The Economic Outlook
Community Development Forum
Salt Lake City    July 19, 2012

Ray Squitieri
Economic and Policy Analysis, OCC
Summary—US economy

- Slow growth to persist, but US likely to avoid recession
- Slow growth means slow improvement in unemployment
- Housing has yet to turn around
- Europe now a big risk to US economy
- Positives: lower energy prices, continued low interest rates
Recovery plods along

Real GDP, % change annual rate

Quarterly average unemployment rate, %

Sources: BEA, BLS, Blue Chip Indicators (June 2012)
Weekly leading index has waffled since end of recession, unlike steady gains in past expansions.
After rising above 200K per month, job growth faltered over the last 4 months

Change in nonfarm employment, thousands

Sources: BLS, E&PA calculations (data through May 2012)
Much of the improvement in unemployment rate due to drop in labor force participation rate

Source: Bureau of Labor Statistics / Haver Analytics

Note: if participation rate had remained at 2010 average, latest UE rate would be 9.5% not 8.2%
If labor force exits had remained unemployed, the statistics would look a lot worse today.

Unprecedented drop in LF participation in recent years

Source: BLS
For most states, employment likely to remain below pre-recession levels through 2013

Source: Moody’s Analytics; Federal Reserve Board Supervisory Stress-Test Baseline
Consumer confidence remains historically low

Source: Conference Board
... though shoppers are gradually returning to the stores

Source: Census Bureau, Moody’s Analytics
Inventory of distressed properties still weighing on housing market

Sources: CoreLogic; NAR; S&P; Fiserv; E&P calculations

*2012 sales data are first quarter at annualized rate. 2012 inventory data are through January.
Distressed existing home sales estimates include short-sales and sales from REO inventory; latter is two-thirds of volume. Shadow inventory includes all properties in serious delinquency or worse that are ultimately expected to be listed as for sale from REO.
Inventory of distressed properties still weighing on house prices

First mortgage loans (number)

- 90+days delinquent
- In foreclosure

Case-Shiller 20-Metro Home Price Index, SA, 2006Q2=100

- 33%
- 36%

Sources: Equifax/Moody’s Analytics, Fiserv/Moody’s Analytics (May 2012 baseline forecast)
Few housing markets are showing much price appreciation yet

Existing single-family (constant quality) home price indexes
Index April 2006 peak = 100

Source: S&P Case-Shiller monthly data through April 2012
Mortgages with negative equity will keep RES RE loss rates high in some states

Share of 1st liens (count) with negative equity

- Underwater less than 20% (LTV 100% to 120%)
- Underwater more than 20% (LTV >120%)

Sources: OCC Mortgage Metrics; LPS Home Price Index; data as of January 2011

Data are for 9 large servicers. Data reflect both loans held in portfolio and serviced for others. Data include FHA/VA mortgages but exclude 1st liens without a refreshed LTV.
Euro area slowdown weighing on U.S. export growth

Sources: IMF July 2012 World Economic Outlook update; BEA
Obstacles to growth still outweigh positives

Negatives
- Weak housing market
- Fiscal drag
- Continued deleveraging
- Generally tight credit
- Low consumer and business confidence
- Risk from Europe

Positives
- Signs of life in construction
- Stronger household balance sheets
- Lower energy prices
- Some credit easing; low interest rates and inflation
- Better US competitiveness
Loss rates still high for residential real estate
National banks and federal thrifts

Annual net charge-off rates, %

Source: Integrated Banking Information System (OCC)

Data are merger adjusted as of 1Q:2012 and use the current supervision designation.
Loss rates well above average on CRE loans at community banks
National banks and federal thrifts
Annual net charge-off rates, %

Source: Integrated Banking Information System (OCC)

Data are merger adjusted as of 1Q:2012 and use the current supervision designation.
Risks to economy: What did we say last year?
[From March 13, 2011 presentation to Utah Bankers’ Roundtable]

Downside risks

- Soft job market keeps unemployment rate high
- Housing falls again as foreclosure crisis drags on
- Weak housing and job market further stresses banks
- Overseas: Mid East turmoil, Japan disaster, European debt crisis
- State and local fiscal woes intensify

Upside risks

- Emerging market growth accelerates
- Strong business sector drives hiring
- Self-sustaining growth cycle kicks in
Risks to economy: This year’s story

US (high-impact, low probability)
- Economy falls off fiscal cliff

US (lower-impact, higher-probability)
- Housing falls again as foreclosure crisis drags on

Global (high-impact, low probability)
- War in Persian Gulf, European financial meltdown

Global (lower-impact, higher-probability)
- Long slump in Europe, Sharp slowdown in China

Upside possibilities
- Emerging markets pick up
- Strong US business sector drives hiring
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Outlook for Utah and Salt Lake City

- Moderate growth in jobs, household income
- Positive signs in housing market, though house prices have yet to turn around
SLC leads Utah and the U.S. in job growth

Sources: BLS, Moody’s Analytics
Office jobs increasing in Utah

Office-using employment 2011Q1 to 2012Q1

Sources: BLS, Moody’s Analytics
Utah will show solid job growth over next 12 months

Forecast employment growth 2012Q1 to 2013Q1

Sources: BLS, Moody’s Analytics (July 2012 forecast)
Foreign migration dominates in SLC

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<th>Year</th>
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<th>Foreign</th>
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<tr>
<td>2011</td>
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</table>

Sources: Census Bureau/Moody’s Analytics
Job gains support income gains in SLC

Wage and salary income, % change yr ago

Sources: BLS, Moody’s Analytics
Moderate growth expected for household incomes in Utah

Forecast household income growth 2012Q1 to 2013Q1

Sources: Census, Moody’s Analytics (July 2012 forecast)
Home sales picking up in SLC ...

Yr-to-date home sales, % change yr ago, Feb 12

Sources: Utah Association of Realtors, Moody’s Analytics
... though house prices have yet to turn back up
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Monthly job gains over the past 18 months have barely exceeded new labor force growth.

Job growth required simply to accommodate 0.9% per year growth in labor force.

Extra needed to achieve 6% unemployment rate in time shown.

Sources: BLS; E&PA calculations

Assumes no change in current labor force participation rate of 63.8% and overall population growth of 0.9% per year.
There’s no doubt that since the recession, growth has been well less than average.
U.S. economic policy uncertainty is rising again, ahead of “fiscal cliff” concerns for 2013

Economic Policy Uncertainty Index
Mean = 100

Source: Haver Analytics (index developed by Scott Baker and Nicholas Bloom of Stanford University and Steven Davis of the University of Chicago)

Index measures the frequency of references to economic uncertainty and policy in Google news media catalog, the number of federal tax code provisions set to expire in future years, and the extent of disagreement among economic forecasters over future government purchases and the CPI.
After six years, new home construction is no longer weighing on overall economic growth

Source: BEA
Despite some improvement, small business optimism remains low, and sales concerns high.

NFIB small business survey

Optimism Index

Reporting poor sales as most important problem

Sources: Federal Reserve, BEA

NFIB members responding to survey typically employ 10 people with annual sales of $0.5 million.
Growth could be significantly reduced if U.S. falls off the “fiscal cliff”

-2.0  -1.0  0.0  1.0  2.0  3.0  4.0
1st half 2012 2nd half 2012 1st half 2013 2nd half 2013

Sources: Blue Chip Consensus Forecasts June 2012; CBO analysis May 2012; E&PA calculations

“Fiscal Cliff” refers to expiration of various tax rate reductions, extended unemployment benefits, and other fiscal programs, as well as sequestration (mandatory reductions) in federal government spending set to begin in calendar year 2013. For details see: http://www.cbo.gov/sites/default/files/cbofiles/attachments/FiscalRestraint_0.pdf
Forecasts for Europe have steadily weakened, adding risk for U.S. economy and banks

GDP growth forecasts for 2012

Source: Consensus Forecasts