PopularEconomics.com

Popular Economics Weekly

WEEK OF JULY 17, 2006—JOBS AND WAR

Will the Mideast wars continue unabated through the end of 2006? That is the question before homebuyers, stock and bond investors. The Lebanon incursion is already causing investors' flight to the safety of Treasury bonds. The 10-year Treasury bond yield has fallen from 5.22 to 5.04 percent at this writing, bringing it once again below short-term rates (therefore an inverted yield curve).

If so, the geopolitical uncertainty could keep interest rates at their current level or lower through the end of the year, boosting real estate in particular. It could also hasten the end to the Federal Reserve's tightening cycle, as energy prices continue to soar.

Fed Chairman Bernanke hinted as much in his latest congressional testimony. Though June PPI and CPI inflation rose slightly, it was mainly due to higher energy and housing (i.e., rent) costs, which are providing the brakes to economic growth.

June was a bum month for jobs, consumer sentiment, and retail sales. This should also make it easier for the Federal Reserve to stop raising interest rates at their August FOMC meeting. Just 121,000 payroll jobs were created, of which 90,000 were in the private sector. Payrolls grew 108,000 per month in the second quarter, much below the Q1 rate of 176,000 per month. It makes Q2-2006 the slowest employment growth since 2003-Q3, according to the Economic Policy Institute.

June's housing construction fell 5.3 percent, and the NAHB Builders' sentiment survey was at 15-year low, therefore look for falling new-home sales. Fannie Mae predicted a 8-10 percent drop in 2006 home sales, mainly due to its belief that interest rates will reach a 5-year high by year end.

The Conference Board's Index of Leading Economic Indicators also indicated a coming economic slowdown in the next 6 months. The index has fallen 1.6 percent in the past 3 months, the worst showing since Q1-2001 prior to the last recession.

The employment slowdown was particularly evident in real estate. Residential construction employment fell 6,800 over the past 2 months and totals just 7,000 new jobs, versus 20,000 that were created last year. Average hourly earnings rose 3.9 percent, but with inflation rising 4.3 percent real earnings are down 0.5 percent in a year, 1.6 percent over 2 years.

UNEMPLOYMENT—The jobless rate remained at 4.6 percent, with 7 million still unemployed and 77 million not in the labor force. Bernanke in his congressional testimony also said that payrolls will not grow as fast as they have in the past, mainly due to slower population growth. Most new jobs were in the service-sector, such as professional, education and leisure/hospitality areas.

INFLATION—The CPI retail index rose 0.2 percent, but core rate was 0.3 percent due to higher housing rent costs. The CPI increased 5.1 percent in the second quarter, but energy prices may go higher from the latest Lebanese conflict.

HOUSING CONSTRUCTION—Starts fell 5.3 percent in June, according to the Commerce Dept., and are down 11 percent over last June. Permits for new-home construction have fallen 15 percent over the past year, signaling that builders are growing more cautious, as more signs of economic slowdown surface.

There is no question that the Mideast fighting will slow the economy, with oil and energy prices at all-time highs. Another casualty of war is the fall in real average hourly wages, which is beginning to hit the middle class.

Real (after inflation) average hourly wages, which covers 80 percent of the American workforce has fallen 0.5 percent in the past year. And the middle class—generally defined as college-educated households earning from 80 to 120 percent of median income, (median approximately $64,000 per year)—has seen its income fall 5.3 percent since 2000 when inflation is factored in.

A study by Wayne State University found that only about 28 percent of Los Angeles' neighborhoods were middle-class, for example, vs. 50 percent in smaller cities like Nashville, Pittsburgh, Seattle and Portland, Oregon. It is mainly due to the loss of middle-income jobs in the major cities, and influx of immigrants. The study found that 15 percent of LA County households now had entry level jobs that pay less than $15,000 per year—jobs that mainly go to immigrants.

The result is further segregation by income groups. Middle class workers are moving to mainly middle-class neighborhoods, the rich to their gated communities, while more of the poor move into subsidized housing. This 'ghettoization' of income groups limits access to public services such as education, according to the study, limiting the ability of low-income residents to move up economically without leaving the region.

What is the answer? Probably some form of governmental action that requires so-called workforce housing—housing affordable for those middle-income groups—to be included in any new building projects. This is already being done in places like Santa Barbara County in order to retain its public service employees like police, fire, teachers and health care workers, who could not otherwise afford to live in the area.