DJC

THE DAILY JOURNAL OF COMMERCE, PORTLAND, OREGON

MONDAY
December 14, 2009
www.djcOregon.com

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Economic data suggest reasons for optimism

Recent numbers for home sales, unemployment and factory orders all bode well for the future

SUMMING IT UP

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As I have stated before, the economy won't hit the bottom until housing prices stabilize. Recent reports show that single-family home prices in the U.S. posted a slight 0.2-percent increase in the third quarter. This was the first quarterly gain in two years. The biggest increases were in the West, despite California, Arizona and Nevada being some of the most troubled states.

Sales of new homes unexpectedly increased in October. Sales of new single-family homes increased 6.2 percent. Sales of existing homes increased 3.7 percent. All of these reports augur well for the economy.

Also, job losses in November slowed to 11,000, the fewest since this recession began, and the unemployment rate fell unexpectedly, indicating that the economy is in a healing process. Unemployment remains stubbornly high, at around 10 percent, although most believe the real level is much higher.

Nevertheless, payroll data reflect a notable improvement in the jobs market. Some think that firings have been too aggressive and that firms will have to start hiring in the next few months. There is a long way to go, however; nearly 8 million people have lost their jobs since the start of the recession.

Average hourly earnings rose a penny in November and the average workweek expanded by 0.2 hours.

Another report showed U.S. factory orders rose for the sixth time in seven months in October, posting a larger-than-expected gain of 0.6 percent.

In the third quarter, the U.S. economy grew 2.8 percent, expanding for the first time in more than a year.

The economy still faces stiff headwinds, including higher taxes and more regulation. But perhaps the strongest is banks' reluctance to lend. Banks have taken billions of dollars from the government, put the money in a lock box and thrown away the key. They are able to borrow from the government, essentially free, and lend money at higher rates, pocketing huge profits. Additionally, they are making billions of dollars from trading gains with the rising market.

According to a Federal Reserve survey of senior loan officers, banks continue to tighten lending for loans of all types, credit

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cards, business and real estate – even to prime borrowers. Only six banks out of all those surveyed reported easing of loan standards. Small businesses and consumers are the hardest hit. Small business contributes significantly to the overall economy, and the consumer is 70 percent of GDP, but loan activity is at deep recession levels.

Bank loans outstanding peaked in October 2008 at $7.3 trillion. Now they stand at about $6.7 trillion, an 8-percent decline. The money supply fell by 25 percent in the Great Depression, and that is why the Fed is buying mortgages. The Fed does not want to see a further decline in the money supply because that would likely mean a depression. But as fast as the banks take in money, they lock it up. If the Fed were not proactive, the money supply would be falling by 1 percent per month.

Even as the banks fail to lend, they pay out billions of dollars in bonuses.

Democrats can take some consolation in the economic numbers. The ruling party was, and maybe still is, headed for an election disaster next fall if they economy does not improve; it cannot take much comfort in the division between Wall Street with its billion-dollar bonuses, and Main Street, where credit is unavailable and job prospects are dim.

For the time being, expect the Fed to be lenient with interest rates and monetary policy. Expect the government to take on huge amounts of debt as it seeks to stimulate the economy. Expect the dollar to remain weak as interest rates remain low and government spending remains high. Expect the politicians to worry a lot about reelection.

William Rutherford is the founder and president of the Portland company Rutherford Investment Management, listed in Barron's as one of the nation's leading separate account managers. He is also the author of a critical appraisal of Alan Greenspan's term as Fed chief, "Who Shot Goldilocks?" Contact him at 888-755-6546 or wrutherford@rutherfordinvestment.com.