

WEEK OF SEPTEMBER 26, 2006—CONFIDENCE

The performance of real estate and the financial markets in general are hinging on consumer's optimism or pessimism about the upcoming year, it seems. So Federal Reserve officials have been less hawkish of late, given the post-hurricane damage and need to replace perhaps 200,000 homes destroyed by Katrina and Rita—with 2 more months left in the hurricane season.

An alarm bell was set off by the sharpest plunge in consumer confidence in 15 years post-Katrina. Both the U. of Michigan and Conference Board surveys of confidence have been falling the past month. Conference Board Chief Economist Ken Goldstein said that the pessimism was mainly due to the estimated 450,000 or so jobs lost in Louisiana, alone. This is while more corporations are announcing layoffs. Delta Airlines' bankruptcy filing is allowing it to shed 9,000 jobs for starters.

Chairman Greenspan's latest comments were part of that campaign of reassurance. He said that homeowners had built up "a substantial pool of home equity" that should cushion any fall in real estate values. But his remarks were disingenuous at best, if not misleading, since he doesn't admit the Federal Reserve's role in both causing the red-hot real estate market, and now attempting to deflate its bubble.

He claimed in a recent satellite address to the National Association of Business Economics that the Fed does not really have the tools to regulate asset bubbles--which he now admits we have in some real estate markets.

"Relying on policymakers to perceive when speculative asset bubbles have developed and then to implement timely policies to address successfully these misalignments in asset prices is simply not realistic."

Yet economists are virtually in unanimous agreement that the Fed's 11 consecutive interest rate hikes begun in the midst of record-high energy prices are specifically targeting excessive consumer spending, and most consumer spending is based on borrowed money from that substantial pool of home equity.

Barron's Magazine cited Merrill Lynch economist David Rosenberg as pointing out the Fed's seeming tin ear to the dangers of continued rate hikes. The "triple play" of Fed tightening, record energy prices, and a flat stock market has occurred only 8 times in the past 50 years. And growth either slowed or stopped dead 7 of those 8 times. The odds are 88 percent that the economy in 2006 will slowdown, and "if past is prescient, we could well be in store for 1 percent-ish-type growth next year," said Rosenberg.

The economy going into Katrina and Rita was still moderately robust, with economic growth steady and real estate activity still at record levels. But the more current consumer confidence decline was cause for worry, as we said.

ECONOMIC GROWTH—Final second quarter GDP growth was 3.3 percent, down from 3.8 percent in Q1 and 4.2 percent for all of last year. Why? All economic sectors are slowing. Personal consumption is down to a 3.4 percent growth rate from 4 percent last year and private domestic investment actually decreased 3.7 percent in Q2.

CONSUMER CONFIDENCE—The September Conference Board’s survey of 5,000 households fell from 105.6 to 86.6, a huge drop. The main culprit was the increase in those expecting fewer jobs to 25 percent of respondents from 17.3 percent in August.

NEW AND EXISTING-HOME SALES—August sales of new homes fell 9.9 percent to a seasonally adjusted annual rate of 1,237,000, according to the Commerce Dept., while the inventory of unsold homes rose to a 4.7 months’ supply from 4.2 months in July. But sales have increased 6.2 percent in a year.

Existing-home sales rose 2 percent to their second-highest level ever, on the other hand, a seasonally adjusted annual rate of 7.29 million homes. Existing-sales are up a huge 7.8 percent, and median sale price up 15.8 percent to \$220,000 from August 2004.

“Hurricane Katrina, coupled with soaring gasoline prices and a less optimistic job outlook, led consumer confidence to its lowest level in nearly two years (81.7 in 10/03) and created a degree of uncertainty and concern about the short-term future,” said the Conference Board’s Lynn Franco. “Historically, shocks have had a short-term effect on consumer confidence, especially on consumers’ expectations,” said Franco.

So consumers focus on more than short-term concerns to change their spending patterns. Standard & Poor’s David Wyss estimates that it would take a 30 percent decline in home prices nationally—and a 50 percent drop in new home starts—to push the economy into even a slight recession. Wyss thinks that scenario is unlikely.

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