

# National Economy

## Mid-Year 2011



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# The National Economy

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### National Economy Enters Soft Patch; Not Enough to Cause Double-Dip Recession

The national economy has entered a soft patch along its economic recovery path. Growth has not measured up to expectations and has created a concern of a double-dip recession. Although recent economic indicators have pointed to slower than expected growth, we do not believe the nation is headed for a double-dip recession.

It would take a notable economic shock to derail the economy from its current slow growth stance. Instead, we are experiencing a soft patch due to the following reasons:

**1. Stimulus program is winding down.** The American Recovery and Reinvestment Act (ARRA) has spent over 80% of funds – with the balance to be spent by year-end. With spending easing, some of those employed by the stimulus program have entered the unemployment line – dragging down net job gains. However, this should be a short-term lull, as private sector hiring picks up during the 2<sup>nd</sup> half of the year providing job openings for those previously hired by stimulus dollars.

**2. The Japanese earthquake/tsunami/nuclear disaster is impacting U.S. economic growth more than originally predicted.** This impact is being felt by the auto industry, as many products used in cars produced in the U.S. are shipped from Japan.

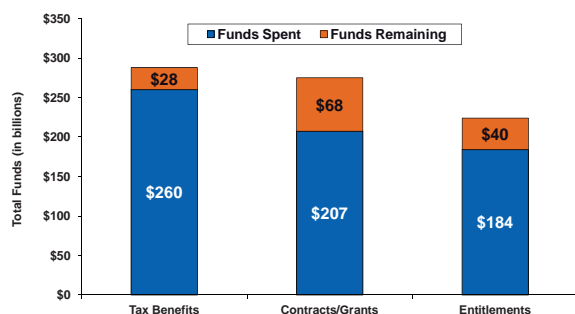
Orders for durable goods declined 3.6% in April 2011, according to the Commerce Department. Transportation equipment orders fell 9.5%. Both declines are a reflection of the impact from Japanese supply chain.

Although the manufacturing sector is adding jobs, at 158,000 new jobs during the 12 months ending May 2011, the rate of growth has decelerated since the tragic events unraveled in Japan. This setback will be temporary; as Japan recovers the supply of auto parts from Japan will increase.

**3. The rise in gasoline prices has impacted consumer spending.** Oil prices soared in recent months – causing gas prices to rise. The rise in gas impacted consumer spending, as expenditure growth ebbed slightly – increasing 0.5% during the 1<sup>st</sup> quarter of 2011, compared to 1.0% during the 4<sup>th</sup> quarter of 2010, and 0.6% during the 3<sup>rd</sup> quarter 2010. Consumers, having to pay more for gas, are spending less on discretionary goods. Most observers believe gas prices will ease during the 2<sup>nd</sup> half of 2011, providing a stimulus to the economy.

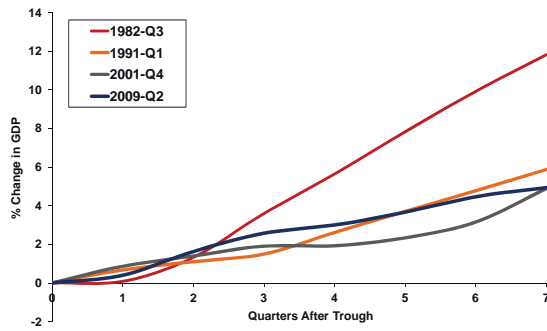
These recent events have led to lowered job gains and muted consumer spending. Despite these minor setbacks, the Gross Domestic Product (GDP) of the most recent downturn continues to track similarly to the prior two recession/recovery cycles.

**American Recovery and Reinvestment Act  
Overview of Funding**



Source: Recovery.gov, Delta Associates; June 2011.

### Recession Recovery Patterns of GDP Past Four Recessions



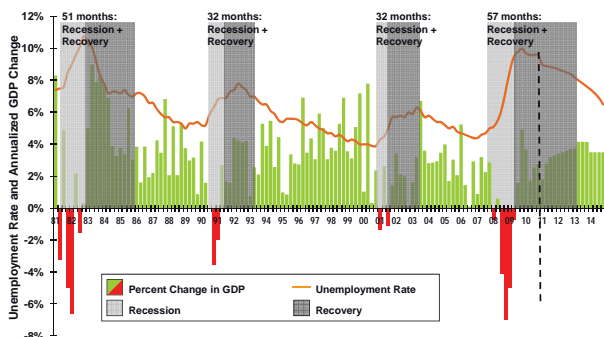
Source: BEA, GMU Center for Regional Analysis, Delta Associates; June 2011.

We expect the slowdown in employment and consumer spending will be temporary, as growth should improve during the 2<sup>nd</sup> half of the year.

The U.S. economy will be boosted during the next six months by rising exports and easing gas prices, which will help recover the economy from the recent soft patch. In addition, corporations have generated cash balances of \$1.91 trillion as of the 1<sup>st</sup> quarter of 2011, a 36% increase since the 1<sup>st</sup> quarter of 2009, according to the Federal Reserve. As concern about current economic conditions ebb, we believe corporations will utilize these resources for capital investment and hiring. Of note, a survey conducted by the Business Roundtable notes 51% of CEOs plan to step up hiring in the 2<sup>nd</sup> half of the year. In addition, the portion of businesses that plan to hire in the 2<sup>nd</sup> half of the year is greater than at any time since the end of 2008, according to a ManpowerGroup Survey.

Economists polled by Bloomberg believe GDP will grow 2.3% during the 2<sup>nd</sup> quarter of 2011, followed by 3.2% growth during July through December. For the year, GDP growth projections have been moderated to around 2.8%.

### U.S. Economic Trends and Forecast 1981 – 2014



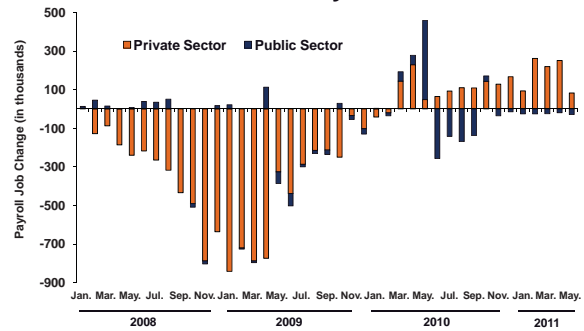
Source: Bureau of Labor Statistics, Bureau of Economic Analysis, FOMC, CBO, Delta Associates; June 2011.

Now, for a look at the components that make up our economy:

### Payroll Jobs

The national economy added 54,000 new jobs during the month of May 2011. Private sector job growth continued in May with 83,000 new jobs added to the economy. The public sector cut 29,000 jobs.

### U.S. Payroll Job Change Monthly



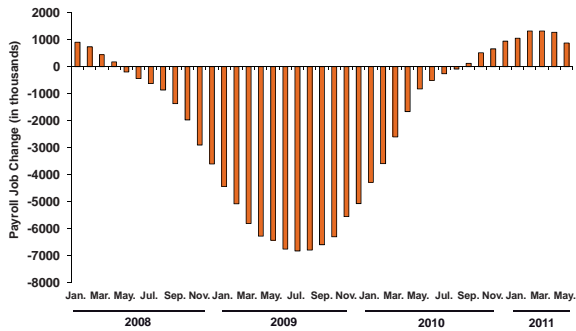
Source: Bureau of Labor Statistics, Delta Associates; June 2011.

We expect more jobs to be trimmed from the public sector during the balance of 2011, as state and local governments trim their workforce to make up for budget shortfalls. However, these losses will be offset by continued growth in private sector hiring.

*The U.S. economy will be boosted during the next six months by rising exports and easing gas prices, which will help recover the economy from the recent soft patch.*

Month-to-month job growth has been uneven – showing continued uneasiness in permanent hiring as confidence in the economy remains lackluster. The lowered confidence has translated to the year-over-year job growth, as 870,000 new jobs have been added to the economy during the 12 months ending May 2011. The growth has ebbed slightly during the past couple of months. We expect sluggish job growth in the near-term, with greater gains during the latter part of the year.

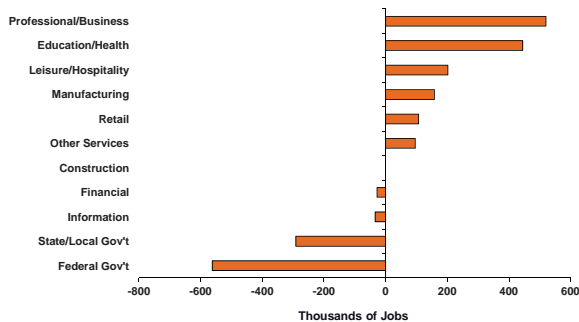
### U.S. Payroll Job Change Year-Over-Year



Source: Bureau of Labor Statistics, Delta Associates; June 2011.

During the 12 months ending May 2011, six sectors added jobs. The top three sectors in job gains were Professional/Business Services, Education/Health, and Leisure/Hospitality – adding a total of 1.2 million new jobs.

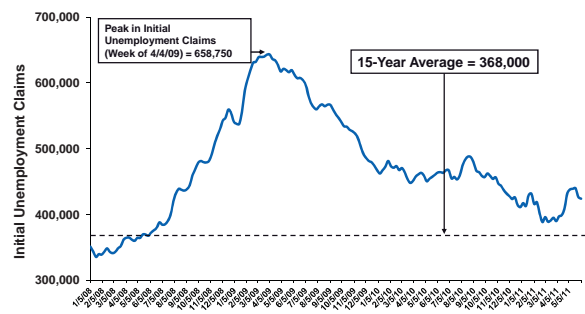
### U.S. Payroll Job Change 12 Months Ending May 2011



Source: Bureau of Labor Statistics, Delta Associates; June 2011.

**Initial unemployment claims** have been steadily declining since the peak in early April 2009 at 659,000. Currently, claims are 424,000 as of early June 2011 – above the 15-year average of 368,000. Although claims have edged up recently, this is indicative of a mid-cycle slowdown rather than entering a double-dip recession. We expect claims to return to a steady downward trend during the 2<sup>nd</sup> half of the year.

### U.S. Initial Unemployment Claims Four-Week Moving Average

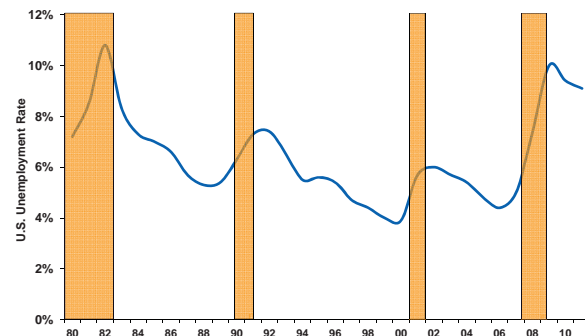


Source: Department of Labor, Delta Associates; June 2011.

Note: Data is seasonally adjusted.

The **unemployment rate** has ticked down to 9.1% as of May 2011 from 9.6% one year ago, although it has edged up slightly in recent months. We anticipate the rate will not edge down materially in the short run, as formerly discouraged job applicants start the application process again. Unemployment will be slow to descend, falling to around 6.5% by 2014 or so.

### U.S. Unemployment Rate



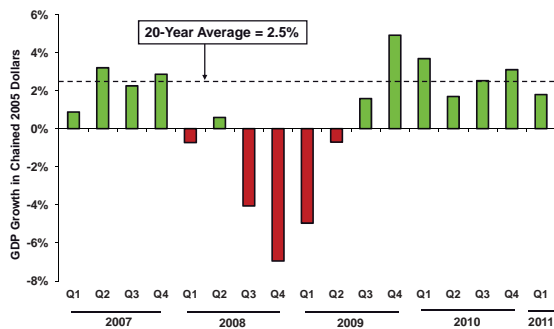
Source: Bureau of Labor Statistics, Delta Associates; June 2011.

Note: Through May 2011; seasonally adjusted; shaded bars represent recessions.

### Gross Domestic Product (GDP) and Consumption

GDP increased 1.8% (annualized rate) during the 1<sup>st</sup> quarter of 2011, after rising 3.1% during the 4<sup>th</sup> quarter of 2010. This rise is below the 20-year annual average of 2.5% – as higher oil prices and severe weather limited growth.

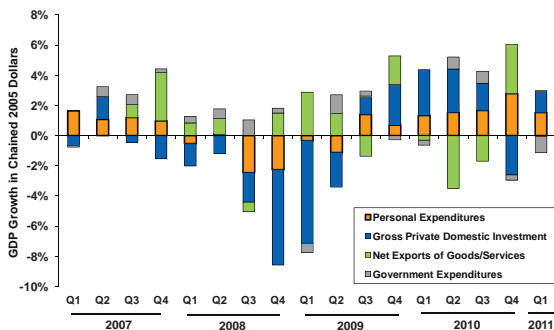
### U.S. GDP Percent Change 2007 – 2011



Source: Bureau of Economic Analysis, Delta Associates; June 2011. Note: Annualized.

Expansion was driven by personal expenditures and gross private domestic investment during the 1<sup>st</sup> quarter, which contributed 1.53% and 1.45% to the GDP growth, respectively. Government expenditures contributed negative 1.07% to the GDP, acting as a drag on overall growth.

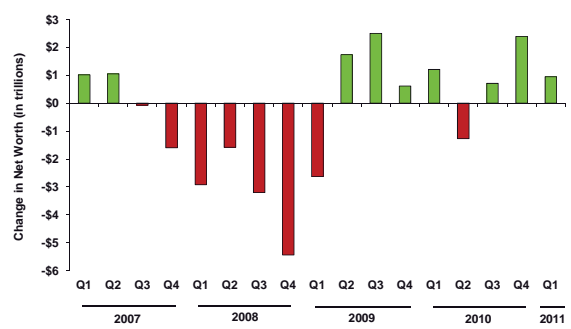
### Contributions to U.S. GDP Percent Change 2007 – First Quarter 2011



Source: Bureau of Economic Analysis, Delta Associates; June 2011. Note: Annualized.

Although **consumer spending** is helping to boost GDP, spending has been restrained due to households losing over \$17 trillion in **personal wealth** from the 4<sup>th</sup> quarter of 2007 to the 1<sup>st</sup> quarter of 2009. Although households have regained some of the assets lost, gains have been uneven and it will take several years to recoup the total amount. Net worth rose by \$943 billion during the 1<sup>st</sup> quarter of 2011, as gains in stocks and other investments offset declines in real estate values.

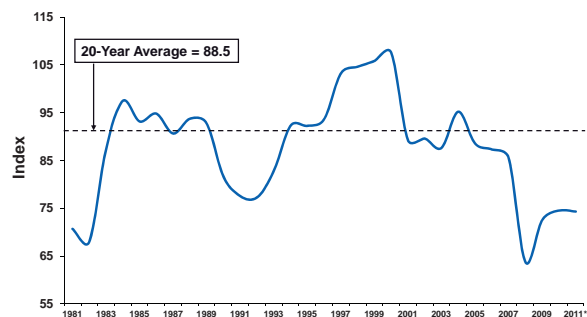
### U.S. Household Net Worth 2007 – 2011



Source: Federal Reserve, Delta Associates; June 2011.

The **consumer sentiment** index rose to 74.3 in May 2011 – rising unevenly since the low of 56.3 in February 2009. Confidence increased in May after dipping in March and April due to concerns of higher gas prices and inflation. Confidence increased due to gas prices easing and higher expectations for the economy – which could boost spending during the 2<sup>nd</sup> half of the year.

### U.S. Consumer Sentiment



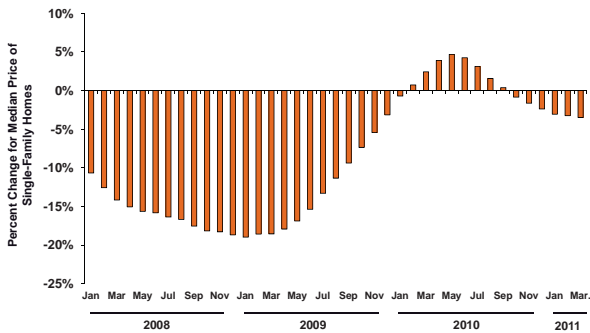
Source: University of Michigan, Delta Associates; June 2011.

\*At April 2011.

### Housing Market

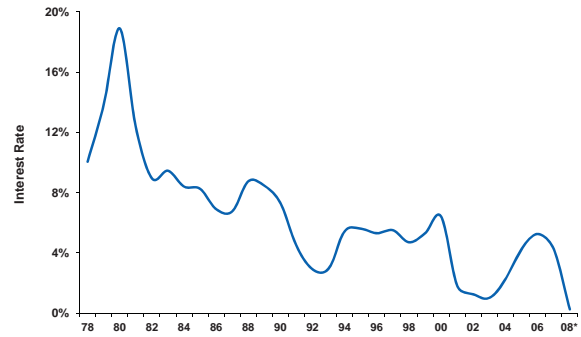
Home prices in the 20 major metro areas declined 3.5% during the 12 months ending March 2011, the most recent data available, according to S&P/Case-Shiller. With home prices falling, the number of mortgages underwater (where the homeowner owes more on the mortgage than the home is worth) remains elevated. According to CoreLogic, 22.7% of all mortgaged homes were underwater during the 1<sup>st</sup> quarter of 2011.

### Annual Change in Existing Home Sale Prices



Source: S&P/Case-Shiller, Delta Associates; June 2011.

### Federal Funds Rate



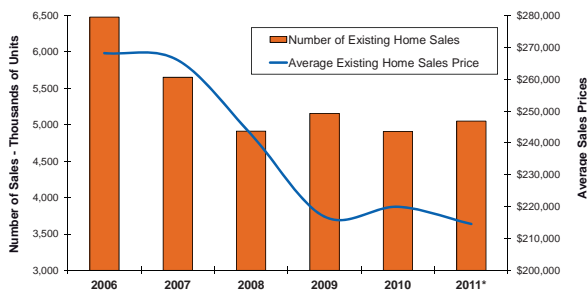
Source: Federal Reserve Board, Delta Associates; June 2011.

\*Unchanged since December 16, 2008.

Price declines in April 2011 were primarily due to distressed sales, as 37% of sales were distressed. Prices are estimated to fall further as the Federal government is expected to reduce the role of Fannie Mae and Freddie Mac and more distressed sales will occur during the balance of 2011. Although prices have ebbed compared to 2010, sales volume has increased as home buyers are taking advantage of lowered prices.

Prices increased 3.4% during the 12 months ending May 2011. Rising food and energy prices contributed to the rise. The Federal Reserve expects prices will remain in check during 2011, with inflation projected at around 2.5%, as long as appropriate monetary measures are in place.

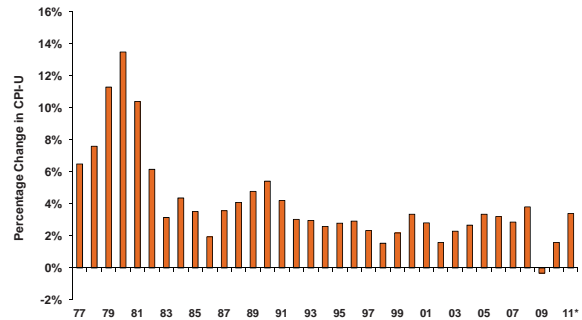
### U.S. Existing Home Sales vs. Sales Price



Source: National Association of Realtors, Delta Associates; June 2011.

\*Annualized sales rate at April 2011.

### U.S. Inflation



Source: Bureau of Labor Statistics, Delta Associates; June 2011.

\*12-month percentage change through May 2011. Note: data is seasonally adjusted.

## Federal Intervention and Inflation

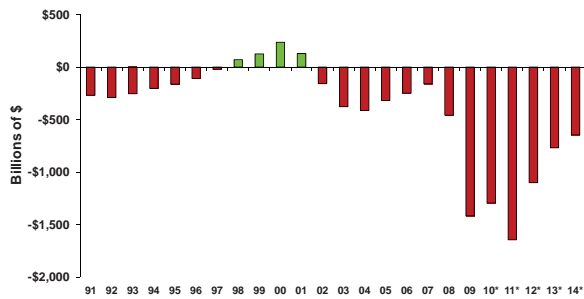
The Federal government continues to implement programs to sustain the national economy, vowing to do what it takes to keep the economy on track.

The Fed has kept the Federal Funds Rate at its current low, as some business sectors continue to shed jobs. Given the economy continues to grow at a slow pace, we believe the Fed will keep short-term rates at its current range of 0% to 0.25% through 2011, before increasing the rate to around 0.75% by mid-2012.

## Federal Budget and Debt

The Congressional Budget Office (CBO) anticipates the U.S. budget deficit for 2011 will total \$1.6 trillion. The budget deficit was \$1.3 trillion in 2010, down from \$1.4 trillion in 2009. The Federal budget imbalance has generated concern by both political parties. A split Congress and the election of many new representatives in 2010 who campaigned on the promise to cut spending has sparked heated debate on how to reduce the deficit. This debate has enforced spending reductions for the remainder of the 2011 budget and adjusted President Obama's proposed 2012 budget, which has yet to be approved.

### Federal Budget Deficit



Source: OMB, CBO, Delta Associates; June 2011.

\* Projected by CBO as of April 2011.

With the 2011 budget resolved in early April, Democrats and Republicans are currently refining their approaches to the 2012 budget and how to tackle the rising national debt. This battle comes at a time when the national debt has reached the limit set by Congress in February 2010. Treasury officials can meet obligations through early August by using money from government retirement accounts. However, a deal must be struck in order to keep the U.S. debt in check after the August deadline. A battle for a deal should continue through the summer, as Republicans are demanding trillions in long-term spending cuts before agreeing to increase the debt ceiling.

### Economic Outlook

We believe the national economy will experience slowly improving conditions during the balance of 2011. We expect the recovery period to last through 2012.

#### We believe the economic outlook is as follows:

- GDP: 2.8% growth during 2011.
- Payroll jobs: 1.2 million added in 2011 (based on December to December calculation).
- Unemployment: slowly falling to around 6.5% by 2014.
- Federal funds rate: 0% to 0.25% through 2011.
- Inflation: 2.5% during 2011.

### National Payroll Job Growth Summary

The U.S. economy gained 870,000 payroll jobs over the 12 months ending May 2011. This represents a rise of 0.7%. After three years of job losses, the economy is showing progress in replacing the 8.0 million jobs that were eliminated during the most recent recession.

| U.S. Payroll Job Growth |            |         |
|-------------------------|------------|---------|
| Year                    | Job Change | %Change |
| 2011*                   | 870,000    | 0.7%    |
| 2010                    | -967,000   | -0.7%   |
| 2009                    | -5,989,000 | -4.4%   |
| 2008                    | -809,000   | -0.6%   |
| 2007                    | 1,496,000  | 1.1%    |
| 2006                    | 2,397,000  | 1.8%    |
| 2005                    | 2,275,000  | 1.7%    |
| 2004                    | 1,423,000  | 1.1%    |
| 2003                    | -344,000   | -0.3%   |
| 2002                    | -1,489,000 | -1.1%   |
| 2001                    | 36,000     | 0.0%    |

\*Change for 12 months ending in May 2011; others are comparisons of annual averages. Note that BLS has rebenchmarked figures since their initial publication; the figures presented above are the most recent estimates.

| 12-MONTH PAYROLL EMPLOYMENT CHANGE THROUGH APRIL 2011 |            |       |                                      |            |       |
|---|------------|-------|--------------------------------------|------------|-------|
| METRO AREA  | JOB CHANGE |       | METRO AREA                           | JOB CHANGE |       |
|   | #          | %     |                                      | #          | %     |
| Dallas/Ft. Worth                                      | 83,100     | 2.9%  | Oklahoma City                        | 10,100     | 1.8%  |
| Houston   | 51,100     | 2.0%  | Cincinnati                           | 10,000     | 1.0%  |
| Chicago   | 37,100     | 0.9%  | Portland (OR)                        | 9,600      | 1.0%  |
| Washington, DC  | 25,700     | 0.9%  | San Francisco Bay Area               |            |       |
| Seattle   | 22,700     | 1.4%  | San Jose/Sunnyvale/Santa Clara       | 13,100     | 1.5%  |
| New York  | 22,400     | 0.3%  | San Francisco/San Mateo/Redwood City | 500        | 0.1%  |
| Boston (Metropolitan NECTA)                           | 20,900     | 0.9%  | Oakland/Fremont/Hayward              | (5,300)    | -0.6% |
| LA Basin  |            |       | Subtotal Bay Area                    | 8,300      | 0.3%  |
| Los Angeles/Long Beach/Glendale                       | 23,500     | 0.6%  | Tampa-St. Pete                       | 7,800      | 0.7%  |
| Orange County (Santa Ana/Anaheim/Irvine)              | 12,700     | 0.9%  | Charlotte                            | 7,600      | 0.9%  |
| Riverside/San Bernardino/Ontario                      | (16,400)   | -1.5% | San Antonio                          | 7,600      | 0.9%  |
| Subtotal LA Basin                                     | 19,800     | 0.3%  | Salt Lake City                       | 7,400      | 1.2%  |
| South Florida   |            |       | Nashville                            | 6,800      | 0.9%  |
| Miami/Miami Beach/Kendall                             | 10,000     | 1.0%  | Denver-Boulder                       | 6,600      | 0.5%  |
| Fort Lauderdale                                       | 5,700      | 0.8%  | Cleveland                            | 5,800      | 0.6%  |
| West Palm Beach/Boca Raton                            | 3,400      | 0.7%  | New Orleans                          | 4,900      | 0.9%  |
| Subtotal South Florida                                | 19,100     | 0.9%  | Jacksonville                         | 4,300      | 0.7%  |
| Orlando   | 15,200     | 1.5%  | Philadelphia                         | 3,300      | 0.1%  |
| Pittsburgh  | 15,100     | 1.3%  | Minneapolis-St. Paul                 | (500)      | 0.0%  |
| Austin  | 14,100     | 1.8%  | Kansas City                          | (800)      | -0.1% |
| San Diego   | 13,400     | 1.1%  | Las Vegas                            | (2,500)    | -0.3% |
| St. Louis   | 12,100     | 0.9%  | Indianapolis                         | (3,500)    | -0.4% |
| Raleigh-Durham  | 12,000     | 1.5%  | Memphis                              | (4,300)    | -0.7% |
| Detroit (Detroit/Warren/Livonia)                      | 11,700     | 0.7%  | Baltimore                            | (4,700)    | -0.4% |
| Phoenix   | 11,000     | 0.6%  | Atlanta                              | (9,000)    | -0.4% |
| Columbus (OH)   | 10,900     | 1.2%  | Sacramento                           | (14,600)   | -1.8% |

Source: Bureau of Labor Statistics, Delta Associates; June 2011.