Popular Economics Weekly

WEEK OF OCTOBER 17, 2005--LEADING INDICATORS

It was a week of so-called ‘leading’ economic indicators. With inflation up and job growth down due to the hurricanes, such indicators that attempt to measure future economic activity help to give us a near-term prediction at least. This is especially important for real estate investors, since interest rates continue to inch upward, though the 10-year benchmark Treasury bond yield fell off after its recent surge to 4.6 percent this past week.

Foremost is the Conference Board’s Index of Economic Indicators, which has been trending downward for the past year, and is now barely growing at a 0.5 percent annual rate. It was growing as much as 10 percent in 1993 during the recovery from the last recession.

Housing construction and permits issued are other forward indicators put out by our Commerce Dept. They tell us that housing demand is still at record levels. The National Association of Home Builders also tracks pending contracts on new-home sales that haven’t yet closed escrow in order to determine pipeline demand, and that number is holding up as well.

The major wholesale and retail inflation indicators (PPI and CPI) shot skyward 1.9 percent and 1.2 percent, respectively, in September. But their core rates without food and energy prices rose just 0.3 percent and 0.1 percent, signaling that energy prices are not yet being passed on to other goods and services. But general retail inflation increased 4.7 percent in a year due to the 35 percent annual increase in energy costs, which is sure to worry the bond markets.

INDEX OF LEADING ECONOMIC INDICATORS—In spite of heroic adjustments to make the indicators look more favorable by ignoring the flattening bond yield curve (and so future economic conditions), the Conference Board’s forward looking indicators cannot lie. The Sept. index plunged 0.7 percent mainly due to the hurricanes, said the report. The problem is that only 4 of the 10 indicators were positive. The negatives included consumer expectations and initial unemployment claims, mostly hurricane related.

The M2 money supply has been steadily shrinking since January (which hurts stocks more than bonds) and the interest rate spread between 10-year and fed funds rate has narrowed to 0.58 percent, when it was a much larger 1.87 percent as recently as March. Then we have the Big 3 auto companies and as well as several airlines beginning to lay off workers, which means more manufacturing (hence higher-paying) jobs permanently lost.

HOUSING CONSTRUCTION—Sept. starts once again broke the record, climbing 3.4 percent over August to 2.1 million annual units. And new construction grew 6.9 percent in the South, in spite of the hurricanes. Starts have now been above 2 million units for six months in a row and for 10 of the past 12 months when 1.96 million units were started in 2004. But median prices are falling, indicating perhaps that supply is beginning to catch up with the demand for new homes.

More than one third of payroll jobs in the New Orleans Metropolitan Area were washed away by Hurricane Katrina, reported the Labor Dept. The storm cost a total of 310,700 jobs in all of Louisiana and Mississippi. The unemployment rates of Louisiana and Mississippi rose to 11.5 percent and 9.6 percent, respectively. But this is a rough guess, said the Labor Dept., as many corporations temporarily kept employees on their rolls even though they did not work. So this news is bound to impact consumer confidence and hence consumer expectations.

The picture we get from all of these indicators is that real estate is more than a safe investment. It is literally a flight to quality in uncertain times. Especially when the stock market is still priced to perfection with the S&P 500 stuck at an average 18:1 P/E ratio (The historical average is 15:1.). In fact, the credit tightening moves by the Federal Reserve might have stimulated the flight to bonds and real estate. Stocks become less desirable as interest rates climb.