"The National Economy and Banking"

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Characteristics of This Recession

- In the previous 10 recessions which sector led the recovery?
- In the first year of the past 10 recoveries, the average increase in residential construction was 26%
- In the first year of recovery, residential construction increased 6%

U.S. Economy – Good News, Bad News

- The first year of the recovery (July, 2009) GDP grew about 3%
- The economy grew at about 2.5% in 2nd and 3rd quarters of last year and then 3.1% in 4th quarter
- For 1st quarter of 2011, GDP grew at rate of only 1.8%
- These growth rates are about one half of that seen in the previous post WWII recoveries

U.S. Economy – Good/Bad News

- U.S. corporations have been sitting on over 7% cash nearly $1 trillion – the highest level in 51 years
- S&P 500 companies enjoying record profits (6 consecutive quarterly increases – productivity
- S&P 500 stock index nearly doubled since bottom at March 2009
- Multinationals doing very well

U.S. Economy – Good News, Bad News

- Consumer confidence fell in May and is lower than in February and the present level is considerably below level at the end of the last recession – gas prices
- ISM Index still above 50 but fell from 60 to 53.5 in May – a huge drop for one month

Consumers and Debt

- The ratio of household debt/income
- Was 131% in 2007 - is 116% at year end 2010 – lowest level in 6 years
- Before the housing bubble, the number was under 80%
- Consumer credit finally rose beginning last October – up in each month this year

Consumers

- Consumers are deleveraging - Consumer credit is up but installment debt is down
- For all income groups, average annual expenditures fell 2.8% from 2008 to 2009 – first drop on record (1984)
- Consider median income for males
- Hourly earnings in March were flat for the 4th time in 5 months – the weakest stretch in 25 years

Housing

- Home sales and construction rising but very slowly
- About 20 million adult children live with parents
- Only building about 500,000-600,000 homes annually

Housing

- Home values suffered the largest decline (3%) in the first quarter of 2011 since late 2008
- Prices still falling – have now fallen for 57 consecutive months
- New home sales about 325,000 on annualized basis with inventory down to 6.5 months

Housing

- Home ownership rates as high in other countries (Canada, England, Australia) that have higher standards and fewer tax breaks
- “Housing creates jobs” or is it “jobs create housing?”
- Demographics/large houses/Economic growth

U.S. Employment

- Added 244,000 jobs in April, for an average of 230,000 since February, then only 54,000 in May, unemployment rate rose to 9.1%
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- After 1980-82 recession, added over 3 million jobs in first year of recovery
- After 23 months of this recovery (through May), we have added about 2.1 million jobs
- Is the problem structural? Long-term(27wks)unemployed

Energy

- The payroll tax cuts this year amount to $120 billion
- If gas prices average $4 a gallon this year, consumers will spend $116 billion more on gas in 2011 than 2010
- Drill for natural gas
- Raise national gas tax – cut other taxes
- Higher prices will do more for green energy than all of the programs coming out of Washington

U.S. Deficit

- Government spending exploding – 25.4% of GDP last year – post WWII record
- Average for last 40 years is 20.7%
- Deficit of $1.3 trillion last year, $1.6 trillion this year
- Interest on debt was about $240 billion this year
- Over one-half of national debt owed to foreigners
- States face combined deficits of over $125 billion this year

Banking Issues

- Institutions in 4th quarter of 2010 and 1st quarter of this year set aside half as much for loan losses as year earlier
- Earnings increased for the 7th quarter in a row through the 1st of quarter of 2011
- Earnings growth uneven by size
- Net operating revenue fell in last two quarters

Banking Issues

- Asset growth is not in the loan portfolio
- Movement to 20% for some mortgages is bad policy
- In 2010, mergers absorbed 197 banks while 157 failed
- Last year saw 11 new charters, lowest number in 77 year history of FDIC

Banking Issues

- Higher capital requirements mean lower ROEs
- Regulators are pushing banks into the hands of private equity firms
- To be "well capitalized" - get small
- P/E ratios will be slow to improve for banks
- TARP repayment will be major problem

Federal Reserve and QE2

- FED has added $684 billion in funds to banks under QE2
- Should spur a large increase in economic growth
- Has not happened – money supply has grown $326 billion
- Consumer won't spend or borrow money – about 50% of the new funds sit in the vaults at banks
- Mortgage demand is at 13-year low in spite of low rates

The Outlook

- GDP will grow 2.75% this year doing little for job growth
- Fiscal policy and the FED are doing about all they can to stimulate growth
- Need to spend on nation's infrastructure – roads, bridges, electric grid
- Congress and President must cut projected budget deficits
- Need policies to stimulate business growth – only way for job growth

The Outlook

- Bank recovery will continue
- Large banks will do much better than community banks
- Capital is "king"
- Regulators are only making a bad problem much worse