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Economic Environment

"Soft, Hard or Bumpy Landing in 2001? Some Web Based Tools to Help You Decide" by Al Schuler

YEAR IN REVIEW

The U.S. economy has clearly pulled back from its hectic pace of four percent or more real annual growth (GDP) during the past four years. In the last half of 2000, annualized growth slowed dramatically to 2.8 percent compared with 5.9 percent in the first six months. Of course, this is exactly what the Federal Reserve (FED) had in mind when they started increasing interest rates in June 1999. The FED's concern during this time was inflation, however, there are several plausible reasons why inflation (e.g. CPI/retail and ECI/wages) did not become a problem—a strong currency, weak offshore markets and global competition are three, but the main reason is increased productivity as a result of business investments in new technology (see Figure 1). The Economist (Dec. 9, 2000) noted that business investments, mostly in information technology, have almost doubled their share of GDP (from nine to 16 percent) since 1992. In essence, the

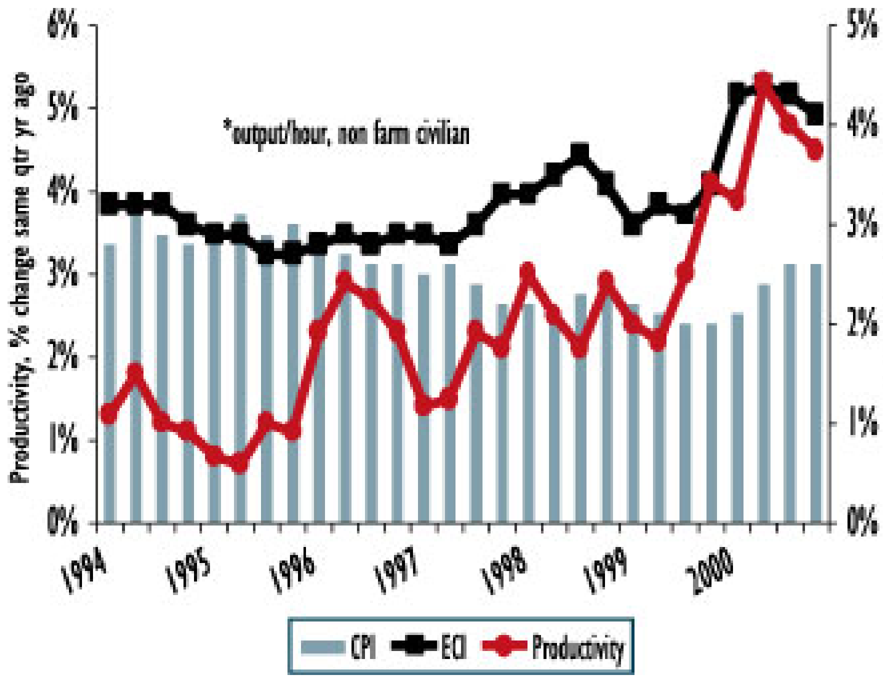

FIGURE 1
CLICK ON IMAGE FOR LARGER VIEW

non-inflationary rate of growth—long thought to be about 2.5 percent—is now probably closer to 3.5 percent.

Remarkably, the housing market has been resilient to this macro-economy slowdown to date—the main reason we are not in recession now!

Today, the concern is what kind of “landing” we will experience. Did the FED raise rates too much thus triggering a sharp drop or hard landing? By lowering the FED funds rate 100 basis points in January, the FED sent the nation the signal that their concern has shifted. This installment of “Economic Environment” presents some tools to help our readers interpret the economy for themselves. No one (including the FED) can forecast the future with certainty, but there are indicators that can help show direction and reduce uncertainty. These indicators and their web addresses are found in Table 1.

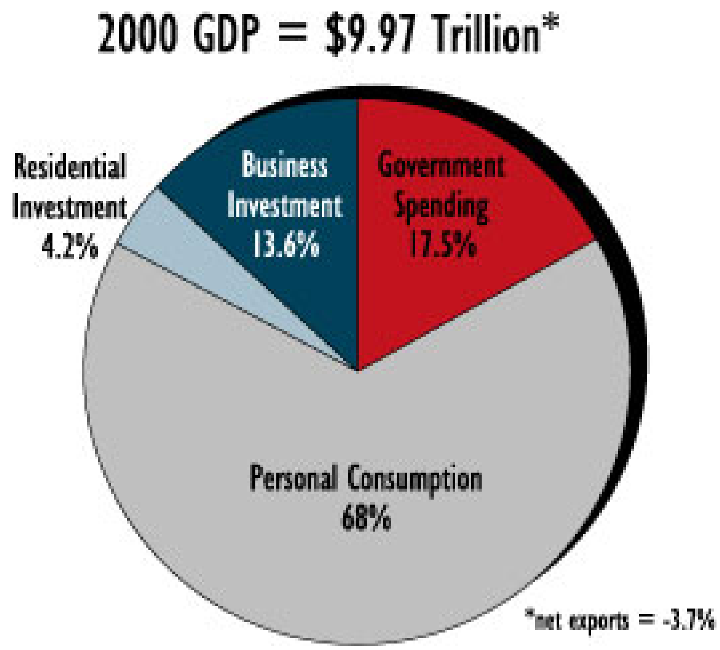

FIGURE 2
CLICK ON IMAGE FOR LARGER VIEW

ECONOMIC INDICATORS

1. Economic Output—GDP
   www.bea.doc.gov/bea/newsrel/gdp
2. Personal Consumption
   - Consumer Confidence: www.conferenceboard.org
   - Job Growth: stats.bls.gov/news.release/empsit.toc.htm
   - Retail Sales: www.census.gov/svsd/www/advtable.html
   - Income Growth: www.bea.doc.gov/bea/rels.htm
3. Investment Spending

   Residential Markets:
   - Housing Starts
     www.census.gov/ftp/pub/indicator/www/housing.html
   - Resales: nar.realtor.com
   - New Home Sales: www.census.gov/const/c25_curr.txt

   Nonresidential Markets:
   - Gross Domestic Product (GDP): www.bea.doc.gov
   - National Association of Purchasing Managers
     www.napm.org/NAPMReport
4. Manufacturing Sector
   www.napm.org/NAPMReport
5. Inflation
   - Retail Prices—CPI: stats.bls.gov/news.release/cpi.toc.htm
   - Wholesale Prices—PPI
     stats.bls.gov/news.release/ppi.toc.htm
   - Wages—Employment Cost Index
     stats.bls.gov/news.release/pdf/eci.pdf

MACROECONOMIC FORECASTS

1. National Association of Home Builders
   www.nahb.com/facts
2. National Association Business Economists
   www.nabe.com
3. National Association of Realtors
   nar.realtor.com/research/home.htm
4. Conference Board
   www.conference-board.org/economics/index.cfm

Table 1. Economic Indicators, Macroeconomic Forecasts and their Web Addresses

TABLE 1
CLICK ON IMAGE FOR LARGER VIEW

ECONOMIC INDICATORS

Where can you look for clues on the direction of the economy? GDP, the quarterly measure of the economy's output, is the best overall measure of where the economy has been. Although it doesn't tell us where the economy is going next, it does provide clues. In 2000, GDP was almost $10 trillion in current dollars, with personal consumption expenditures accounting for 68 percent (see Figure 2). This is why so much attention is paid to consumers, and their spending habits.

PERSONAL CONSUMPTION

Two indicators that directly affect consumer spending are job growth and consumer confidence.

When job growth drops below 100,000 new jobs per month, confidence usually erodes. During the last three months of 2000 monthly, non-farm, payroll job growth averaged 77,000 compared with 187,000 during the first nine months. Consumer confidence peaked in the summer of 2000, but has since been trending lower partly in response to the weakening job market.

Monthly retail sales and personal income growth can answer questions about consumer's ability and desire to spend. There was little retail sales growth during the last half of 2000 compared with solid growth in the first six months of the year. Disposable personal income growth (income after taxes) was stagnant in the last half of 2000. The Conclusion? Consumers are starting to keep their wallets in their pockets because they are not sure how much longer the “good times” will continue.

INVESTMENT SPENDING

This is of particular importance to building material manufacturers because the bulk of their products are consumed here. For residential investment, there are several good indicators: housing starts, resale market activity and new home sales. To date, each of these housing markets have remained immune to the macroeconomic slowdown. According to David Lereah, the National Association of Realtors chief economist, “Whether housing stays strong depends on a classic tug of war between low mortgage rates and the slowing economy.” Translation: Falling mortgage rates are great as long as we keep our jobs!

Nonresidential (business) investment spending is equally important to the economy because of its affect on productivity. The monthly National Association of Purchasing Managers (NAPM) report, and the quarterly GDP report provide excellent insight on this area. Both reports state that business investment spending is slowing, presumably in response to the cooling economy, weaker earnings and the readjustment taking place in equity markets.

MANUFACTURING SECTOR

We can analyze the economy by studying consumption/investment patterns (see above) or we can study it from production patterns. The manufacturing economy represents about 25 percent of the producing economy while the service sector is the other 75 percent. According to the NAPM, the “smokestack economy” has been in recession since August 2000 while the service sector remains in good shape.

INFLATION INDICATORS

The major influence on mortgage rates, and therefore housing demand, is inflation. We have several indicators that gauge inflation both at the retail level (CPI index) and at the wholesale level (PPI index). During the past three years, retail inflation has been very tame (see Figure 1) while inflation at the wholesale level has been increasing. For wage inflation, we have the quarterly employment cost index, an index watched closely by the FED. Although the ECI increased 4.1 percent in 2000 (the fastest rate in over six years), it has been trending lower through 2000. This is an indication that wage inflation remains under control, thus giving the FED more "wiggle room" to lower interest rates in 2001.

CONSENSUS "BUMPY LANDING/HEALTHY HOUSING" FORECAST

There are many organizations that make their forecasts available to the public. Two with close ties to the building materials industry are the National Association of Home Builders (NAHB) and the National Association of Realtors (NAR) forecasts. Two others for comparison are the Conference Board and the National Association of Business Economists forecasts (see Table 1 for web addresses). Their current forecasts reflect a "bumpy landing"/no recession scenario for 2001. The outlook is characterized by a halving of GDP growth (most of the weakness is in the first half of the year), led by slower growth in consumer spending and business investment. However, housing is expected to experience only a slight pullback from 2000 levels.

Using these economic indicator tools, you can decide how these forecasts may affect your business, and if they are reasonable. Remember, forecasting is a "work in progress." To be useful, it must be reassessed as new indicator data becomes available.

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