

Georgia's economic outlook for 2009

Jeffrey M. Humphreys
Robert T. Sumichrast

The Terry College believes that this recession will be the worst in more than 30 years. It will be severe and it will be prolonged, because recessions with credit crunches and housing busts are always deeper and longer than other recessions.

But, the big news is that we are approaching a turning point, and the upturn will begin before the end of 2009. Before then, however, we must weather the first and second quarters of 2009, and these months will be dreadful. Just how dreadful depends on when, and to what degree, the credit markets thaw. Given what we know today, the most likely scenario is that the economy bottoms out late in the second quarter or early in the third quarter of 2009.

Until the upswing begins, we are going to see very sharp pullbacks in spending by both consumers and businesses. The aftershocks of the financial panic will last for a while. People and companies have lost assets, and many are, and will be, truly less well off.

These wealth reductions will accentuate the pullback in consumer spending that began before the credit markets seized up in mid-September. Realistically, the wealth that has been lost will not be easily rebuilt, so, even though the economy is likely to bottom out in two more quarters, it will be very slow to recover.

The Selig Center's forecast expects U.S. GDP to decline by 3.5 percent in the fourth quarter of 2008, by 3 percent in the first quarter of 2009, and by 2 percent in the second quar-

ter of 2009. And, that comes on the heels of the 0.2 percent drop in the third quarter of 2008. GDP will rise only slightly in the third quarter of 2009, before advancing by 1.5 percent in the final quarter of the year. The amplitude of these quarter-to-quarter drops in U.S. GDP will qualify this as a severe rather than a mild recession.

From peak to trough, we believe the recession will last about 18 months (January 2008-July 2009), which makes it the longest recession since the Great Depression of the 1930s, which lasted 43 months. The average recession lasts only about 10 months.

Georgia's economy will suffer because the state has not, and will not, find adequate shelter from the major headwinds confronting the economy in general, namely, the credit crisis, the housing recession, wealth destruction, the deepening recession in nonresidential real estate, and the lagged effects of high oil prices.

Like the nation as a whole, Georgia's economy will begin to grow in the third quarter of 2009. The pace of state GDP growth will be very subdued in the final half of 2009, but should accelerate to about 2.5 percent by mid-2010. That's on par with the average rate of state GDP growth over the last ten years.

Despite the fact that Georgia's GDP will decline much more sharply than it did in 2001, the 4.1 percent (-190,000 jobs) peak-to-trough job loss that will accompany this downturn will be only moderately heavier than the 3.8 percent



(-151,000 jobs) job loss that accompanied the 2001 downturn. The main reason job losses will not be dramatically heavier, is that many businesses entered this recession with very lean staffing levels. So, the job losses associated with this downturn mostly reflect substantial declines in demand rather than overstaffing or overdue restructuring. With the notable exception of the finance and real estate sectors, corporate America was in fairly good shape going into this recession.

Still, there will be pain. The period of job losses will last for 17 months (March 2008 through July 2009). Those job losses will more than double Georgia's unemployment rate, which will exceed 8 percent in 2009. When hiring resumes in the third quarter of 2009, job growth initially will be too anemic to keep pace with the growth of the labor force. So, the state's unemployment rate will rise throughout 2009, topping out at about 9 percent in early 2010. That will be the highest unemployment rate since the current data series began in 1976.

So how will we get out of this mess? It will not be easy, given the lack of any truly powerful engines of growth. A lessening of the five major headwinds that have been pushing the economy down is what will allow an upturn to begin in the third quarter of 2009. First, the credit markets are thawing. Second, housing sales and starts will bottom out. Third, barring a major supply interruption, oil prices will be lower in 2009 than they were throughout most of 2008. Fourth, a

huge drop in inflation—from 4.5 percent in 2008 to about 1.5 percent in 2009—will reassure almost everyone. Fifth, the cycle of wealth destruction will end.

In addition, there will be a few positive forces pushing the economy forward. Both the federal fiscal and monetary stimuli will be very strong. The 14 percent increase in relocation and expansion projects announced in FY08 will provide a slight tailwind to Georgia's economic growth. The caveat is that some of those projects may be postponed or cancelled. For example, Kumho Tire recently announced that it has delayed the construction of a massive (\$225 million) tire plant in Macon. The plant would have brought 450 jobs to middle Georgia.

Also, over the next two years, Georgia—and Columbus in particular—will realize an economic boost from the round of base closings and realignments that was recently finalized. The net gain statewide will be 4,300 jobs. Furthermore, despite the sharp global slowdown, net exports will make positive contributions to Georgia's growth, because compared to previous recessions our exports are more focused on developing countries than on developed countries. Also, our exports are less focused on any specific industry or product category than in the past.

The combination of these positive forces and less of the bad stuff will revive consumer spending in the third quarter of 2009, which initially will benefit primarily the business-to-consumer sector of Georgia's economy. The upturn in business-to-business activity will lag the upturn in the consumer sector by a quarter or more, because it always takes awhile to use up inventories, gain confidence that the upswing in consumer spending will be sustained, generate some profits, and place new orders.

But, one thing different about this recovery from recent recoveries is that the cycle of wealth destruction not only has been very intense, but it has done much more damage to middle income households than the wealth destruction that accompanied previous recessions. This time, the losses in households' net worth are in residential real estate as well as in equities whereas in recent recessions the losses were in equities alone. So, middle-income consumers are likely to come out of the starting gate much more slowly in the second half of 2009 than they did in the wake of prior recessions. That's one reason why the first two quarters of the upturn will be anemic.

Looking Ahead

During the upswing that begins in the second half of 2009, some sectors of Georgia's economy will lead the way while others will languish or continue to decline.

The employment services industry will be one of the first to turn and initially will see some of the fastest paced growth. That's because the 2008-09 recession is characterized by extreme volatility, especially in the financial and commodity markets. So, more firms than usual will opt to remain flexible and responsive to changing economic conditions in the initial

GEORGIA BUSINESS AND ECONOMIC CONDITIONS

Fourth Quarter 2008
Volume 68, number 4

SELIG CENTER FOR ECONOMIC GROWTH

Robert T. Sumichrast
Dean

Jeffrey M. Humphreys
Director

Lorena M. Akioka
Editor

Beata D. Kochut
Research Analyst

Ian Armit
Data Manager

GEORGIA BUSINESS AND ECONOMIC CONDITIONS (ISSN 0297-3857) is published quarterly by the Selig Center for Economic Growth, Terry College of Business, The University of Georgia, as a service to the business and academic communities. Signed articles reflect the author's opinion but not necessarily those of the Selig Center for Economic Growth, Terry College of Business, or The University of Georgia.

stages of the economic recovery.

As Georgia's economy emerges from the recession, educational services will be in high demand, primarily because people will recognize the imperative to have marketable skills to succeed in what is still likely to be a very tough labor market. The shortage of jobs also reduces the opportunity cost of obtaining additional education, spurring enrollment. Sluggish government revenue growth—which has hurt public education—is another factor that will support higher demand for educational services provided by the private sector. This window could remain open for a while because public education is unlikely to see significant funding increases until at least FY 2011 (mid-2010). Long-term trends are favorable, too, since current and future jobs will require significant investment in higher education.

At the other extreme, conditions in nonresidential construction will worsen dramatically throughout 2009, primarily because the pipeline of projects in development emptied out and the credit crunch caused the number of new projects to plunge. In addition, there is a lot of vacant space. So we do not expect an upturn in this industry before mid-2010.

The same is true for the housing market. After all it will be difficult to stop the adverse feedback loop between the credit markets and housing until both situations show signs of stabilizing. The good news is that:

- In Georgia, home price declines have been and will continue to be very modest. We are not seeing much of a home price correction because there really is nothing to correct. We have a supply bubble, but not a price bubble. So, home equity values are relatively intact.

- The steep downturn in single-family home sales will bottom out by April.

- New home construction will bottom by June.

These are very positive developments, but any realistic upturn in either home sales or home building will pale in comparison to recent plunges in activity. For example, permits to build new homes in Georgia have dropped about 75 percent since peaking in the first quarter of 2006. Georgia's single-family housing starts are at their lowest level since the 1981 recession when our population was only 5.6 million. Today, Georgia's population is nearly 10 million. So, relative to the size of the economy, today's housing downturn really is much, much worse than the 1981 downturn. At the national level, single-family housing starts have hit their lowest level in 63 years.

Even though we will see upturns in home sales and new home construction, we may not see existing home prices appreciate until very late in 2009 or early in 2010. That's because there is still an overhang of unsold homes that will keep a lid on house prices.

But, it could be worse. Home price declines have been very sharp in states that developed large home price bubbles during the housing boom. By mid-2009, the pace of home price declines will slow to a snail's pace in even the nation's most bubbly markets. So, the cycle of household wealth destruction that began back in the first quarter of 2007 will come to an end.

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With that, we predict that some positive forces for housing rebound will come into play. First, the credit crisis presumably will settle down. Housing will not stabilize until that happens.

Second, on the demand side, the temporary \$7,500 tax credit for first-time homebuyers included in the Housing and Economic Recovery Act of 2008 will strengthen the starter home segment of Georgia's housing market. Since first-time homebuyers do not have to sell a home before they buy another, this tax credit will help to take excess inventory off the market.

Given that home prices have been drifting downward, people will wait to take advantage of the tax credit until shortly before it expires on July 1, 2009. That expiration date should boost home sales late in the second quarter.

Third, as the tax credit expires, the situation in the labor market will stabilize and personal income growth should resume. Even a small increase in the number of jobs (in the third quarter) will give more people the confidence and the wherewithal to buy homes, helping to ensure that the housing market's initial recovery is not a false dawn.

Finally, the state's rapid population growth constitutes a powerful demand-side driver that provides long-term stimulus to Georgia's housing industry.

Preparing for Economic Recovery

As counterintuitive as it sounds, this may be a good time to start or expand a business. Rents are depressed. Talent is available. Established businesses are cutting back on promotions, which increases the chance that your message and your business will be noticed.

Also, during tough times, longstanding loyalties to well-established businesses get tested. Increased customer churn will create opportunities for your new company, especially if you have a lower cost structure. Of course, the re-assessment of risk by the financial sector means that it will be hard for startups to get bank loans, but that's when family and friends come into the picture.

Speaking of banks, the recent acquisition or failure of some of the most venerable banks will open up opportunities for some of Georgia's smaller and better-capitalized banks to expand.

Also, if you have the cash, need the space, and do not want to rent, this is a great time to build. Many commercial and residential contractors will cut their normal profit margins to keep their crews busy. But, the best deals will be had when the recession is at its absolute worst—in the second quarter of 2009. In addition, the dearth of projects implies that your project will be completed on time.

State and local governments' budget woes will lead to substantial reductions in the range, and potentially the quality, of services they provide. Businesses that move into some of the abandoned niches could do well. Also, there will be opportunities for agile companies that are able to take advantage of sudden outsourcing or privatization of activities tradition-

ally performed in-house by state or local government.

Although the upswing in the overall economy will not be too vigorous, there will be some dramatic shifts in underlying economic conditions that businesses need to anticipate. For example, once the recovery gains traction, be prepared for the Federal Reserve to take back its rate cuts much faster than it did after the 2001 recession. So, if you have good credit and a solid business plan, 2009 will be a good time to borrow money at some very attractive rates. By 2010, it probably will be too late to get the cheap money.

On a more dismal note, when the economy falls, crime rates rise. Georgia's unemployment rate will be rising for some time. Meanwhile, government budgets for police and other protective services get axed. Ominous as it sounds, these trends will create opportunities for companies that provide security and protective services.

One consumer segment that offers some immediate potential for growth consists of retirees whose spending depends

primarily on Social Security income and/or defined benefit pension plans. Each month, about 50 million Americans get Social Security checks. In 2009, Social Security payments will rise by 5.3 percent, which will be the largest increase in 27 years. Meanwhile, retirees' payments to Medicare will not go up. Of course, retirees who depend primarily on dividends, interest, or rental income will not see their incomes rise in 2009, but even they should begin to see higher returns in 2010.

Georgia is particularly well positioned to attract retirees in much greater numbers than ever before. But, that source of demand has been stymied by retirees' inability to sell their primary residences so that they can relocate to Georgia. Once the ice breaks in the housing markets that traditionally send retirees our way, the upswing in revenues earned by Georgia's retiree-oriented businesses will accelerate.

TABLE 1

GEORGIA'S ECONOMIC FORECAST, 2008-2009

| Georgia | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 |
|---|---------|---------|---------|---------|---------|---------|
| Real Gross State Product, Bil of 2000\$ | 310.7 | 322.1 | 327.3 | 336.6 | 340.0 | 335.2 |
| Percent change | 3.7 | 3.7 | 1.6 | 2.8 | 1.0 | -1.4 |
| Nonfarm Employment (thousands) | 3,898.5 | 4,001.2 | 4,089.1 | 4,147.0 | 4,126.5 | 4,022.2 |
| Percent change | 1.4 | 2.6 | 2.2 | 1.4 | -0.5 | -2.5 |
| Personal Income, Bil of \$ | 264.9 | 284.1 | 299.8 | 319.3 | 331.5 | 337.1 |
| Percent change | 5.6 | 7.3 | 5.5 | 6.5 | 3.8 | 1.7 |
| Housing Permits, Total | 108,356 | 109,336 | 104,200 | 73,165 | 33,550 | 27,954 |
| Percent change | 12.0 | 0.9 | -4.7 | -29.8 | -54.1 | -16.7 |
| Unemployment Rate (percent) | 4.7 | 5.2 | 4.6 | 4.4 | 6.0 | 8.4 |

Source: The Selig Center for Economic Growth, Terry College of Business, The University of Georgia, November 11, 2008.

TABLE 2

NEW RESIDENTIAL BUILDING UNITS AUTHORIZED FOR GEORGIA, 1995-2009

| | Total New Residential | Percent Change from Previous Period | New Single-Unit Residential | Percent Change from Previous Period | New Multi-Unit Residential | Percent Change from Previous Period |
|-------|-----------------------------|---|-----------------------------------|---|----------------------------------|---|
| 1995 | 72,225 | 11.4 | 55,027 | 4.8 | 17,198 | 39.5 |
| 1996 | 74,874 | 3.7 | 59,397 | 7.9 | 15,477 | -10.0 |
| 1997 | 75,123 | 0.3 | 59,596 | 0.3 | 15,527 | 0.3 |
| 1998 | 85,401 | 13.7 | 67,879 | 13.9 | 17,522 | 12.8 |
| 1999 | 89,581 | 4.9 | 71,530 | 5.4 | 18,051 | 3.0 |
| 2000 | 91,820 | 2.5 | 68,852 | -3.7 | 22,968 | 27.2 |
| 2001 | 93,059 | 1.3 | 71,531 | 3.9 | 21,528 | -6.3 |
| 2002 | 97,523 | 4.8 | 75,529 | 5.6 | 21,994 | 2.2 |
| 2003 | 96,704 | -0.8 | 80,683 | 6.8 | 16,021 | -27.2 |
| 2004 | 108,356 | 12.0 | 87,731 | 8.7 | 20,625 | 28.7 |
| 2005 | 109,336 | 0.9 | 94,467 | 7.7 | 14,869 | -27.9 |
| 2006 | 104,200 | -4.7 | 86,106 | -8.9 | 18,094 | 21.7 |
| 2007 | 73,165 | -29.8 | 55,210 | -35.9 | 17,955 | -0.8 |
| 2008* | 33,550 | -54.1 | 24,250 | -56.1 | 9,300 | -48.2 |
| 2009* | 27,954 | -16.7 | 22,068 | -9.0 | 5,887 | -36.7 |

*Indicates forecasted value.

Source: Data for 1995-2007 were obtained from the Construction Statistics Division, Bureau of the Census. Values forecast for 2007-2008 were obtained from the Selig Center for Economic Growth, Terry College of Business, The University of Georgia (November 2008).

TABLE 3

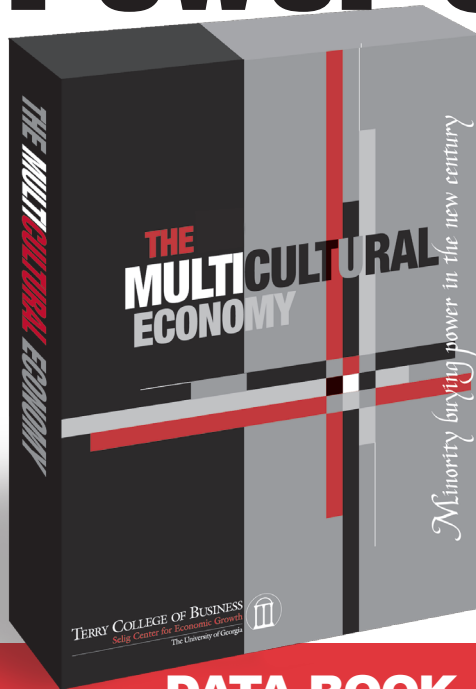
GEORGIA'S EMPLOYMENT FORECAST, 2008-2009

| Georgia | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 |
|------------------------------------|---------|---------|---------|---------|---------|---------|
| Nonfarm Employment ¹ | 3,898.5 | 4,001.2 | 4,089.1 | 4,147.0 | 4,126.5 | 4,022.2 |
| Goods Producing | 660.3 | 670.7 | 678.5 | 664.5 | 629.6 | 574.1 |
| Natural Resources and Mining | 12.2 | 12.1 | 12.2 | 12.0 | 11.3 | 10.5 |
| Construction | 199.8 | 208.8 | 218.8 | 221.6 | 207.5 | 180.8 |
| Manufacturing | 448.3 | 449.8 | 447.5 | 431.0 | 410.7 | 382.8 |
| Services Providing | 3,238.2 | 3,330.5 | 3,410.6 | 3,482.6 | 3,496.9 | 3,448.1 |
| Trade, Trans., Utilities | 830.2 | 852.9 | 871.3 | 888.1 | 890.8 | 873.8 |
| Information | 115.8 | 114.1 | 113.5 | 114.5 | 114.7 | 111.9 |
| Financial Activities | 218.8 | 225.4 | 230.7 | 231.1 | 223.9 | 219.9 |
| Professional and Business Services | 510.8 | 534.2 | 549.4 | 560.2 | 561.9 | 547.8 |
| Education and Health Services | 409.3 | 424.0 | 439.4 | 455.5 | 464.6 | 474.4 |
| Leisure and Hospitality | 360.1 | 372.0 | 384.0 | 396.5 | 398.1 | 390.9 |
| Other Services | 156.2 | 158.3 | 159.2 | 160.8 | 161.0 | 159.0 |
| Government | 637.2 | 649.6 | 663.1 | 675.9 | 682.0 | 670.4 |
| Percent Change | | | | | | |
| Nonfarm Employment | 1.4 | 2.6 | 2.2 | 1.4 | -0.5 | -2.5 |
| Goods Producing | 0.2 | 1.6 | 1.2 | -2.1 | -5.3 | -8.8 |
| Natural Resources and Mining | -0.8 | -0.8 | 0.8 | -1.6 | -5.8 | -7.1 |
| Construction | 2.5 | 4.5 | 4.8 | 1.2 | -6.3 | -12.9 |
| Manufacturing | -0.8 | 0.3 | -0.5 | -3.7 | -4.7 | -6.8 |
| Services Providing | 1.6 | 2.9 | 2.4 | 2.1 | 0.4 | -1.4 |
| Trade, Trans., Utilities | 0.7 | 2.7 | 2.2 | 1.9 | 0.3 | -1.9 |
| Information | -4.3 | -1.5 | -0.5 | 0.9 | 0.2 | -2.5 |
| Financial Activities | 1.1 | 3.0 | 2.4 | 0.2 | -3.1 | -1.8 |
| Professional and Business Services | 3.7 | 4.6 | 2.8 | 2.0 | 0.3 | -2.5 |
| Education and Health Services | 3.6 | 3.6 | 3.6 | 3.7 | 2.0 | 2.1 |
| Leisure and Hospitality | 3.4 | 3.3 | 3.2 | 3.3 | 0.4 | -1.8 |
| Other Services | 0.5 | 1.3 | 0.6 | 1.0 | 0.1 | -1.2 |
| Government | 0.8 | 1.9 | 2.1 | 1.9 | 0.9 | -1.7 |

¹Indicates thousands of workers.

Source: Selig Center for Economic Growth, Terry College of Business, The University of Georgia, November 11, 2008.

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