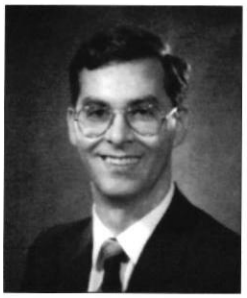
FOCUS ON THE ECONOMY

Ain't No Cure for the Summertime Blues

by Hugh F. Kelly, CRE



Back in 1958 (in dinosaur times, my kids tell me), Eddie Cochran complained, "I'm gonna raise a fuss/I'm gonna raise a holler/About workin' all summer/Just tryin' to earn a dollar."[1] (I'll admit to being out of touch these days. Do they still write songs about working?) Readers who have been following my adventures in economics columny[2] know by now that the Federal Reserve, last spring, took the aggressive path outlined in my previous essay, a path which I predicted would see rebounding consumer confidence, the Dow Jones Industrial Average in a trading range of 10,000 – 11,000; business fixed investment for 2001 in the 8 percent - 10 percent range; and year-end GDP growth at 2.5 percent to 3 percent.

As I write this in July, such targets probably invite skepticism. Indeed, there are those claiming that Alan Greenspan and his confreres still don't "get it" and those who call for still further interest rate cuts through the dog days of August. That's not a good idea, in my opinion. I'd like to look at a few of the charts published in each edition of *The Counselor* newsletter to explain why.

Figure 1, "Non-Farm Employment and GDP," presents two of the broadest and most familiar measures of the economy, albeit in a somewhat non-traditional format. Most often, these statistics are presented in terms of "quarterly change at a seasonally adjusted annual rate." *Figure 1*, however, simply shows the data based upon their year-over-year percentage change, *i.e.*, the actual difference from (say) the first quarter 1999 to the first quarter 2000. I think this perspective reveals very clearly what the Fed's sense of the economic "speed limit" is. When year-over-year GDP spikes up toward 6 percent, the Open Market Committee looks for the brakes. On the other hand, if Gross Domestic Product falls under 2 percent growth, the Greenspan Fed has systematically primed the pump for greater liquidity and subsequent spending-induced expansion.

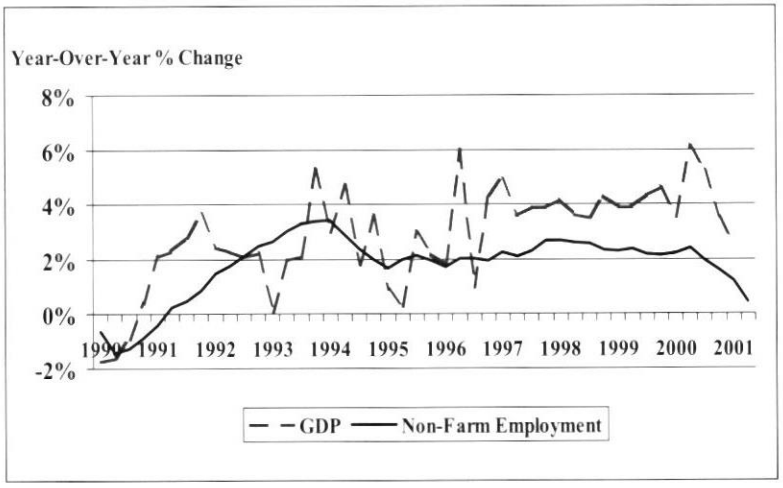
GDP, as normally reported, grew at a seasonally adjusted 1.0 percent in the final quarter of 2000, and at 1.2 percent in the first quarter of 2001. On a year-over-year basis, its growth rate from first quarter 2000 to first quarter 2001 was 2.5 percent. As the robust expansion of early 2000 is replaced by the tepid results in the spring and summer of 2001, the GDP curve will dip lower, as it did in 1993, 1995, and in 1996. The Fed's critics see this, and want further stimulus.

A contraction in employment, the most severe job slowdown since the last recession, is adding urgency to the situation. Indeed, though the year-over-year job figures were still marginally positive in June, it is likely that net job losses will be accruing as the summer wears on. That, of course, is when the bite becomes most painful and calls for further Fed action come from the politicians, the editorialists, and the armchair economists, all a-fussin' and a-hollerin'.

Figures 1, 2, 3

Figure 1

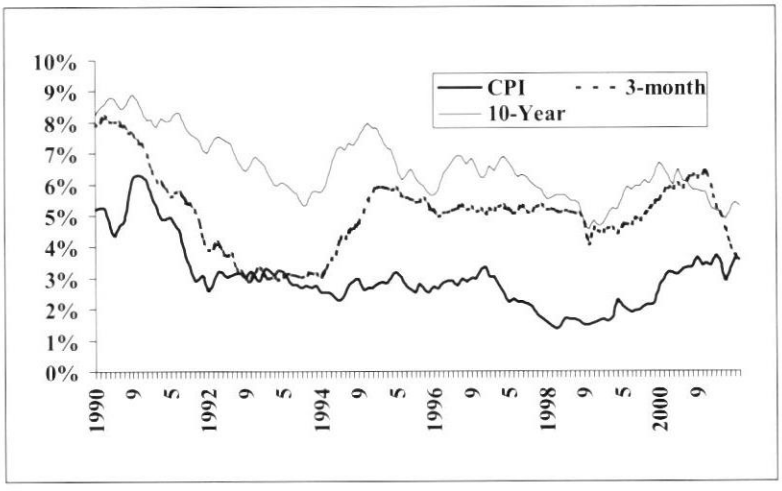
Non-Farm Employment & GDP



Sources: U.S. Bureau of Economic Analyses; U.S. Dept. of Labor

Figure 2

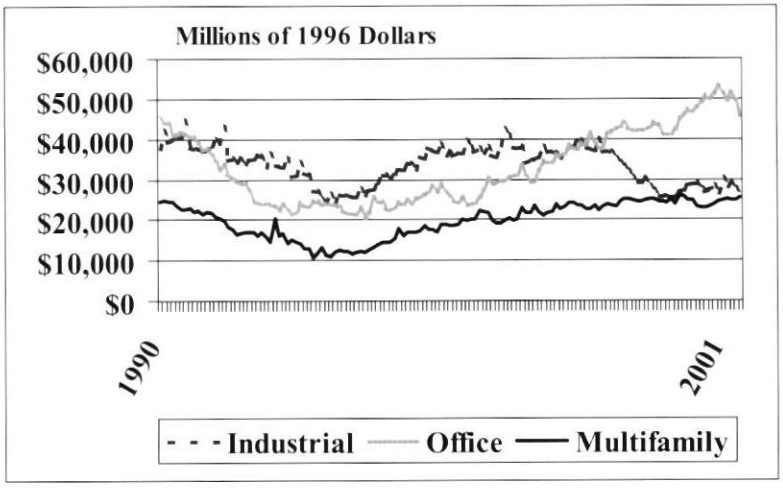
Interest Rates & Inflation



Sources: U.S. Dept. of the Treasury; U.S. Census Bureau

Figure 3

Value of New Construction Put in Place



Sources: U.S. Dept. of Commerce; U.S. Census Bureau

Patience may be required, but I would say that the Fed has already done its job and should refrain from an overdose of monetary medicine. *Figure 2*, "Interest Rates and Inflation," shows that the three-month Treasury Bill has already descended to approximately the same level as the Consumer Price Index. The last time this happened was in 1992 – 1993, and the Fed held its discipline even as pundits were sounding the alarm about a potential "double-dip" recession (as in the early Eighties). That discipline paid off with the strong growth – low inflation expansion of the Nineties.

Without being callous about the difficulty of unemployment, it is worth noting that the U.S. is in a period of general labor shortage. The jobless rate, though rising, is still just at 4.5 percent and not long ago sustained unemployment under 5 percent was considered unachievable without dire inflationary consequences. Productivity gains have allayed some of those fears, and I believe that the Fed is correctly betting on continued productivity advances to turn the corner on corporate profits, triggering a resumption of growth.

That does take time, though. Economists usually expect a six- to nine-month lag in the effects of interest rate policy changes, meaning that we will see the effects of lower rates gradually taking hold through the late summer and becoming more apparent during the fall. My column in the Spring 2001 (Vol. 26, No.1) edition of *Real Estate Issues* noted that real estate risk had shifted from the supply side to the demand side. That's what the employment figures are now confirming. Ray Torto's column in that edition, by the way, underscored the continuing cyclical risk from the development cycle, so readers of *Real Estate Issues* had a full alert to the rising vacancy rates we are seeing in the commercial property markets as 2001 wears on.

Nevertheless, I remain fairly sanguine about the outlook for the economy and the real estate industry looking ahead. The demand side cycle is typically much shorter and shallower on its downward leg than the risks of a construction boom. And, as *Figure 3* ("Value of New Construction Put in Place") illustrates, office and industrial development has already begun the process of pulling back from their peaks. Liquidity for real estate investment remains ample, and the pullback of prices and rents from the speculative levels seen in the dot-com euphoria should be regarded as a healthy correction.

Some may look at the present U.S. economic dilemma with the fear that we will follow Japan's sad lead, where a bursting of an economic bubble led to a prolonged slump. And, naturally, there is enough residual pain from the last real estate depression here in the states to provoke nervousness in our own industry. Frankly, though, the numbers don't support such worries, much less any threat of panic. Absent any external shocks, the year-over-year numbers in the summer of 2002 should be showing acceleration in both the fundamental economy and in the property markets across the United States. For now, though, Eddie Cochran had it right, "There ain't no cure for the summertime blues." REI

NOTES

1. "Summertime Blues", words and music by Eddie Cochran and Jerry Capehart. © Warner-Tamerlane Publishing, 1958 (renewed).
2. My spellcheck says this is an illegal word, but if William Safire, the language maven, can use it, so can I!

ABOUT OUR FEATURED COLUMNIST

Hugh F. Kelly, CRE, *is the principal of an independent counseling practice, specializing in applied real estate economics for clients with domestic and international commercial property interests. Kelly is based in Brooklyn, NY, and is well-known as a writer and public speaker. Formerly, he was chief economist for Landauer Realty Group and author of the Landauer* Forecast *from 1986 to 2000. Kelly was a 2000 national vice president of The Counselors of Real Estate, chair of its New York Metropolitan Chapter in 1999 and 2000, and editor in chief of "The Counselor" newsletter from 1997-1999.* [redacted]*)*