



AN UPDATE ON THE ECONOMIC RECOVERY / QUESTIONS AND ANSWERS

by Mark Schniepp

Q: Is the economic recovery still on course?

Definitely. The recovery continues to evolve. Nearly all economic indicators are rising. Job creation is now occurring. Consumer surveys reveal more optimism about growth in the economy. There is less pessimism in the belief that a double dip recession will occur. The stock market has corrected, but no serious pull back is expected.

Q: How much will the European meltdown affect the regional economy?

The European debt crisis will likely result in a serious impact on the continent's economy this year. A relapse into recession is a strong possibility. The dollar is strengthening relative to the Euro because of it. That may slow down world demand for our goods implying that our export pace will slow. The U.S. lapsing into recession is unlikely. There is too much momentum building for that to occur.

Locally, the best thing about the European debt crisis is that it will make going to Europe this summer cheaper. So book your flight and hotel now!

Q: What's Happening to Interest Rates?

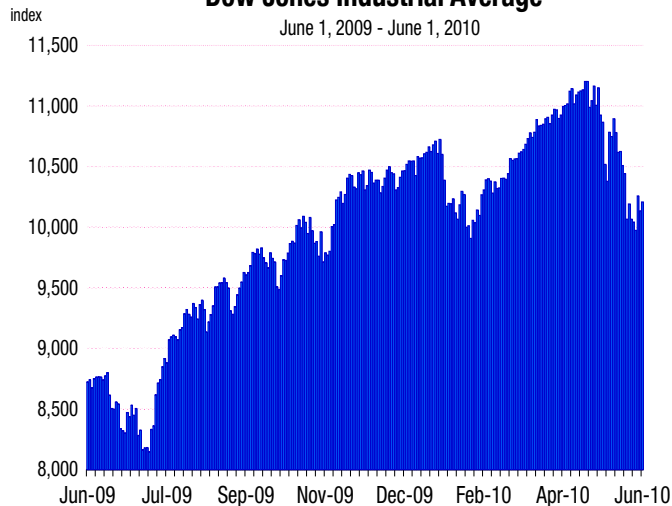
The European debt crisis has created uncertainty and that is driving U.S. investors into the bond market, dropping yields sharply. The 10 year Treasury bond fell to 3.15 percent on May 26. Mortgage rates have dropped to well under 5.0 percent.

Current 30 year jumbo refinance rates are between 5.375 and 5.6 percent. Wells Fargo, who originates more residential mortgages than any other lender, is advertising a 30 year fixed rate of 4.875 percent today (June 1, 2010) with an APR of 5.07 percent on their website.

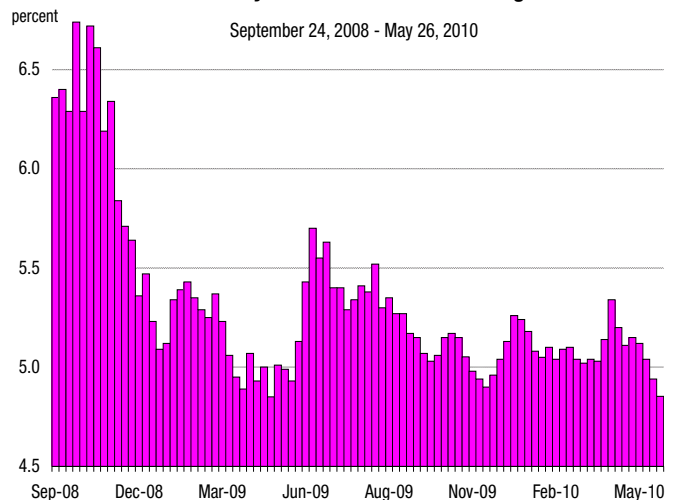
The very low interest rate environment won't last though, because the U.S. recovery is picking up momentum, earnings are strong for U.S. companies and more investment into the stock market and out of the bond market is expected.

The Fed is likely to raise interest rates during the Fall and begin a slow but steady tightening of monetary policy. If you can refinance under current credit standards, do it now.

Dow Jones Industrial Average



**30 year Fixed Rate Mortgage Yield (conventional loans)
Weekly Southern California Average**



Q: How much pain in this year's state and local budgets?

There will be horrendous pain for the state regarding balancing the budget. They need to make serious cuts in services and personnel. These are cuts the California legislature has been unwilling to make in the past. The local municipalities also need to make large cuts in services and people.

Cuts in workers will produce a drag on the recovery in California, but not derail it. This is an opportunity for the State to come to serious grips with it's profligate spending ways, and pair them back substantially. There will be a cost however. Cuts in workers will produce a drag on the economic recovery in California, but not derail it. The unemployment rate is already high. More worker layoffs in the public sector are not wanted, but California is faced with no other choices.

Q: Is the banking crisis over on the Central Coast?

A highly probable yes, meaning that Santa Barbara Bank and Trust will likely be saved. Texan Gerald Ford has offered to invest \$500 million in the bank. Once the new pending deal is approved, there will be consolidations and some layoffs somewhere in the Pacific Bancorp system later in the year. That said, the bank is likely to emerge much stronger as the economic recovery transitions into an expansionary phase sometime next year.

Other local banks in our region appear to be well-capitalized and have no recent history of trouble with federal regulators.

Q: What are the most important themes for 2011, 2012, and 2013?

The Federal government deficit must be addressed by this administration or certainly by the next one in 2013. Federal spending must be curtailed or substantial tax increases will have to be implemented to eliminate record government debt. Otherwise, Inflation could become a nagging problem for the Federal Reserve after the expansion in the U.S. economy begins.

There is a growing probability that the economic recovery in the U.S. could evolve into a full fledged expansion by mid 2011 (or certainly by 2012). The risk to the current forecast is to the upside.

Weighing down this likelihood are the budget difficulties in California (which would essentially reduce the probability of a vibrant expansion in the state) and other states. Furthermore another uncertainty is how severe the European economy will suffer as a result of fixing the debt problems for the most troubled counties---the PIIGS (Portugal, Italy, Ireland, Greece, and Spain). The ECB and the IMF have already approved a \$1 trillion bail out plan for the PIIGS. This allocation of funds is likely to crowd out lending to private companies needed for Europe to fully recover from the Great Recession.

When Europe rebounds, it will be a much stronger economic region of the world, and hopefully cognizant of it's past sins and therefore ready to avoid them going forward.

Getting through the debt crisis in Europe, reducing the current domestic inventory of distressed homes (which is currently underway), and watching the credit markets ease further as the recovery continues to pick up momentum will enable a more vibrant economy in the U.S. over the next few years.

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