Outlook 2009
A Good Year to Stay Away from Sharp Objects
by
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2008 has not been an easy year thus far. It appears that 2009 will not be much better. While some progress has been made to correct the imbalances that exist in the national and local economies, there are still substantial problems in front of us.

Credit markets remain in disarray and are not likely to turn around until housing prices stabilize. While this has happened in some markets around the country, many markets, including Greater Phoenix, could be a year or more from stability. This is true despite the fact that the excess supply of housing could be in the process of bottoming out.

While credit and housing markets are a good part of the problem, they are not the only problem. With the decline in housing prices and relatively flat stock market values, consumers cannot rely on those assets to provide them liquidity as they did prior to 2000 and especially from 2002 through 2006. On top of that, consumer debt levels remain high and traditional savings is near a record low. Thus, consumers have to restructure their balance sheets. They can do this by spending less and saving more. This would be difficult at any point in the cycle, but in a period of reduced employment and hours worked, it suggests the difficulty is still in front of us.

Other issues affecting the consumer relate to oil prices and food prices. While inflation less food and energy is still running at only about 2.5%, only slightly above the Fed's target of 2%, the average guy on the street does pay for food and energy. This means more money in the tank and more money spent at the food store and less money for other retail items. Oil prices are likely to trend up in the long run. However, they are very volatile in the short run. The problem is that oil is found in all the bad neighborhoods and as a result, the precarious supply and demand balance is always subject to shocks of unforcastable origin. It does appear, however, with world demand weakening, especially as Americans adjust their driving patterns as a result of higher gas prices, that there will be downward pressure on oil and food commodities in the near term. If oil prices and food prices do come down, that could free up income for the average consumer. If they do not, it will take that much longer for people to readjust their spending habits. In the short term, expect further price declines of both food and oil.

The economy is bifurcated. Housing and auto sales appear to be in severe recessions, while other sectors, such as export related business, appear to be doing well. However, business has been doing well because of the decline in the dollar, which makes our goods less expensive overseas and foreign goods more expensive here. This has helped substantially. Business spending on physical plants has been a positive and essentially has carried the economy so far in 2008. It now appears that foreign economies such as the Euro zone and even China are having slowdowns in their rates of growth. This cannot help but slow down the business sector for the remainder of this year and into next. In addition, even though businesses are liquid and have strong balance sheets, they are having a difficult time securing capital as the credit crunch has spread into more than just the subprime segment. Thus, the one positive sector of the economy will not have as bright of an outlook over the next year or so. This will translate into further weakness in commercial construction.

Overall, the national economic outlook is for a weak 2009. Growth will occur in the second half only because the comparisons will be so easy since 2008 was such a weak year itself. The slowdown, which could very easily be characterized as a recession, is likely to continue into 2009.

Greater Phoenix has been affected by these factors more so in this cycle than in any other in the past forty years. Relative to other metropolitan areas (MSAs), employment in Greater Phoenix is doing very poorly. After being ranked first or near the top among 34 other MSA's with more than one million employees for most of this decade, Greater Phoenix ranked 27th year-to-date through June of 2008. Indeed, employment has declined 0.3% through the first half of 2008 over the similar period in 2007. Only mining, education and health services, leisure and hospitality, other services and government (five sectors which represent 38% of the economy) are showing an increase of employment. Construction is down substantially and other sectors such as manufacturing; trade, transportation, and utilities; financial activities; and even business and professional services, are showing weakness. This shows how the construction industry ripples throughout the economy. The oversupply of housing may have peaked, but housing will bump along the bottom for some time and it will be a long time until things get back into normal balance.

In the meantime, this slowdown in economic activity has also affected the local commercial sector where absorption has slowed dramatically. Yet, there is still substantial new square footage in the pipeline. Thus, vacancy rates in all commercial sectors are likely to increase in 2009, putting more downward pressure on rents and construction employment.

Retail sales in Greater Phoenix have been the weakest on record. While some improvement can be expected, even in autos, 2009 will not feel very much better than 2008. The slowdown in housing and the expanded crunch in mortgage markets continue to make it difficult for people to move into Arizona and Greater Phoenix. Thus, population flows will be lower than normal as well.

Overall, 2008 has been a disappointing year and 2009, even though in the second half of the year could see a recovery, will not feel very good. Any positive growth in 2009 will occur because 2008 was so weak and the comparisons will be easier. The good news is that the underlying dynamics of Greater Phoenix remains positive. But, we need to be patient. The recovery will be slow to materialize just as the recession was slow to develop.