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ECONOMIC TALKING POINTS

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The Economic Momentum Keeps Building

Whatever you may think of the record stimulus package President Obama signed into law last February, there is one indisputable conclusion we can make about the economy a year later: Business activity is accelerating on almost every front --- housing starts and sales, consumer spending, factory output, inventory investment, foreign trade, and business capital expenditures. The cascade of positive economic news since the final quarter of 2009 cannot be dismissed and they portend faster employment in the months ahead. Indeed, we expect the recovery to gather enough critical mass by the second half of the year that it no longer needs the crutch of government spending programs to support growth.

Today we received more encouraging economic news.

Housing Starts & Permits

Housing starts shot up by a faster than expected 2.8% in January, as builders broke ground at an annual rate of 591,000 homes, the most in six months and 21.1% higher than a year ago. Construction work on single family houses rose 1.5%, to a 484,000 rate, up 35.6% from January 2009. Permits did slip a bit last month, but not as much as forecaster's had predicted. Applications for future construction fell to a 621,000 rate last month, but that is still the second highest since November 2008!

To be sure, the housing sector will experience some fresh turbulence in the coming months as it confronts several conflicting forces. Factors that will support home sales include historically low mortgage rates, rising prices, an improved outlook for the jobs, the extension and expansion of the homebuyer tax credit, and the pent up demand to purchase a home.

But the industry also faces some headwinds. Rising foreclosures this year could pound prices down again and dissuade builders from moving ahead with new construction. Some 2.8 million homes were foreclosed on last year, according to the research group, RealtyTrac, and they say a record 3 million will be repossessed in 2010. Secondly, there is still uncertainty how much mortgage rats will climb once the Federal Reserve stops purchasing mortgage back securities at the end of next month.

The tug of war from these two opposing forces will be fierce, though ultimately the housing recovery will remain on track this year. Our analysis shows that mortgage rates will rise this spring, but only by 25 to 50 basis points, not enough to scare away homebuyers. Why so little? Because while the Fed may end its purchase of mortgage-backed bonds after March, its highly unlikely they will turnaround and rush to sell these securities back into the market. Fed officials know how critical housing is to the overall economy and they will refrain from taking any action that could lead to a sharp rise in mortgage rates and endanger the recovery in residential real estate.

Just yesterday we got a report showing that even the builders have grown more confident about the outlook. The Housing Market Index, a survey done by the National Association of Home Builders (people on the front lines of the industry), showed confidence among members in February did better than analysts predicted after it rose to a three-month high.

Our own forecast calls for housing starts to climb to 800,000 units in this year, compared with 554,000 in 2009.

Import Prices

We also got the first of several inflation reports for January and it showed a sharp acceleration in import prices, both on a month-to-month basis and year over year. Import prices surged 1.4% in January and was up 11.5% annually. Should we be alarmed by this pickup? No. First of all, the main cause, once again, was the jump in oil and gas prices, which climbed 5.3% in the month and 78.6% for the year. Prices for both commodities slipped in recent weeks so I expect to see a smaller increase in import inflation for February.

In any event, if you exclude the volatile energy component, January import prices rose just 0.4%, essentially the same pace it has maintained since last July. Second, and more broadly, let’s shake off the inflation phobia. We should not be afraid of rekindling some inflation at this stage of the recovery. This is not meant to be heretical. Rising prices following the worst recession in 70 years would reflect a stronger economy and set the stage for additional hiring. Along with an improvement in pricing power, comes rising profit margins --- which are good for stocks and thus household wealth -- and faster employment.

Industrial Production

We got additional great news on output during January. Keep in mind we're now past the holiday season, a time when production and orders typically slow. Not so this time. Industrial production was up 0.9% last month, the best showing in five months and the seventh consecutive increase. Moreover, all the production wheels appear to be turning forward this time. Manufacturing activity was up 1.0%, aided by a 1.1% increase in consumer goods, 0.9% rise in business equipment, a 0.8% jump in materials (energy, textiles, paper, chemicals and etc.), and even construction equipment leaped by 1.0%! The Fed also revised December's rise in production upward to 0.7%, from 0.6%.

As manufacturers ramp up production, more of their factories and machinery are being put to use. Capacity utilization rose to 72.6% in January. While that is still below the average of 80% in the last two decades, last month's utilization rate has now climbed to the highest in more than a year.

Thus, today's reports faithfully follow an abundance of other recent indicators showing an increasingly vibrant economy with no intention of succumbing to a double-dip recession. To believe otherwise is to ignore the entire series of positive news in recent days and weeks. We list a few below.

1. Even though businesses were madly trying to replenish their depleted inventories in December, they still weren't able to keep up with rising demand. US inventories actually fell in the final month of 2009, which means companies will have to spend even more aggressively in the months ahead to keep their stockrooms and back lots well furnished. That's more good news for future production and employment.

2. Consumer spending continues to impress. Retail sales in January jumped for the 3rd time in four months, clearly a sign that consumer are eager to shop again. And they have the resources to do so. How? Not by borrowing more! Consumer credit has actually been falling for 11 straights months! Instead, Americans are financing much of their consumption by tapping the savings they have accumulated during the recession --- and from the ongoing growth in personal income, which has risen in December for the sixth month in a row.

3. Nor should we forget the January employment report, which showed manufacturers have lengthened their average weekly hours and overtime to the most in a year and a half.

4. Finally, the Federal Reserve Bank of New York the other day released its Empire Index for February, which noted that manufacturing in the New York region expanded by the most in four months, with new orders and sales coming in at the fastest in four years!

Bottom line:

With economic numbers coming in better than expected time after time, those warning of a double-dip recession or a "new normal" that's characterized by just lethargic growth, are going to have an increasingly tough time finding supporting data.

Look for some of these pessimists and market bears to grab that metaphorical eraser --- and start over.