12th Annual Groundhog Day Economic Development Forecast Breakfast

The City of Gahanna’s Department of Development held its 12th Annual Groundhog Day Economic Development Forecast Breakfast on Friday, January 30th, 2009. The annual breakfast provides a collective forum for business leaders and elected officials to understand the current economic trends and how to strategically plan for the year ahead. Over 300 guests attended the breakfast this year to hear the forecast by keynote speaker Dr. Edmond J. Seifried, Executive Director of Sheshunoff Affiliation Programs and the Chief Economist for m.rae resources inc., a community bank investment firm.

In addition to helping businesses plan for the year ahead, the breakfast event also recognized three local projects completed in 2008 as part of the City's prestigious Development of Excellence Awards series. The awards program honors development projects that demonstrate exemplary design, promote community, evoke positive, responsible growth, and encourage economic progress. The following projects were recognized:

**Best New Medical Office**

Pizzuti Development for Stonybrook Medical Office Building

5175 Morse Road

**Best New Multi-Tenant Development**

Dr. Maria Van Huffel, DDS

960 N. Hamilton Road

**Best New Housing**

Creative Housing for Apartments at Stoneridge

243 N. Hamilton Road
The Economic Outlook for 2009: Recession or Worse?

Edmond Seifried Ph.D.

Sheshunoff Consulting + Solutions
&
m.rae.resources, inc
The Imminent Demise of the Great American Housing Boom –
Is Your Community Bank Ready for It?
The Imminent Demise of the Great American Is Your Community Bank Ready for It?

An Interview With Dr. Edmond Selfried, Chief Economist, BNK Advisory Group
The National Impact

What will be the impact on the overall economy when the housing bubble bursts?

I’d like to point to a study by the International Monetary Fund. The study found that there have been 20 episodes of rapid home devaluation in different locales around the world during the last quarter-century. Prices fell 30 percent or more. The study found that in 19 of the 20 countries, a recession followed the burst of the housing bubble.

What were those recessions like?

Bad. The recessions tended to be longer than average and deeper than average.

The best scenario would have a gradual slowing of appreciation in most areas and only minor depreciations in a few areas.

The worst is that the busted bubble will put the whole economy into a recession that is long and deep.
Today’s topics

• The U.S. Housing Market Crisis: How did it happen?

• Real Estate Prices: Post Bubble final Equilibrium market Pricing?

• How long will the Recession last? How deep?

• How to identify bubbles and Madoff-like Ponzi schemes?

• Three academic, financially-oriented, theories that are actually, surprisingly, very useful for the business professional in these troubled economic times.
One Bank’s Story of Subprime Decisions and the Aftermath
The following is typical:

Excerpts from M&T Bank’s 2007 Annual Report’s “Message to Shareholders
“To put things bluntly, in our search for higher investment returns, we made two major mistakes”
“The first error involved...Alt-A mortgages...less rigorous underwriting standards...we thought we could sell them... then the markets for them declined..., we were left holding the bag”
“The second error…our purchase of subprime linked collateralized debt obligations (CDOs - technically described as mezzanine ABS CDO securities all, at the time, rated AAA or AA)!

“Message to Shareholder”, M&T Bank Corporation 2007 Annual Report
“We bought $131.7 million, ...the sort of mortgages we seldom originate... They weren’t all that higher [yielding]...25 basis points more...makes one rue the choice all the more”
“Our $131.7 million (CDO)…based on market bids we received… is worth $4.4 million or $127.3 million less than what we paid.”

“Message to Shareholder”, M&T Bank Corporation  2007 Annual Report
“What have we learned?”

Part I

It is a bad idea to outsource our underwriting standards”
“What have we learned?”

Part II

If it grows too fast- it’s a weed!
Early Bubbles: Circa 1680
The Viceroy Tulip
Where One Tulip’s Price was higher than the average house?
A Anatomy of a Bubble

Consumer Income does not match bubble pricing and bubble collapses!
Tulip and all other Bubble Pricing Ends like This
Resort Real Estate Pricing

• The Bubble

• Post-Bubble Equilibrium Pricing

• Could millions of Pre-Bubble market participants have been wrong?
“How to avoid Madoff Ponzi Schemes?”

If it grows too fast- it’s a weed!
Macroeconomic Principles the Business Executive Must Know!

The Fisher Effect

The Twisted Yield Curve

The Helicopter Drop
The Fisher Effect:
A double-edged sword

Impacts Production Costs & Sales
March 18, 2008 FOMC Meeting: More Disagreement!

- Rates cut by 0.75% to 2 ¼% - “Recent information indicates that the outlook for economic activity has weakened further. Growth in consumer spending has slowed and labor markets have softened.”

- “Today’s policy action, should help to promote moderate growth over time and to mitigate the risks to economic activity. However, downside risks to growth remain.”

- Voting for the FOMC monetary policy action were: Ben S. Bernanke, Chairman; Timothy F. Geithner, Vice Chairman; Donald L. Kohn; Randall S. Kroszner; Frederic S. Mishkin; Sandra Pianalto; Gary H. Stern; and Kevin M. Warsh. Voting against were Richard W. Fisher and Charles I. Plosser, who preferred less aggressive action at this meeting.

- Next Meeting April 29-30, 2008
April 29-30, 2008 FOMC Meeting: More Disagreement!

- Rates cut by 0.25% to 2.0%

- Recent information indicates that economic activity remains weak... tight credit conditions and the deepening housing contraction are likely to weigh on economic growth over the next few quarters.

- Still, uncertainty about the inflation outlook remains high. It will be necessary to continue to monitor inflation developments carefully.

- The Committee will continue to monitor economic and financial developments and will act as needed to promote sustainable economic growth and price stability.

Voting for the FOMC monetary policy action were: Ben S. Bernanke, Chairman; Timothy F. Geithner, Vice Chairman; Donald L. Kohn; Randall S. Kroszner; Frederic S. Mishkin; Sandra Pianalto; Gary H. Stern; and Kevin M. Warsh. Voting against were Richard W. Fisher and Charles I. Plosser, who preferred no change in the target for the federal funds rate at this meeting

Next Meeting June 24-25, 2008
"Messrs. Fisher and Plosser dissented... they preferred no change in rates. Rising prices for food, energy, commodities; signs of higher inflation expectations; negative real federal funds rate raised concerns about inflation.

Mr. Plosser cited the recent rapid growth of monetary aggregates evidence the economy had ample liquidity.

Mr. Fisher was concerned that an adverse feedback loop was developing.. lowering the funds rate pushing down the value of the dollar, contributing to higher commodity and import prices, cutting real spending and ultimately impairing economic activity."
June 24-25, 2008 FOMC Meeting: A Tipping Point!

- Rates unchanged at 2.0%

- Recent information indicates that overall economic activity continues to expand… However, labor markets have softened further …

- The Committee expects inflation to moderate later this year and next year. However, in light of the continued increases in the prices of energy and some other commodities and the elevated state of some indicators of inflation expectations, uncertainty about the inflation outlook remains high.

- Although downside risks to growth remain, they appear to have diminished somewhat, and the upside risks to inflation and inflation expectations have increased.

- Voting for the FOMC monetary policy action were: Ben S. Bernanke, Chairman; Timothy F. Geithner, Vice Chairman; Donald L. Kohn; Randall S. Kroszner; Frederic S. Mishkin; Sandra Pianalto; Charles I. Plosser; Gary H. Stern; and Kevin M. Warsh. Voting against was Richard W. Fisher, who preferred an increase in the target for the federal funds rate at this meeting.

- Next Meeting August 5, 2008
October 8, 2008 FOMC Emergency Meeting: Central Banks of the World Unite!

- *Rates cut 0.50% to 1.50%*

- Inflation expectations are diminishing and remain anchored to price stability. The recent intensification of the financial crisis has augmented the downside risks to growth and thus has diminished further the upside risks to price stability.

- Some easing of global monetary conditions is therefore warranted. Accordingly, the Bank of Canada, the Bank of England, the European Central Bank, the Federal Reserve, Sveriges Riksbank, and the Swiss National Bank are today announcing reductions in policy interest rates. The Bank of Japan expresses its strong support of these policy actions.

- *Next Meeting October 28-29, 2008*
October 28-29, 2008 FOMC Meeting: The Bottom is Reached!

• *Rates cut 0.50% to 1.00%*

• The pace of economic activity appears to have slowed markedly, consumer expenditures, business equipment spending and industrial production have weakened in recent months…

• This rate reduction, *coordinated interest rate cuts by central banks*, and official steps to strengthen financial systems, should help over time to improve credit conditions and promote a return to moderate economic growth. Nevertheless, *downside risks to growth remain*.

• Voting for the FOMC monetary policy action were: Ben S. Bernanke, Chairman; Timothy F. Geithner, Vice Chairman; Elizabeth A. Duke; Richard W. Fisher; Donald L. Kohn; Randall S. Kroszner; Sandra Pianalto; Charles I. Plosser; Gary H. Stern; and Kevin M. Warsh.

• *Next Meeting December 16, 2008*
Dec 16, 2008 FOMC Meeting: Interest Rate Range Introduced!

- Rates cut from 1.00% to a target range of 0.0% to 0.25%

- Labor market conditions have deteriorated, and consumer spending, business investment, and industrial production have declined. Overall, the outlook for economic activity has weakened further.

- The Committee is also evaluating the potential benefits of purchasing longer-term Treasury securities. Voting for the FOMC monetary policy action were: Ben S. Bernanke, Chairman; Christine M. Cumming; Elizabeth A. Duke; Richard W. Fisher; Donald L. Kohn; Randall S. Kroszner; Sandra Pianalto; Charles I. Plosser; Gary H. Stern; and Kevin M. Warsh.

- Next Meeting Jan 27-28, 2009
Jan 27-28, 2009 FOMC Meeting:

• Rates unchanged at a target range of 0.0% to 0.25%. … conditions are likely to warrant exceptionally low levels of the federal funds rate for some time.

• The economy has weakened further. Industrial production, housing starts, and employment have continued to decline steeply… global demand slowing significantly

• The Committee is prepared to purchase longer-term Treasury securities if necessary and the Federal Reserve will be implementing the Term Asset-Backed Securities Loan Facility to facilitate the extension of credit to households and small businesses.

• Voting for the FOMC monetary policy action were: Ben S. Bernanke, Chairman; William C. Dudley, Vice Chairman; Elizabeth A. Duke; Charles L. Evans; Donald L. Kohn; Dennis P. Lockhart; Kevin M. Warsh; and Janet L. Yellen. Voting against was Jeffrey M. Lacker, who preferred to expand the monetary base at this time by purchasing U.S. Treasury securities rather than through targeted credit programs.

• Next Meeting March 17, 2009
The Twisted Yield Curve: A New Monetary Policy tool for 2009

Can the twisted yield curve save us from a depression?
Could this be the 2009 Yield Curve used to support a weak housing sector?

Higher rates for senior citizen’s CDs’ and savings accounts

Lower mortgage rates aids housing market…….. plus another refinancing cycle!
The Long Term Effects of the Bailout?

Government Deficits and Inflation
What if Monetary and Fiscal Policy Fail to Stop Recession?

The Nuclear Option
Traditional Way to finance Government Spending?

Issue debt to private investors-treasury securities

This removes liquidity from the economy and reduces risk of inflation.
Nuclear Option?

The Helicopter Drop!
The Helicopter Drop
The Helicopter Drop
The Helicopter Drop!

Government spending rises!
But instead of issuing debt to the public....
Federal Reserve Bank provides US Treasury a deposit account - printing $
Tax Rebate and Expenditure checks are cleared through the account!
Results: Stimulation and inflation!
Conventional Government Spending
Fiscal Stimulus without Severe Inflation

U.S. Treasury

- Tax Cuts
- Gov’t spending

Treasury Securities

- Payment

Dealers

- Securities
- Cash

Corp Investors

- Securities
- Cash

Consumers
Helicopter Drop Government Spending  
Fiscal Stimulus with Severe Inflation

- Tax Cuts
- Treasury Securities
- Fed
- Checking Account
- Inflation
- Consumers
- U.S. Treasury
- Gov’t spending
Everyone has a Debt Problem!

Gross Gov't Debt as % of GDP

<table>
<thead>
<tr>
<th>Country</th>
<th>Debt as % of GDP</th>
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<tr>
<td>USA</td>
<td>54</td>
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<tr>
<td>Japan</td>
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<tr>
<td>Italy</td>
<td>105</td>
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<tr>
<td>Euro Area</td>
<td>53</td>
</tr>
<tr>
<td>Canada</td>
<td>53</td>
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</table>
Everyone has a Debt Problem!

Budget Balance as % of GDP

<table>
<thead>
<tr>
<th>Country</th>
<th>Budget Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>USA</td>
<td>-1.2</td>
</tr>
<tr>
<td>Japan</td>
<td>-3.2</td>
</tr>
<tr>
<td>Italy</td>
<td>-1.6</td>
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<tr>
<td>Euro Area</td>
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</tr>
<tr>
<td>Canada</td>
<td>1.4</td>
</tr>
</tbody>
</table>
2001 Expansion Officially Ends: NBER says

NBER declares U.S. 2001 Expansion lasted 73 months:

Economy began to grow in November, 2001 thru December, 2007

December 1, 2008  Wall Street Journal
NBER declares U.S. is in recession, and it began in December 2007.
Factors “for” a Long and Deep Recession in 2009

- The U.S. Housing Market: Housing starts dropped from a high of 2.300 to 0.550 million units in two years!

- Unemployment up to 7.2% from 4.5% in one year?

- ISM Manufacturing Index in Nov, 2008 = 32.4% (42.3% considered Recession Level!)

- Losses in 401 K’s and other investment funds shock consumers into reduce spending modes (e.g. Glut of Resort Real Estate).

- Home prices down sharply from peak—negative wealth effect on consumer spending?
Will this Recession become a Depression?

Answer: No, if the monetary and fiscal bailout packages stimulate the economy enough to overcome the financial, housing and consumer confidence issues.

Answer: Unfortunately, maybe yes, if they do not!!!
2009 Economic Forecast
GDP Growth Forecast for 2009:

2009 (I & II) = (-4.5 to -5.0%)

2009(III & IV) = (+2.5 to +3.5%)
Inflation Forecast for 2009:

Total CPI: 1.0% - 2.0%
Interest Rate Forecast for 2009:

The Forecast for 2009 (IV):

Fed Funds: 2.0 – 2.5%
Thank You!