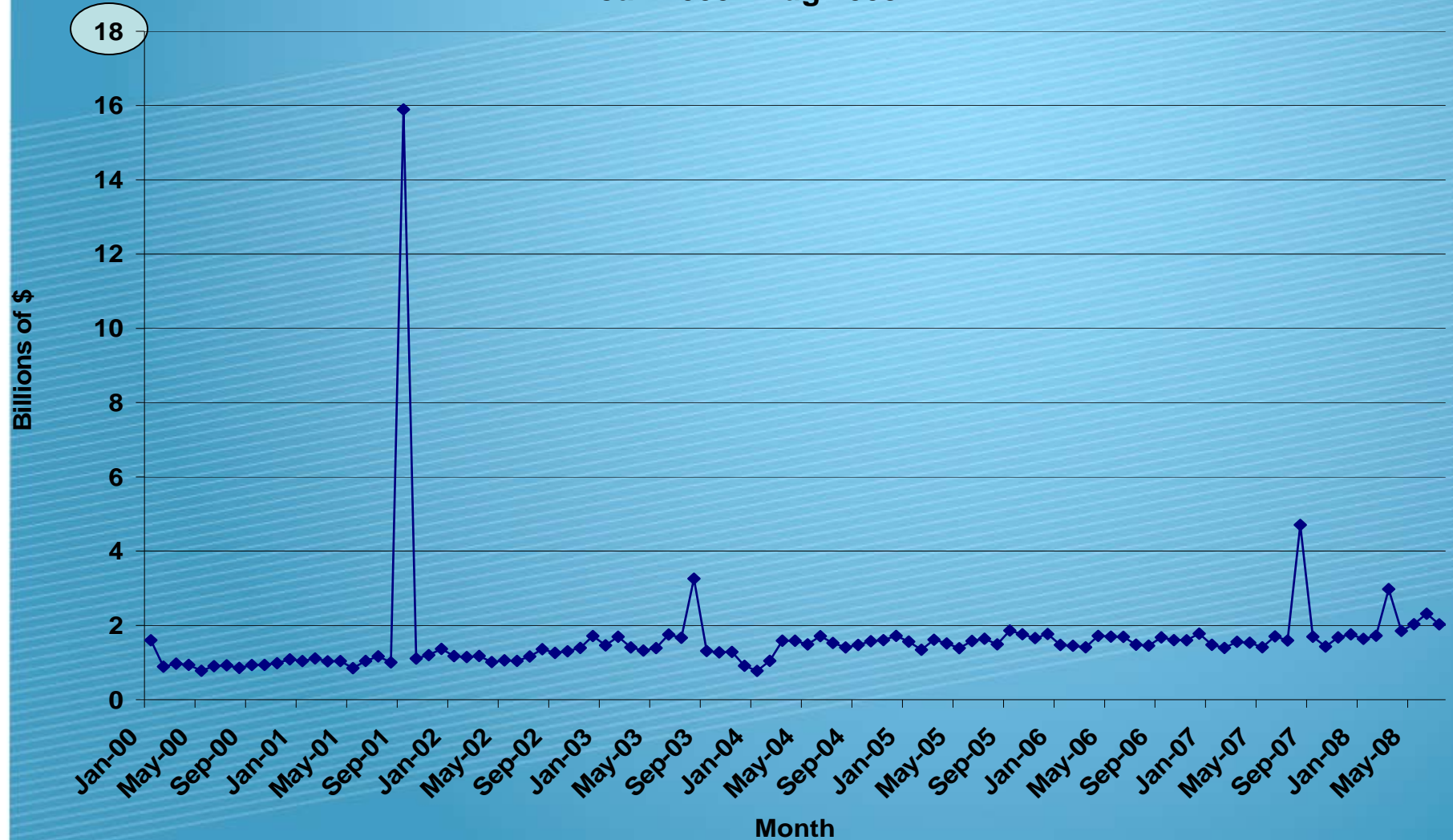
Current State of Affairs

- Tipping Point
 - Remember 1992-1993?
 - Remember 1981?
- International issues (Europe) may have hurt rebound
- National: will stimulus have any permanent effects?
 - Macroeconomics depends on a certain chain of events: financial, labor, goods markets
 - Losing momentum: exports and government spending slowly fading

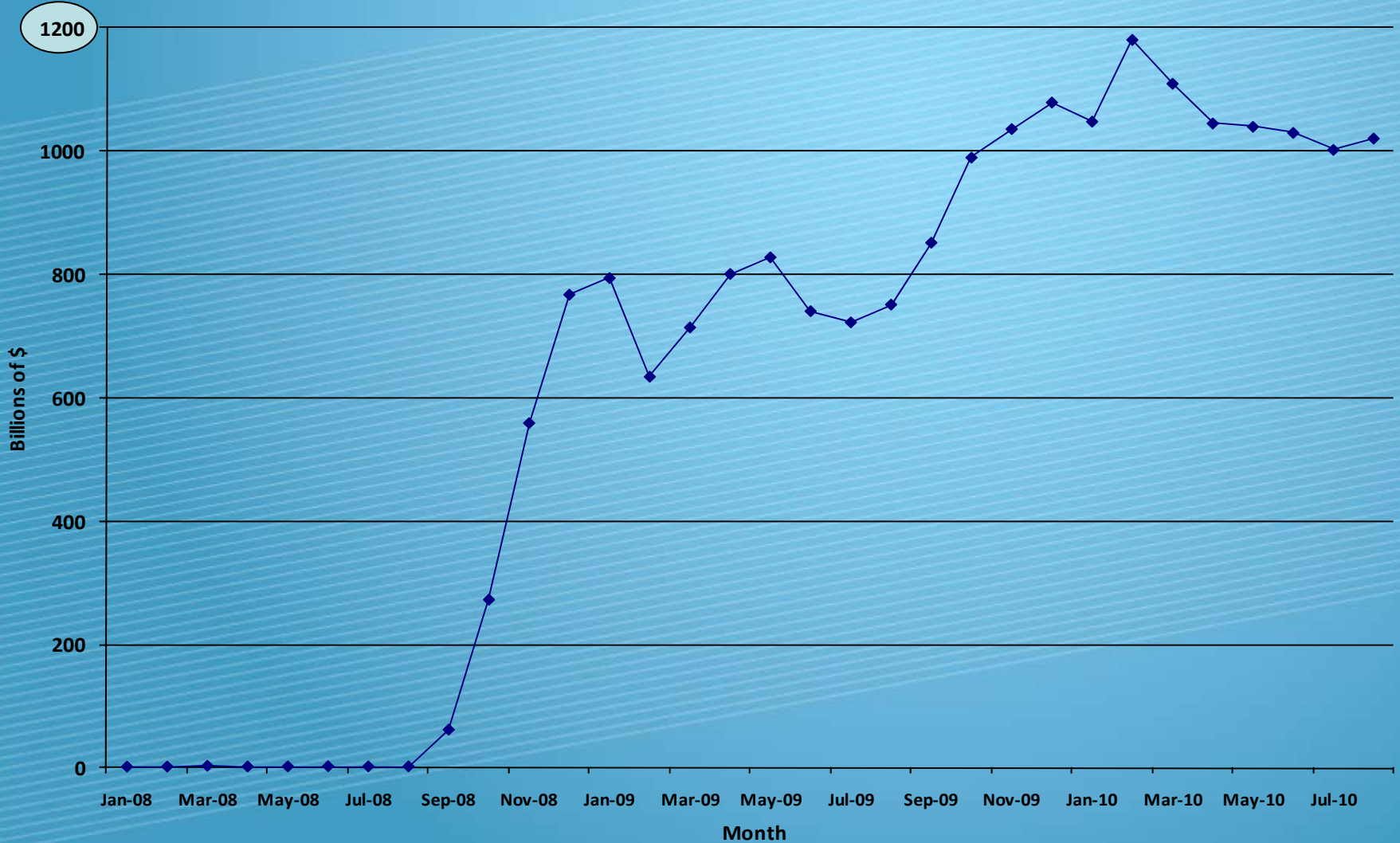
Excess Reserves at U.S. Banks (Loanable Funds Not Lent), 2008\$ Jan 1970 - Dec 1999



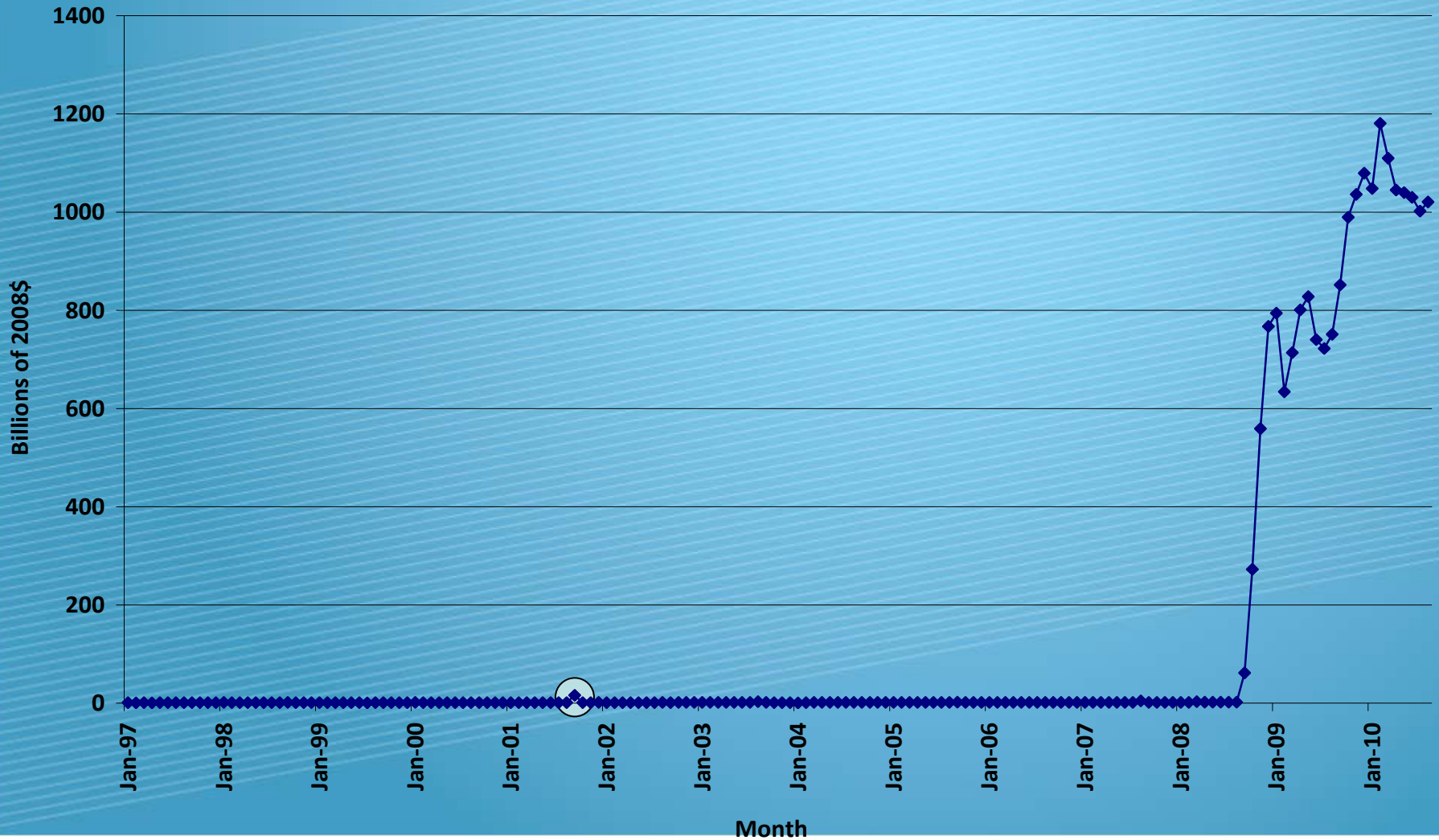
Excess Reserves at U.S. Banks (Loanable Funds Not Lent), 2008\$ Jan 2000 - Aug 2008



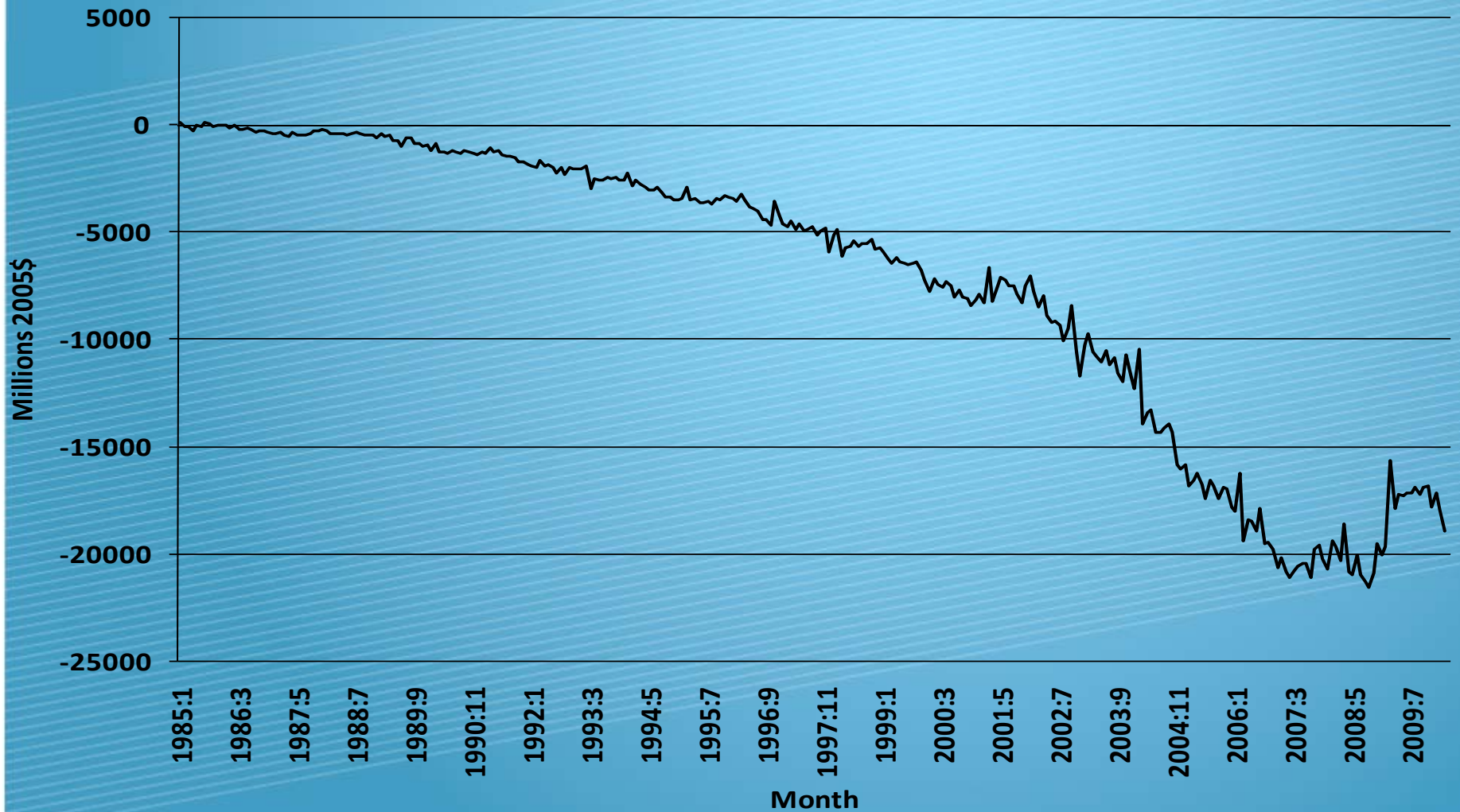
Excess Reserves at U.S. Banks (Loanable Funds Not Lent), 2008\$ Jan 2008 - Present



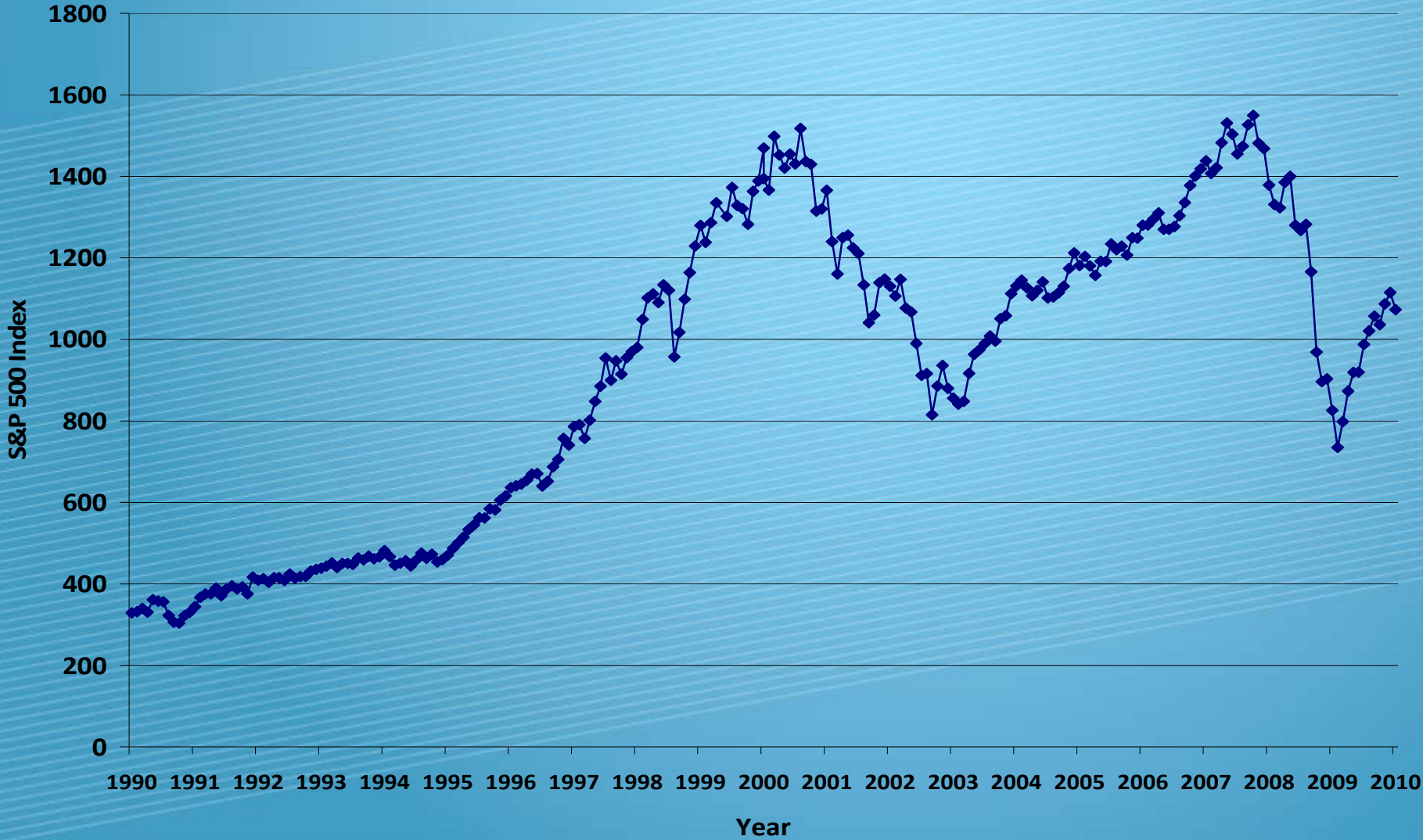
Excess Reserves at U.S. Banks (Loanable Funds Not Lent), 2008\$ Jan 1997 - Present



Trade Balance, US with China, 1985 – Present, Millions 2005\$



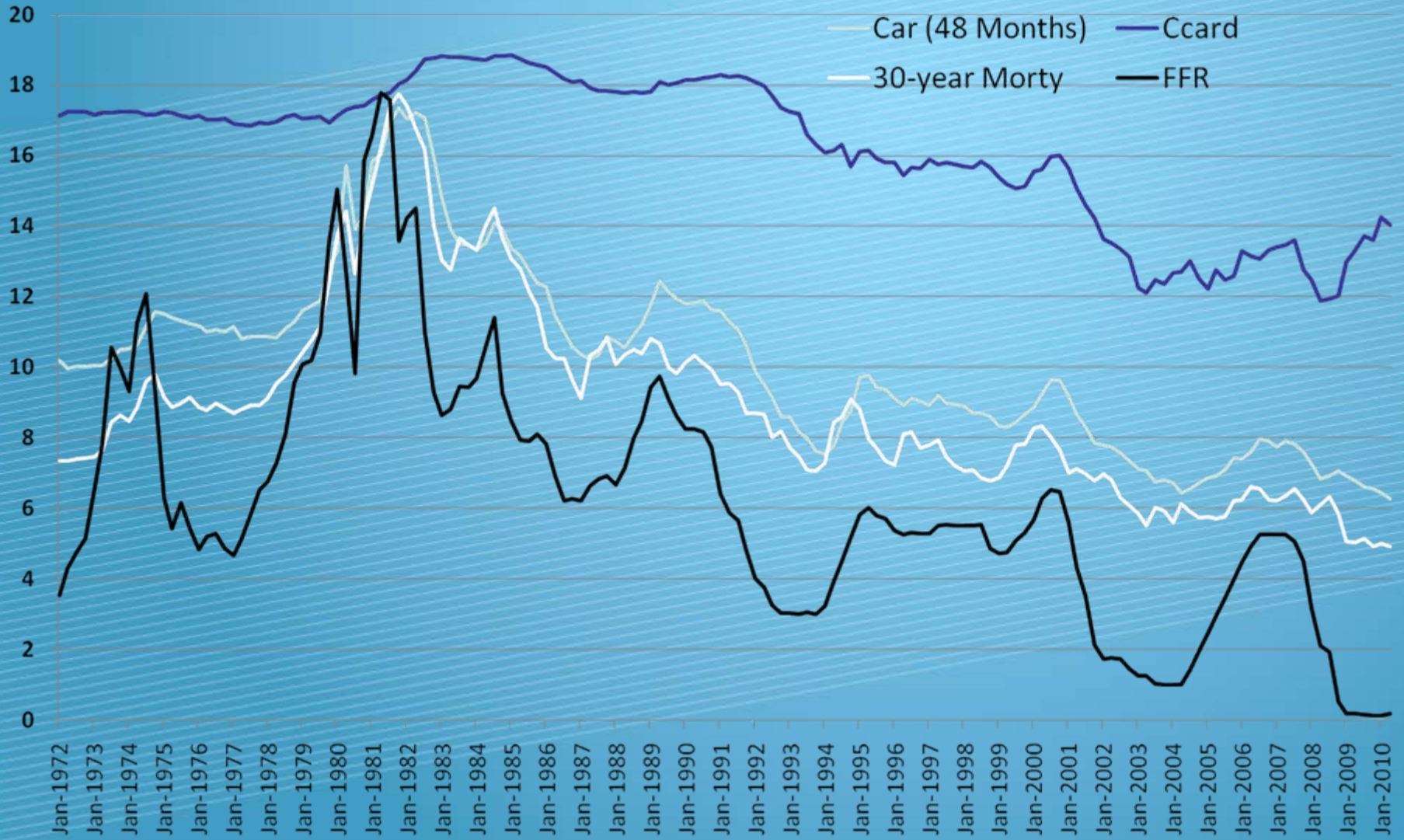
S&P 500 Index, 1990 - Present



Credit Markets

- Supply Issues
 - Construction of new commercial property likely to be project-specific rather than anticipatory
 - **\$1.4 trillion to face refinance or foreclosure in next 3 years**
- Demand Issues
 - Borrowers not racing to low rate financing either
 - Continued economic uncertainty and savings cycle affect demand
- Interest rate low and stable for this reason
 - Slowly becoming a problem for depository institutions

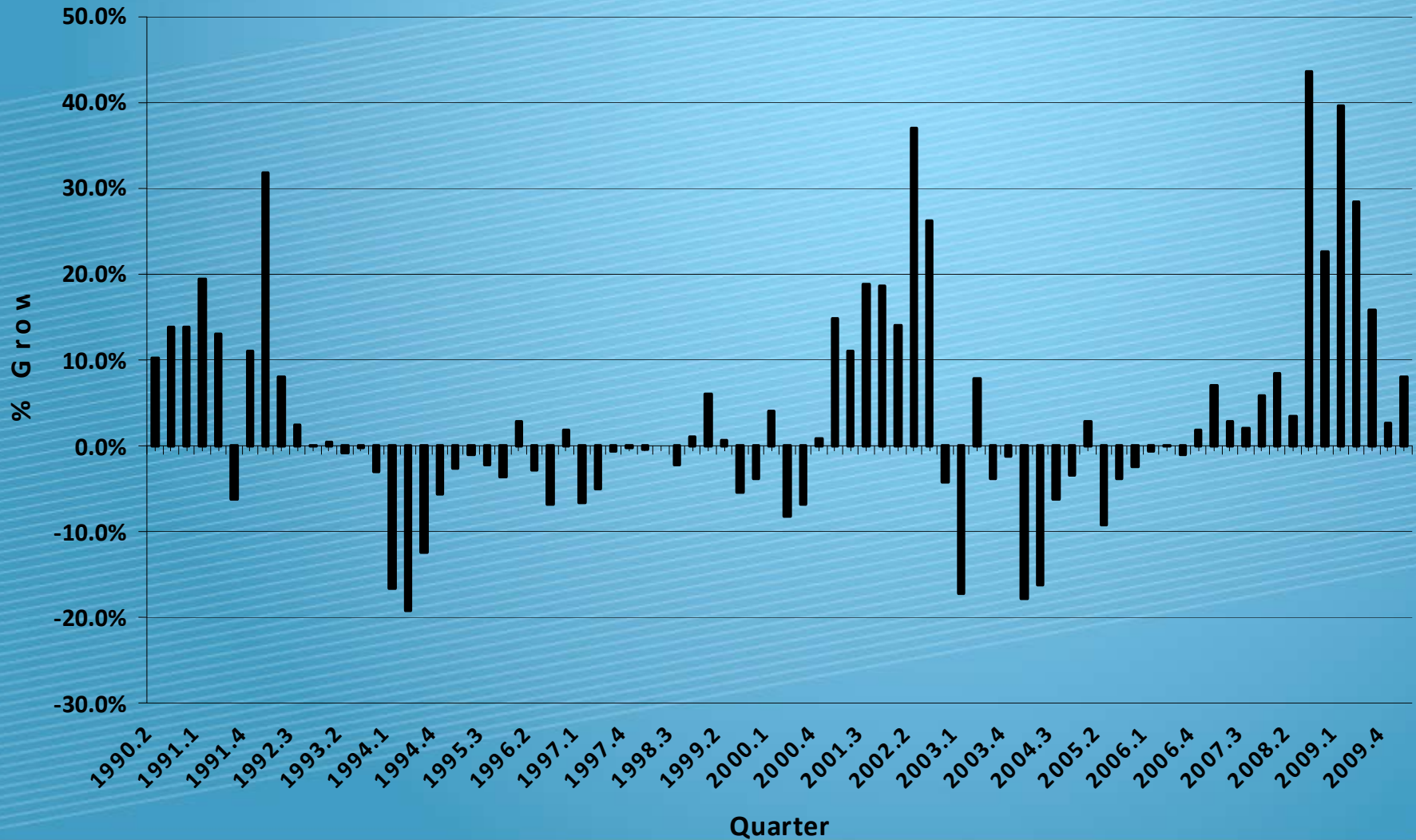
Interest Rate Comparison, 1972 – Present



California, Elections and Reality

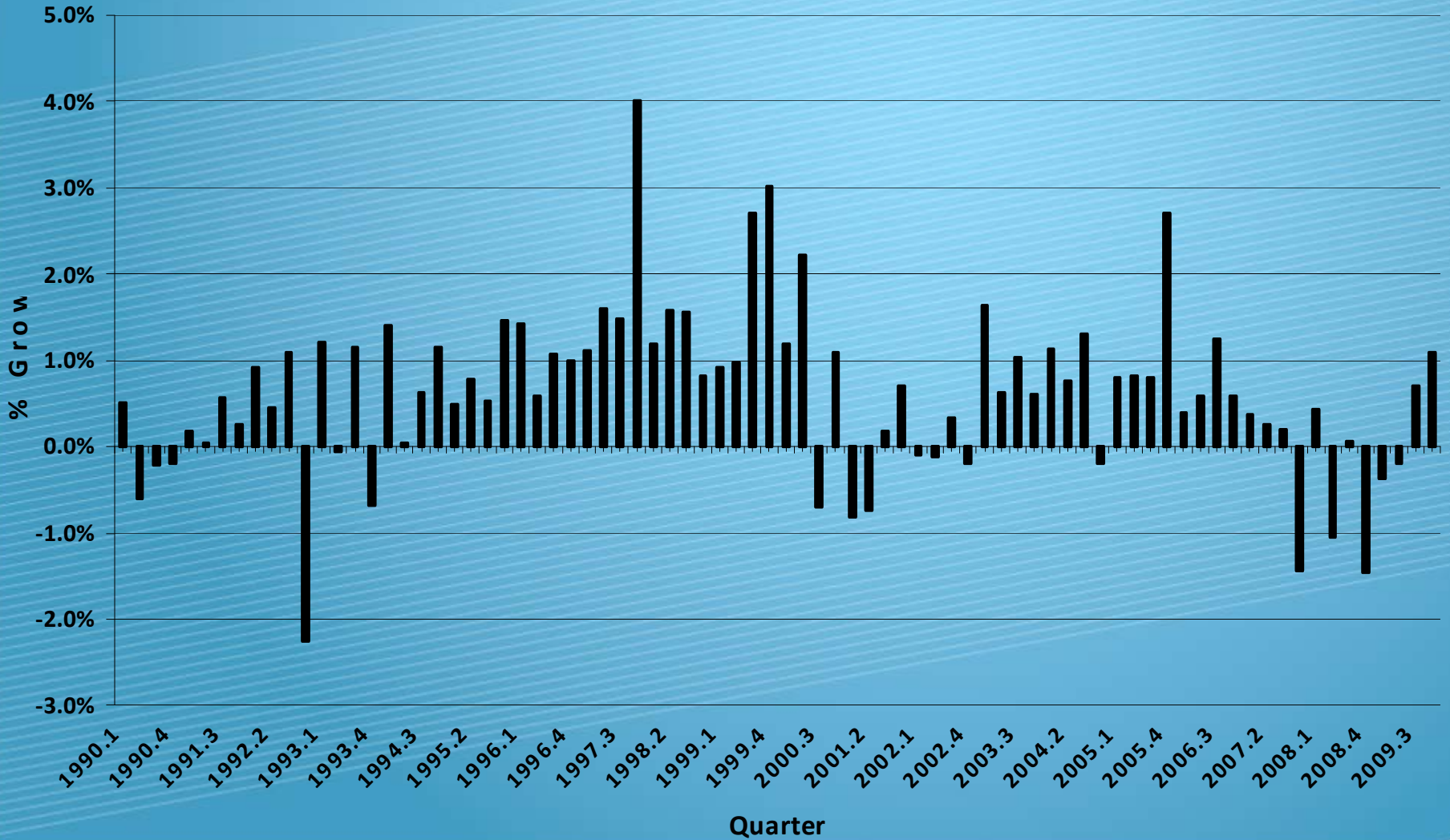
- 2010-11 likely to be worse
 - No change in core budget process or tax code
- Elections will do little to change the basics
 - Prisons, education, social services the foci
- Cannot rely on current model
 - Pension systems to be stretched soon
 - Reserves not in place for this: tax up, benefits down or both
- Prop 23 now a big issue concerning economic growth

CA Unemployment Insurance Payments, Real 2003\$



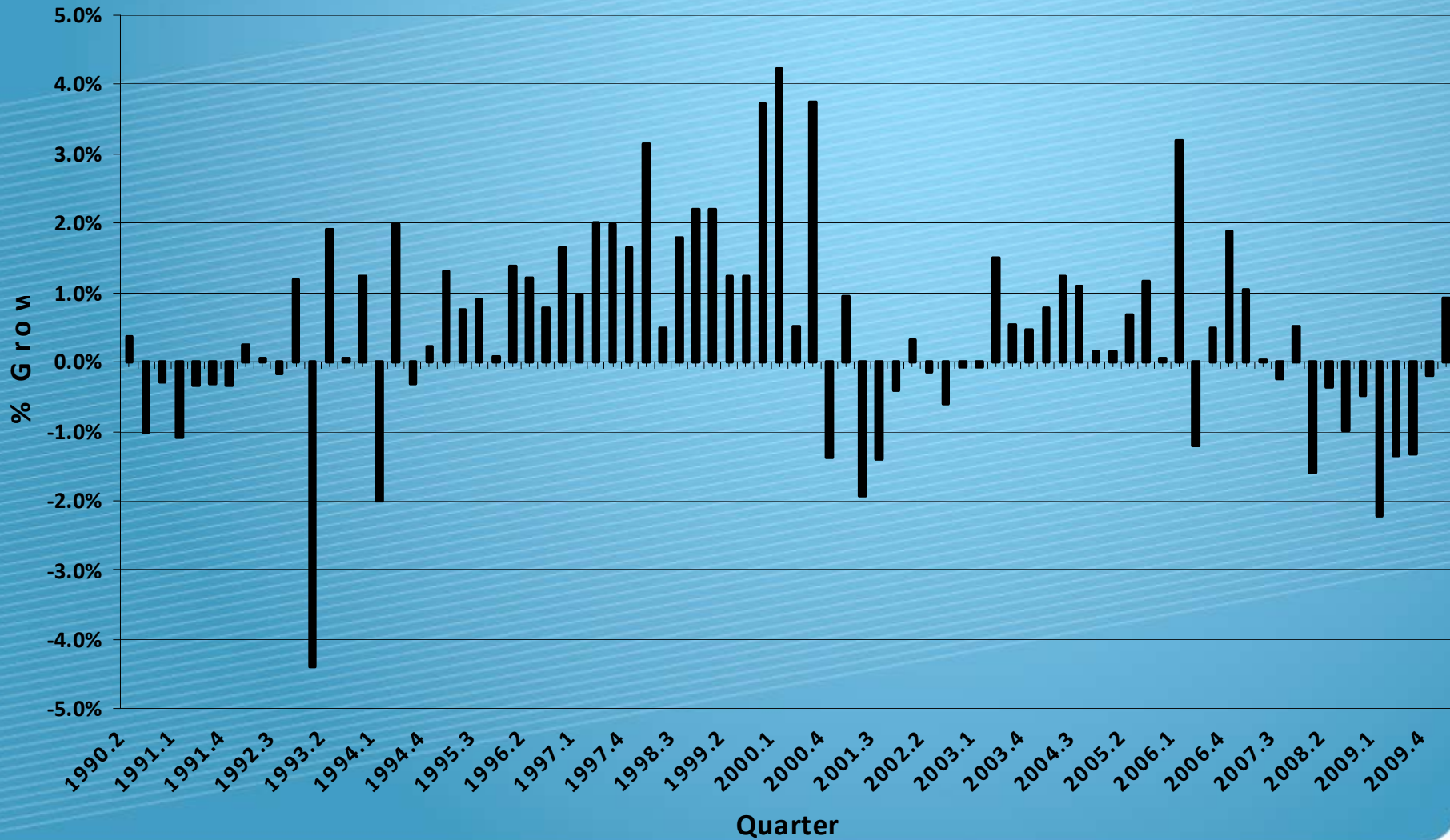
Source: BEA (www.bea.gov)

CA Personal Income Growth, Real 2003\$



Source: BEA (www.bea.gov)

CA Wage and Salary Growth, 1990-2010



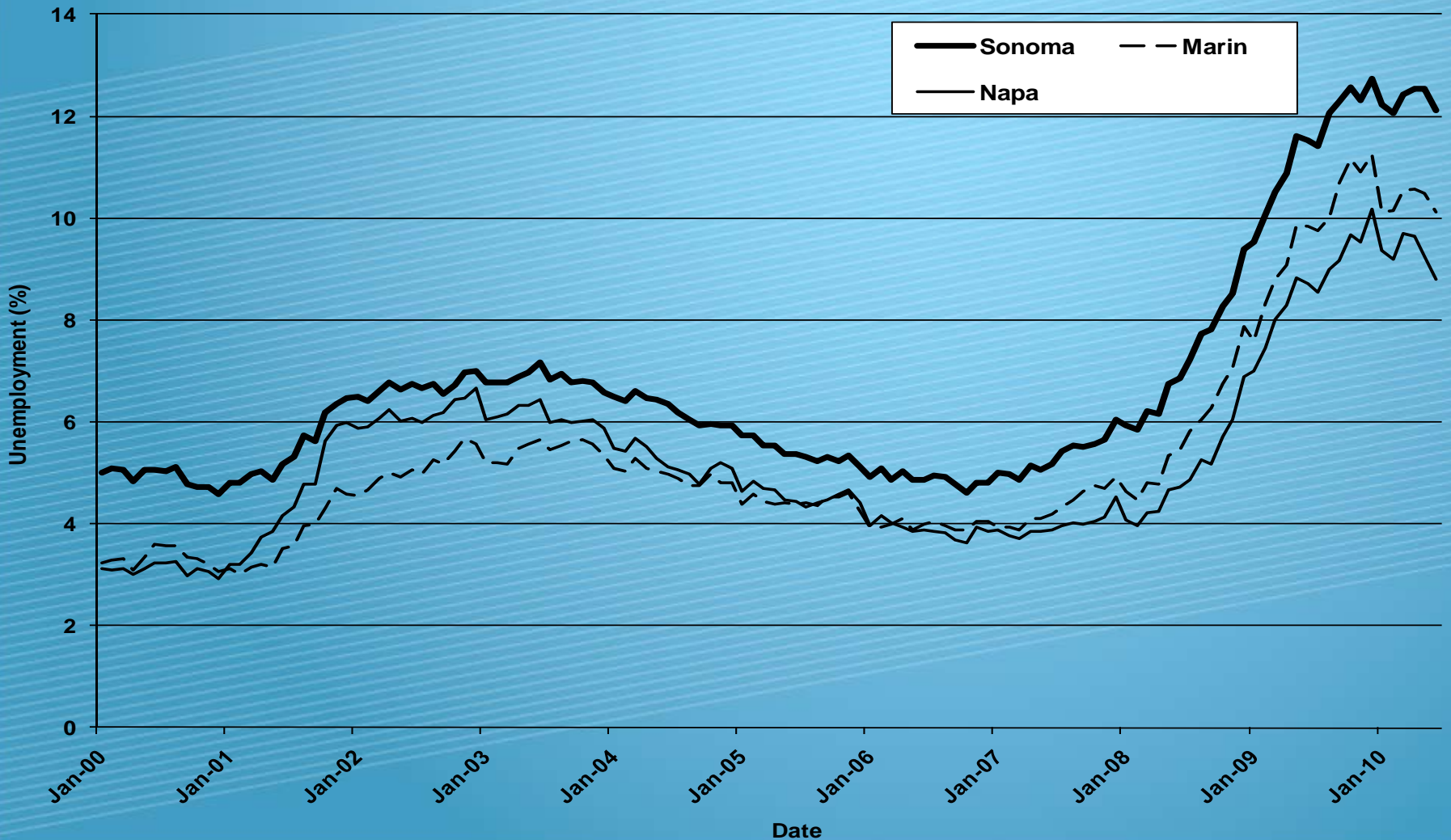
Source: BEA (www.bea.gov)

Local Stats

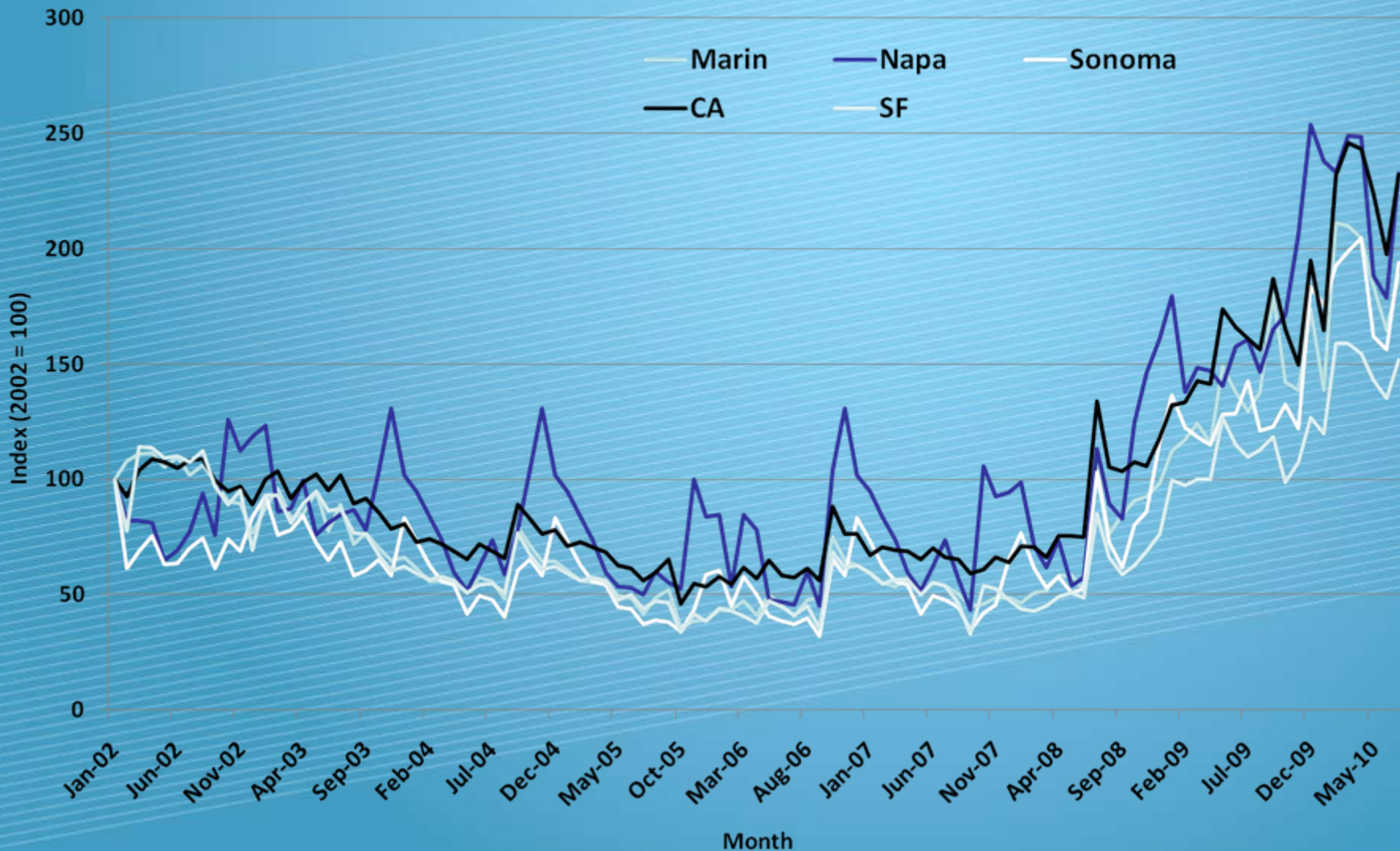
Unemployment Rate: US, CA and Sonoma, 2000-Present, SA



Unemployment Rate: Napa, Marin and Sonoma, 2000-Present, SA



New UI Claims, Seasonally Adj., 2002-2010



Leading Indicator

- Weighted average of macroeconomic variables for all counties (SSU Alum methodology).
- Leading variables tell us where we are headed
 - Default Notices: As defaults ↑, economy ↓
 - Building Permits: As permits ↑, economy ↑
 - New UI Claims: As new claims ↑, economy ↓
 - US Leading Index: As USLI ↑, economy ↑
 - Help-Wanted Ads: As ads ↑, economy ↑
 - Ag Price Index **** : As ag prices ↑, economy ↑
 - Assumes demand not costs causing the price increase

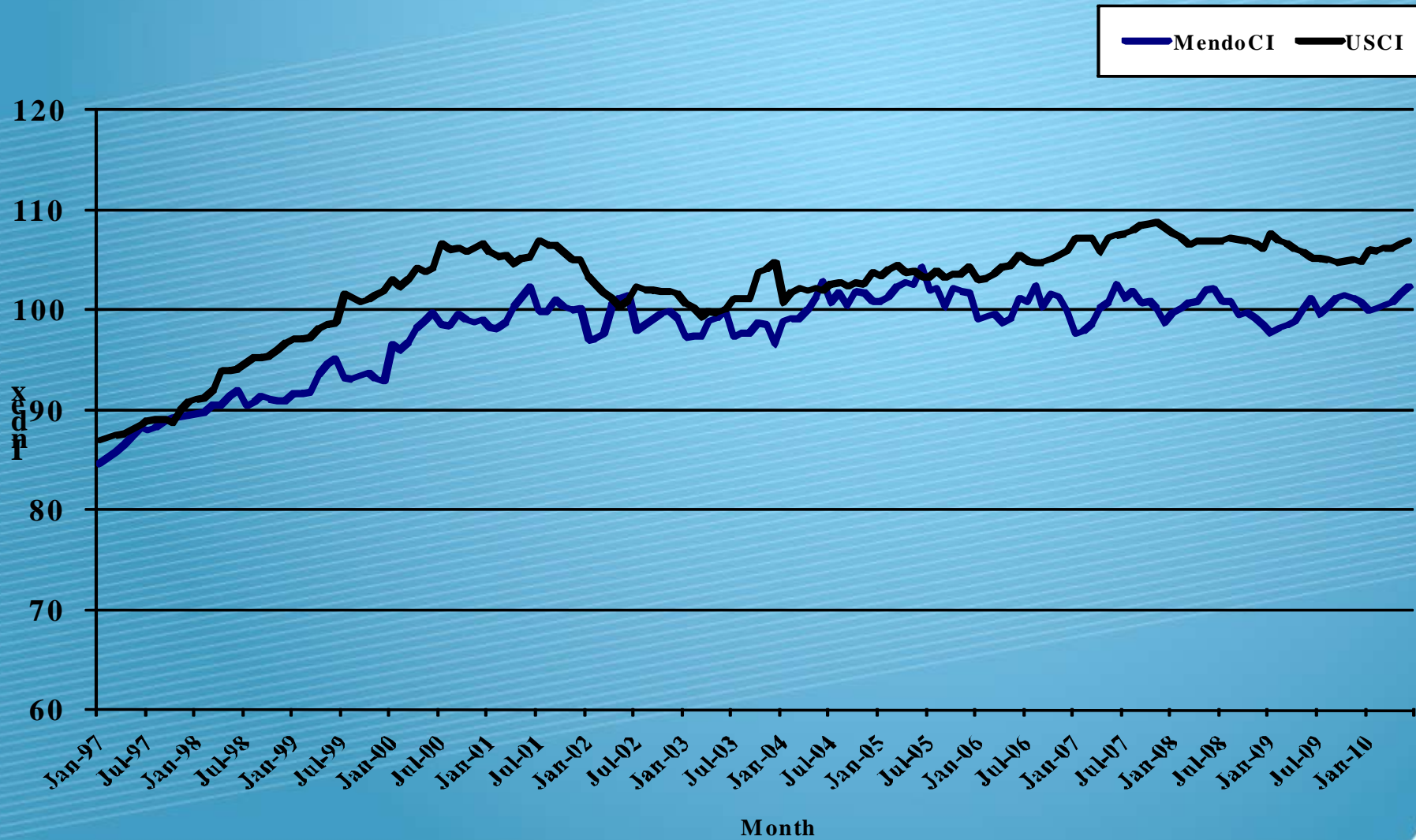
Comparison of MendocLI and USLI



Coincident Indicator

- Coincident Indicator tell us where we are (all components positively related with economy):
 - **Non-agricultural employment**
 - **Retail Sales**
 - **Personal Income**
- The leading indicator drives the coincident.
 - Outlook showing signs of hitting bottom in 2009
 - 2010 a year of recovery, albeit slow and tentative

Tyler Coincident Economic Indicator, Mendocino County, 2003 = 100



The Drivers of Change

- Job growth + business growth
 - Will green industries come to North Bay and stay?
 - Need to monitor how new firms affect local economies and living space:
- Government cooperation that is overt for business
 - North Bay challenged here: wealth meets demography meets geography

The Politics of Economic Growth

- Cost of businesses leaving
 - Does Sonoma County care about this?
- Regulatory streamlining
 - Easy to get a permit through?
- Prioritize how any funding is focused
 - Must think as investment not cost recovery
 - North Bay counties faced with similar issues as CA overall
- “Anti-business” stance or perception a troubling, vocal minority

Where are we headed?

- Real recession into 2011 concerning labor markets
 - Hiring not concentrated in private firms or with sustainable funding
 - Only a double dip if at first we recovered
- State economy will lag
 - Elections will not change the fundamental issues
- Recognize regional connections and economies
 - **Is the political will available for economic growth?**