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JOBS AND HOUSING

We now know why housing prices have soared in the most desirable markets. The housing market boom has been spurred by a drastic redistribution of incomes, with more flowing to upper income workers, and middle and low-income wages stagnant or falling. The Census Bureau has documented this phenomenon. While the share of total national income flowing to the bottom 60 percent of households was essentially unchanged in 2004, the share going to the top 5 percent was up 0.4 percentage points, from 21.4 to 21.8 percent.

So as of 2004, the top fifth of households held 50.1 percent of all income—those earning roughly $85,000 annually and more—tied with 2001 for the highest share on record. Similarly, as shown below (see Figure 2, courtesy of the Economic Policy Institute, a think tank that studies labor issues), while the average real income of middle-income households fell slightly (down $300 or 0.7 percent—from $44,759 to $44,455), that of households in the top 5 percent grew by over $4,000 (+1.7 percent), from $260,045 to $264,387.

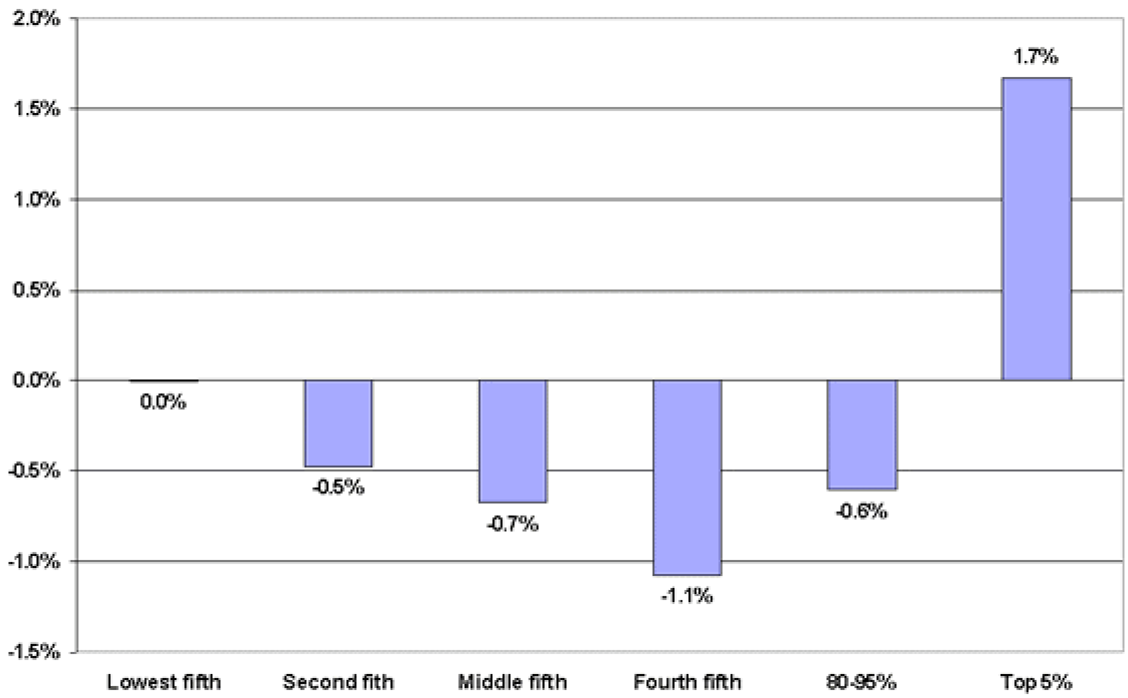
This has to affect housing appreciation this year. Because housing values have risen 16 percent in 2005, existing homeowners were able to continue to spend by borrowing from their homes. But household spending exceeded incomes for the first time since the Great Depression, resulting in a negative savings rate for all of 2005. December same-store retail sales rose 3.2 percent, barely keeping up with inflation. This could mean that housing prices this year will be similarly affected—declining to the historical appreciation rate of 1 percent above the inflation rate—or 4 to 5 percent per year—by the year end.

Slowing job formation might also crimp the housing market. According to the December report from the Bureau of Labor Statistics (BLS), the nation's private payrolls rose by 108,000, well below economists' expectations of over 200,000 jobs. However, November's revised gains of 305,000—an upward revision of 90,000 jobs—means that the pace of growth over the last two months has been about par for the year. A total of 2 million payroll jobs were created in 2005, taking into account the job losses from the hurricanes.

The December unemployment rate improved slightly, dipping to 4.9 percent from 5 percent in November. But 250,000 more left the workforce, which if added to the unemployed would have raised the jobless rate back to 5.1 percent. On average, unemployment was 5.1 percent in 2005, the lowest annual rate since 4.7 percent in 2001.

Lower-income workers are becoming discouraged, in a word, because their incomes have not kept up with inflation. One reason unemployment has remained relatively low—though still above the 4.0 percent rate of 2000—is the decline in the share of population participating in the labor force. This share, 66 percent last month, is down 1.2 percentage points from its peak in March 2001. The lack of upward movement in this key variable suggests that slack remains in the job market, i.e., job creation has not been strong enough—or wages attractive enough—to signal those who left the labor force to get back in.

Figure 2: Change in real average income by quintile, 2003-04



Over a similar period in the last recovery, payrolls grew by nearly 300,000 per month. Thus, while the U.S. labor market is consistently generating job growth, the pace remains below that of past recoveries. Though payrolls grew by 2 million jobs in 2005 (December 2004-December 2005), payrolls grew by 3.5 million jobs over a similar period in past recoveries. In percentage terms, payrolls grew 1.5 percent over the past year. The average over prior recoveries that lasted at least 49 months is twice that rate at 3.1 percent.

While some economic analysts view a job market at 5.0 percent unemployment to be one close to "full employment," the historically tepid rate of job growth in tandem with off-peak labor force participation suggest otherwise. Most industries did add jobs last month. Manufacturing payrolls have expanded for three consecutive months, including 18,000 jobs in December. For the year, however, factory jobs are down by 51,000. Jobs in retail trade continue to lag; after adjusting for the expected seasonal gains associated with the holidays, retail employment fell by 16,000 jobs in December. This may reflect lower demand at "brick and mortar" retailers due to a sharp rise in Internet sales this holiday season.

Hourly earnings rose 0.3 percent in the month, but the revised increase for November was a slight 0.1 percent gain. Over the past year, hourly wages grew by 3.1 percent. As the job market has improved over the year, wage growth has accelerated, but has still remained below the rate of inflation, suggesting that most workers continue to lose ground in real hourly pay.

This continues a pattern that has prevailed throughout 2005, with strong job growth months consistently followed by weaker ones. Also, the addition of 2 million jobs, a 1.5 percent increase, over the year is unimpressive in historical context, as shown in the table above. Labor force participation also reveals continued slack. In sum, a substantial gap remains between job creation, earnings, and the productivity of the overall economy. And this must eventually affect the housing market.