San Diego Business Journal

Former UCLA Economist Says National Economy Slipping Into Recession

By MIKE ALLEN - 11/19/2007
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Citing the housing crash and consumer spending retreat, economist Christopher Thornberg, speaking at the annual convention of the California and Nevada Credit Union League on Nov. 12, predicted that a recession, or shrinkage in the national gross domestic product for at least two quarters, is almost a certainty next year.

“I do believe the economy is slipping into a recession,” said Thornberg to 1,000 attendees at the convention held at the Manchester Grand Hyatt downtown. Thornberg is a partner in Beacon Economics LLC in Los Angeles and a former economist at UCLA’s Anderson School of Business.

Despite third-quarter GDP growth of 2.9 percent, Thornberg said problems associated with a deflating housing market are getting worse. But an even more influential factor is a slowdown in consumer spending that will bring increased job loss, and less business investment, he said.

Consumers who have racked up excess debt in recent years are having a tougher time as the bills pile up, and they are unable to refinance those debts by new home equity loans. One of the graphs displayed by Thornberg showed the average debt as a percentage of income last year reaching nearly 120 percent.

“The most important number here is the American consumer is starting to run out of steam,” Thornberg said.

Consumer spending accounts for 70 percent of the national economy, and has been propping it up in recent years, fueled by borrowing on home equity now declining in value, particularly in higher-growth states such as California.

“Prices (of homes) are going to continue to fall. They’re going to go down 20 to 30 percent, top to bottom,” he said.

Housing Woes

In San Diego this year, prices on the lower end houses have decreased nearly 13 percent; on middle tier houses by 9 percent; and in the upper tier product by 5 percent, according to data displayed by Thornberg.

Using an array of economic charts and data sources, Thornberg said the housing market is not set to rebound anytime soon. “Housing markets don’t bounce,” he said.

The real estate bubble took about three years to swell and will take about the same time to deflate, he said.

The housing bubble peaked in 2005, but it’s only this year that the pain is being felt in the form of escalating defaults and foreclosures. He defined a bubble as an asset price that increases when fundamentals say it shouldn’t.

Foreclosures are occurring at a faster pace in California and in other high-growth states, but are even more pervasive in the Midwest, where the economy is in worse shape, he said.

According to Default Research Inc. of Mount Pleasant, Pa., San Diego County led the state of California in foreclosure filings with 3,427 in October, up 400 percent from the same month a year earlier.

The research firm said of the five largest counties in California, the hardest hit in foreclosures were San Diego, Riverside and Los Angeles. “Last month was bad for the Golden State and the coming months could be even worse,” said Serdar Bankaci, president of Default.

Subprime home loans that use adjustable interest rates are due to reset in the third quarter of next year, and should result in higher rates of default, “so the worst is still in front of us,” Thornberg said.

Further dampening prospects is the tumult playing out on the global capital markets — the declining value of the dollar and escalating price of oil, all of which are causing further pressure on consumers, he said.

The cost of oil was nearing $100 per barrel this month, but fell to about $91 as of Nov. 13. The dollar has been losing ground for most of the year, and through Nov. 13, it declined nearly 7 percent against the yen, nearly 10 percent against the euro, and 18 percent against the Canadian dollar.

“This is not a good time for the U.S. economy,” Thornberg said.

It won’t be until 2009 that the economy “will get going again,” Thornberg said.

Regional Economy Looks Good

Kelly Cunningham, an economist with the San Diego Institute for Policy Research, a private research firm bankrolled by former mayoral candidate Steve Francis, said while he agreed with much of Thornberg’s assessment, he didn’t foresee a recession.

Although the housing market is now worse than he believed about a year ago and is having a greater impact, Cunningham said the regional economy appears “fairly sound.”

“We’re still adding jobs in the high-tech sector, and the visitor industry is doing well,” he said.

The area’s most recent unemployment rate is 4.8 percent, below that of California at 5.4 percent, but higher than the national unemployment rate of 4.5 percent.

The region’s rate is generally regarded as practically full employment, Cunningham said.

Should the national economy fall into a recession, Cunningham said it will likely be similar to the most recent one in 2000-2002 that affected Northern California far more than San Diego. That’s because the northern part of the state was so immersed with technology or dot-com businesses, while San Diego has a more diversified industry mix, he said.

The three major industries here are manufacturing, defense and tourism.

Still, even optimists like Cunningham are not forecasting a turnaround anytime soon.

“2008 is not going to be a great year by any means, and it will probably be 2009 before we see strong economic growth,” Cunningham said.
