

Money-Rx Blog

Monday, October 1, 2007

Christopher Thornberg (Beacon Economics)



Christopher F. Thornberg is a principal and founder, along with Dr. Jon Haveman, of [Beacon Economics](#), a Los Angeles based company which researches and produces papers related to economic development issues relevant to the regional economies of California and other western states.

Dr. Thornberg's expertise lies in the study of regional economies, real estate dynamics, labor markets and business forecasting. Dr. Thornberg has appeared on CNN, Fox News and CNBC and is acknowledged by the media as an expert on the intricacies of the western economies. He has been involved in studies measuring the impacts of NAFTA and the California power crisis. He is quoted extensively by the California Dailies and national publications like the Washington Post, and interviewed by PBS.

Career: Before starting Beacon in 2006, he worked with UCLA Anderson Forecast (2000-2006) and currently also teaches courses on Business forecasting and global economics at the Rady School of Business at UCSD (2000-Present). Prior to that, he was an Assistant Professor at Clemson University (1997-2000) and a Lecturer at the USC Marshall School of Business (1996-1997).

Education:

Ph.D., Business Economics, Anderson School, UCLA, 1997

B.Sc., Business Administration, State University of New York at Buffalo, 1989

Editor's note: Considering the downward spiral in the real estate market, which has spilled over into the general economy and spooked investors, I contacted Dr. Thornberg for his take on the overall effect of the subprime crisis on the real estate market, investors and the general state of the economy. Dr. Thornberg's views are even more important when you consider that he [forecasted](#) the current subprime crisis nearly a year ago, in November 2006. Below are his comments, as is, without any editing.

Is housing a threat to the economy? As far as real estate bubbles goes, this past cycle has no precedent even in California's turbulent housing past. Prices relative to past trends and

household income have never been higher, nor has the cycle ever gone on as long as this one. As we know now, the causes of this unusual cycle are not unlike the causes of the dot.com frenzy—investors, seemingly blind to the lack of fundamentals, have been snapping up mortgage backed securities by the billions, allowing the industry to lend money to buyers seemingly without any standards.

When the market finally topped out in 2005, the market went into a slow decline. The forces of growth outside the housing sector—productivity and business investment—remained strong and with labor markets tightening incomes began to rise sharply again. The housing market, while clearly distressed, remained mainly a distraction to the economy rather than a fundamental threat to it. Many forecasters believed that the economy could weather the housing storm. The thinking might be paraphrased this way: *'sure-past recessions were led by a slowing housing market, but this was correlation, not causality. Housing simply responded faster to the external shock that would hit the economy.'* For a while the bulls seemed to be right, as the rest of the economy moved along for close to a year without housing having a substantial impact.

It is true that the housing construction sector is a small portion of the overall US economy—comprising about 3.5 percent of the economy on average, only about 5.5 percent this time at the peak. But this isn't the issue. Price increases and then decreases in real estate alone cannot cause a recession either—after all home prices simply reflect a financial swap—for each home buyer paying a high price there is a home seller making a handsome profit. The issue is the consumer reaction to perceived home wealth. The economy over the last few years has been out of balance. Consumers have been on a spending binge fueled by home price appreciation. Savings rates have been negative and the US overall has been running a massive trade deficit as consumers have used mortgage equity withdrawals to expand spending. The old rules about housing do not apply anymore. Now the housing market can cause a recession.

The cooling housing market cooled growth in consumer spending, but did not stop it—after all consumers had lots of excess equity in their homes and the stock market has been booming along. As long as home prices didn't start to fall, consumers could slowly move back to a balanced position and the US economy would continue to grow. Unfortunately prices have started to fall—they had to as they were simply unsustainable given their level relative to prices. Many buyers had used risky alternative financing to speculate on real estate with the idea of using short term low rates to capitalize on rising prices. When the market peaked, those last in suddenly found themselves with mortgages that were ticking time bombs—when the reset date kicked in they simply couldn't pay the mortgage and foreclosure was in the works. The situation had started to reach a crisis point in the second quarter of this year. Foreclosure across the nation and right here in California started to reach record high levels despite the tight labor market. This caused prices to start to fall and consumer spending growth to slow in the second quarter of this year.

The economy was already substantially at risk when the credit crunch began in August. Hedge funds began to implode due to the lack of performance of the low-tranche mortgage

backed securities that formed the base investment product. Bond holders have suddenly realized that their paper may not be worth what they paid for it, and the credit markets dried up rapidly. The Fed has made moves to relieve the liquidity crisis, but there is little they can do now about the mortgage markets. The mortgage markets will no longer touch any potential borrower who has less than stellar ratings and a large down payment. Foreclosures—already high—are sure to spike in the wake of this and the cooling US economy is likely to tip into a recession by the end of this year or the beginning of next. Some analysts will blame the credit crunch, but this isn't the case. This is simply a factor that will hasten to slowing, but not create it.

Is a recession going to happen? From our perspective the answer is almost certainly yes. There are some potential factors that may help. A falling US dollar will stimulate exports. Much of the impact of the consumer spending slowdown will accrue to foreign producers through falling imports. The government may find a real way to slow the housing implosion. A major fiscal expansion, as driven by a major expansion of a foreign conflict, could replace consumer spending as a driver of growth. We see these as low probability events.

That was Dr. Christopher F. Thornberg, [Beacon Economics](#), predicting a recession, but labeling the subprime mess as a hastening factor, instead of a trigger for a temporary scare. That is likely a more serious issue, and one that can take a substantially longer period to correct.

posted by Admin @ 7:52 PM

Comments: [Post a Comment](#)

Links to this post:

[Create a Link](#)

[<< Home](#)



Subscribe to Posts [[Atom](#)]