

PA HealthCare Credit Union

2010 Economic and Financial Forecast

The PA HealthCare Credit Union is making
your financial health better.

Agenda

- Welcome & Introduction
- What we said was going to happen
- Recap of 2009 Forecast
- Financial & Credit Crisis Lingers
- Welcome to the Great Recession
- 2010 Economic Forecast – Overview
- 2010 Economic Forecast - Indicators
- Interest Rate Forecast
- Stock Market Forecast
- Putting it All Together

Welcome & Introduction

- The PA HealthCare Credit Union is proud to sponsor this event to better educate members and non-members on the 2010 forecast of economic and financial indicators.
- Paul Fero is the CEO of the PA HealthCare Credit Union and is also part of the Adjunct Faculty of Robert Morris University, LaRoche College and the University of Phoenix teaching in areas of Economics and Finance.
- Weekly commentary available at our website under Member Service\Weekly Commentary or directly at www.PAHealthCareCU.com/wc/html.
- **DISCLAIMER:** The views and comments, are solely the views of the presenter and do not necessarily reflect the views of the PA HealthCare Credit Union.

What we said was going to happen...

- “2009 will bring a worsening of the economy as the credit and financial crises continue with a contraction of the US economy all year as unemployment continues to rise.” – Better than the rest - while our forecast missed the quarterly depth of the recession, our forecast did hit the mark for annual decline on par for the worst recession since the Great Depression.
- “The federal government will continue with it’s loans/bailouts.” – Right on the money. Given the “too big to fail” Washington mentality, this one was easy.
- “Look for the federal budget deficit to easy exceed \$1 trillion.” – Right on the money. With a new Presidential administration and supportive Congress, this was easy as well. As I like to say about Washington, when your only tool is a hammer, everything looks like a nail.

What we said was going to happen...

- “The next area of real estate concern will be commercial real estate very similar to the residential issues.” – Right on the money. Capmark, one of the largest commercial properties owners and General Growth properties the second largest mall owner each files for bankruptcy.
- “Look for “new” programs intended to help those with foreclosures which will prolong the recovery”. – Right on the money as the new Presidential administration and supportive Congress try to aid “main street”, such as the \$300 billion HOPE for Homeowners program designed to aid homeowners from foreclosure. The result was zero benefited with only 326 applications in the first three months of program with none of the major mortgage lenders signed on to support the program.

Recap of 2009 Forecast

- Interest Rate Forecast - Right on the money
 - Short-term rates – The Federal Reserve lowered rates to near zero and keep them there all year.
 - Medium and long term rates began to come up from their historical lows as the credit part of the crisis abated but stayed relatively low all year.
- Stock Market Forecast – Right on the money...partly.
 - We forecasted the S&P 500 to bottom at 650 and end the year at 850. With the S&P hitting 660 for the low that was about as perfect as you can get. However, we wouldn't have expected the rebound to be as strong especially since it had never happened before especially given the lingering issues. So the final year end result was a bit of a miss.
- Overall Forecast – Right on the money
 - While not perfect all the way around, the forecast was better than most others, so therefore better than most wins.

Financial & Credit Crisis Lingers

- While it may appear on the surface that the financial and credit crisis is over, it's far from over.
 - Commercial real estate lending has slowed to barely a trickle from before the recession. With commercial real estate vacancy rates in the high single digits and retail sector some of the hardest hit, as regional mall vacancy rates are also high single digits and strip mall vacancy rates in double digits. These will only continue to climb further in 2010.
 - Many of the large money center banks and community banks continue to rein in lending as concerns continue over rising delinquency rates on all sectors of loans but hardest hit by consumer loans as unemployment will remain stubbornly high.
 - The Federal Reserve has “propped” up the financial system with trillions of dollars of liquidity, loans and financial backing. Without the Fed’s continuing support, the financial system would grind to a halt.

Financial & Credit Crisis Lingers

- The residential real estate market will continue to struggle.
 - With 25% of mortgages balances greater than their respective market values, this will continue to be a burden on the real estate market.
 - Many adjustable rate mortgages such as 5 year ARMs have yet to re-price as these will continue through 2012.
 - Credit standards and down payment requirements make it more difficult for many to obtain mortgages.
 - Nearly one-third of all existing home purchases are considered “distressed” sales.
 - Without the demand for more homes, real estate values will stagnate.
 - The Federal Reserve has “artificially” kept mortgage rates low which will have a huge negative impact on the value of these securities when rates eventually “normalize”.
 - The federal government removed the \$400 billion bailout efforts in favor of unlimited assistance for Fannie Mae and Freddie Mac which will have hugely negative impacts for both firms. This is a financial disaster in the making putting hundreds of billions of taxpayer dollars at risk forcing the government to become the only mortgage provider.

Financial & Credit Crisis Lingers

- The too big to fail to mentality will continue
 - The government will continue with it's efforts to “aid” the economy to supporting existing and continuing firms. As noted with the Fannie Mae and Freddie Mac above as well as GMAC, AIG and others.
 - The risk taking enterprises, notably those on Wall Street, have nothing to fear as they continue with business as usual. With or without TARP being repaid. They realize the government will ultimately come to their “aid”.
 - TARP assistance now seen as a minor limitation without any real enforcement for change behavior.
 - Anticipated regulation which still has not come about will be so watered down as to be a mere nuisance that it won't be effective.

Welcome to the Great Recession

- Given this has been the worst economy since the Great Depression, the term Great Recession has been used by some and myself beginning with my May 1st weekly commentary.
- Not only is this the worst economy but this will be so much longer than the other recessions we have had. How so? Because this isn't the same as the other recessions.
- Recessions that include a credit crisis or credit related component of the recession last much longer in duration. Japan in the 1990's had both and their version lasted nearly ten years and is commonly referred to as the "Lost Decade". Not quite as simple an apples to apples comparison but many of the commonalities are similar.
- While most recessions end with consumer spending as the component to pull us through. Given the debt laden consumer cutting back and unwillingness of banks to lend, this won't be happening anytime soon.

Welcome to the Great Recession – (continued)

- The labor market is going through a generational shift.
 - With the top line unemployment rate (U-3) at 10% this isn't expected to fall much in 2010 and may only drop to 7.5% when in full recovery in a few years.
 - The “real” unemployment rate (U-6) which measures the marginally attached workers and those that work part time as they can find full time employment is over 17% and will remain stubbornly high for years and certainly won't fall below 15% in 2010 and begin to see some relief in 2011 and 2012.
 - Huge numbers of workers have just left the labor market entirely as they can't find suitable employment.
 - The participation rate of the workforce is at historical lows.
 - With about 7.4 million jobs lost during this recession to date it would take over three years just to replace those jobs given a normal monthly employment gain of 200,000 a month. Add to that the general increase of the labor market and that could take another year or so. In the end, it would generally take an entire business cycle to just to recoup the lost jobs.

Economic Forecast - Overview

- This is a tale of two economies. First are those that are employed and have a reasonable belief of the stability of their jobs.
 - These individuals will continue to pull back on some of the discretionary spending. One as a result of lack of home equity to tap into and the second is the likely reduction in access to credit as reduction of credit lines or self imposed as credit rates, namely credit cards increase significantly.
 - These individuals see themselves in a self imposed mode of financial restructuring.
 - This will ultimately be a financial positive for these individuals as one becomes more financially self-contained.
 - What this doesn't do is help the economy as reduced consumer spending drains the economy of growth and doesn't create jobs.
 - Evidence of this is seen the Federal Reserve report on consumer debt which continue to decline in double digits.

Economic Forecast - Overview

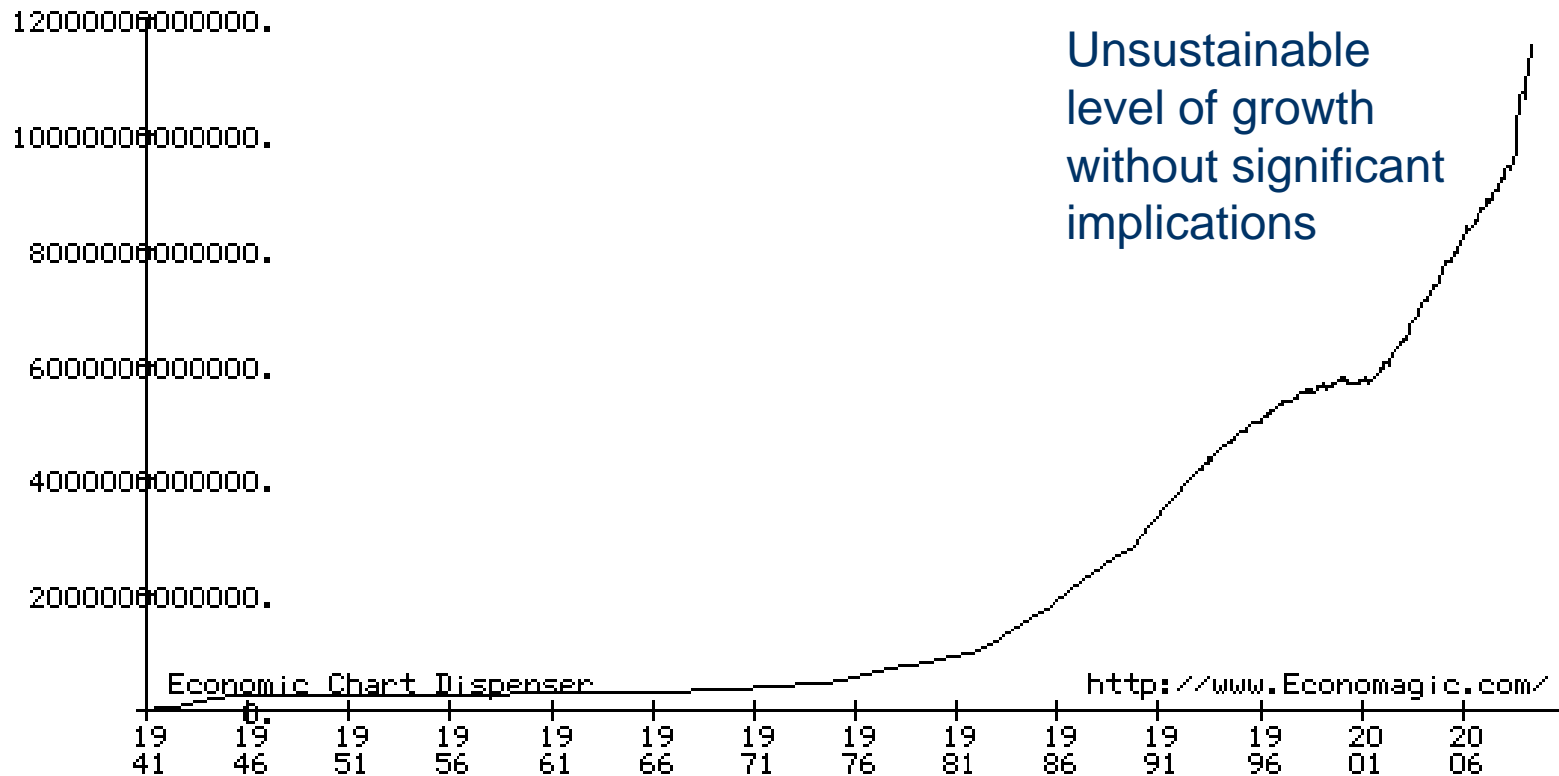
- The second group are those that have been significantly impaired by the recession through lost jobs, foreclosure etc.
 - These individuals see themselves as having the rug pulled out from under them and their families.
 - For those that have been foreclosed there's plenty of blame to go around and while unfortunate, for many it was just a bad financial decision.
 - For those that lost jobs, many are finding a new one either difficult or impossible, especially at or near the same pay level.
 - While the government has expanded the unemployment insurance program four times to date, this will continue well into 2010 if not later.
 - Many have taken lesser qualified positions, the underemployed, and many are taking part-time positions to make ends meet.
 - This usually has negative results both financially and socially. The financial aspects would include foreclosure, repossession and worsen of credit history. The social stresses related to these run the gamut within economically distressed families and would include an increase in divorce etc.

Expanded Crisis – Sovereign Debt

- The expanded crisis will result from the sovereign debt of a number of countries, primarily in Europe
 - Ireland and Iceland started off the concerns over their economies and subsequent debt.
 - Next up, mainland Europe as Greece, Portugal, Spain and Italy will begin to have difficulties as large government deficits in the wake of the recessions expands government debt yields.
 - Significant weakness may lead to Eurozone (countries that use the Euro as their currency) currency difficulties that will only add to the difficulties.
- US Government Deficit and Total Debt now at “Tipping Point”
 - Without the “will” to control the government deficit this will lead to higher taxes, reduced government spending and higher inflation and interest rates

US Government Debt Problem

U.S. Public Debt in dollars



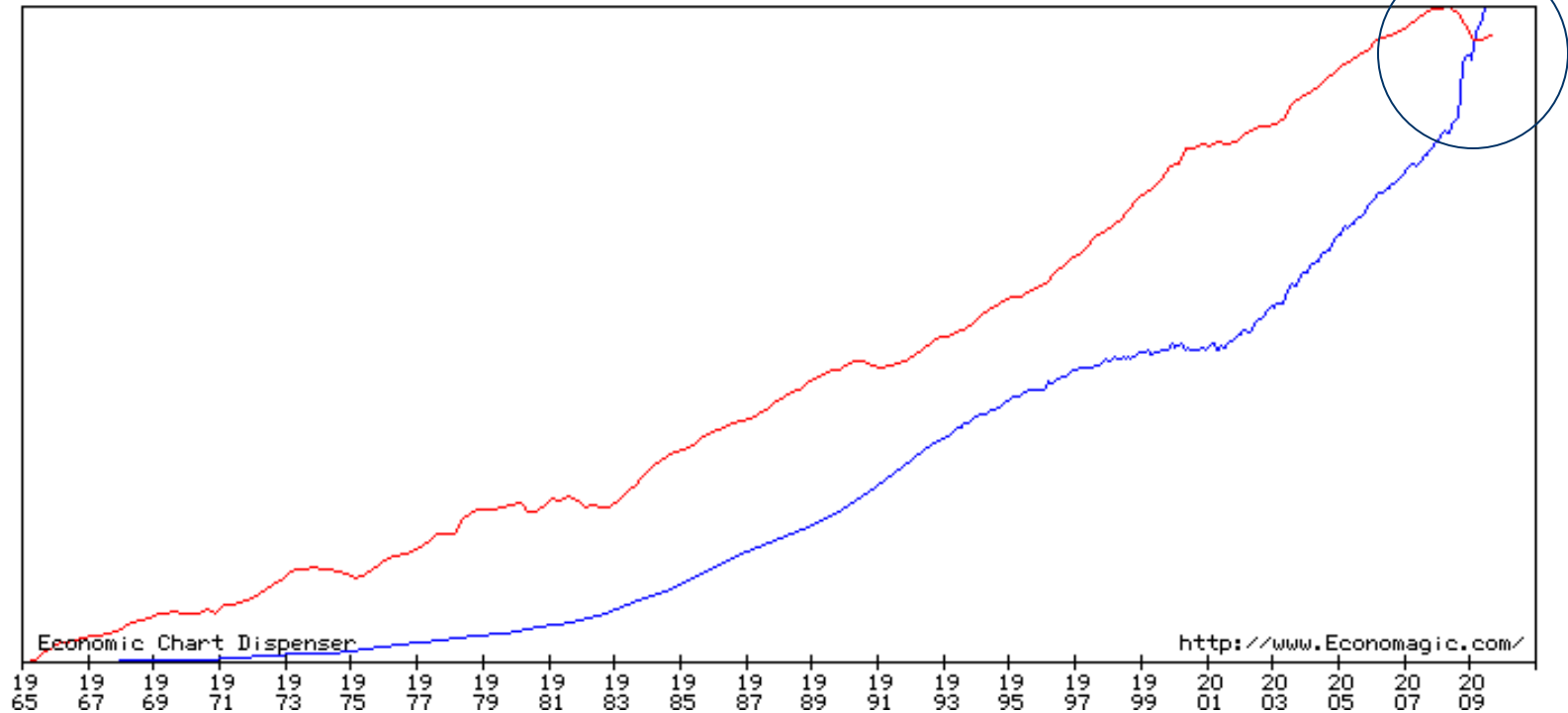
Unsustainable level of growth without significant implications

US Government Debt Problem

Growth in Public Debt Compared to Growth in Real GDP

Tipping Point

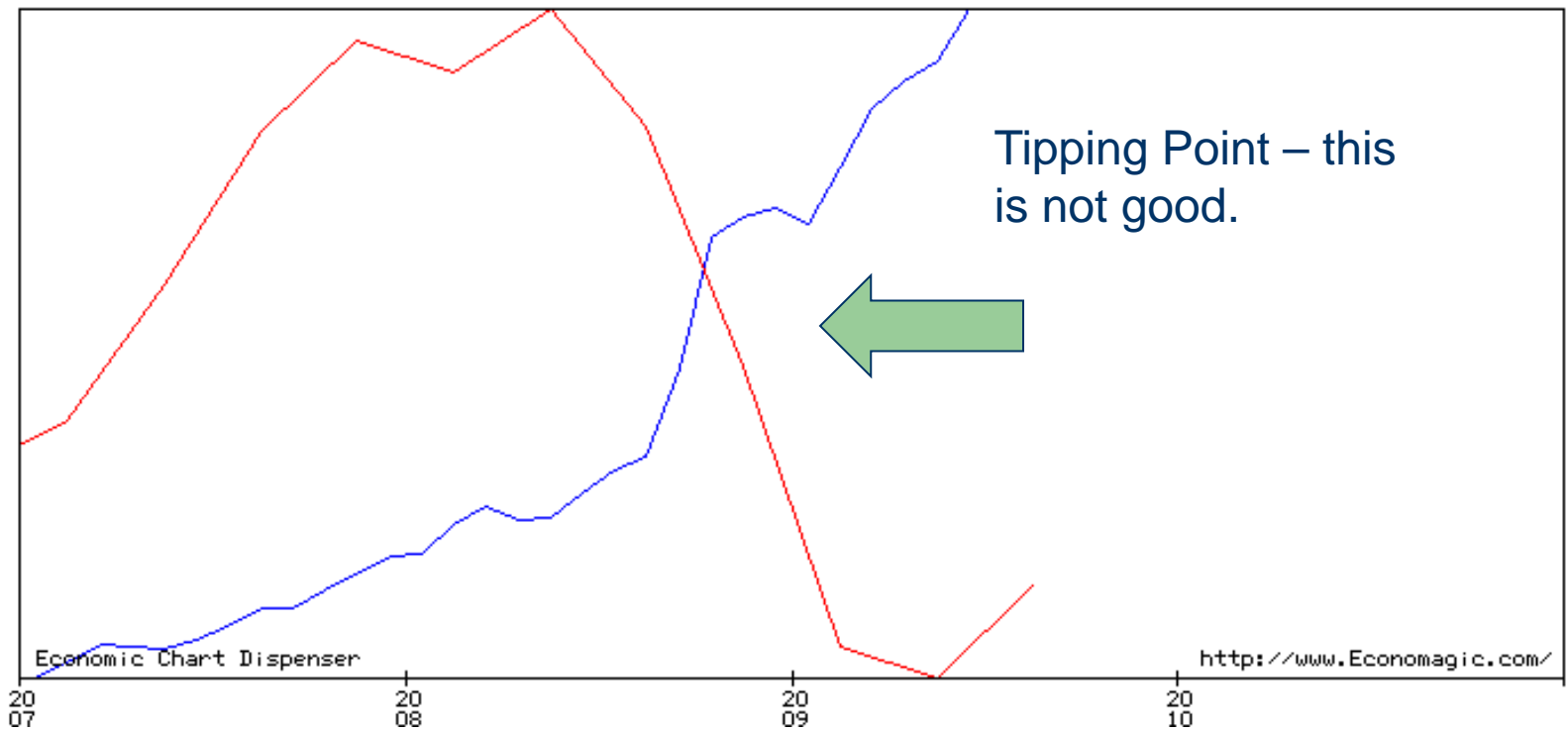
- U.S. Public Debt (in dollars)
- Real Gross Domestic Product (in dollars)



US Government Debt Problem

Growth in Public Debt Compared to Growth in Real GDP

- U.S. Public Debt (in dollars)
- Real Gross Domestic Product (in dollars)



Not all bad...the recession is over

- The recession will officially be declared over in the first half of 2010.
 - While GDP will begin to turn positive that will mark the official end of the recession. However, with unemployment still linger, the official call may be pushed out.
 - Inventories will slowly be restocked which led to the positive GDP. Consumer spending will slowly trickle in adding the “feel” of a positive recovery.
 - With improved stock market the first half of the year, the feeling will be progress is being made.
 - As the economy continues to the strengthen, employee productivity will soar and corporate earnings will improve.

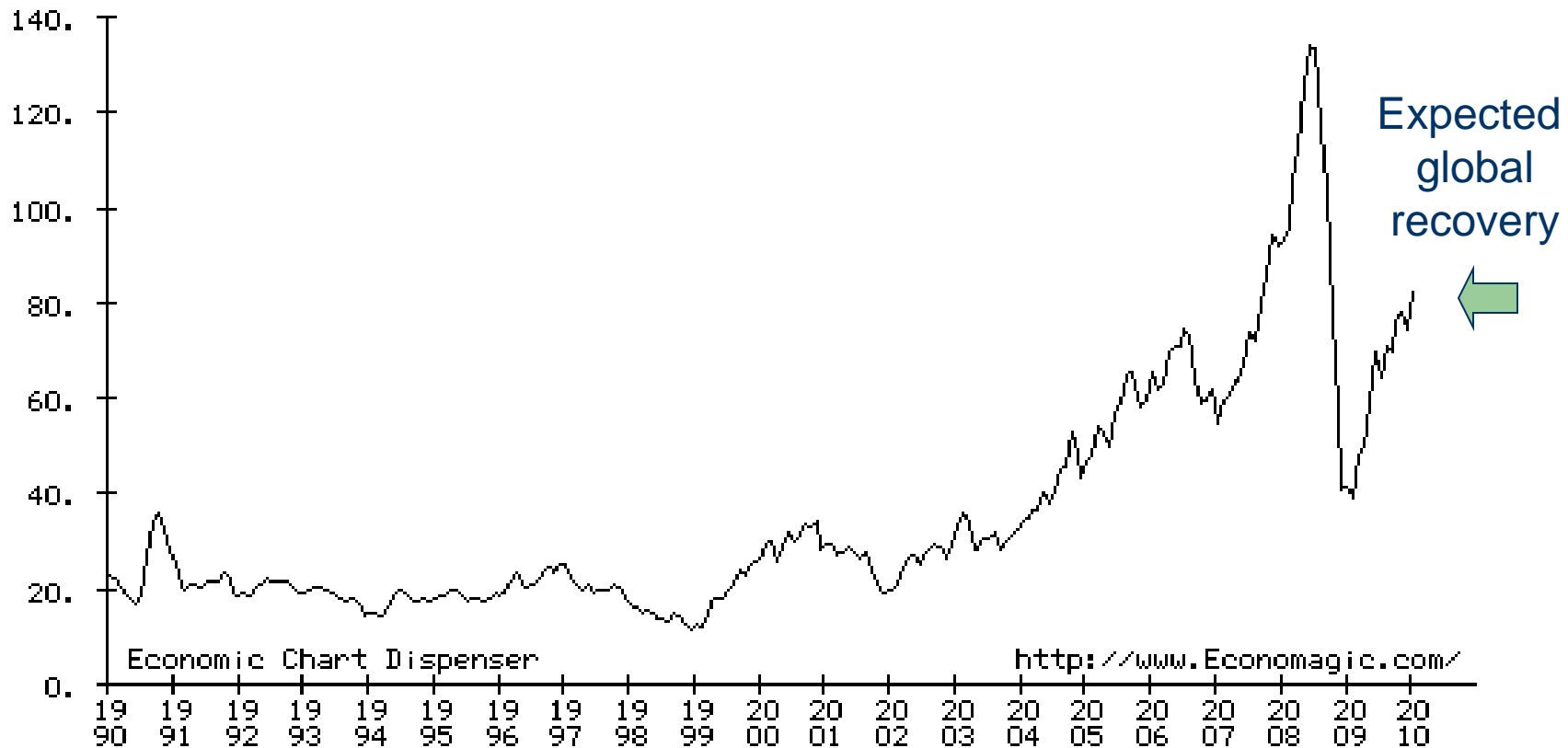
Economic Forecast

	2010				Average or Annualized Forecast
	Q1 Forecast	Q2 Forecast	Q3 Forecast	Q4 Forecast	
Oil per barrel*	\$ 80	\$ 100	\$ 100	\$ 90	\$ 90
CPI - Urban-Annual	1.5%	2.0%	2.5%	2.0%	2.0%
Unemployment Rate (U-3)	10.0%	9.8%	9.7%	9.6%	9.8%
Unemployment Rate (U-6)	18.0%	17.8%	17.4%	17.0%	17.5%
GDP	2.5%	2.0%	1.0%	2.0%	2.0%
Fed Funds Rate	0%-.25%	0%-.25%	0%-.25%	0.25%	0%-.25%
10 yr Treasury Yield	3.6%	3.5%	3.5%	3.6%	3.6%
S&P 500 Index	1,150	1,200	1,000	1,150	1,100

* West Texas Intermediate / Light Sweet Crude

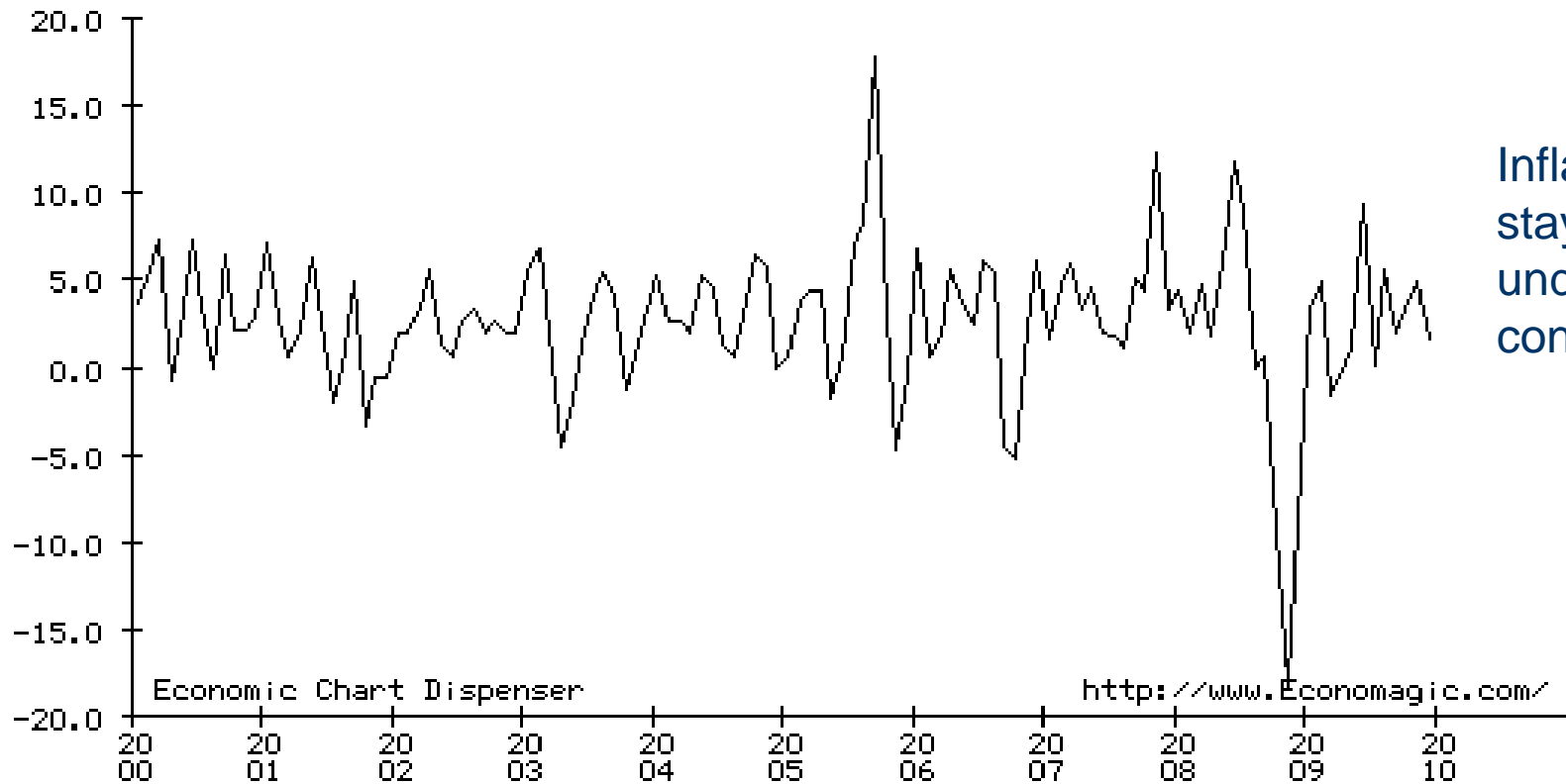
Oil Prices

West Texas Intermediate Crude Oil (dollars per barrel)



Consumer Price Index - CPI

Inflation in Consumer Prices at Annual Rates: Percent: CPI-Urban



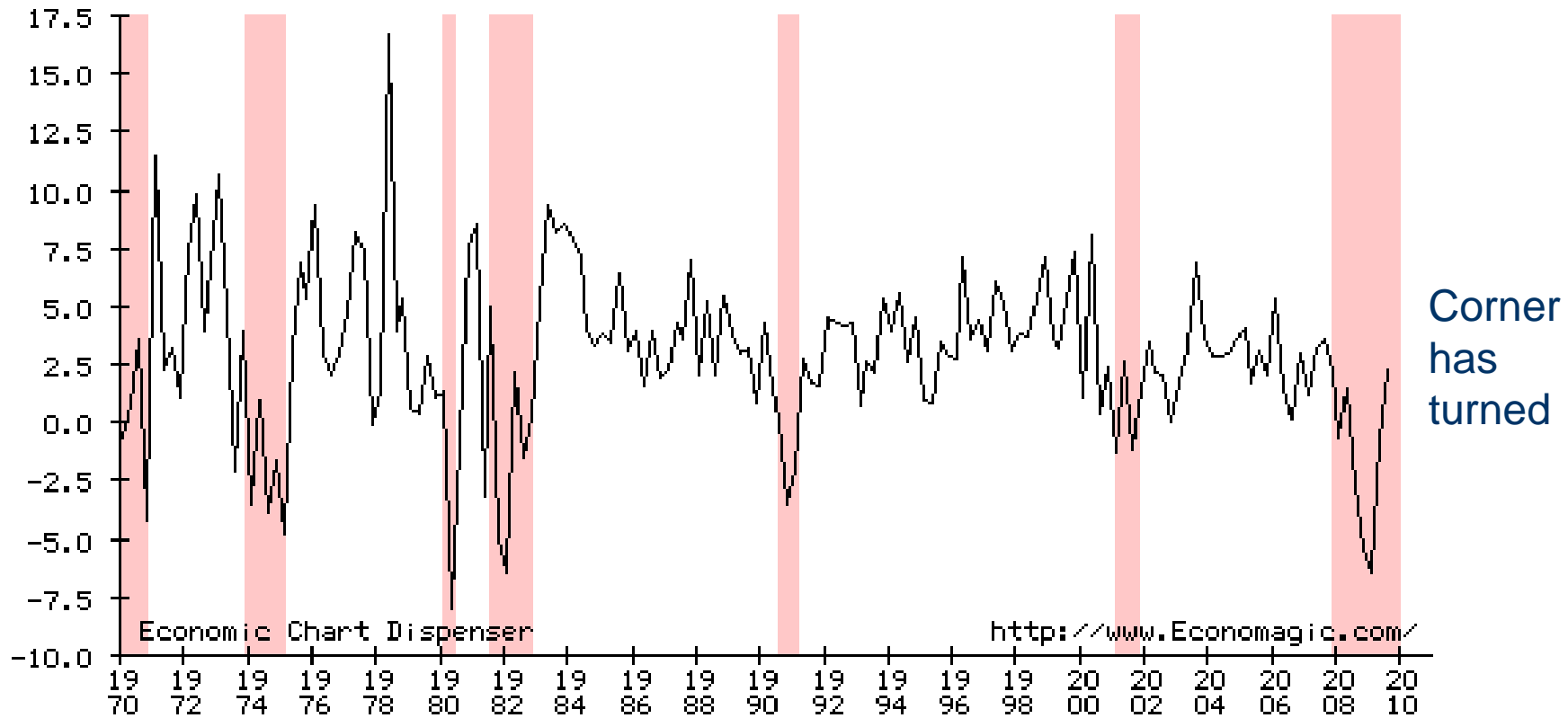
Inflation stays well under control

Economic Chart Dispenser

<http://www.Economagic.com/>

Gross Domestic Product - GDP

Quarterly Growth in real GDP at annual rates, Percent

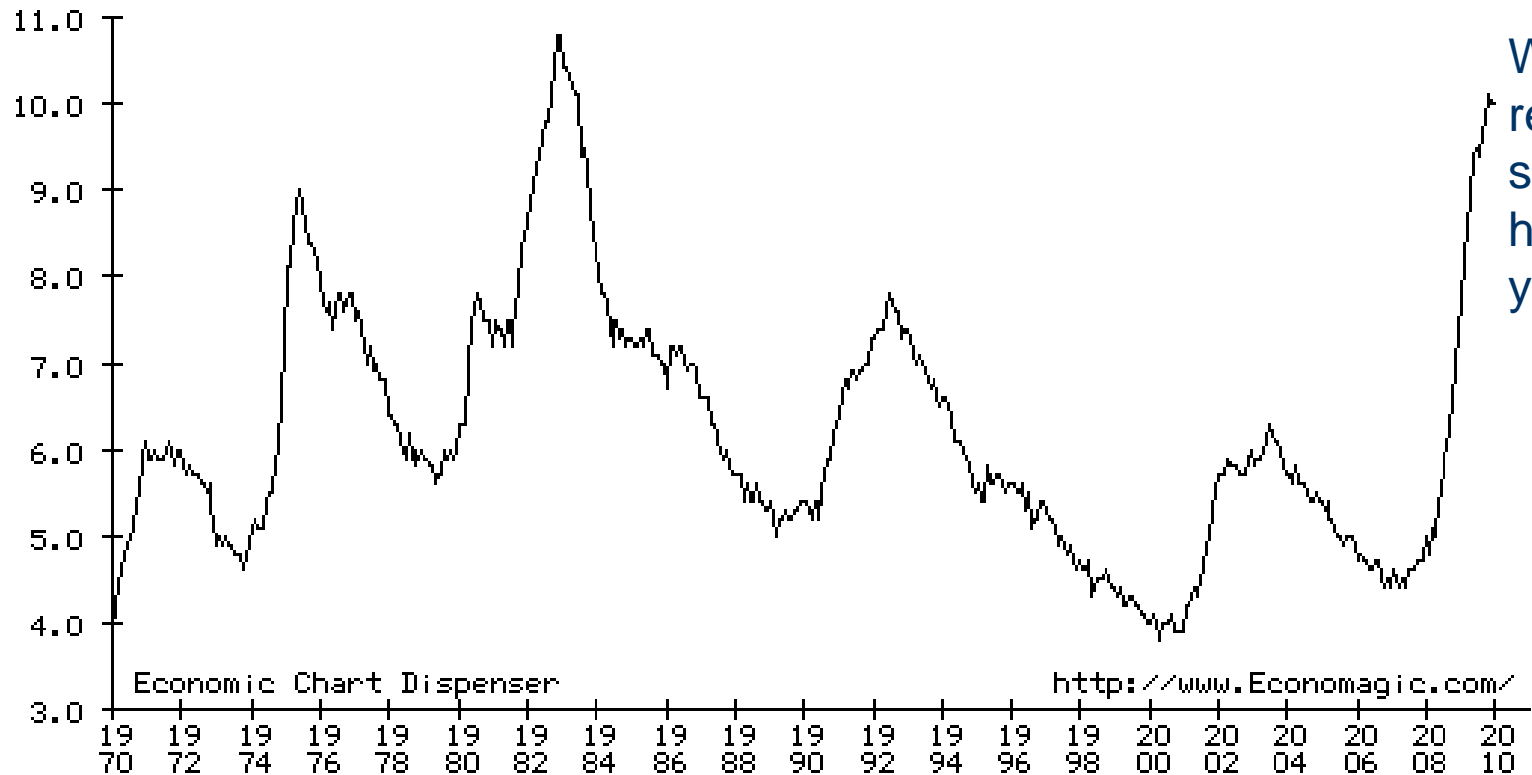


Bars represent recessions

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Unemployment Rate

Unemployment Rate (percent)



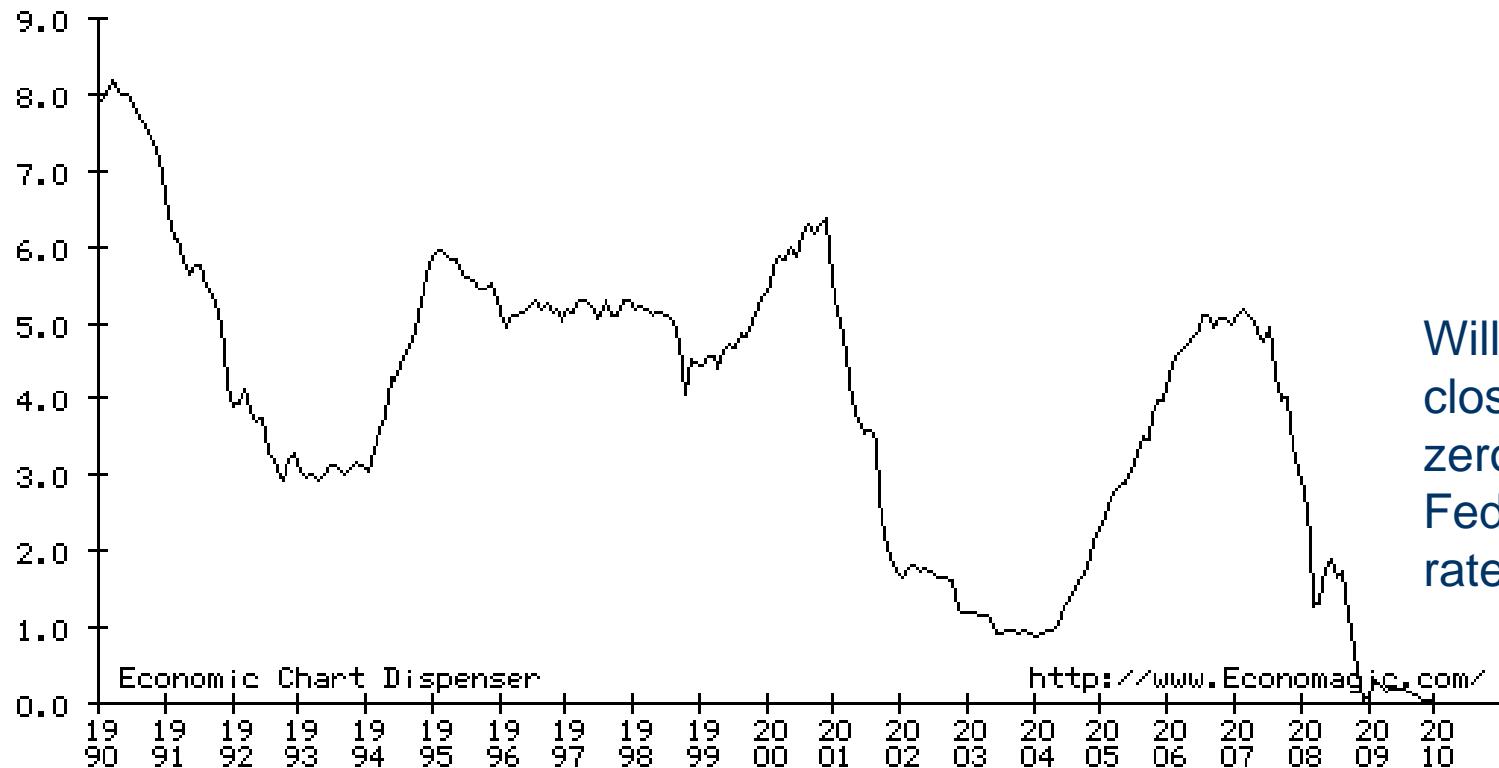
Will remain stubbornly high for years

Interest Rate Forecast

- Short term interest rates, as controlled by the Fed, will continue to decline at a “measured” pace as the Fed will balance anemic economic growth with continued inflationary pressures from high oil prices.
- Longer term interest rates will continue in a relatively narrow and moderately low level as anemic economic growth continues.
- The yield curve, that is the interest rate spread between short term and long term maturities, will begin to widen somewhat to more “normalized” and historic level.

Interest Rate Forecast – Short Term Rates

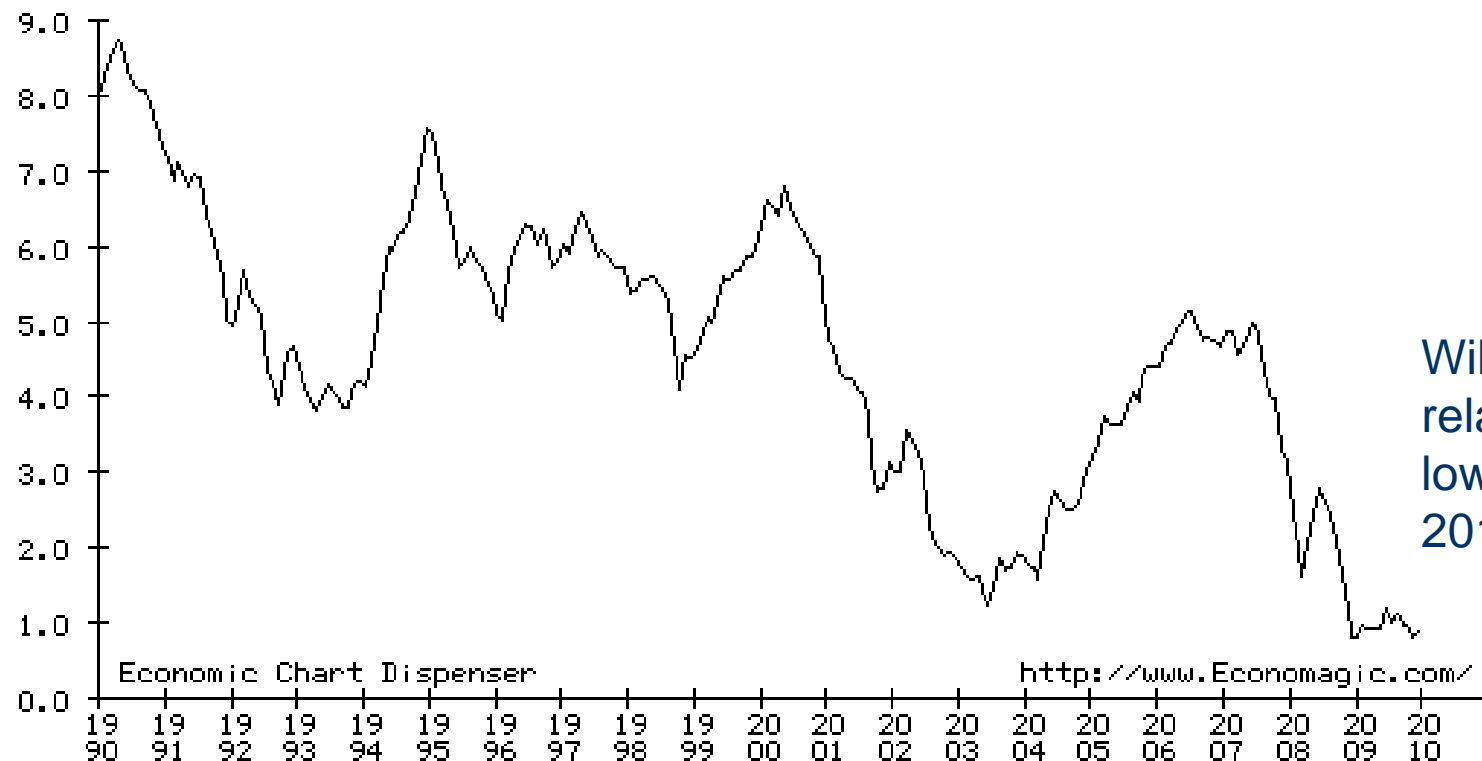
3 Month US Treasury Yield



Will remain close to zero until Fed raises rates in 2011

Interest Rate Forecast – Medium Term Rates

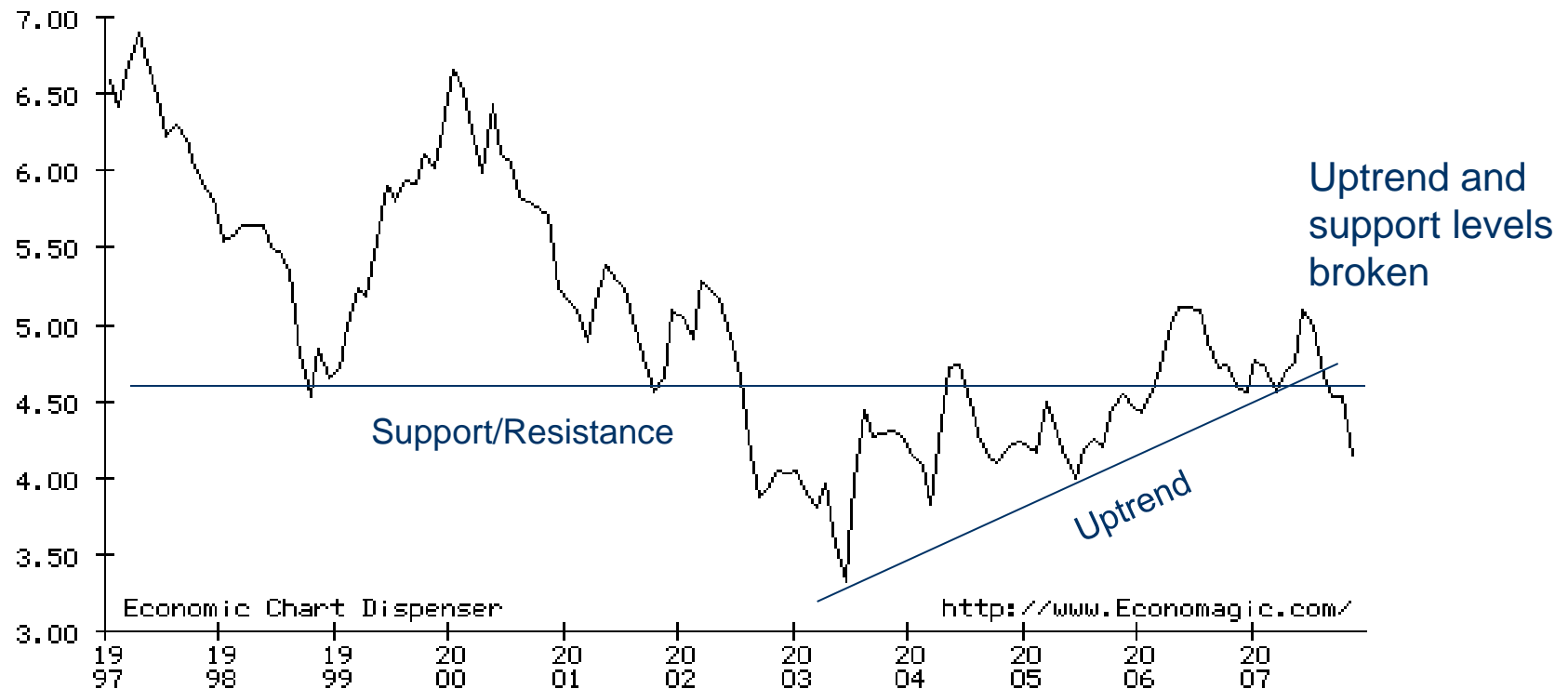
2 Year US Treasury Yield



Will remain relatively low through 2010

Interest Rate Forecast – Long Term Rates

10-year Treasury Constant Maturity



Economic Chart Dispenser

<http://www.Economagic.com/>

Stock Market Forecast

- Overall, the recent increases in the stock market can be attributable to greater growth from international markets as a result of the weak U.S. dollar relative to other major currencies.
- However, as the global economy begins to weaken, the sales will begin to decline and thereby exert negative pressures on the stock prices.
- With nearly 5 years of growth, the stock market is once again at a “tipping-point” and anticipate a slight pull-back as economy begins to slow.

Stock Market Forecast

S&P 500: Close



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Putting It All Together

- The economy has been somewhat weak outside of business and government spending. However, over 60% of economic growth is attributed to consumers.
- The “sub-prime” and “credit crisis” will continue and worsen into 2008. There will be spill over effects into other areas of lending, including auto loans, unsecured loans and credit cards.
- The excessive real estate markets in the past few years will see dramatic declines, as these markets begin to moderate to more rationale levels.