

More trouble ahead for state, experts say

by *Betty Beard* - Sept. 25, 2008 12:00 AM
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As far as forecasts go, it was hardly sunny. The state's economy is probably not going to get better next year and could get worse, analysts predicted Wednesday.

That gloomy outlook even assumes that Congress' bailout can do something to thaw the credit markets and help people get home, car and other loans.

At an annual forecast breakfast at the Arizona Biltmore Resort & Spa, Scottsdale economist Elliott Pollack said some measurements of the state's economy have set historic precedents because they are so bad, including the dip in retail spending and job growth relative to other states.

He doesn't forecast much improvement next year because of an excess of 55,000 to 75,000 houses on the market, according to his estimates. Other challenges: In-migration has slowed; foreclosures may not peak until next year; and the state is now one of the worst in the country for job growth.

The housing market probably won't get back to normal until 2012, assuming the credit markets don't freeze, he told about 800

people attending the Greater Phoenix Chamber of Commerce/Cox Communications economic-forecast breakfast.

University of Arizona economist Marshall Vest, asked to comment on Pollack's dismal outlook, agreed that the state may not see any decent growth until at least the end of 2009 or into 2010.

Vest said the current crisis in the credit markets would make the recession longer and deeper.

Arizona State University economics Professor Lee McPheters, speaking at a separate function to Valley mortgage bankers, was a little more bullish but said the economy is likely to worsen before it improves. He doesn't expect clear signs of recovery before 2010.

"We're going into three or four very, very bad quarters for Arizona and the nation," he said.

McPheters said economic indicators such as consumer spending, jobs and inflation don't reflect a full-blown recession like the ones in 2001 and 1991.

Pollack also pointed to some positives, particularly dramatically improved housing affordability in Arizona, strong long-term

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fundamentals and higher gas prices that in the long term will encourage fuel-efficient cars.

"Frankly, the worse thing that can happen is that oil goes back to \$2.50 a gallon," he said.

Federal bailout

Pollack said he believes some form of federal support is essential to help ensure housing and other loans, but he has misgivings about the proposed \$700 billion federal bailout.

He called it "an astonishingly bad idea" because of all the conditions Congress is proposing and because it rewards those who took reckless risks and failed.

"Those of us who made our house payments and lived within our means will now subsidize those who didn't. And that's not a very good idea for a capitalist system," he said.

Nevertheless, he predicts Congress will pass some form of relief.

Vest said that without some federal action to free up credit, the country is looking at a 1930s-style depression. If the Federal Reserve and Treasury take action, the state is looking at a "recession comparable to what we saw in the mid-1970s and early 1980s."

In the late 1980s and early 1990s, the state also went through a downturn similar to what it's experiencing today, linked to the collapse of savings and loans.

Retail sales

The federal stimulus checks mailed out in the spring slightly boosted personal income and perhaps retail sales in the second quarter. Now, retail sales have sunk sharply, dropping 10 percent from a year earlier in July, Pollack said.

"Retail sales are negative. And they rarely turn negative other than during periods of recession," he said.

"They are way negative in Arizona, down like 10 percent, which is unheard of. There is no historic precedence for this."

Consumers are being squeezed on so many fronts, he said. They have less home equity, have been spending more on gasoline and food, haven't been saving enough in previous years, and generally are just being more cautious.

"You will make that car last another year. You won't go out and buy a flat-screen TV," he said.

Job growth

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When it comes to job growth compared with other states, Arizona has had an unusually steep descent, Pollack said.

The state has usually been in the top three in the country.

But it fell from second in 2006 to 22nd last year to 46th in August, according to the U.S. Bureau of Labor Statistics.

Metropolitan Phoenix fell from its usual perch in the top three, to 27th, out of 34 major metropolitan markets of 1 million residents or more.

"This, for us, is uncharted territory. We have never been here before," Pollack said.

"It's far worse here than most places, and in the 39 years I've been doing this, this is the first time I ever had to say that."

Real estate

Housing will slowly improve, Pollack said, but he expects the commercial market to get worse next year.

"This time next year, you will have a lousy housing market and a lousy commercial market," he said.

In the major commercial markets - industrial, office and retail - absorption has

been falling this year and builders are still building.

Vacancies are up and probably will continue rising.

Under construction are 4.3 million square feet of office space, 5.8 million square feet of industrial and 5.1 million square feet of retail, Pollack said, citing numbers from CB Richard Ellis.

One bright spot in the housing market is that affordability has improved, he added.

In early 2000, 64 percent of residents could afford the average home in Phoenix, making it one of the most affordable housing markets west of the Mississippi River.

In 2006, only 27 percent could afford the median home, but today, affordability is back up to 65 percent, although securing financing could be a problem.

McPheters said he believes home prices will reach "equilibrium" when they have fallen an additional 15 percent, equivalent to 2004 values.

Resale values will continue to decline for nine more months, he said, and new-home starts aren't likely to rebound for another year.

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Much of that recovery is contingent on nationwide economic-relief efforts, although McPheters noted that Arizona historically recovers from recessions more vigorously than the nation at large.

"Arizona will not independently rebound if the nation does not," he said.

Anne Randolph of Denver, publisher of *lore Magazine*, said that nationally, 3 percent of owners are delinquent on their mortgages; 1 percent of the homes are being foreclosed.

The other 2 percent are working out their problems with lenders.

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