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ECONOMIC NEWS UPDATE

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10 March 2006

So far, so good. That about describes the US economy as the first quarter comes to an end. Of course, that's what the man who jumped off the 102-storey Empire State Building said as he passed the 50th floor. There is mounting opinion that 2006 will come in like a lion and go out like a lamb, that first-quarter boom will eventuate in fourth-quarter bust, that the bills for the past spending splurge are coming due – pick your cliché, and you'll find it somewhere in the output of the economic commentariat.

These analysts are focused on the softening of the housing market. In the last quarter of 2006 sales of existing single-family homes registered their largest quarterly decline in over a decade, followed by January sales that were the lowest in almost two years. The unsold supply of homes at its highest level since 1998.

The affordability index, which measures the ability of the average family to finance the purchase of a new home, continues its plunge to levels not seen for years. Mortgage applications are falling. So most analysts are predicting a slump in construction and in sales of new homes, and a softening of prices after a 13% jump in 2005, with the gloomiest predicting sharp declines in many markets.

If the housing boom is really over, it might affect the confidence and spending of the 69% of Americans who are now proud homeowners, up from 67% when George W. Bush began his temporary, rent-free tenancy in the White House in 2000. Many have been taking advantage of the rising value of their homes and low interest rates to refinance their mortgages, freeing up cash for the consumer spending that has kept the American economy moving forward, and made it the engine of world economic growth. With their houses rising in value, consumers were in the enviable position of seeing their net worth increase – by 2.3% in the fourth quarter of 2005, to a record $52 trillion – even as they spent as much as, or at times more than they earned.

That raises two questions: First: Is the housing market headed for melt-down. Probably not. For one thing, the fundamentals are sound. Demand at the entry-level end of the market is being held up by immigrants eager to get on the first step of the housing ladder, while baby boomers contemplating their golden years – these boomers will be the richest retirees in history -- are shoring up the upper-end of the market by buying second homes. Mortgages taken out to finance the purchase of second homes rose from 7% of all mortgages in 2000 to twice that by the end of 2004, and, according to Alan Greenspan, have probably risen further since.

Equally important, according to Greenspan, "The vast majority of homeowners have a sizable equity cushion [the amount by which the value of the house exceeds the mortgage] with which to absorb a potential decline in house prices." For that reason, and because potential sellers can sit tight rather than dump their properties on the market, an easing of prices is unlikely to produce a wave of panic selling, as it might in the stock market.

That may explain why some leading builders remain optimistic. Toll Brothers, a builder of high-end homes that has seen its share price fall almost in half from its peak last summer, is annoyed but unfazed. The company and its partners have just paid over $300 million for a 5,500-acre, desolate desert site 35 miles from downtown Phoenix, Arizona. It plans to build 31,000 new homes, two high schools, 13 elementary schools and the usual amenities – at least one golf course and all of the other goodies so-called climate-conscious "sun birds" expect when they move to Arizona, where property prices have been rising at two and three times the national average. Even with global warming believed to be a threat, and temperatures in Phoenix soaring above 100 on 89 in the average year (and 143 days as recently as 1989), still they come.

The second question is: Would a house price decline throw the economy into recession? Again, probably not. The economy is unlikely to sustain its first-quarter growth spurt of somewhere around 5%. But Citigroup economists say that residential construction contributed only about half a percentage point to GDP growth last year. And a halving of the spending financed by extracting equity from homes would reduce GDP growth by only a bit more than one percentage point. Even economists at Dresdner Kleinwort Wasserstein, who can be counted among the pessimists, believe that "the adverse knock-on effect on consumer spending will …[force] US GDP growth to … slip into a 2-3% range this year…." Not great, but hardly a recession.

Against the downward pull of a housing slowdown must be set several offsetting factors. The unemployment rate is a low 4.7%, and new jobs are being created at a rate that has begun to be reflected in rising wages in what economists at Goldman Sachs dub "a tightening labor market". Most CEOs in large companies plan to step up hiring. Consumers should be helped by the drop in gasoline prices from the levels they reached in the aftermath of Katrina. If OPEC holds to its pledge to keep production at current levels, and the cutback by Europe in its gasoline exports to the US is not too sharp, the worst of the petrol price explosion might be behind us. Unless, of course, Muslim extremists succeed in disabling some of Saudi Arabia's oil facilities.

Then there is the continuing

strength of corporate earnings, which rose in the fourth quarter of last year by around 14%, the tenth consecutive quarter of double-digit earnings growth. (Drop out the increased earnings of energy companies, and growth was still about 9% -- in a quarter in which the effect of hurricane Katrina undoubtedly dragged down earnings.) That has turned cash flows into cash floods and improved balance sheets. Little wonder that most executives are planning to step up their investment spending and hiring.

All of which presents Fed chairman Ben Bernanke with a problem. He is looking at an economy with a tightening labor market, rising wages and declining productivity, companies boasting to shareholders of a return of pricing power, and what William Poole, President of the Federal Reserve Bank of St. Louis calls a "great deal of momentum." All of these factors should incline him to continue raising interest rates.

But that would increase the "risk-management challenge" he has warned small banks they face because of their exposure to the commercial property market. It would strengthen the dollar, making exports more expensive and imports cheaper, thereby widening a trade gap that many experts considered unsustainable, even before it soared again in January. And it would result in higher mortgage rates that might turn a soft landing in the housing sector into the sort of loud thump one hears when there is a crash.

Bernanke won't complain as he wrestles with the burdens of office. If he does, President Bush might sing him a few lines from an old hit: "I never promised you a rose garden…Share the good times while we can… along with the sunshine there's gotta be a little rain sometimes."

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THE SUNDAY TIMES

A version of this Update appeared in The Sunday Times (London)