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ECONOMIC TALKING POINTS

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September 17, 2009

A Good Week: Fewer People Seeking Jobless Benefits, Housing Improves ---And Americans Are (A Little) Wealthier

Employment and housing are without question the two most critical sectors of the economy right now. One sheds light on changes in the labor market --- which has been improving lately and can encourage consumer spending. The other is residential real estate, which happens to be the sector most responsible for precipitating the worst economic downturn since the Great Depression and the subsequent credit crunch. Here, too, we see tangible signs of a turnaround. An improvement in the housing market can help rebuild bank balance sheets and set the stage for lenders to provide more loans to consumers and businesses. Progress in both the job and housing markets are thus absolute prerequisites for this recovery to gather momentum.

Today, we got relatively positive news on both.

Claims for jobless benefits

New claims for unemployment benefits fell another 12,000 in the latest week, bringing such filings down to 545,000, the lowest in two months. The trend since last March shows employers scaling back layoffs, though the numbers are still way to high. While the recovery appears to be underway the pace of new applications for jobless benefits now stand nearly 90,000 higher than a year ago when the economy was deep in recession territory and the financial crises crisis was at its gravest. So the best we can say about the jobless claims data is that it is moving in the right direction and that employment conditions are less horrific now than earlier this year. We believe claims will have to remain below 400,000 a week before Americans detect a fundamental improvement in the labor markets, and we're still about 6 months to a year away from achieving that.

Housing Starts and Permits

In sharp contrast, we are seeing a more dramatic turnaround in the housing industry. Today's report on new home construction showed housing starts jumped to a 598,000 unit rate in August, the strongest performance since last November. Even July's numbers were revised upwards. True, most of the increase last month was due to a jump in apartment style buildings. But even if we look at the rate of single family units being built (where starts fell 3% last month), July and August still saw the most construction since last fall. Evidently homebuilders are prepared to ramp up construction even more. Total permits filed for new groundbreaking jumped to a 579,000 rate in August, the highest since November 2008. Again, it was mainly multi-unit dwellings that lifted permits. Filings for single-family home construction were essentially flat the last two months (463,000 and 462,000 for July and August, respectively), yet even this pace was the strongest in a year.

Is the improvement seen in housing starts and permits consistent with other economic reports on residential real estate? Absolutely. The National Association of Home Builders released this week their confidence survey and it showed that builder sentiment this month jumped to its highest level since May 2008! Moreover, sales of new homes for July, the latest month available, surged 9.6% to a 433,000 unit rate. It was fourth consecutive monthly rise in purchases and that managed to bring the inventory of new homes down to a 7.5 months supply. This brings the inventory/sales ratio far below its January 2009 peak of 12.4 months and is now within reach of the more normal level of 6 months supply. Same basic story with existing home sales, where sales in July climbed to a 5.24 million unit rate, the strongest showing since August 2007. In fact, July's 7.2% jump in sales was the largest monthly gain ever recorded by the National Association of Realtors (who have kept such record since 1999).

We'll get August numbers on new and existing home sales next week, and we expect to see more evidence of progress in the housing sector. The big question ahead, of course, is whether the White House and Congress will agree to extend and perhaps even increase the $8,000 the tax credit that has helped spur home sales this year. Our expectation is that Washington will come around to extending this successful program another 6 to 12 months. However, we doubt they will move to increase the credit to $15,000 given how problematic the budget deficits will be the next ten years. Nor is it really necessary since the $8,000 credit turned out to be enough of an inducement to get many prospective buyers off the fence to purchase a home.

Household Wealth

Finally, the Federal Reserve today released its much-awaited Flow of Funds report for the second quarter, which showed that household wealth turned up this past spring as the value of their homes and the securities increased. At the same time, Americans reduced their liabilities. The result: household wealth increased by $2 trillion in the April thru June period, bringing their net worth up to $53.1 trillion, the most since the third quarter of 2008.

Breaking down some of the numbers we see that real estate owned by households rose by $323 billion, to $18.27 trillion, the first increase since 2006. The value of equities Americans owned grew by $1.1 trillion and mutual funds, $486 billion. As these assets moved higher, the amount of total liabilities declined by $35 billion. On a seasonally adjusted basis, the Fed calculated that household debt fell a 1.7% rate to $13.7 trillion.

The improvement in the second quarter likely continued into the third and this rise in wealth will lift consumer spirits. But… let's keep the most recent increase in perspective. Even with the latest rise in net worth, the fact remains Americans still saw more than $10 trillion of their wealth go up in smoke this recession and it is going to take at least another half a decade before they will recoup that loss. In the meantime, we expect consumers will be far more cautious in their spending. We've said this before and we'll say it again: There's a fundamental shift underway in the behavior of consumers. People are going to tie spending more to income growth, and rely far less on borrowing or on savings as ways to finance consumption. So while the increase in net worth makes Americans feel a little better, it is also a sobering reminder of just how much damage this recession has done to household balance sheets.