



## Mid-Year Economic Update for the Florida Economy

Our 2008 Florida economic forecast, presented in the January, 2008 Economic Commentary, alerted readers that;

“Healthy population gains, a bottoming of the residential real estate slide, an improving national economy, an easing of the liquidity crunch that has seized financial markets and genuine progress in resolving the subprime mortgage fiasco are necessary to stave off recession in Florida in 2008.”

Unfortunately, as of mid-year none of the above events have come to pass. Population growth has noticeably slowed; the free-fall in the housing sector has intensified; nationwide economic growth has remained anemic while economic activity in Europe has softened; the liquidity - credit crunch has persisted; and home foreclosures have soared.

While some meager progress can be reported, such as economic stimulus spending items in the state's fiscal year 2008-2009 budget and recent U.S. Congressional action to slow the home foreclosures onslaught, this progress has not been and will not likely be sufficient to stem further contractions in Florida's economy. A trough or bottom in the state's economic slide is unlikely before roughly this time in 2009. Recovery may not occur until 2010.

### Data Document Deterioration

Hosts of economic data, some of which have been reported elsewhere, document the deepening and broadening decline in the state's economy. They include:

1. A recent U.S. Department of Commerce report that Florida's Real (inflation-adjusted) Gross Domestic Product growth was flat – 0.00 percent – for 2007 versus national growth of 2.00 percent. For 2007, Florida ranked 47th among states for economic growth after being among the top growth states the previous five years.
2. 87,300 non-agricultural job losses have been recorded since the start of 2008, and jobs have been lost every month since January, 2008. 119,000 non-agricultural jobs have been lost since employment peaked in March, 2007.
3. The state's unemployment rate has jumped a full percentage point to 5.5 percent since the start of 2008, and stands more than 2 percentage points above the 3.4 percent rate of September, 2006.
4. Population growth estimates and forecasts have been sharply revised downward to less than 1.00 percent per year for 2008 - 2010.
5. Statewide taxable sales of consumer durables fell 16 percent in May, 2008 versus a year earlier. Year-over-year declines have accelerated in every month of 2008.

### Recession Rooted in Residential Real Estate

The January, 2008 Economic Commentary also noted that, “...the downturn in Florida is likely to be deeper and more prolonged than in the rest of the nation.” The collapse of Florida's residential real estate market is the proximate cause of the state's recession, and the

depth of the decline in this market is why Florida's economic growth is now trailing the rest of the nation.

**Table 1**  
**Construction and Real Estate in the Florida and U.S. Economies**

Measure	Florida	U.S.
<b>Construction Jobs/Total Jobs</b>		
Peak - 6/2006	8.22%	5.66%
Current - 6/2008	6.55%	5.23%
<b>Construction Job Losses</b>		
Percent of Total Job Losses 6/07 - 6/08	51.0%	NA
Percent Decline from Peak	-21.2%	-6.5%
<b>Construction/GDP</b>		
Peak - 2005	7.47%	4.92%
Current (2007)	6.13%	4.09%
<b>Housing Starts</b>		
Peak - 2005	287,250	2,155,316
Current - 2008 annualized	73,000	1,042,728
Percent Change - Number	-75%	-52%
Percent Change - \$ Value	-74%	-51%
<b>Existing Home Sales</b>		
Peak - 2005	248,505	6,180,000
Current - annualized	119,000	4,270,000
<b>Construction Contribution to RGDP Growth</b>		
2001 -2005	8.02%	NA
2006- 2007	-31.00%	NA

Sources: U.S. Department of Commerce, Bureau of Economic Analysis; U.S. Bureau of Census; Federal Reserve Bank of St. Louis - FRED data base, Florida Association of Realtors, National Association of Realtors.

Table 1 provides revealing indications of the contributions and subsequent diminutions of Florida's construction and residential real estate sectors to the state's economy. Data are also provided for the U.S. economy to provide perspective.

The data in the table reveal that at its peak, Florida's construction sector directly accounted for almost 7.50 percent of the state's GDP and more than one of every twelve jobs. Expansion in the construction sector contributed about 8 percent of the state's 23 percent cumulative economic growth from 2001-2005. Additionally, Florida accounted for 13 percent of all new houses constructed nationwide - a figure roughly in line with the increase in the number of its households. However, Florida accounted for only 4 percent of existing home sales in the peak year of 2005.

The data in the table also illustrate the pronounced plunge since the peak. About 140,000 construction jobs have been lost since the mid-2006 peak. More than one-half of the state's job losses in the last year have been in the construction sector. Housing starts are on track to record their lowest level in at least twenty-five years. Existing home sales are on a pace to topple by 52 percent from the peak year. And, instead of contributing to Florida's economic growth, the contraction in construction has depressed economic growth by more than 30 percent.

### **Price Expectations Key to the Bottom**

Expectations of ever-rising home prices by market participants were the single common factor behind the residential real estate bubble. Now, expectations of ever-falling home prices by market participants are the single common factor behind the residential

real estate bust. The state's economy will not hit bottom until the residential real estate market bottoms-out, and this will not happen until market participants no longer expect home prices to decline.

Prices diverge, often wildly, from those based on economic fundamentals during manias and panics. However, there is a strong tendency for economic fundamentals to eventually reassert themselves. A salient question is where home prices might be relative to economic

fundamentals. Has the bottom been 'overshot,' or is there still a ways to go? The data seem to indicate the latter as demand continues to weaken and supply - particularly owing to foreclosures - continues to mount. In particular:

1. Florida home foreclosures, in addition to the personal pain and anguish they cause, have escalated at a striking pace and are adding substantially to the glut of unsold homes. RealtyTrac.com reports approximately 192,000 home foreclosures in Florida during the first-half of 2008; about 82,000 in the first quarter and 109,000 in the second quarter. The second quarter figure is roughly 181 percent higher than for the same time in 2007. The peak in foreclosures may not occur until the end of 2008.
2. New home construction - which is in the neighborhood of 70,000 units – plus the wave of foreclosures could add as many as 300,000 housing units to the state's housing stock in 2008.
3. New home sales for the South Census Region have slackened 33 percent on a year-to-date basis through June, and likely are even larger in Florida. Existing home sales are on a pace to decline about 10 percent from 2007's anemic level.
4. Florida's inventory of unsold homes is uncertain, but may be twice as large as the national inventory of about 11 months. Typically, inventories are in the 4 month range.
5. Lending institutions, suffering from a wave of primarily mortgage-related loan losses, are focused on preserving capital and are hesitant to lend for home mortgages.

**Table 2**  
**Housing Price Changes: Florida, Selected MSAs and U.S.**

The Bubble Years			The Bust Years	
Area	Time Period	Price Increase	Time Period	Price Decrease
Florida <sup>1</sup>	12/01 - 12/06	+94%	7/06 - 6/08	-18%
Miami <sup>2</sup>	12/01 - 12/06	+127%	12/06 - 4/08	-29%
Tampa <sup>3</sup>	12/01 - 7/06	+98%	7/06 - 4/08	-25%
U.S. 20 City <sup>4</sup>	12/01 - 7/06	+107%	7/06 - 4/08	-18%

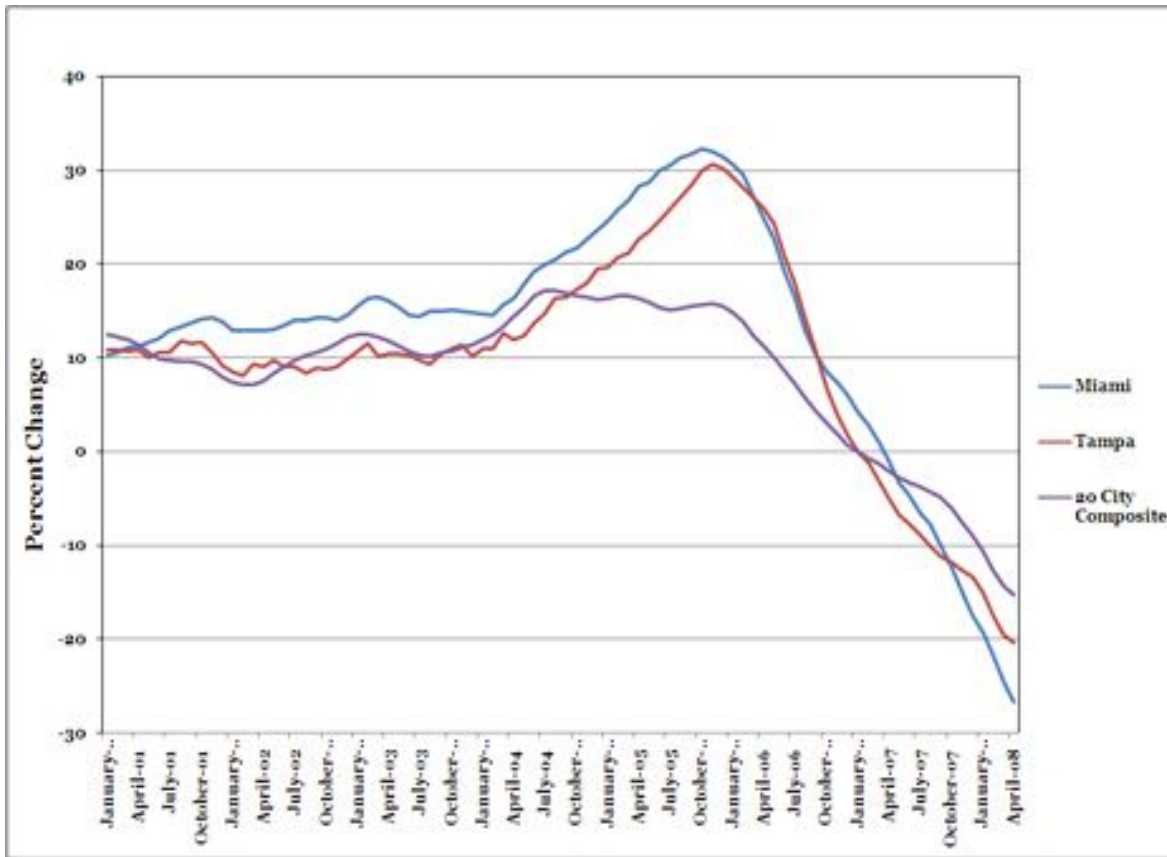
Sources: 1. Florida Association of Realtors median existing home price data. 2. Case - Shiller/S&P home price index. The Miami area includes Miami-Dade, Broward and Palm Beach counties. 3. Case-Shiller/S&P home price index. The Tampa area includes Hillsborough, Pinellas, Pasco and Hernando counties. 4. Case Shiller/S&P home price index for 20 U.S. metropolitan areas including Miami and Tampa.

The above points indicate that the imbalance between housing demand and supply is worsening, putting further downward pressure on prices and fueling expectations of additional price declines. Table 2 and Chart 1 provide data on housing price changes.

The roughly doubling of housing prices from 2001 to 2006 - an average annual increase of more than 20 percent - is the first notable feature from the table. The price escalation in the Miami metro area of 127 percent was among the highest in the nation. Since the peaks, substantial price declines have been observed in all areas - the second notable feature from the table. Price declines, on an annual average basis, are running at about half the pace of the bubble year price increases.

Table 2 depicts the year-over-year percentage price changes from January, 2001 through April, 2008 for the Miami, Tampa, and 20 City indexes. Prices have declined for 13 consecutive time periods in Miami and for 16 successive periods in Tampa and the 20 City indexes. Even more disturbing is that all these price

## Year-Over-Year Housing Price Changes: 2001 - 2008



Source: Case Shiller/S&P

declines are accelerating, especially in the Miami area. The clear inference is that price declines and expectations of such declines are not near a bottom.

An admittedly crude, 'back of the envelope' estimation of how much further home prices have to fall in Florida is by 15 to 20 percent. Using the Florida Association of Realtors 2001 median sales price of \$127,700 for an existing single family home as the base, this price was increased at a compound annual rate of 5.5 percent - assuming 5.5 percent was 'normal' price appreciation - for six years until 2006 - the peak price year. The 'normal' price should have been about \$176,000 versus an actual price of \$247,100. Prices were then about \$71,000, or 40 percent, above fundamentals. The current median price of \$203,000 is still about \$27,000, or 15 percent, above 'normal'. Clearly, there will be substantial regional variations in such calculations.

### Policy Adjustments

Florida's economy is in the midst of a serious economic downturn - a downturn that may persist, if not worsen, into 2009. The bursting of the housing bubble is the chief cause of the recession, and an end

to the housing market free-fall is critical to ending the recession. The tide of foreclosures is likely to persist until year-end, barring innovative solutions to this vexing problem. Expectations of further price declines may not be reversed in the near-term.

Arguably, the magnitude and adverse economic effects of the housing market collapse are more pronounced in Florida than in any other state. Recent federal legislation may help, but the focus of the legislation is national and not state-specific. It is unlikely that federal policies will come to the rescue of any one state - even one as large as Florida. Florida is left in the unenviable position of having to devise its own policies to deal with what may prove to be the worst housing market in its storied history.

State policies to date have emphasized property tax reductions as a means of lowering housing costs and stimulating demand as well as tougher legal actions against fraudulent lending practices. Amendment 5 proposes to further reduce property taxes in exchange for inevitable but vague and unspecified tax increases elsewhere. Such a proposal is fraught with unnecessary risk.

Property tax and local government spending reform are important to Florida's economic health; however, these reforms will not arrest the

