DESPERATE HOUSEWIVES (EPISODE 2): THE HOME FRONT
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"The percentage you're paying is too high-priced
While you're living beyond all your means
And the man in the suit has just bought a new car
From the profit he's made on your dreams." Traffic, "The Low Spark of High-Heeled Boys

CONCLUSION

Past and future money printing by the Federal Reserve alongside sustained low interest rates dreams of promoting real economic growth. Central to this imaginative quest is a vigorous effort to rally real equity prices and real real estate prices (especially homes). However, these economic guardians and their allies will settle for nominal GDP increases and nominal rallies in stocks and real estate. What is one key reason? The American consumer is the foundation of the United States economy, and its balance sheet still needs substantial repair in nominal terms.

Much captivating wordplay within regulatory kitchens spins around the language of inflation and unemployment. Such talk reflects assorted intertwined economic concerns. Yet the bottom line of Federal Reserve and related rescue efforts is a battle to restore and sustain prosperity. **So let's focus one arena of the fight, the household real estate sector.** After all, the home is important to consumer balance sheets, confidence, and the American Dream, and thus to overall economic growth.

Although Halloween has departed, troublesome real estate conditions probably will continue to terrify homeowners, builders, and banks for some time. Regulators and politicians therefore will remain fearful and vigilant regarding housing (and commercial) real estate. Substantial damage to consumer balance sheets in general and the housing sector warns of more than an effort to continue the era of very low nominal interest rates. The next course of quantitative easing may start out as relatively modest. The menu surely will include slogans related to exit strategies. However, for the money printing policy to help fix consumer balance sheets (and to generate sufficient inflation), it eventually will have to be substantial and sustained.

UNDER THE COVERS: BALANCE SHEETS AND DEVILISH DETAILS

Personal consumption expenditures represent about 70 percent of US GDP. From end 2007 to end 1Q09, US household net worth collapsed about $15.4 trillion dollars. This exceeds 2009's nominal GDP ($14.1tr) and that of 3Q10 ($14.7tr, annualized; Federal Reserve Z.1; Bureau of Economic Analysis). By end of 2Q10, net worth had recovered about $4.7tr. Even allowing for further balance sheet improvement since end 2Q10, consumers remain many trillions worse off than during the blissful Goldilocks era.

At end 2006, owners' equity in household real estate was about $12.8tr. At end 2007, it was $10.4tr. By the end of 1Q09, and around the time of the start of the equity marketplace rally, that equity was only $5.9tr, an almost $6.9tr smash relative to the sunny times of late 2006. **Thus declines in housing values played a major role in the severe wounding of consumer net worth**. By end 2Q10, owner's equity had recouped only about one trillion. Owners' equity as a

percentage of household real estate slumped from the 2004-06 average of about 58.3pc to 36.2pc at end 1Q10, with that at end 2Q10 only 40.7pc.

Current housing conditions suggest little improvement since then. Low Federal Funds levels and declines in mortgage rates, even if they have helped to make houses more affordable for some people, have not remedied the housing debacle.

The median sales price of US existing homes fell over 28.0pc from its July 2006/June 2007 peaks around $230 thousand to its January 2010 low around $165m. Despite inching up to $184m in June 2010, the September 2010 median level slid to under $172m (the September average sales price was about $218m). End September 2010 inventory of existing homes represents 10.7 months of supply. Though beneath the heights of July 2010's 12.5pc, it dwarfs 2006's 6.5 months as well as levels under five pc in 2005 and earlier years. (National Association of Realtors). The Case-Shiller Composite 20 Index for August 2010 slumps mournfully about 28.1pc beneath its July 2006 pinnacle. The NAHB-Wells Fargo Housing Market Index is "designed to take the pulse of the single-family housing market". In this index, respondents rate market conditions for the sale of new homes at the present time and in the next six months and assess the traffic of prospective new homes buyers. The October 2010 level of 16, though out of the basement of eight in January 2009, is far below June 2005's peak of 72 (June 2006 was 42, June 2007's 28).

Foreclosures presently make up 25pc of home sales (US Secretary for Housing and Urban Development, 10/17/10). The 2Q10 delinquency and foreclosure rate (combined) for mortgage loans on one to four unit residential properties is quite high- around 14.4pc (Mortgage Bankers Association, 8/26/10). Though down from very elevated 4Q09 and 1Q10 tops, delinquency and charge-off rates on residential (and commercial) real estate loans at US commercial banks for 2Q10 remain very far above those of 2007 and preceding years (Federal Reserve data).

Despite improvements in household debt service and financial obligations ratios since 3Q07 (Federal Reserve), consumer confidence measures reflect a still weak consumer balance sheet and a still unhealthy real estate marketplace. The Conference Board's 50.2 October level, has slipped from recent levels of just over sixty, even though it remains above the horrific low just over 25 of February 2009. However, fifty is far under the marvelous pinnacle of 145 (January 2000) and the peaks around 110 in 2007 during the joyous Goldilocks era. High unemployment and related concerns interrelate with consumer spending and housing purchases. November 2010 US election results suggest dismay about current and prospective economic conditions and prospects.

Moreover**, the International Monetary Fund stated only last month: "The stabilization of U.S. real estate prices remains fragile and negative macro-financial spillovers could cause a double dip in real estate**. U.S. residential house prices fell by over 30 percent between 2006 and 2009, and the value of commercial properties by over 40 percent since early 2007. The outlook remains weak." ("Global Financial Stability Report", Ch.1, Box 1.3, p20). The IMF's "World Economic Outlook" has a similar headline: "Dismal Prospects for the Real Estate Sector (Ch. 1, Box 1.2, p20). As these comments suggest, the commercial real estate battlefield, like that of homes remains quite worrisome. See also the testimony regarding American commercial real estate before the US Congress Joint Economic Committee (7/9/09).

HOME ON THE RANGE

"Home, home on the range,
Where the deer and the antelope play;
Where seldom is heard a discouraging word,

And the skies are not cloudy all day." "Home on the Range", a traditional cowboy song

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But despite this litany of gloomy housing reports, why care all that much? Aren't things getting better on America's shores and elsewhere? Look at stock marketplace rallies in America and beyond! US corporate profits have rebounded from the dark days of the worldwide economic crisis. US 3Q10 real GDP rose 2.0pc (annual rate), the fifth consecutive quarter of growth. (Bureau of Economic Analysis, 10/29/10, Table 1). Scan forecasts for real GDP growth in 2011. For example, the IMF's World Economic Outlook (October 2010, Table 1.1, p2) weathervane predicts fair even if not remarkable US real economic growth of 2.3pc in 2011; it expects a rise in world GDP next year of 4.2pc.

Why might the Federal Reserve embark on a new and eventually quite substantial agenda of money printing, thus risking not only hard-to-contain inflation, but also further US dollar weakness? Isn't its previous gigantic monetary (quantitative) easing- and given its marriage to very low nominal interest rates- sufficient? **If the Fed hurries, it must be worried**.

Keeping the consumer balance sheet and still weak real estate in mind, let's burrow further into the backyard of the statistical landscape of the BEA's US Gross Domestic Product Report. Table 2, "Contributions to Percent Change in Real Gross Domestic Product" is worth staring at. **Look at the breakdown of the overall GDP increase of two percent for 3Q10. It is not a source for optimism. It underlines Federal Reserve concerns about the underpinnings of economic strength and therefore the consumer balance sheet and housing marketplace. Recent sources of economic growth perhaps have worn out, or may soon become frayed.**

The recent five quarter string of real GDP increases received notable assistance from increases in (rebuilding of) nonfarm private inventories (about 1.5pc in 3Q10). Federal spending seems to have offered incremental help in the most recent two quarters. So assume that US inventories have been substantially rebuilt. Then future GDP will receive little help from this source. Suppose the past stimulus spending tied into economic rescue efforts has generally worked through the economy. It's unlikely that yesterday's US election results will prompt another substantial stimulus package anytime soon. Thus future GDP help from this avenue cannot be counted on. Although personal consumption expenditures have been fairly strong in recent quarters, this may not continue given a fairly weak consumer balance sheet and mediocre consumer confidence. The "net exports" category (due to high imports) has been a drag on growth for the past three quarters.

Thus the Fed's effort to cook up real GDP growth and some inflation (avoid deflation; repair consumer balance sheets, rally real estate and equities) receives at best little help from other sources. So any new money printing recipes, even if modest at the outset, probably will have to be substantial in scope and sustained in time to succeed. All else equal, however, money printing represents a sales pitch seeking to buy time- via boosts in consumer and business confidence- for the invention and implementation of genuine and durable solutions to severe economic problems.

FIXING A HOLE

"I'm fixing a hole where the rain gets in
And stops my mind from wandering
Where it will go." The Beatles, "Fixing a Hole"

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In early 2009, James Bullard, the President of the St. Louis Fed, gave an interesting speech, "Dial 'M' for Monetary Policy" (New York Association for Business Economics; 2/17/09). He remarks: "we can be fairly certain that rapid expansion of the monetary base will be sufficient to head off any incipient deflationary threat. Rapid base growth has been associated with inflation in a wide variety of times and places in economic history." **How much inflation and dollar depreciation will the Federal Reserve risk?**

In further money printing parties, the Federal Reserve of course will buy interest rate securities. Yet pretend that it acquires all the existing family homes for sale. The September 2010 inventory is just over four million homes (National Association of Realtors). Pretend it buys them at a premium to current prices, say at $250m per dwelling. Doesn't that total about a trillion dollars? Won't that solve the housing problem? Maybe buying half this housing inventory is a sufficient start. Besides, shouldn't some dollars be devoted to commercial real estate acquisitions?