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First Trust

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Monday Morning Outlook

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Headed to Havana?

One of the main arguments defending the “stimulus” bill now working its ways through the bowels of government is that US consumers need help to keep spending. Without it, say many, consumption will continue to decline rapidly, extending the recession deep into 2009 and possibly beyond.

We highly doubt this type of stimulus will really stimulate. Moreover, the decline in energy prices since last summer has lifted workers’ total cash earnings (adjusted for inflation) even as employment has fallen.

We believe that without Keynesian stimulus (spending), the economy would recover from the rock bottom levels of activity that currently exist. The economy, especially auto sales and home building, is operating at unsustainably low levels already. The only way the recent pace could be sustained is if the US starts to resemble Cuba after Castro’s communist coup, with homes and cars frozen in time 50 years later.

Take home building: There are about 130 million homes in the US, according to the Census Bureau. In December, the latest data available, home builders started houses at a 550,000 annual rate. In other words, at the current pace of housing starts, it would take 236 years to replace all the homes in the US.

To put this in perspective, homes are normally built at a pace that would replace the existing stock of houses every 75 years. Unless you can imagine everyone living in Thomas Jefferson’s Monticello – first lived in 239 years ago – this is impossible to sustain.

Assuming we eventually get back to the normal “replacement rate” of 75 years suggests housing starts will have to go up to 1.75 million, a dramatic climb from the current 550,000 pace.

Of course, the main reason housing starts are so low is because an enormous excess inventory must be worked off. So the current low pace of starts is exactly what must occur for the housing market to eventually get back to normal. Our point is merely to indicate what “normal” should look like when we get back there and how much home building could climb in the future.

The same goes for auto sales. Figures from the Federal Highway Administration suggest there are now about 240 million light vehicles in the US, including those owned by individuals and businesses.

In December, light vehicles sold at a 10.3 million annual rate. At that pace, it would take 23.4 years to replace all the cars and trucks now on the road in the US. Normally, the replacement rate for auto sales is about 13 years, and even at the bottom of the recession in 1981-82 it was only 16.3 years.

None of this means that the US is on the verge of an immediate boom. However, it does mean that we are already at, or very close to, an economic bottom.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
1-26 / 9:00 am	Leading Indicators - Dec	-0.2%	**0.0%**		-0.4%
9:00 am	Existing Home Sales - Dec	4.400 Mil	**4.250 Mil**		4.490 Mil
1-27 / 9:00 am	Consumer Confidence - Jan	39.0	**38.2**		38.0
1-29 / 7:30 am	Durable Goods - Dec	-2.0%	**-2.5%**		-1.5%
7:30 am	Durable Goods (Ex-Trans) - Dec	-2.7%	**-3.3%**		0.6%
7:30 am	Initial Claims - Jan 24	578K	**558K**		589K
9:00 am	New Home Sales - Dec	0.398 Mil	**0.395 Mil**		0.407 Mil
1-30 / 7:30 am	Q4 GDP Advance	-5.5%	**-5.2%**		-0.5%
7:30 am	Q4 GDP Chain Price Index	0.5%	**0.2%**		3.9%
9:00 am	Chicago PMI - Jan	35.0	**29.9**		35.1
8:45 am	U. Mich. Consumer Sentiment	61.9	**64.0**		61.9